Securities Litigation

Contributing editors

Antony Ryan and Philippe Z Selendy

2019

GETTING THE DEAL THROUGH

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Securities Litigation 2019

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Securities Litigation 2019

Fifth edition

Getting the Deal Through is delighted to publish the fifth edition of *Securities Litigation*, which is available in print, as an e-book and online at www.gettingthedealthrough.com.

Getting the Deal Through provides international expert analysis in key areas of law, practice and regulation for corporate counsel, cross-border legal practitioners, and company directors and officers.

Throughout this edition, and following the unique **Getting the Deal Through** format, the same key questions are answered by leading practitioners in each of the jurisdictions featured. Our coverage this year includes new chapters on Greece, Korea and Nigeria.

Getting the Deal Through titles are published annually in print. Please ensure you are referring to the latest edition or to the online version at www.gettingthedealthrough.com.

Every effort has been made to cover all matters of concern to readers. However, specific legal advice should always be sought from experienced local advisers.

Getting the Deal Through gratefully acknowledges the efforts of all the contributors to this volume, who were chosen for their recognised expertise. We also extend special thanks to Antony Ryan of Cravath, Swaine & Moore LLP and Philippe Selendy of Selendy & Gay PLLC for their continued assistance with this volume.

GETTING THE DEAL THROUGH

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1 Describe the nature and extent of securities litigation in your jurisdiction.

Securities litigation is very active in the United States, both in terms of the number of cases filed and the size of cases. In 2017, 432 new federal securities class actions were filed – the highest number since the downturn in the technology industry in 2001. The vast majority of such cases are dismissed or settled before trial. Between 2000 and 2017, around 38 per cent of cases in which a motion to dismiss was filed were dismissed with prejudice. Of those cases that do settle, around 60 per cent are for US$10 million or less, and around 8 per cent are for US$100 million or more, with the rest in between (see NERA, Recent Trends in Securities Class Litigation: 2017 Full-Year Review). In June 2018, the district court approved a securities class action settlement by which the Brazilian oil company Petrobras has announced a securities class action settlement in which it agreed to pay US$2.95 billion, which, if approved, would represent the largest settlement ever by a foreign corporation in a US action. In addition to class actions, hundreds of individual securities cases are filed each year.

The major pieces of securities legislation in the United States are the Securities Act of 1933 (the 1933 Act) and the Securities Exchange Act of 1934 (the 1934 Act). The 1933 Act regulates the initial offering and distribution of securities, while the 1934 Act regulates securities trading in securities markets.

The 1933 and 1934 Acts were enacted in the wake of the stock market crash of 1929. Seeking to remediate the problems ailing the industry, Congress undertook a series of investigations into how securities were bought and sold in the United States. These investigations prompted Congress to enact the 1933 and 1934 Acts to promote truthfulness and disclosure in securities markets.

By 1995, Congress believed that too many meritless securities claims were being brought. As a result, it passed the Private Securities Litigation Reform Act (PSLRA), which makes it more difficult to plead securities fraud in private actions and postpones discovery in most securities cases. In 1998, Congress enacted the Securities Litigation Uniform Standards Act (SLUSA), which pre-empts most large state law fraud claims arising from the sale of a security. Despite these reforms, securities litigation remains very active.

2 What are the types of securities claim available to investors?

Plaintiffs can bring both federal and state law claims. Federal claims are more common and important.

The most common federal securities claim is a Rule 10b-5 claim. Rule 10b-5 was promulgated by the Securities and Exchange Commission (SEC) pursuant to section 10(b) of the 1934 Act. Rule 10b-5 broadly prohibits fraud or deceit in connection with the purchase or sale of a security. It can be enforced either by the SEC or by private plaintiffs. Although there is no express private enforcement mechanism, courts have found that the rule implies a private right of action. The fraud-on-the-market presumption (question 8) allows investors to bring Rule 10b-5 claims on a class basis.

Other common federal law claims include sections 11 and 12 of the 1933 Act and section 18 of the 1934 Act. Section 11 prohibits misstatements in the registration statement of securities. Defendants in a section 11 action may include the issuer, directors, accountants, and others named as experts in the registration statement, such as underwriters. Section 12 prohibits the sale of most unregistered securities and prohibits misstatements in the sale of securities, whether through oral communication or by a prospectus. Section 18 of the 1934 Act provides an express cause of action for investors who are harmed by false or misleading statements made in filings with the SEC.

State securities laws, commonly known as 'blue-sky laws', vary considerably. Over 30 states have adopted in full or part a version of the Uniform Securities Act. Almost all blue-sky laws have some form of anti-fraud provision (eg, Uniform Securities Act section 501). New York is the only state without a private right of action for securities fraud in its blue-sky law (known as the Martin Act) (see *CPC Int'l Inc v McKesson Corp*, 70 NY2d 268, 276-77 (1987); see also *Assured Guar (UK) Ltd v JPMorgan Inv Mgmt Inc*, 18 NY3d 341, 348 (2011) (holding that the Martin Act does not preclude a private litigant from bringing a non-fraud common law cause of action)).

Although blue-sky laws remain important in individual investor claims, SLUSA precludes a securities claim from being brought under state law or in state court if it is a class action or if damages are sought for more than 50 individuals (see 15 USC section 78bb(f)). Additionally, common law tort claims, such as negligent or fraudulent misrepresentation, are often available to securities plaintiffs outside the class action context.

The focus of this chapter is on Rule 10b-5 and sections 11 and 12.

3 How do claims arising out of securities offerings differ from those based on secondary-market purchases of securities?

The legislative scheme governing initial offerings is very different from the scheme governing secondary-market purchases of securities.

For initial offerings, sections 11 and 12 prohibit misstatements in registration statements, oral communications, and prospectuses. Sections 11 and 12 create a near strict liability regime for issuers, without the need to prove reliance, causation, or the defendant's mental state (commonly referred to as 'scienter'). The damages available for primary-market violations are generally rescissionary in nature, in that they seek to return plaintiffs to the position they would have been in had they never purchased the securities.

For secondary-market transactions, Rule 10b-5 broadly prohibits fraud and misstatements. Under Rule 10b-5, knowledge, causation, and reliance are necessary elements of the claim. The damages available under Rule 10b-5 are somewhat broader than in primary-market transactions, in that plaintiffs can recover their out-of-pocket losses.

4 Are there differences in the claims available for publicly traded securities and for privately issued securities?

This is not a critical distinction in American law. Generally, for the claims discussed in question 2, the basis for a suit is the purchase or sale of a security. The 1933 Act defines 'security' broadly, without reference to whether the security is publicly traded or privately issued (see 15 USC section 77b(a)(1)). The Supreme Court has held, however, that privately negotiated sales of stock are not sold by means of a prospectus and, therefore, are not covered by section 12(a)(2) (see *Gustafson v Alloyd Co*, 513 US 561 (1995)).

Two cautionary notes should be made. First, as discussed in question 8, proving reliance on a misrepresentation under Rule 10b-5 is often easier in the context of a publicly traded security because plaintiffs may utilise the fraud-on-the-market presumption and, therefore, show reliance by proving price impact in a well-functioning market.

Second, as discussed in question 30, limitations on the extraterritorial reach of American securities laws may have different effects on publicly and privately issued securities (namely, American courts may not be open to claims based on fraud in the sale of foreign, privately issued securities).

5 What are the elements of the main types of securities claim?

The elements of a Rule 10b-5 claim are:

- a material misrepresentation or omission;
- scienter (ie, knowledge);
- a connection between the misrepresentation or omission and the purchase or sale of a security;
- reliance (often referred to as transaction causation in fraud-on-the-market cases);
- economic loss; and
- loss causation (a casual connection between the misstatement and the plaintiff's losses).

The elements of a section 11 claim are:

- a registration statement that either:
  - contains an untrue or misleading statement of material fact; or
  - omits a fact that is either required by law or necessary to make the registration statement not misleading.

The elements of a section 12(a)(1) claim are:

- the sale of, or offer to sell, a security;
- the absence of a registration statement covering the security; and
- use of an instrument of interstate commerce (such as the US mail system) in connection with the sale or offer.

The elements of a section 12(a)(2) claim are:

- the sale of, or offer to sell, a security by means of a prospectus or oral communication which misstated a material fact;
- privity between the buyer and seller; and
- the use of interstate commerce in connection with the sale or offer.

The elements of a section 18 claim are:

- a false or misleading statement or omission in a document filed with the SEC;
- reliance on the misrepresentation;
- economic loss; and
- loss causation.

Common law negligent misrepresentation claims may be brought where the defendant made a false statement through negligence in obtaining or communicating information, intending the plaintiff to act on the false statement, resulting in the plaintiff relying on the statement and, therefore, suffering damages. The tort of fraudulent misrepresentation has the same elements but requires knowledge of falsity.

6 What is the standard for determining whether the offering documents or other statements by defendants are actionable?

As an initial matter, it is important to note the breadth of Rule 10b-5 claims. In the case of publicly traded securities, almost any public statement can be the basis for a Rule 10b-5 claim, as the 'in connection with' prong of the rule is very broad. (see, eg, *Merrill Lynch, Pierce, Fenner & Smith Inc v Dabit*, 547 U.S. 71 (2006)). By contrast, section 18 liability attaches only to statements in SEC filings, section 11 liability attaches only to registration statements for an initial offering, and section 12 liability attaches only to statements regarding an initial offering.

The general rule of actionability is fairly simple – a misrepresentation of fact is actionable if it is material. A statement is material if there is a substantial likelihood that a reasonable investor would consider the information contained in the statement when making an investment decision.

Two special types of statements deserve additional discussion: omissions and opinions. To state a claim for an omission, the plaintiff must show both that the defendant failed to disclose a material fact and that the law created a duty to disclose that fact. The mere possession of non-public information does not create a duty to disclose. A disclosure of part of the truth, however, can create liability for the misleading impression that a partial disclosure may create. When one makes a representation, it must be complete and accurate.

Both opinions and forward-looking projections can be deemed statements of fact. Generally, the only actionable content of such a statement is the implied representation that the statement is made in good faith. For example, in *Virginia Bankshares, Inc v Sandberg*, 501 US 1083 (1991), the Supreme Court found that a statement that the value of a company is 'high' or the terms of a merger are 'fair' states a fact that the speaker believed that the value was high or the terms were fair. Therefore, the Court held that liability could attach if, at the time the statement was made, the value of the company was not high or the terms were not fair and the speaker knew it. Most courts have held that *Virginia Bankshares* applies to all types of securities claims.

Further, in *Omnicare, Inc v Laborers District Council Construction Industry Pension Fund*, 135 S Ct 1318 (2015), the Supreme Court held that an opinion could form the basis of a claim under section 11 of the 1933 Act if the speaker did not sincerely hold the opinion or if the statement omitted material information and the opinion implied that the speaker had a factual basis for holding the opinion, when the speaker did not. Securities cases around the country are raising questions about how to apply *Omnicare*, including its application to claims under section 10(b) of the 1934 Act, which contains a scienter element (see, eg, *In re Atossa Genetics, Inc Sec Litig*, 868 F3d 784, 801-02 (9th Cir 2017) (statement that 'FDA clearance risk had already been achieved' was 'a statement of opinion" but because this statement did not comport with other facts known to the speaker at the time, this opinion statement was 'misleading by omission'). In *Tongue v Sanofi*, 816 F3d 199 (2d Cir 2016), a case with claims under both section 10(b) of the 1934 Act and section 11 of the 1933 Act alleging material omissions, the Second Circuit gave a narrow interpretation to opinion liability, and held that issuers 'need not disclose a piece of information merely because it cuts against their projections'.

In the PSLRA, Congress codified protection for forward-looking statements (see 15 USC section 78u-5). The PSLRA 'safe harbor' applies when a forward-looking statement is cloaked in meaningful cautionary language or the plaintiff fails to show that the statement was made with actual knowledge of its falsity. In such situations, liability will not attach.

7 What is the standard for determining whether a defendant has a culpable state of mind?

Rule 10b-5 claims require a showing of intentional or knowing misconduct ('scienter'). In a number of cases, most recently *Matrixx Initiatives Inc v Siracusano*, 563 US 27, 48 (2011), the Supreme Court has declined to decide whether extreme recklessness suffices to fulfil the scienter requirement. Most circuit courts have found that extreme recklessness is sufficient (see *Tellabs, Inc v Makor Issues & Rights, Ltd*, 551 US 308, 319 n3 (2007) ('Every Court of Appeals that has considered the issue has held that a plaintiff may meet the scienter requirement by showing that the defendant acted intentionally or recklessly, though the Circuits differ on the degree of recklessness required')). Under the PSLRA, in order to plead scienter adequately, a plaintiff must plead specific facts sufficient to convince a reasonable person that the inference of scienter is at least as compelling as any opposing inference (see question 14).

For section 11 claims, plaintiffs generally do not need to prove knowledge. Defendants who are non-issuers have several affirmative defences that function similar to scienter requirements (eg, non-issuer defendants are not liable if they acted with due diligence).

Section 12(a)(1) does not require plaintiffs to prove knowledge. Likewise, section 12(a)(2) does not require knowledge, although it does allow for a due-diligence defence. Due diligence requires a defendant to have exercised reasonable care in making the actionable statement.

For section 18 claims, plaintiffs do not need to prove knowledge.

Common law negligent misrepresentation claims generally require the plaintiff to prove that the defendant acted without reasonable care, and common law fraudulent misrepresentation claims generally require the plaintiff to prove scienter.

8 Is proof of reliance required, and are there any presumptions of reliance available to assist plaintiffs?

Reliance is required to make out a Rule 10b-5 claim. In order to show reliance, a plaintiff must demonstrate that he or she relied on the misrepresentation in the purchase or sale of the security.

The most direct way to show reliance is through direct reliance on an affirmative misrepresentation – for example, where a plaintiff hears a misrepresentation and acts on that misrepresentation by buying a stock.

Many plaintiffs, however, buy securities on national exchanges without directly confronting the misrepresentation. For this reason, the Supreme Court has sanctioned the use of the fraud-on-the-market presumption. In *Basic, Inc v Levinson*, 485 US 224 (1985), the plaintiffs claimed that they had sold their shares in Basic after the Basic board had claimed publicly that the company was not engaged in merger negotiations. It subsequently became known that Basic was in negotiations to, and did in fact, merge with another company. The plaintiffs claimed that the public denial of the merger talks artificially deflated Basic's stock price. The Supreme Court noted that the modern securities market involves millions of shares changing hands between faceless investors. It reasoned that the means of proving reliance must reflect this market. That is, it would be impractical, if not impossible, for each plaintiff to show individual reliance. Therefore, the Court sanctioned the use of the fraud-on-the-market presumption, which postulates that buyers and sellers in a well-functioning exchange rely on the market price to transmit information honestly about the underlying security. Therefore, misstatements that enter into the market price can be said to be relied upon.

In *Halliburton Co v Erica P John Fund, Inc*, 573 U.S. 258 (2014), the Supreme Court revisited the *Basic* presumption of reliance and reaffirmed it in a 6-3 decision. The Court noted the academic controversy over the 'efficient capital markets hypothesis' but concluded that there was widespread agreement that public information affects stock prices. The Court also observed that, while some investors may not rely on the integrity of market prices, it is reasonable to presume that most investors do so.

Consequently, in order for the fraud-on-the-market presumption to apply:

- the defendant's misrepresentation must be public;
- the misrepresentation must be material;
- the security must be traded in an efficient market; and
- the plaintiff must have purchased or sold shares between the time when the misrepresentation was made and when the truth was revealed.

If these facts are shown, the plaintiff can establish reliance by showing only that the misrepresentation impacted price.

The defendant can rebut the fraud-on-the-market presumption by severing the link between the alleged misrepresentation and either the market price or the plaintiff's decision to trade. However, this is a high burden. On remand from the Supreme Court in *Halliburton*, the district court placed the burden to show lack of price impact on the defendant, and held that it would not decide on the class certification stage whether a disclosure was in fact a corrective disclosure (see *Erica P John Fund, Inc v Halliburton Co*, 309 FRD 251 (ND Tex 2015)). In April 2018, the district court approved a US$100 million settlement of the underlying securities class action.

In the wake of *Halliburton*, in considering applications to defeat class certification by rebutting the fraud-on-the-market presumption, courts are facing questions about how the burden of proof should be allocated, what evidence is required to rebut the presumption by showing lack of price impact, and how to consider expert testimony on these issues. Courts have already begun facing these questions (see, eg, A*rk. Teachers Ret Sys v Goldman Sachs Grp, Inc*, 879 F3d 474, 486 (2d Cir 2018); *Waggoner v Barclays PLC*, 875 F3d 79, 85, 99 (2d Cir 2017)).

There is a separate presumption of reliance, known as the *Affiliated Ute* presumption, where the claim is based on an alleged omission, and the defendant had a duty to disclose (see *Affiliated Ute Citizens v United States,* 406 US 128, 153-57 (1972)). Courts may look beyond the asserted pleadings to evaluate whether the case involves a failure to disclose or material misstatements (see *In re Smith Barney Transfer Agent Litig*, 290 FRD 42, 47-48 (SDNY 2013)). There is disagreement over whether this presumption applies to claims based on mixed misrepresentations and omissions. The defendant can rebut this presumption by showing that, regardless of the omission, the plaintiff would have made an identical investment decision.

Section 11 does not require plaintiffs to prove reliance. Nonetheless, a defendant can escape liability by showing that the plaintiff knew about the misstatement before making its investment decision.

Likewise, section 12 does not require plaintiffs to prove reliance.

Section 18 claims, by contrast, require actual reliance on the document filed with the SEC. That is, a plaintiff must show that he or she personally saw and relied on the misstatement ('eyeball reliance'). Therefore, the fraud-on-the-market presumption is inapplicable to section 18. The requirement of eyeball reliance makes class actions under section 18 nearly impossible.

State law negligent and fraudulent misrepresentation claims generally require proof of reliance.

9 Is proof of causation required? How is causation established?

Proof of both transaction causation and loss causation is required for Rule 10b-5 claims. Whereas transaction causation largely mirrors traditional notions of reliance (that the investor relied on the market price in making a purchase or sale), loss causation requires a plaintiff to show a causal connection between the misrepresentation or omission and a plaintiff's losses.

In *Dura Pharmaceuticals Inc v Broudo*, 544 US 336 (2005), the plaintiffs attempted to plead loss causation by alleging that Dura's executives had made misstatements to the market about the likelihood that the Food and Drug Administration would approve an asthmatic spray device that the company was developing. In relying on these statements, the plaintiffs claimed to have paid an inflated price for Dura stock and, therefore, the plaintiffs claimed that they suffered damages. The Supreme Court found that the plaintiffs had not adequately alleged loss causation. Instead, the Court noted that purchasing at an inflated price does not cause any harm. Harm arises only when investors sell at a lower price than they paid. Consequently, the Supreme Court held that, to show loss causation, plaintiffs must demonstrate both their specific losses and the causal connection between those losses and the misstatement. This can be accomplished by showing, for example, that there was a decline in the stock price following corrective disclosure of the misstatement.

Usually, such a showing will require an expert witness. Typically, an expert will conduct an 'event study', which attempts to ascertain what portion of the decline in the stock price was caused by the disclosure of the alleged fraud. The purpose of such a study is to disentangle the effects on the stock price of other factors, such as market or industry-wide events. Courts have observed that event studies are now 'almost obligatory' in securities litigation (see *In re Vivendi Universal, SA Sec Litig*, 634 F Supp 2d 352 (SDNY 2009)).

Confusion regarding loss causation persists. Federal courts remain divided over whether (and if so how) loss causation may be established in cases without a corrective disclosure in the classic sense (ie, where the event or disclosure that triggered the stock price decline did not reveal the fraud on which the plaintiff's claim is based). In *Mineworkers' Pension Scheme v First Solar, Inc*, 881 F3d 750 (9th Cir 2018), the Ninth Circuit held that a plaintiff 'need only show a causal connection between the fraud and the loss' and may satisfy the loss causation requirement 'even where the alleged fraud is not necessarily revealed prior to the economic loss'. Other federal courts have taken a stricter approach (see, eg, *Tricontinental Indus Ltd v PricewaterhouseCoopers LLP*, 475 F3d 824, 844 (7th Cir 2007) (plaintiffs must show they 'experienced loss as a result of the exposure of [the defendant's] misrepresentations')).

In section 11 cases, plaintiffs need not show loss causation. However, defendants can reduce or eliminate recovery by showing that the misstatement did not cause any harm. This affirmative defence is called 'negative causation'.

In section 12(a)(1) claims, loss causation is not required.

In section 12(a)(2) claims, plaintiffs need not show loss causation. Absence of loss causation is, however, an explicit statutory defence.

Common law fraudulent misrepresentation and negligent misrepresentation claims generally require the plaintiff to show loss causation (see *Fin Guar Ins Co v Putnam Advisory Co*, 783 F3d 395 (2d Cir 2015)).

10 What elements present special issues in the securities litigation context?

Two additional elements of a Rule 10b-5 claim should be highlighted: statutory standing and the scope of persons who may be liable.

To have standing to sue under Rule 10b-5, a plaintiff must have been a purchaser or seller of the security at issue. Therefore, fraud that causes a person not to engage in a securities transaction is not actionable (see *Blue Chip Stamps v Manor Drug Stores*, 421 US 723 (1975)).

This rule has taken on broader importance following the enactment of SLUSA. As noted in question 2, SLUSA pre-empts state law class actions that could have been brought in federal court. The Supreme Court has found that SLUSA applies even where state blue-sky laws would allow a 'holder claim' – that is, a claim that misinformation caused a person to hold a security and thereby suffer a loss. Therefore, the combined effect of SLUSA and the *Blue Chip Stamps* rule is that the federal law purchaser or seller requirement applies to all covered class actions.

With respect to the scope of liability, the Supreme Court has rejected secondary liability – liability for those who assist a primary violator – under Rule 10b-5 for private securities fraud actions (secondary liability for 'controlling persons' is discussed in question 16). In *Central Bank of Denver NA v First Interstate Bank of Denver*, 511 US 164 (1994), the plaintiff sued the Central Bank of Denver under Rule 10b-5 for statements made by the Colorado Springs–Stetson Hills Public Building Authority relating to certain bonds. The Central Bank of Denver was required to review the value of the property backing the bonds. The plaintiff alleged that, by not competently reviewing the value of the property, the Central Bank of Denver had aided and abetted the fraudulent statements. The Supreme Court held that Rule 10b-5 did not allow for aiding and abetting liability. Therefore, following *Central Bank of Denver*, courts have required a showing that the particular defendant made a fraudulent statement in order to find Rule 10b-5 liability (see *Stoneridge Inv Partners, LLC v Scientific-Atlanta*, 552 US 148, 158 (2008)).

The Supreme Court has subsequently defined narrowly who makes a statement for the purposes of Rule 10b-5. The Court held in *Janus Capital Group, Inc v First Derivative Traders*, 564 US 135 (2011), that a person makes a statement only if that person had ultimate authority over the statement, including its content and whether and how to communicate it. In *Janus Capital*, the Court held that an investment adviser could not be held liable under Rule 10b-5 for statements made in a mutual fund prospectus, as the fund, and not its adviser, made the statements. The SEC, however, retains statutory authority to bring suits against any person who 'knowingly or recklessly provides substantial assistance' to the speaker (see 15 USC section 78t(e)). As discussed in 'Update and trends', the scope of *Janus* is currently being litigated, including its application to scheme liability claims.

Finally, a practical note should be made about how the elements discussed above actually arise in securities cases. As noted in question 1, the vast majority of securities cases are dismissed or settle before trial. Often, therefore, the ultimate outcome of a securities claim will be decided on a pleading motion, as many defendants who do not succeed in obtaining an early dismissal will seek settlement. This places heavy emphasis on pleading standards, which are discussed further in question 14.

11 What is the relevant limitation period? When does it begin to run? Can it be extended or shortened?

For a claim brought under Rule 10b-5, the limitation period is two years (see 28 USC section 1658(b)(1)). For claims brought under sections 11 and 12, the limitation period is one year (see 15 USC section 77m). Following recent statutory amendments, it is unclear whether the limitation period for claims brought under section 18 is one or two years. See *DeKalb Cnty Pension Fund v TransOcean Ltd*, 817 F3d 393 (2d Cir 2016) (holding that 28 USC section 1658(b) supersedes 15 USC section 78r(c)). The limitation period begins to run upon the discovery of the violation, which includes both actual and constructive discovery of the violation. That is, courts determine when the limitation period begins to run by asking when the plaintiff discovered the fraud and when a reasonable investor would have discovered the fraud. The limitation period begins to run from whichever is earlier in time.

In order for the limitation period to begin, the plaintiff must have discovered sufficient facts to plead each element of a claim under the PSLRA, including scienter. In *Merck & Co v Reynolds*, 559 US 633 (2010), the plaintiffs brought a suit against Merck for misrepresenting the heart attack risks associated with its drug, Vioxx. The defendants moved to dismiss, claiming that the two-year limitation period had run. In support of this position, the defendants claimed that two events should have begun the limitation period. First, a study had shown that Vioxx caused more heart attacks than another drug, Naproxen. At the time, Merck explained the study by claiming that Naproxen may confer heart benefits. Second, the Food and Drug Administration sent Merck a warning letter alleging that its marketing of Vioxx was misleading, although the letter acknowledged that the Naproxen hypothesis could be true. The Court found that these events did not trigger the limitation period because they did not indicate scienter. The Court reasoned that, because scienter is an element of a Rule 10b-5 violation, the limitation period does not begin to run until the plaintiffs discover, or could discover, facts suggestive of scienter (see id at 648–49).

The two-year statute of limitations is extended for all members of a pending class action under the rule in *American Pipe & Construction Co v Utah*, 414 US 538 (1974), whether or not the class is eventually certified. This is referred to as 'tolling' the limitation period.

Rule 10b-5 claims also have a five-year 'statue of repose' (28 USC section 1658(b)(2)), which creates a substantive right for the defendant to be free from suit, and operates separately from the statute of limitations. The statute of repose does not depend on discovery of the violation. For claims brought under sections 11 and 12, the statute of repose is three years (see 15 USC section 77m). For the reasons given above, the repose period for claims brought under section 18 is unclear.

The Supreme Court has recently held that *American Pipe* tolling does not apply to the three-year statute of repose for sections 11 and 12. See *Cal Pub Emps' Ret Sys v ANZ Sec, Inc* (CalPERS), 137 S Ct 2042 (2017). Following the same logic as *CalPERS,* courts have held that *American Pipe* tolling does not apply to the statute of repose for claims brought under section 10(b) of the 1934 Act either. See, for example, *N Sound Capital LLC v Merck & Co*, 702 F App'x 75 (3d Cir 2017); *Dusek v JPMorgan Chase & Co*, 832 F2d 1243 (11th Cir 2016); *SRM Global Master Fund Ltd P'ship v Bear Stearns Cos*, 829 F3d 173 (2d Cir 2016); *Stein v Regions Morgan Keegan Select High Income Fund, Inc*, 821 F3d 780 (6th Cir 2016). As discussed further below, the Court has more recently declined to extend *American Pipe* to allow subsequent filing of additional class actions after the statute of limitations expires.

Limitations periods for state law negligent and fraudulent misrepresentations claims vary by state.

12 What defences present special issues in the securities litigation context?

Rule 10b-5 does not have any statutory defences other than the statutes of limitations and repose discussed in question 11. The typical defendant will contend that its conduct did not meet the elements of the Rule. Equitable defences will rarely apply (see *Bateman Eichler, Hill Richards, Inc v Berner*, 472 US 299 (1985)).

Section 11 has a number of statutory affirmative defences – defences that defendants must raise and prove (see 15 USC section 77k). First, a defendant can escape liability if it shows that the plaintiff knew of the misstatement when it acquired the security. Second, a defendant other than an issuer (eg, a director) may avoid liability by resigning from his or her position and informing both the SEC and the issuer that he or she will not be responsible for the registration statement. Third, if defendants did not know that a registration statement had become effective, they may avoid liability if, upon learning of the active registration statement, they:

- take steps to sever ties with the issuer;
- advise the issuer and the SEC that they will not be responsible for the statement; and
- if the registration statement is already effective, give reasonable public notice that they did not know the statement was effective.

Fourth, as explained more fully in questions 17 through 19, defendants can avoid liability if they acted with due diligence. Finally, a defendant can reduce or eliminate liability by showing that a plaintiff's losses were not caused by the misstatement.

Section 12(a)(1) does not have any statutory defences.

Section 12(a)(2) creates a variety of statutory affirmative defences (see 15 USC section 77l). First, since section 12(a)(2) requires that a plaintiff tender back its securities, failure to tender is a defence. Second, as discussed more fully in question 18, defendants may avoid liability if they acted with due diligence. Third, a defendant can avoid liability if it shows that the plaintiff knew of the misstatement when acquiring the security. Finally, a defendant may reduce or eliminate damages by proving loss causation as an affirmative defence.

13 What remedies are available? What is the measure of damages?

In Rule 10b-5 cases the usual measure of damages is out-of-pocket damages. Out-of-pocket damages allow a plaintiff to recover the difference between the true value of the security at the time of sale and what the plaintiff actually received. Determining the true value of the security requires a court to determine what the security would have been worth absent fraud (see *Action AG v China North East Petroleum Holdings Ltd*, 692 F3d 34, 41 (2d Cir 2012)).

In a class action, the most common way that plaintiffs establish damages is to construct a 'price inflation ribbon', which measures the amount by which the true value of the security exceeded the market price throughout the class period. In a case involving misrepresentations at different points in time or multiple corrective disclosures (ie, the complete truth reached the market in stages), the price inflation ribbon can vary in size over the class period, until a complete corrective disclosure dissipates all price inflation. Class members will then recover damages based on the difference between the price inflation at the time of purchase and the price inflation at the time of sale.

In 1995, Congress was concerned about plaintiffs recovering excessive damages when a stock price overreacts to a corrective disclosure. Consequently, the PSLRA requires courts to use a 90-day window following corrective disclosure to determine price. This means that a plaintiff cannot receive a windfall if a stock price drops dramatically following a corrective disclosure but then quickly bounces back (as is often the case) (see 15 USC section 78u–4(e)(1)).

Section 11 allows for three measures of damages:

- the difference between the amount paid for the security and the price at filing of the suit;
- the difference between the amount paid for the security and the sale price, if the security was sold before suit; or
- the difference between the amount paid for the security and the post-suit sale price, so long as the amount is less than or equal to the difference between the purchase price and the price at filing of the suit.

This section 11 damages formula is particularly important in cases about bonds, where the price at the filing of suit may have fallen below par on the risk of default, but the issuer ultimately makes all interest and principal payments and the price recovers to par.

Section 12 allows rescission when a plaintiff still owns the security. It allows money damages when the plaintiff does not own the security. The value of the money award is intended to approximate rescission; therefore, courts typically calculate the difference between the price paid for the security and the amount the security was sold for.

In all securities cases, the plaintiff bears the burden of proving damages.

14 What is required to plead the claim adequately and proceed past the initial pleading?

To adequately plead a securities claim, a plaintiff must set forth sufficient allegations to state a cause of action. Under Rule 8 of the Federal Rules of Civil Procedure, the plaintiff must make factual allegations sufficient 'to raise a right to relief above the speculative level' (see *Bell Atlantic Corp v Twombly*, 550 US 544, 555 (2007)). In other words, the complaint must allege 'enough facts to state a claim to relief that is plausible on its face' (see id at 570).

In addition, a claim alleging fraud under Rule 10b-5 must meet the heightened pleading requirements set forth in Rule 9(b) of the Federal Rules of Civil Procedure and the PSLRA. These provisions require the plaintiff to plead with particularity not only which statements were fraudulent, but also when, where, and by whom the statements were made, and why they were fraudulent (see 15 USC section 78u-4(b)(1); *ATSI Commc'ns, Inc v The Shaar Fund, Ltd*, 493 F3d 87, 99 (2d Cir 2007)). Plaintiffs must do more than simply assert that a statement is false – 'they must demonstrate with specificity why and how that is so' (see *Rombach v Chang*, 355 F3d 164, 174 (2d Cir 2004)).

Moreover, plaintiffs must plead facts that, taken together not read in isolation, give rise to a 'strong inference' that the maker of the alleged misrepresentations acted with scienter (see *Tellabs, Inc v Makor Issues & Rights, Ltd*, 551 US 308, 323 (2007)). A plaintiff adequately alleges scienter 'only if a reasonable person would deem the inference of scienter cogent and at least as compelling as any opposing inference one could draw from the facts alleged' (see id at 324).

Facts giving rise to a strong inference of scienter can be alleged by pleading the motive and opportunity of the maker of a statement to commit the fraud, or strong circumstantial evidence of conscious misbehaviour or recklessness (see *Kalnit v Eichler*, 264 F3d 131, 138 (2d Cir 2001)). Motive and opportunity require plausible allegations that the maker of a statement could realise, and had the likely prospect of realising, concrete benefits by the misstatement. Allegations limited to the type of 'corporate profit' motive possessed by most corporate directors and officers do not suffice (see id at 139).

Where a plaintiff fails to plead motive, its allegations regarding conscious misbehaviour or recklessness 'must be correspondingly greater' (see id at 142). Conscious misbehaviour generally consists of deliberate, illegal behaviour. Recklessness requires allegations that a defendant's conduct was 'highly unreasonable' and constituted 'an extreme departure from the standards of ordinary care to the extent that the danger was either known to the defendant or so obvious that the defendant must have been aware of it' (see *S Cherry Street, LLC v Hennessee Grp LLC*, 573 F3d 98, 109 (2d Cir 2009) (emphasis omitted)). However, allegations of mere corporate mismanagement are not actionable (see *Santa Fe Indus, Inc v Green*, 430 US 462, 477-79 (1977)).

Although it is well settled that Rule 9(b) and the PSLRA's heightened pleading standards apply to allegations regarding the misstatements underlying the fraud, it is not yet clear whether these standards apply to allegations of loss causation. The United States Supreme Court, First Circuit, Second Circuit and Tenth Circuit have specifically left this question open (see *Dura Pharms, Inc v Broudu,* 544 US 336, 346-47 (2005); *Nakkhumpun v Taylor,* 782 F3d 1142, 1153-54 (10th Cir 2015); *Mass Ret Sys v CVS Caremark Corp,* 716 F3d 229, 239 n6 (1st Cir 2013); *Acticon AG v China N East Petroleum Holdings Ltd*, 692 F3d 34, 38 (2d Cir 2012)). The Fourth Circuit and the Ninth Circuits have held that a heightened pleadings standard applies to loss causation (see *Katyle v Penn Nat'l Gaming, Inc*, 637 F3d 462, 471 (4th Cir 2011); *Oregon Pub Emps Ret Fund v Apollo Grp Inc*, 774 F3d 598, 605 (9th Cir 2014)), while the Fifth Circuit has held that loss causation is not subject to a higher pleading standard (see *Lormand v US Unwired, Inc*, 565 F3d 228, 256 (5th Cir 2009)). At a minimum, adequately pleading loss causation requires more than merely alleging that a company's shares declined substantially in value proximate to the revelation of the falsity of some prior statement (see *Dura*, 544 US at 343).

Claims under sections 11 and 12 of the 1933 Securities Act 'do not require allegations of scienter, reliance, or loss causation' (see *Fait v Regions Fin Corp,* 655 F3d 105, 109 (2d Cir 2011)). Thus, as a general rule, such claims need not be pled with particularity. However, if a pleading 'sounds in fraud' (ie, if the complaint relies on 'the exact same factual allegations to allege violations of section 11 as it uses to allege fraudulent conduct under section 10(b) of the Exchange Act', then the heightened pleading requirements of Rule 9(b) of the Federal Rules of Civil Procedure will apply) (see *Rubke v Capitol Bancorp Ltd*, 551 F3d 1156, 1161 (9th Cir 2009); *Rombach v Chang,* 355 F3d 164, 176 (2d Cir 2004)).

15 What are the procedural mechanisms available to defendants to defeat, dispose of or narrow claims at an early stage of proceedings? What requirements must be satisfied to obtain each form of pretrial resolution?

In a federal court, the Federal Rules of Civil Procedure, as well as the local rules of the particular district, and the individual rules of the particular judge before whom a case is pending, govern the process by which claims may be disposed of or narrowed at an early stage.

Bringing a motion to dismiss pursuant to Rule 12(b)(6) of the Federal Rules of Civil Procedure is the most common procedural device used for this purpose. In such a motion, the defendant contends that the complaint is insufficient as a matter of law. Questions of fact cannot be litigated on a Rule 12(b)(6) motion and must await a later stage of the proceedings.

In reviewing a motion to dismiss, a court is required to 'accept as true' the facts alleged in the complaint, subject to the *Twombly* plausibility standard discussed in question 14. A defendant argues that, even when the allegations are accepted as true, they are facially insufficient to support a claim. In response, a plaintiff has two choices: to argue that the allegations are sufficient as a matter of law, or to seek to amend the pleadings to bolster its allegations. Federal courts are encouraged to be liberal in allowing amendments, applying a standard of 'when justice so requires' (see Fed R Civ P 15(a)(2)). However, a district court is not required to allow a plaintiff to amend a facially defective complaint without a proffer of what amendments would be made; and if the court's conclusion is that the proposed amendments would not resolve the legal insufficiency, it may deny the amendment.

The sufficiency of a complaint, including its plausibility, is determined on an element-by-element basis. Each element of a claim must be adequately pleaded in order for the claim to survive.

Further, in Rule 10b-5 cases, the PSLRA provides that discovery – the period during which documents and information are disclosed between the parties – is stayed during the pendency of motions to dismiss dismiss (see 15 USC section 78u-4(b)(3)(B)). This stay prevents the plaintiff from obtaining documents and information from the defendant, but does not prevent it from further developing theories of the case on its own, such as by obtaining publicly available documents, seeking confidential witnesses, or working with experts in the securities area during this time. Such work can prove useful in connection with any potential amendments to an initial pleading a plaintiff may choose to make.

The initial motion practice described above can consume substantial time. Federal courts vary in the amount of time they allow the parties to brief a motion to dismiss, and whether they require (or allow) oral argument of that motion once it is fully submitted. Courts can also take anywhere from a day to a year or more to rule on a motion to dismiss. In some instances, with additional amendments and motion practice, this can mean that a securities case does not get past the initial motion phase for a lengthy period of time.

Defendants seeking to narrow securities claims have other options in addition to a motion to dismiss. A defendant may seek to narrow claims through negotiation (for instance, a plaintiff might 'trade' a claim against an individual corporate defendant in exchange for a corporate defendant not opposing a motion for class certification), or through a motion for judgment on the pleadings pursuant to Rule 12(c) of the Federal Rules of Civil Procedure, which is decided under the same standard as that for a Rule 12(b)(6) motion, but may be brought by either a plaintiff or a defendant after the defendant has answered the complaint. In addition, litigants have the ability to bring motions pursuant to Rule 56 of the Federal Rules of Civil Procedure for summary judgment. Motions for summary judgment are typically made when the parties have completed some or all discovery, and one side or the other asserts that because there is no triable issue of fact, judgment can be entered as a matter of law. Some courts, however, will allow such a motion to be brought earlier to facilitate the streamlining of the case.

16 Are the principles of secondary, vicarious or 'controlling person' liability recognised in your jurisdiction?

The US securities laws provide for claims of 'control person liability'. Section 20(a) of the 1934 Act provides that:

> *[e]very person who, directly or indirectly, controls any person liable under any provision of this chapter...shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable, unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action (see 15 USC section 78t(a)).*

Courts are deeply divided on the requirements for alleging control person liability. The Second, Third, and Fourth Circuits have required three elements to sustain claim of control person liability under section 20(a):

- there was a primary violation by a controlled person;
- the 'controlling' defendant controlled the primary violator; and
- the defendant who is alleged to be the controlling person was, in some sense, a culpable participant in the controlled person's fraud (see *ATSI Commc'ns, Inc v The Shaar Fund, Ltd,* 493 F3d 87, 108 (2d Cir 2007); accord *Carpenter v Harris, Upham & Co*, 594 F2d 388, 394 (4th Cir 1979); R*ochez Bros, Inc v Rhoades*, 527 F2d 880, 890 (3d Cir 1975)).

Other circuit courts, with degrees of variation, have required less to sustain a claim, for example, requiring allegations of potential or indirect control as opposed to actual control and rejecting 'culpable participation' as an element of the claim (see *Lustgraaf v Behrens,* 619 F3d 867, 877 (8th Cir 2010) (collecting cases); *Harrison v Dean Witter Reynolds, Inc*, 974 F2d 873, 881 (7th Cir 1992)). Courts that require a plaintiff to plead 'culpable participation' are also divided on what the claim requires, although most 'have held that the PSLRA's heightened pleading requirements apply', meaning, 'as noted above, that the plaintiff must plead with particularity facts giving rise to a strong inference' of the requisite state of mind' to meet a heightened pleading standard with respect to those allegations, as discussed in question 14. *In re ShengdaTech Inc Sec Litig.*, 2014 WL 3928606, at *10 (SDNY 12 August 2014) (internal quotation marks omitted).

Regardless, a claim for control person liability first requires the pleading and proof at trial of an underlying violation of the securities laws. Absent such a violation, a claim for control person liability cannot be sustained. In addition, a plaintiff must plead and prove that a defendant is in fact a 'control person' within the meaning of the law, although the degree of control, as noted, may vary depending on the jurisdiction.

Section 15 of the 1933 Securities Act provides that the control person for any issuer liable under sections 11 or 12 will also be jointly and severally liable, unless the control person 'had no knowledge of or reasonable ground to believe in the existence of the facts by reason of which the liability of the controlled person is alleged to exist' (see 15 USC section 77o(a)).

17 What are the special issues in your jurisdiction with respect to securities claims against directors?

It is difficult to hold independent directors (not part of management) liable for securities claims under Rule 10b-5. One major barrier to liability is that directors rarely make statements that can serve as the basis for a claim. As discussed in question 10, the Supreme Court has found that, in order to be liable under Rule 10b-5, a person must make the fraudulent statement. Directors rarely make statements in their individual capacity. Therefore, individual directors are rarely held liable under Rule 10b-5.

A second hurdle is that it is difficult to prove scienter on the part of a director. As noted in question 7, in order to state a claim under Rule 10b-5 a plaintiff must allege facts that present a cogent basis for concluding that a defendant was, at a minimum, highly reckless with regard to the truth of the alleged misstatement. It is difficult for a plaintiff to show that an independent director had actionable scienter.

Section 11 claims, for initial offerings, are somewhat easier to make out against a director. Under section 11, directors are liable for a misstatement in a registration statement unless they can show that they acted with due diligence. The due diligence defence essentially places the burden of proof on directors to show that they were not negligent.

It is relatively rare for directors to be forced to pay out-of-pocket damages to settle a securities action or pay a judgment. Most directors are covered by directors' and officers' liability insurance, which covers legal expenses and damages paid. Moreover, most companies indemnify directors for their legal defences and settlements. According to one study, there have been around a dozen cases since 1980, all involving settlements of claims under section 11, in which directors ended up paying settlements from their own pockets (see Bernard Black et al, Outside Director Liability, 58 *Stanford L Rev* 1055 (2006)).

18 What are the special issues in your jurisdiction with respect to securities claims against underwriters?

Underwriters are unlikely to face liability under Rule 10b-5. Following *Janus Capital Group, Inc v First Derivative Traders*, 564 US 135 (2011), a defendant is liable only if it had 'ultimate authority' over the statement. Generally, ultimate authority over whether a particular statement will be made rests with the issuer, not the underwriter.

Underwriters are more likely to face liability under sections 11 and 12. Section 11 explicitly allows for underwriter liability. For section 11 purposes, an underwriter is an entity that participates directly or indirectly in the offer and sale of the security. Section 11 allows for a due diligence defence for non-issuers. The due diligence defence has two standards of proof depending on whether the statement is made based on the authority of an 'expert', such as an accountant. These are generally referred to as 'expertised' statements.

For expertised statements (eg, audited financial statements), an underwriter will meet the statutory defence if it had no reasonable ground to, and did not, believe that the statement was false. There is relatively little case law concerning this standard, but it is generally believed that the underwriter will not be liable unless a 'red flag' triggered a duty to investigate (see *In re WorldCom, Inc Sec Litig*, 346 F Supp 2d 628 (SDNY 2004)). For non-expertised statements, the defence requires the underwriter to engage in affirmative due diligence. The defence is satisfied when, after reasonable investigation, the speaker had reasonable grounds to, and did, believe the statement was true (see id).

Section 12(a)(2) applies to those who sell securities to a plaintiff. A 'seller' within the meaning of section 12(a)(2) is one who either passes title to a buyer or solicits the purchase at least in part by a desire to serve their own financial interests. Therefore, underwriters are generally considered sellers under section 12.

Section 12(a)(2) also allows for underwriters to avoid liability if they exercised due diligence. The section 12(a)(2) due diligence standard allows underwriters to escape liability if they did not have actual knowledge of the misrepresentation and could not have acquired that knowledge through reasonable care (see *FHA v Nomura Holding Am, Inc,* 873 F3d 85, 122 (2d Cir 2017)).

Finally, on a practical note, underwriters are usually indemnified by issuers for any misstatements. Therefore, absent issuer insolvency or a botched initial public offering, underwriters are generally unlikely to pay out-of-pocket damages.

19 What are the special issues in your jurisdiction with respect to securities claims against auditors?

In Rule 10b-5 cases, an auditor can be held liable for the statements in its report on the issuer's annual financial statements. The auditor generally cannot, however, be held liable for other statements in the company's annual report (which are made by management), or in connection with unaudited quarterly financial statements.

Proving auditor scienter is particularly difficult. As explained more fully in question 7, to show scienter a plaintiff must plead facts showing either actual knowledge or extreme recklessness. For independent auditors, courts have found that extreme recklessness requires a showing that the performed audit was so deficient that it amounted to 'no audit at all' (see *SEC v Price Waterhouse*, 797 F Supp 1217, 1240 (SDNY 1992)). That is, allegations that the audit was conducted badly or that the auditor should have uncovered a misstatement may allege negligence but are insufficient to prove 10b-5 liability. For this reason, courts have concluded that evidence that the company's financial statements are not in accordance with Generally Accepted Accounting Principles does not by itself support an inference that the auditor acted with extreme recklessness.

Plaintiffs generally attempt to prove auditor scienter by alleging that the auditor knew of, but ignored, various red flags pointing to fraud. In order to make out a red-flag claim, courts have demanded that the auditor actually knew of the red flag and that the purported red flag be truly indicative of fraud (see *In re DNTW Chartered Accountants Sec Litig*, 172 F Supp 3d 675, 687-88 (SDNY 2016)).

Auditors also face liability under section 11. The statute allows for liability against auditors who are named as preparing or certifying a report or valuation in the registration statement. Unlike with Rule 10b-5 cases, there is no scienter requirement. As discussed in question 18, an auditor, as a non-issuer, is able to assert a due diligence defence. Showing that an audit complied with Generally Accepted Auditing Standards should generally be sufficient to make out the due diligence defence.

20 In what circumstances does your jurisdiction allow collective proceedings?

Private securities actions may be brought by a single individual or by an individual as a representative of a class of similarly situated individuals. Securities claims are often brought by multiple plaintiffs, seeking to represent the same or overlapping classes, who are represented by multiple firms. In such cases, the courts have developed various mechanisms to enhance efficiency for plaintiffs, defendants, counsel, and the courts. Where multiple cases involving broadly the same underlying facts are filed in the same district, those cases may be consolidated or coordinated before the same judge. In securities class actions, a lead plaintiff is appointed within 90 days after notice is given to class members that a complaint has been filed, with preference being given to larger investors (see 15 USC section 78u-4(a)(3)(B)).

Further, where cases are filed in different US jurisdictions, there is a process whereby a party or a court may seek to have them treated as a group. The Judicial Panel on Multi-District Litigation, composed of judges and administrators, oversees the rules and process whereby similar cases brought in different jurisdictions may be consolidated in one court (see 28 USC section 1407). This is referred to as an 'MDL' process. Once an MDL process has been commenced, it can take a number of months before cases are situated in the court that is formally designated to handle them. An interesting quirk of US law is that the MDL court designated to handle a group of cases need have no relationship to any of the cases – it may be chosen due to docket availability or congestion, expertise, location of witnesses, costs of travel, or compromise.

A case that is initiated in one jurisdiction and sent by way of an MDL process to an alternative jurisdiction remains in that alternative jurisdiction for pretrial purposes. At the conclusion of the pretrial process (ie, when the case is trial-ready), it may go back to its 'home' jurisdiction. In practice, many parties do not want or seek to return to a home court after having spent what may have been years before a different court. And, of course, settlements often occur before a case returns home for trial.

In certain instances, a court may allow a single plaintiff or group of plaintiffs to bring suit on behalf of similarly situated in persons in a suit referred to as a 'class action'. Before certifying a class in a federal case, a court must conduct a 'rigorous analysis' to determine whether the plaintiff has satisfied the four prerequisites of Rule 23(a) of the Federal Rules of Civil Procedure – numerosity, commonality, typicality and adequacy of representation – and the requirements of one of the three alternatives of Rule 23(b) (see *Wal-Mart Stores, Inc v Dukes*, 564 US 338 (2011)). The plaintiff must prove the Rule 23 prerequisites by a preponderance of the evidence.

Under Rule 23(a) of the Federal Rules of Civil Procedure:

> *One or more members of a class may sue or be sued as representative parties on behalf of all members only if: (1) the class is so numerous that joinder of all members is impracticable; (2) there are questions of law or fact common to the class; (3) the claims or defenses of the representative parties are typical of the claims or defenses of the class; and (4) the representative parties will fairly and adequately protect the interests of the class.*

The commonality, typicality and adequacy requirements are closely related. Indeed, the 'commonality and typicality requirements of Rule 23(a) tend to merge' (see *Wal-Mart Stores*, 564 US at 349 n5).

Under Rule 23(b):

> *A class action may be maintained…if: (1) prosecuting separate actions by or against individual class members would create a risk of: (A) inconsistent or varying adjudications with respect to individual class members that would establish incompatible standards of conduct for the party opposing the class; or (B) adjudications with respect to individual class members that, as a practical matter, would be dispositive of the interests of the other members not parties to the individual adjudications or would substantially impair or impede their ability to protect their interests; (2) the party opposing the class has acted or refused to act on grounds that apply generally to the class, so that final injunctive relief or corresponding declaratory relief is appropriate respecting the class as a whole; or (3) the court finds that the questions of law or fact common to class members predominate over any questions affecting only individual members, and that a class action is superior to other available methods for fairly and efficiently adjudicating the controversy.*

Securities class actions are typically brought under Rule 23(b)(3), which provides for opt-out damages class actions. To certify a Rule 23(b)(3) class, the court must determine that 'questions of law or fact common to the class predominate over any questions affecting only individual members,' and that a class action is the superior method of resolving the question of liability (see Fed R Civ P 23(b)(3)). Although Rule 23(b)(3)'s 'predominance' requirement is more exacting than Rule 23(a)'s 'commonality' prerequisite, the 'court's [Rule 23(b)(3)] inquiry is directed primarily toward whether the issue of liability is common to members of the class' (see *In re IndyMac Mortgage-Backed Sec Litig*, 286 FRD 226, 236 (SDNY 17 August 2012) (quotation omitted)).

Class certification is appropriate after the district court 'resolves factual disputes relevant to each Rule 23 requirement and finds that whatever underlying facts are relevant to a particular Rule 23 requirement have been established and is persuaded to rule, based on the relevant facts and the applicable legal standard, that the requirement is met' (see *Teamsters Local 445 Freight Division Pension Fund v Bombardier,* *Inc*, 546 F3d 196, 202 (2d Cir 2008) (quotation omitted)). However, class certification should not 'become a pretext for a partial trial of the merits' (see id at 204 (quotations omitted)). The rules governing prosecution of class actions under state law vary by state.

21 In collective proceedings, are claims opt-in or opt-out?

Most US class actions provide that all members of the class are included as plaintiffs in a lawsuit, unless they specifically 'opt out' during a defined time period. This process occurs by way of a well-defined notice process. Once a class has been certified, the court typically approves a form of notice (the content of which is negotiated by the parties and submitted to the court for approval), which is then disseminated to class members. The form of notice is typically sent by mail, increasingly by email, or published in a newspaper with particular circulation characteristics (eg, a publication with acknowledged national or regional reach). The notice provides a period of time during which a class member may choose to 'opt out' of the class, thereby preserving the ability for him or her to pursue a claim individually, or not pursue a claim at all. An individual who has 'opted out' of a class is not then covered by the release of claims that might be included in any settlement agreement, and is unable to recover any amounts from a settlement fund or, if the matter proceeds to trial, from any damages awarded. In many cases, the number of opt-outs ranges from zero to a small handful. The court must also approve any settlement of the class's claims following a hearing and on a finding that the settlement is 'fair, reasonable and adequate' (see Fed R Civ P 23(e)). Putative class members have a right to object to the terms of the settlement at this hearing (see question 23).

22 Can damages be determined on a class-wide basis, or must damages be assessed individually?

As discussed in question 20, one of the issues relevant to class certification is whether the claims and defences of a named plaintiff are 'typical' of other class members, and whether common issues 'predominate' over individual ones. Questions regarding whether damages need to be assessed on an individualised basis typically arise in assessing such issues. The law that has developed on this issue contains some grey areas. On the one hand, the law is clear that the fact that damages must be assessed on an individual basis is not necessarily fatal to certification. On the other hand, the Supreme Court has stated that, in order to certify a class, a plaintiff must allege and then demonstrate by a preponderance of the evidence that there is some methodology that can be applied to assessing damages on a class-wide basis (see *Comcast Corp v Behrend*, 569 US 27 (2013)).

While these two legal doctrines may appear to be in some tension, they are reconciled by the distinction between a single methodology that is both capable of assessing damages and of accounting for individual differences, and multiple different methodologies that are required to assess damages on a plaintiff-by-plaintiff basis (see *Sykes v Mel S Harris & Assocs LLC*, 780 F3d 70, 88 (2d Cir 2015)). Broadly speaking, the former is permitted in a class action; the latter is not.

23 What is the involvement of the court in collective proceedings?

As described above, the court plays an active role in collective proceedings. It must conduct a rigorous analysis to determine whether class certification is appropriate, including holding an evidentiary hearing if necessary to resolve factual disputes relevant to such inquiry. In addition, once a class is certified, the court has an affirmative obligation to review and approve any settlement (see Fed R Civ P 23(e)). The court must 'carefully scrutinize the settlement to ensure its fairness, adequacy and reasonableness...and that it was not a product of collusion' (see *D'Amato v Deutsche Bank*, 236 F3d 78, 85 (2d Cir 2001)).

The standards a court uses in reviewing a settlement were set forth in the seminal case *City of Detroit v Grinnell Corp*, 495 F2d 448, 462 (2d Cir 1974), abrogated on other grounds by *Goldberger v Integrated Res Inc*, 209 F3d 43 (2d Cir 2000). The following nine '*Grinnell*' factors are cited by courts around the country in assessing settlements of class actions:

- the complexity, expense and likely duration of the litigation;
- the reaction of the class to the settlement;
- the stage of the proceedings and the amount of discovery completed;
- the risks of establishing liability;
- the risks of establishing damages;
- the risks of maintaining the class action through trial;
- the ability of the defendants to withstand a greater judgment;
- the range of reasonableness of the settlement fund in light of the best possible recovery; and
- the range of reasonableness of the settlement fund to a possible recovery in light of all of the attendant risks of litigation (see *D'Amato*, 236 F3d at 86).

Public policy also favours settlements of class actions.

The court's review of a settlement follows a defined process. First, once a settlement has been reached, notice must be provided to the class. Class members are then provided an opportunity to object to the terms of the settlement or otherwise comment on its terms. A public hearing is held at which plaintiffs' counsel typically makes a presentation as to how and why each of the *Grinnell* (or, in other districts, equivalent) factors have been met. The court must then make appropriate findings.

24 What role do regulators, professional bodies, and other third parties play in collective proceedings?

Class actions are litigated by court-approved class counsel. It is typical for class counsel to retain expert witnesses such as economists to assist them with damage models, as well as other experts who might have an area of expertise relating to a liability claim (eg, an accountant who can opine on an appropriate professional standard, a mortgage lender on loan considerations or a broker-dealer on process). Defendants will also typically retain their own experts on the same topics. Experts may thereafter submit affidavits or reports in connection with various pre-trial motions, and appear at depositions or at trial.

Regulators, such as the SEC, do not play a direct role in collective actions. They do not bring class actions, though they operate in the public interest and may, pursuant to a consent decree or other settlement, obtain relief that benefits class members. Any monies that the SEC might obtain by way of settlement are not distributed to a 'class', although the SEC has the option of distributing civil penalties to defrauded investors ('fair funds'). On the other hand, there are numerous instances in which an SEC enforcement action against the same defendant, in a similar industry or addressing a similar issue, may be used by the plaintiffs, to the extent admissible, in a class action or otherwise. In this sense, the SEC plays an indirect role in the class action by presenting a vehicle through which evidence, positions and/or arguments might be developed, previewed, and credited or discarded. Under the Class Action Fairness Act, 28 USC section 1715, the defendant in any class action is required to notify both the federal government (in most cases, the Attorney General) and any relevant state officials (either the state attorney general or the state official with responsibility for the subject matter of the class action) within 10 days of filing a proposed class action settlement with the court for approval.

25 What options are available for plaintiffs to obtain funding for their claims?

Depending on the circumstances, a number of different options may be available in the United States to help a securities plaintiff obtain funding for its claims.

Many securities plaintiffs' law firms will bring cases for a contingency fee, whereby they agree to take a percentage of the plaintiffs' recovery in lieu, either partially or wholly, of their hourly fee. Because the law firm's potential recovery will typically exceed the hourly fee that might be earned on the case, such an arrangement means that the law firm will share in both the risk and potential reward of the litigation. Such arrangements are worked out on a private contractual basis between the plaintiff and the law firm.

In addition, many contracts, especially in the structured finance context, provide for reimbursement by the defendant of the plaintiff's costs incurred in preparing for and bringing litigation. Such provisions are narrowly construed, and must make clear that they contemplate recovery against the defendant for costs incurred in claims brought against the defendant. If this is not made clear, such provisions will typically be construed as limited to reimbursement of costs incurred in bringing claims against third parties.

There is no statutory provision for reimbursement of the plaintiff's attorney's fees in a securities claim, even if the plaintiff prevails. As discussed below, the court may (but need not) award 'costs' to the prevailing party, but such costs do not include attorneys' fees (see question 26).

Litigation funding is also an option for securities plaintiffs. This may take the form of a litigation funder providing capital for the plaintiff to prosecute its claim or acquiring the claim itself to prosecute on its own behalf. (See *Trust for the Certificate Holders of the Merrill Lynch Mortg Inv'rs, Inc v Love Funding Corp*, 591 F3d 116 (2d Cir 2010); *Trust for the Certificate Holders of the Merrill Lynch Mortg Inv'rs, Inc v Love Funding Corp*, 13 NY3d 190 (NY 2009)). In a recent case, the New York Court of Appeals held that the transfer of notes for which any consideration was contingent upon the outcome of litigation to enforce the notes was champertous because it did not fall within the safe harbour under New York law exempting notes with an aggregate purchase price of US$500,000 from champerty restrictions (see *Justinian Capital SPC v WestLB AG*, 28 NY3d 160, 170-71 (NY 2016)). Thus, although '[t]he consistent trend across the country is toward limiting, not expanding, champerty's reach', *Del Webb Communities, Inc v Partington*, 652 F3d 1145, 1156 (9th Cir 2011), scrutiny – both legislative and judicial – may increase as such arrangements become more commonplace. Litigation funding arrangements do not need to be disclosed under federal rules.

26 Who is liable to pay costs in securities litigation? How are they calculated? Are there other procedural issues relevant to costs?

In US courts, there is a distinction between the 'costs' of an action and 'attorneys' fees'. 'Costs' are generally defined narrowly to include a specified series of items such as filing fees, costs of duplication of documents, transcripts of proceedings, and, to the extent relevant nowadays, facsimile transmissions. The court may, but is not required to, award costs to a prevailing party in a securities case.

Outside the class-action context, courts are not required to, and typically do not, award attorneys' fees to a prevailing party. There are certain types of cases where an award of fees is specifically contemplated by statute. For example, section 11(e) of the Securities Act of 1933 provides that a court may award fees to the defendant if it believes the suit was without merit (see 15 USC section 77k(e)). To find that a claim lacked merit, a court must find that it was frivolous or brought in bad faith (see *Zissu v Bear, Stearns & Co*, 805 F2d 75, 80 (2d Cir 1986)). In practice, courts rarely make such findings.

It is common for settlements of private securities lawsuits to include a provision awarding fees to counsel for the plaintiffs. If the settlement is of a class action, the court must review the entire settlement, including the fee award, to ensure that it is fair and reasonable. Attorneys' fees may also be recoverable pursuant to a contract.

27 Are there special issues in your jurisdiction with respect to interests in investment funds? What claims are available to investors in a fund against the fund and its directors, and against an investment manager or adviser?

There are a variety of types of investment funds available in the United States, including mutual funds, hedge funds, and private equity funds.

Mutual funds are professionally managed collective investment vehicles that pool money from a large number of investors to purchase securities, including money-market instruments, bonds, stocks, or a combination thereof. Mutual funds must be registered with the SEC, are governed by a board of directors (or in some cases trustees) and are subject to an extensive regulatory scheme. They may be 'open-end' (the fund will buy back shares from investors at any time), 'closed-end' (after issuance, shares may only be traded on an exchange) or 'exchange-traded' (open-end funds where the shares are also traded on an exchange).

Hedge funds and private equity funds, by contrast, are not publicly traded, and shares in such funds may only be sold through a private placement (though, again, in an open-end fund, investors may increase, withdraw, or reduce their investments over time through direct transactions with the fund). These funds are not subject to the same regulatory constraints as mutual funds. The distinction between hedge funds and private equity funds is that hedge funds typically invest in more liquid assets.

Investors in investment funds have a wider range of claims available than investors in other securities to redress mismanagement of the fund, largely because fund managers and directors owe fiduciary duties to investors. Thus, in addition to claims under the securities laws and for common law fraud, investors may also bring claims for breach of fiduciary duty based on mismanagement by managers and directors. These fiduciary relationships also typically create 'special relationships' sufficient to support claims for negligence and negligent misrepresentation.

In certain jurisdictions (based on the fund's domicile), a claim based on breach of fiduciary duties owed to an investment fund that results in the diminution of value to the fund as a whole (ie, to the fund's investors rateably in proportion to their shares) belongs to the fund and must be brought by the fund itself or by investors derivatively on the fund's behalf (ie, it cannot be brought directly by investors on their own behalf) (see *In re Bayou Hedge Fund Litig*, 534 F Supp 2d 405 (SDNY 2007) (holding that the Martin Act pre-empted investors' breach of fiduciary duty claim)).

Pleading securities claims against funds may be subject to special constraints, including with respect to who may be liable for statements where an investment adviser prepares a prospectus that the fund actually files with the SEC (making the fund the speaker of the statement for purposes of *Janus Capital Group, Inc v First Derivative Traders*, 564 US 135 (2011)), as discussed in question 10) and alleging loss causation, as discussed in question 14, because the value of certain funds is determined by a statutory formula that is unaffected by corrective disclosures (see *In re State St Bank & Tr. Co Fixed Income Funds Inv. Litig.*, 774 F Supp 2d 584, 591 (SDNY 2011) (an 'alleged misrepresentations regarding a fund's investment objective and holdings . . . can have no effect on a fund's share price')).

28 Are there special issues in your country in the structured finance context?

A variety of structured finance vehicles are used in the United States. The most common are:

- asset-backed securitisations, which pool income-producing assets such as residential mortgages, commercial mortgages, auto loans, and student loans into a trust, and issue 'asset-backed securities' (ABS) backed by those assets (known as 'residential mortgage-backed securities' or 'RMBS' where the assets are residential mortgages, and as 'commercial mortgage-backed securities' or 'CMBS', where they are commercial mortgages); and
- collateralised debt obligations (CDOs), which are one more step removed from the underlying income-producing assets than ABS and typically pool ABS or other CDO securities, or both, and issue securities backed by those assets.

ABS and CDO securities are typically traded on the private market through established dealers or market makers. They may be traded either in cash transactions, involving the exchange of an actual security for cash on either the primary (new issue) or secondary market, or in synthetic transactions entered into through credit default swaps (in which a 'long' party sells protection to a 'short' party against the possibility of the reference security's non-performance or some other contingency in return for payment of a premium, and neither party need actually own the reference security). The Commodity and Futures Modernization Act of 2000 amended section 10(b) so it covered 'security-based swap agreements' as well as 'securities'. The full implications of this provision have not yet been determined by the courts. For example, the Second Circuit has left open the question of whether a party to a securities-based swap agreement has statutory standing to sue a non-counterparty under Rule 10b-5 (see *Parkcentral Global Hub Ltd v Porsche Auto Holdings SE*, 763 F3d 198 (2d Cir 2014)). Recently, in *SRM Global Master Fund Limited Partnership v The Bear Stearns Companies LLC*, 829 F3d 173, 177 (2d Cir 2016), the Second Circuit dismissed fraud claims brought by a plaintiff alleging that the plaintiff both purchased common stock and entered into swap agreements and that, based on defendants' misrepresentations, the plaintiff chose not to unwind the swap agreements. However, the scope of the decision is unclear as the Second Circuit dismissed the fraud claims based on the swap agreements because the plaintiff failed to include sufficient allegations (see question 14).

ABS, especially RMBS, are typically issued subject to a set of contractual representations and warranties made by the sponsor bank that created the ABS, concerning the credit quality of the underlying assets. If the assets fail to comply with these representations and warranties, the ABS trustee, and in some cases the financial guaranty insurer of the senior tranches of the ABS, will typically have the contractual right to demand that the sponsor repurchase such defective assets or pay an equivalent amount of damages.

Update and trends

This past year, the Supreme Court decided *Cyan, Inc v Beaver County Employees Retirement Fund*, 138 S Ct 1061 (2018). The issue was how to reconcile section 22 of the Securities Act of 1933, 15 USC § 77v, which grants concurrent jurisdiction to state courts over 1933 Act claims and prohibits their removal to federal court, with SLUSA, the 1998 statute that aimed to bring 'covered class actions' into federal court. The Court held that SLUSA 'does nothing to deprive state courts of their jurisdiction to decide class actions brought under the 1933 Act' (id at 1069). *Cyan* does not affect secondary disclosure cases (governed by the 1934 Act). But *Cyan* will have the effect that plaintiffs' counsel can decide whether to bring initial offering cases under the 1933 Act in a state or federal court. In certain states, such as California, plaintiffs' counsel will likely direct 1933 Act cases to a state court.

In June 2018 the Court decided two cases involving procedural questions in securities litigation. First, in *China Agritech v Resh*, 138 S Ct 1800, 1804 (2018), the Court held that, after class certification is denied, '*American Pipe* does not permit the maintenance of a follow-on class action past expiration of the statute of limitations'. This decision limits the *American Pipe* tolling doctrine, by which the filing of a class action tolls the statute of limitations period for members of the putative class (as discussed above in the answer to question 11), to follow-on individual actions. Second, in *Lucia v SEC*, 138 S Ct 2044, 2049 (2018), the Court determined that the SEC's administrative law judges (ALJs) must be appointed pursuant to the appointments clause of the Constitution (article II, § 2, cl 2), and decisions rendered by ALJs appointed by SEC staff are invalid.

In the current Supreme Court Term, the Court will decide *Lorenzo v Securities and Exchange Commission*, No. 17-1077. The question presented in Lorenzo 'is whether a misstatement claim that does not meet the elements set forth in *Janus* [*Capital Group, Inc v First Derivative Traders*, 564 US 135 (2011)] can be repackaged and pursued as a fraudulent scheme claim' under SEC Rules 10b-5(a) and (c). The particular facts of *Lorenzo* are unusual: a broker who sent false emails contends that he sent the emails at the direction of his boss (indeed, he copied and pasted the text from his boss's email to him) and argues therefore that he was not the 'maker' of the statement. The *Lorenzo* case may shed light not only on the *Janus* doctrine, but also on the meaning of the provisions of Rule 10b-5 other than the fraudulent misstatement prong of Rule 10b-5(b).

Two other important securities cases to watch in the US Supreme Court are *First Solar* (discussed above in the answer to question 9), which concerns loss causation, and *Toshiba* (discussed in the answer to question 29), which concerns extraterritorial jurisdiction. For each of these petitions for a writ of certiorari, the Court has called for the views of the Solicitor General, a sign that the Court may be interested in taking the case. If the Court grants the petition in either of these cases, the case will not be heard until next term.

Finally, an emerging question in US securities law is whether cryptocurrencies are securities and how to regulate them. In *SEC v Blockvest, LLC*, No. 18CV2287-GPC, 2018 WL 6181408 (SD Cal 27 November 2018), the court denied the SEC's motion to enjoin Blockvest from issuing what the SEC argued were 'unregistered securities' in the form of digital tokens. The court held that heavily 'disputed issues of fact' prevented it from deciding on a motion for preliminary injunction whether the tokens were securities. This debate over cryptocurrency and its regulation will likely continue over the coming years.

In addition, depending on the circumstances, purchasers or an insurer may be able to bring a claim against the sponsor for fraud, either securities fraud under section 10(b) and Rule 10b-5, or common-law fraud, based on the sponsor's misrepresentations in marketing the securities, including misrepresentations contained in the sponsor's contractual representations and warranties as well as any separate misrepresentations concerning, among other things, the underwriting, due diligence, and quality control performed on the assets.

Insurers also benefit from insurance-specific laws like the New York Insurance Law, which allows them to bring claims against ABS sponsors and CDO-arranging banks and managers for material misrepresentation in the inducement of an insurance contract (see NY Insurance Law section 3105) and material breach of warranty in an insurance contract (see NY Insurance Law section 3106). Claims under New York Insurance Law sections 3105 and 3106 have at least one significant advantage over common-law fraud claims: they do not require the insurer to prove scienter (see *Process Plants Corp v Beneficial Nat'l Life Ins Co*, 53 AD2d 214, 216 (1st Dep't 1976)).

29 What are the requirements for foreign residents or for holders of securities purchased in other jurisdictions to bring a successful claim in your jurisdiction?

A foreign plaintiff is treated no differently in the US courts than a US plaintiff: if it can establish standing under article III of the US Constitution (that is, if it can prove that it has suffered an injury in fact) and that it otherwise has a viable claim under the US securities laws, it may sue in a US court.

The primary issues that arise in this context are with regard to the identity of the defendant – if the defendant is itself a foreign entity, then service of process and personal jurisdiction issues may arise (see question 30) – and whether the plaintiff is seeking an extraterritorial application of the US securities laws.

The law regarding the extraterritorial application of the US securities laws has evolved over the past decade. Most notably, the Supreme Court has ruled that the US securities laws do not have extraterritorial application (see *Morrison v Nat'l Australia Bank, Ltd*, 561 US 247 (2010)). Specifically, the Supreme Court found that the statutory language underlying the anti-fraud provisions of the securities laws does not suggest intended extraterritorial application, and that section 10(b) only applies to 'transactions in securities listed on domestic exchanges, and domestic transactions in other securities' (see id at 267).

Applying this standard, one influential appellate court has held that 'to sufficiently allege the existence of a 'domestic transaction in other securities', plaintiffs must allege facts indicating that irrevocable liability was incurred or that title transferred in the United States' (see *Absolute Activist Master Fund Ltd v Ficeto*, 677 F3d 60, 62 (2d Cir 2012)). A plaintiff may satisfy the 'irrevocable liability' test by alleging either 'that the purchaser incurred irrevocable liability within the United States to take and pay for a security, or that the seller incurred irrevocable liability within the United States to deliver a security' (see id at 68). In addition, the court held that 'a sale of securities can be understood to take place at the location in which title is transferred' (see id). In determining where title was transferred, the court may consider, among other things, 'facts concerning the formation of the contracts, the placement of purchase orders, the passing of title, or the exchange of money' (see id at 70). The Second Circuit also held that '*Morrison* precludes claims brought pursuant to the Securities Exchange Act of 1934 (Exchange Act) by purchasers of shares of a foreign issuer on a foreign exchange, even if those shares were cross-listed on a United States exchange' (see *City of Pontiac Policemen's & Firemen's Ret Sys v UBS AG*, 752 F3d 173, 176 (2d Cir 2014)). Questions related to domesticity of transactions may defeat class certification, which is discussed in question 20, if they raise individual questions that predominate over common ones (see *In re Petrobras Sec*, 862 F3d 250, 272 (2d Cir. 2017)).

Another influential appellate court recently decided a case involving so-called 'unsponsored ADRs': the shares of a foreign corporation were traded on a foreign exchange, but banks sold American Depositary Receipts (ADRs) based on those shares, and the ADRs traded over the counter in the United States (see *Stoyas v Toshiba Corp*, 896 F3d 933 (9th Cir 2018)). While the court held that the over-the-counter market was not an 'exchange' in the US, the court gave the plaintiffs the opportunity to plead that they had purchased the ADRs in the US under the 'irrevocable liability' test. Compare *Parkcentral Global Hub Ltd v Porsche Auto Holdings SE*, 763 F3d 198 (2d Cir 2014) (domestic transaction is necessary but not sufficient to apply US securities laws; US law does not apply to 'predominantly foreign claims' where conduct occurred in a foreign country and shares of a foreign corporation were traded exclusively on a foreign exchange).

The day after *Morrison* was decided, Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act, which, as codified, gives United States courts jurisdiction over section 10(b) cases brought by the SEC involving '(1) conduct within the United States that constitutes significant steps in furtherance of the violation, even if the securities transaction occurs outside the United States and involves only foreign investors; or (2) conduct occurring outside the United States that has a foreseeable substantial effect within the United States' (see 15 USC section 77v(c)). This was intended to codify the extraterritorial application of US securities law as it existed before *Morrison* (see *Securities and Exchange Comm'n v Traffic Monsoon, LLC*, 245 F Supp 3d 1275, 1294 (D Utah 2017)). Courts will likely continue to address the tension between Dodd-Frank, which applies only to actions brought by the SEC, and *Morrison*, which is likely limited to private causes of action.

30 What are the requirements for investors to bring a successful claim in your jurisdiction against foreign defendants or issuers of securities traded on a foreign exchange?

To sue a defendant, whether US-based or foreign, in any federal district court, the court must have 'personal jurisdiction' over that defendant. In addition, as discussed above, the securities laws do not have extraterritorial application, so the standards set forth in *Morrison* and (probably) *Absolute Activist* must be met (see question 29).

The personal jurisdiction inquiry comprises two steps. First, the court 'look[s] to the law of the forum state to determine whether personal jurisdiction will lie' (see *Licci v Lebanese Canadian Bank, SAL*, 732 F3d 161, 168 (2d Cir 2013)). Then, '[i]f jurisdiction lies, [the court] considers whether the district court's exercise of personal jurisdiction over a foreign defendant comports with due process protections established under the United States Constitution' (see id).

To determine whether exercise of jurisdiction over a foreign defendant comports with US constitutional due process protections, a court considers first whether 'a defendant purposefully established minimum contacts within the forum State', and second 'whether the assertion of personal jurisdiction would comport with fair play and substantial justice', that is, whether it would be reasonable (see *Burger King Corp v Rudzewicz*, 471 US 462, 476 (1985) (quotation omitted); see also *World-Wide Volkswagen Corp v Woodson*, 444 US 286, 292 (1980)).

The legal standards governing personal jurisdiction are only one hurdle to suing a foreign defendant in a US court. There are additional issues relating to service of process. Federal law requires that a summons and complaint alleging a claim must be served on a defendant within 90 days of filing, except for service in a foreign country (see Fed R Civ P 4(m)). There is a specific provision regarding service on an individual (defined to include both a natural person and a corporation) in a foreign jurisdiction (see Fed R Civ P 4(f)). That provision requires that service may occur by 'any internationally agreed means of service that is reasonably calculated to give notice, such as those authorised by the Hague Convention' (see Fed R Civ P 4(f)(1)). When there is no such international agreement (for instance, with regard to China), then additional provisions apply (see Fed R Civ P 4(f)(2)). A court has the discretion to order a particular means of service that it determines achieves the notice requirements of Rule 4. In practice, the rules governing service of process on foreign defendants mean that the complexity and expense involved in suing such a defendant in the US can vary greatly by foreign jurisdiction.

31 How do courts in your jurisdiction deal with multiple securities claims in different jurisdictions?

US courts will grant forum non conveniens where they have jurisdiction to hear a case but there is a more convenient forum in another country. Courts consider a non-exhaustive range of factors, including access to sources of proof, availability of witnesses, possibility of view of premises (if appropriate), expeditious use of resources, enforceability of judgment, obstacles to a fair trial, and public policy (see *Piper Aircraft Co v Reyno*, 454 US 235 (1981)). The plaintiff's choice of forum will rarely be disturbed unless the balance is strongly in favour of the defendant (see id at 242). However, a plaintiff cannot defeat a claim of forum non conveniens by showing that substantive law would be less favourable in the alternative forum (see id at 261), for instance, because the alternative forum does not permit class actions or has less favourable discovery (see *In re Herald, Primeo & Thema Sec Litig*, 540 F App'x 19, 28 (2d Cir 2013)).

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US courts have also developed procedures for determining whether foreign residents should be included in a US class action. Although this issue should be less common since *Morrison v National Australia Bank*, 561 US 247 (2010), restricted Rule 10b-5 claims to securities traded or purchased in the United States, it may still arise where foreign residents purchased US securities. US courts will only include foreign purchasers or sellers within the class definition if it is more likely than not that the foreign country would recognise a US class-action judgment as final (see *In re Vivendi Universa*l, *SA Sec Litig*, 242 FRD 76, 102-06 (SDNY 2007)). This requires a country-by-country analysis. Since the content of foreign law is a question of fact in the United States, parties almost always use expert witnesses and evidence. This can mean that different cases will reach different conclusions on whether it is more likely than not that a particular country would recognise a US judgment (compare id at 102 (finding that French courts more likely than not would recognise a US judgment), with *In re Alstom SA Sec Litig*, 253 FRD 266, 284 85 (SDNY 2008) (finding the opposite)).

A significant issue following *Morrison* will be how US courts handle cases in different jurisdictions that raise the same issues but do not involve the same parties. This will be a particular issue for class actions against dual-listed companies since, after *Morrison*, those who purchased foreign-listed securities are unable to bring claims with respect to those securities under US securities laws. For example, IMAX was dual-listed in the US and Canada, and parallel class actions were brought against it in 2006. In 2009, the Canadian court certified a global class that included purchasers on both exchanges. In 2012, the parties to the US case settled the claims brought by purchasers on the US exchange before the class was certified, subject to the Canadian court's narrowing the class definition, which it did in 2013. Had the US IMAX case not settled, there was a potential for conflicting rulings in respect of the US securities.

32 What are the requirements in your jurisdiction to enforce foreign-court judgments relating to securities transactions?

US courts generally apply federal law to determine whether to recognise a foreign country judgment (see *Omega Importing Corp v Petri-Kline Camera Co*, 451 F2d 1190, 1196–97 (2d Cir 1971)). Over a century ago, the US Supreme Court set forth the applicable standard in *Hilton v Guyot*, 159 US 113 (1895). The court must satisfy itself that there has been a full and fair opportunity to be heard on any defence to the judgment in a court of competent jurisdiction abroad, under a system of jurisprudence likely to secure the impartial administration of justice between the citizens of its own country and those of other countries, and that there is nothing to show either prejudice in the court or the system of laws under which it operates, fraud in procuring the judgment, or any special reason of comity that suggests that the court should not allow it full effect (see id at 202–03). A foreign judgment will be granted comity 'if it is shown that the foreign court is a court of competent jurisdiction, and that the laws and public policy of the forum state and the rights of its residents will not be violated' (see *Cunard SS Co v Salen Reefer Servs AB*, 773 F2d 452, 457 (2d Cir 1985)). Lack of reciprocity is not a bar to recognition of a foreign award (see id at 460).

33 What alternatives to litigation are available in your jurisdiction to redress losses on securities transactions? What are the advantages and disadvantages of arbitration as compared with litigation in your jurisdiction in securities disputes?

Where there is a contractual relationship between an investor and a potential defendant to a securities claim, for example, a direct sale and purchase contract between the parties, or an account agreement governing the account through which the sale and purchase was effected, the contract may provide that any disputes shall be submitted to mediation or arbitration. Alternatively, the parties may agree, after a dispute has arisen, to submit the dispute to mediation or arbitration.

In the United States, there are two principal sets of arbitral rules used for the arbitration of securities disputes: the American Arbitration Association (AAA) and the Financial Industry Regulatory Authority (FINRA). Both AAA and FINRA arbitrations offer certain advantages over litigation, at least from a claimant's point of view, most notably by providing a more flexible, streamlined procedure that can result in faster (and sometimes cheaper) claim resolution (of course, the same features of arbitration that are attractive to plaintiffs may not be as attractive to defendants). The FINRA rules, in particular, contain no mechanisms for summary dismissal or other summary disposition of claims, favour expedited document discovery, strongly disfavour depositions, and do not require strict adherence to the rules of evidence. However, the subpoena powers of arbitrators are less extensive than those of courts, third-party discovery may be more difficult to obtain in an arbitration, and the claimant must forgo a jury trial, to the extent one would be available in court.

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