UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

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THE CITY OF EDINBURGH COUNCIL ON BEHALF OF THE LOTHIAN PENSION FUND, On Behalf of Itself and All Others Similarly Situated,

Plaintiff,

-against-

VODAFONE GROUP PUBLIC COMPANY, ANDREW N. HALFORD, KENNETH J. HYDON, LORD IAN MACLAURIN OF KNEBWORTH and ARUN SARIN,

Defendants.

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07 Civ. 9921 (PKC)

MEMORANDUM AND ORDER

P. KEVIN CASTEL, District Judge:

Plaintiff the City of Edinburgh Council on Behalf of the Lothian Pension Fund ("Lothian") filed this securities class action on behalf of itself and others similarly situated, alleging that the defendants engaged in acts of securities fraud in violation of Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), Rule 10b-5 promulgated thereunder, and Section 20(a) of the Securities Exchange Act of 1934, 15 U.S.C. § 78t(a).

Defendants move to dismiss the Amended Complaint. They contend that dismissal is warranted pursuant to Rule 12(b)(1), Fed .R. Civ. P., for lack of subject matter jurisdiction; that the Amended Complaint fails to satisfy the heightened pleading requirements of the Private Securities Litigation Reform Act of 1995, 15 U.S.C. § 78u-4(b)(3)(A), and Rule 9(b), Fed. R. Civ. P.; and that the Amended Complaint fails to state a claim for control-person liability under Section 20(a).

For the reasons explained below, the defendants' motion to dismiss for lack of subject matter jurisdiction is granted, and the action is dismissed.

BACKGROUND

The facts as described in this section are drawn from the allegations set forth in the AC, and are assumed as true for purposes of this motion. See Morrison v. National Australia Bank Ltd., __ F.3d __, 2008 WL 4660742, at *2 (2d Cir. Oct. 23, 2008).

Defendant Vodafone Group Plc ("Vodafone," or the "Company") is a telecommunications company doing business primarily in Europe, the United States and the Asia Pacific. (Amended Complaint (the "AC") ¶ 25.) The individual defendants are members of Vodafone's management and board. (AC ¶¶ 26-35.) The Company grew rapidly through a series of acquisitions, including the acquisition of a German telecommunications company, Mannesmann. (AC ¶¶ 44-45.) In 2002, Vodafone took a series of write-downs arising out of the Mannesmann acquisition. (AC ¶ 46.) The Company indicated that no future asset-impairment write-downs would be required for assets acquired from Mannesmann. (AC ¶ 6.)

In 2004, Vodafone pursued another large telecom acquisition, this time of AT&T's wireless assets. (AC ¶ 7.) Vodafone's share price dipped, and the negative shareholder reaction prompted Company management to abandon the deal. (AC ¶ 7.) According to plaintiffs, the price decline pressured Vodafone's management team to boost the Company's share value, including for reasons related to management's own enrichment. (AC ¶ 8.) In order to do so, the plaintiffs allege, Vodafone management

began to assert that its operating units were performing profitably, and predicted "huge cash flow improvements" in coming years. (AC ¶ 9.) Vodafone proceeded to issue financial statements that falsely inflated the company's results and future business prospects, including the exaggeration of likely operating profits, EBITDA, assets and net worth – all because the Company failed to account for required write-downs in a timely fashion. (AC ¶¶ 9-11.) Simultaneously, Company management indicated to investors that Vodafone's operations in Germany and Italy were growing, and that its sometimes-troubled operations in Japan were improving dramatically. (AC ¶¶ 10-11.) Plaintiffs contend that these representations were part of a fraudulent scheme to inflate the price of Vodafone's securities. Plaintiffs also contend that defendants overstated the success of a so-called "One Vodafone" program, which was intended to integrate and streamline the company operations, and the success of new 3-G phones and services in Japan. (AC ¶¶ 10-11.)

Vodafone and its management then made a series of disclosures that revealed the Company's weak financial health. On November 15, 2005, Vodafone disclosed a 23-percent decline in operating profits; $7 billion in cash-flow impairments stemming from tax payments; and a sharp drop in the EBITDA of Japanese operations. (AC ¶ 14.) Vodafone maintained that its Japanese operations were going forward as planned, but its share price nevertheless dropped immediately. (AC ¶ 14.) On February 27, 2006, Vodafone announced an asset write-down of a $40-49 billion impairment charge associated with its German, Italian and Japanese operations. (AC ¶ 14.) Vodafone's stock price made another sharp drop. (AC ¶ 14.) Vodafone thereafter sold its Japan operations at a loss alleged to be $8.6 billion. (AC ¶ 14.) Plaintiffs allege that

prior to the Company's disclosures of loss, the individual defendants sold approximately 11.1 million shares of personally held Vodafone stock, for proceeds of more than $29 million. (AC ¶ 153.)

On November 9, 2007, Lothian filed a complaint claiming that Vodafone and certain of its officers and directors artificially inflated the Company's stock price through allegedly false statements about its financial health and business prospects. An Amended Complaint was filed on March 26, 2008. It asserts claims "on behalf of all persons who purchased Vodafone's publicly traded securities, including its [American Depository Receipts] and ordinary shares, on the open market during the Class Period." (AC ¶ 163.)

ANALYSIS

Absent subject matter jurisdiction, a court lacks constitutional or statutory power to adjudicate a case. Arar v. Ashcroft, 532 F.3d 157, 168 (2d Cir. 2008). Whether subject matter jurisdiction exists is "a threshold inquiry." Id. A plaintiff must prove subject matter jurisdiction by a preponderance of the evidence. Makarova v. United States, 201 F.3d 110, 113 (2d Cir. 2000). In weighing a challenge to subject matter jurisdiction, a court construes all facts alleged in a complaint as true, and draws reasonable inferences in favor of the plaintiff – but jurisdiction still must be affirmatively shown, and mere favorable inferences, standing alone, will be inadequate. Morrison, __ F.3d __, 2008 WL 4660742, at *2.

The text of the 1934 Act does not explicitly set forth any application to extra-territorial activity. See SEC v. Berger, 322 F.3d 187, 192 (2d Cir. 2003). Federal

subject matter jurisdiction has been held to extend to claims implicating transnational securities fraud. Id. The recognition of subject matter jurisdiction is guided by the underlying purposes of the anti-fraud provisions of the federal securities laws. Europe & Overseas Commodities Traders, S.A. v. Banque Paribus London, 147 F.3d 118, 125 (2d Cir. 1998). Courts have reasoned that, first, Congress "would not want the United States to become a base for fraudulent activity harming foreign investors," and, second, "that Congress would want to redress harms perpetrated abroad which have a substantial impact on investors or markets within the United States . . . ." Id.

These two categories of harm have been formulated into separate tests. The first is described as the conduct test, and looks to "whether the wrongful conduct occurred in the United States." Berger, 322 F.3d at 192-93 (collecting cases). The second, described as the effects test, looks to "whether the wrongful conduct had a substantial effect in the United States or upon United States citizens." Id. Either the conduct test or effects test can provide a basis for subject matter jurisdiction – both need not be established. Id. at 195. Courts often look to "'an admixture or combination of the two.'" Morrison, __ F.3d at __, 2008 WL 4660742, at *3 (quoting Itoba Ltd. v. Lep Group PLC, 54 F.3d 118, 122 (2d Cir. 1995)). In this instance, plaintiffs rely exclusively on the conduct test. (Lothian Mem. at 18.)

The Second Circuit has described the conduct test in various formulations, all of which return to the same basic consideration: the existence and scope of a defendant's fraudulent activity in the United States. The conduct test provides for jurisdiction when "'substantial acts in furtherance of the fraud were committed within the United States.'" Berger, 322 F.3d at 193 (quoting Psimenos v. E.F. Hutton & Co., Inc.,

722 F.2d 1041, 1045 (2d Cir. 1983)). These substantial acts occur "whenever (1) 'the defendant's activities in the United States were more than "merely preparatory" to a securities fraud conducted elsewhere' and (2) the 'activities or culpable failures to act within the United States "directly caused" the claimed losses.'" Id. (quoting Itoba Ltd., 54 F.3d at 121-22 (2d Cir. 1995)). Morrison held that the conduct test requires a court to "identify which action or actions constituted the fraud and directly caused harm . . . and then determine if that act or those actions emanated from the United States." __ F.3d at __, 2008 WL 4660742, at *5. A party's activities fall short of the conduct test if conduct alleged to have occurred in the United States was merely secondary to the core acts of fraud. Europe & Overseas Commodities Traders, 147 F.3d at 128-29. Jurisdiction may exist over a predominantly foreign securities transaction when, "in addition to communications with or meetings in the United States, there has also been a transaction on a U.S. exchange, economic activity in the U.S., harm to a U.S. party, or activity by a U.S. person or entity meriting redress." Id. at 130.

Any analysis of the conduct test is intensely fact specific. Instances in which the Second Circuit has found jurisdiction pursuant to the conduct test include fraud consummated during a negotiation and sale to U.S. parties, Alfadda v. Fenn, 935 F.2d 475, 478-79 (2d Cir. 1991), the issuance of a misleading pamphlet from a U.S. office, with fraud completed by the trading of domestic futures contracts on a U.S. exchange, Psimenos, 722 F.2d at 1046, misconduct by a U.S. issuer of securities with the preponderance of activity occurring in the U.S., IIT v. Cornfeld, 619 F.2d 909, 918-21 (2d Cir. 1980), perpetration of alleged fraud that arose in the U.S. via payments made between two registered broker dealers, Arthur Lipper Corp. v. SEC, 547 F.2d 171, 179-

80 (2d Cir. 1976), and use of a foreign alter ego by an American corporation. Leasco Data Processing Corp. v. Maxwell, 468 F.2d 1326, 1334-39 (2d Cir. 1972). In Berger, 322 F.3d at 194-95, the Second Circuit concluded that the conduct test was satisfied when a fraudulent scheme was masterminded and implemented in the United States, even though the statements conveying the actual fraudulent information were mailed from Bermuda.

The U.S.-based conduct alleged by Lothian is limited, and falls short of that found sufficient to premise subject matter jurisdiction. Here, the Amended Complaint includes a series of vague jurisdictional assertions, with no specific allegations as to what, if any, fraudulent conduct occurred inside the United States. The Amended Complaint asserts in conclusory fashion that Section 27 of the 1934 Act confers subject matter jurisdiction. (AC ¶ 18.) In support of the allegation, the Amended Complaint cites to portions of Vodafone's 2004 Annual Report that appear to assert that Vodafone is subject to the United States securities laws, and it alleges that Vodafone submits filings to the Securities and Exchange Commission. (AC ¶¶ 21-22.) In addition, it notes that while Vodafone's common shares are listed on the London Stock Exchange and the Frankfurt Stock Exchange, its American Depository Receipts are listed on the New York Stock Exchange. (AC ¶ 23.) Vodafone alleges that "[m]any of the false and misleading statements were made in or issued from this District," although the Amended Complaint does not identify them. (AC ¶ 19.)

There are other gaps in the Amended Complaint. It is silent as to the defendants' nationalities and office locations, and silent on the nationality of Lothian

itself.[1] It does not allege the situs of any purported acts of fraud. The individual defendants are identified by name and job title, and information is provided as to their backgrounds, but nowhere does the Amended Complaint allege that they engaged in fraudulent conduct inside the United States.

In response to the motion, plaintiffs have submitted additional evidence pertaining to Vodafone's conduct in the United States during the Class Period. A court confronted with a jurisdictional controversy may consider evidence outside the pleadings. Filetech S.A. v. France Telecom S.A., 157 F.3d 922, 932 (2d Cir. 1998). Lothian's evidentiary submissions include slides from an October 6, 2004 presentation held in New York City, during which defendant Arun Sarin discussed "key messages," including the Company's "commit[ment] to 3G," its plan for "executing one Vodafone" and its goal of "increasing returns to shareholders." (Lothian Mem. at 19; Rosenfeld Dec. Ex. D.) On September 22, 2005, Sarin made another presentation in New York City, regarding "Vodafone's unique competitive position, growth potential and more." (Lothian Mem. at 19; Rosenfeld Dec. Ex. E.) The presentation emphasized the strength of the Company's operations in Japan and indicated confidence in the Company's growth. (Rosenfeld Dec. Ex. E.)

Other conduct described in the Amended Complaint and the Rosenfeld Declaration occurred in Europe. The Amended Complaint references a conference held in Dusseldorf on July 14, 2005, (AC ¶ 95; Rosenfeld Dec. Ex. B at 5; Ex. C at 5 (noting "[c]onfident messages from Germany")) which appears to be colloquially known as "German Investor Day." (AC ¶ 97.) It notes contacts with national tax authorities,

[1] For instance, neither the Amended Complaint nor defendants' declaration states whether plaintiff, the City of Edinburgh Council, is a body of Edinburgh, Scotland – as opposed to the cities of Edinburgh, Indiana or Edinburgh, Australia. Nevertheless, it appears that the lead plaintiff is located in Edinburgh, Scotland.

including those of Germany, (AC ¶ 99(c)) and cites an article in The Financial Times that describes Vodafone as a "UK mobile phone operator." (AC ¶ 106.) Lothian also cites to a number of statements made at the 1st Annual Pan European Strategic Decisions Conference of September 24, 2004. (Rosenfeld Dec. Ex. B at 1-2; Ex. C at 3.) The purported confidential witnesses listed by the plaintiff are described as residing in Germany, the United Kingdom and Italy, while others listed are not identified as having national affiliations. (Rosenfeld Dec. Ex. F.) Lothian explicitly alleges that major financial publications asserted that Vodafone "misled" and "failed" "the City, *i.e.*, London's important financial community . . . ." (AC ¶ 8.)

The Amended Complaint is silent as to where many alleged misstatements were made, where the purportedly fraudulent scheme was devised, and the locations of various global actors who were party to (or harmed by) the alleged misstatements. Prior to the filing of this motion, the Court invited plaintiff to file a Second Amended Complaint to remedy any purported defects in the Amended Complaint. (Docket Entry No. 30.) Plaintiff explicitly elected not to do so. (Docket Entry Nos. 30, 23.) Nowhere does Lothian suggest that discovery is needed in order to establish the basis of jurisdiction.

The silence of the Amended Complaint and the factual record on this motion is significant. For instance, in Morrison, __ F.3d __, 2008 WL 4660742, at *1, the Florida subsidiary of the National Australia Bank ("NAB") was alleged to have engaged in accounting practices that misrepresented its profitability and financial health, with those misstatements in turn circulated and submitted to regulatory agencies by it Australian parent. NAB's ordinary shares traded on various non-American exchanges,

but, like Vodafone, its American Depository Receipts traded on the New York Stock Exchange. Id. Morrison described the dispute as implicating "a set of (1) foreign plaintiffs . . . suing (2) a foreign issuer in an American court for violations of American securities laws based on securities transactions in (3) foreign countries." Id. at *4 (emphasis in original). The Second Circuit concluded that even though an underlying act of wrongdoing occurred within the United States (in the case of Morrison, misleading statements originating in Florida) the Australian parent company had ultimate responsibility to verify the accuracy of statements made to the public and to potential investors. Id. at *7. Morrison noted "the striking absence of any allegation that the alleged fraud affected American investors or America's capital markets." Id. at *8.

As in Morrison, plaintiff Lothian's argument on behalf of subject matter jurisdiction is limited to the conduct test, with no reliance on the effects test. Yet the U.S. nexus in Morrison case was significantly stronger than the activity Lothian cites in this case. In Morrison, the chain of events leading to the defendants' purported acts of securities fraud originated in the United States before culminating abroad. In the case of Vodafone, it appears that a United Kingdom company, overseen by executives and directors operating abroad, with common shares traded in London and Frankfurt exchanges, devised and implemented a scheme to artificially inflate the Company's share price, allegedly to the damage of a United Kingdom plaintiff. Vodafone's conduct in the United States was incidental, and was limited to a pair of presentations by defendant Arun Sarin in New York, New York. (Lothian Mem. at 18-20; Rosenfeld Dec. Exs. D, E.)

Vodafone's scant U.S. activity stands in contrast to the conduct that

provided for jurisdiction in In re Vivendi Universal, S.A., 2004 WL 2375830 (S.D.N.Y. Oct. 22, 2004), an opinion relied upon by Lothian. Vivendi concluded that the conduct test was satisfied when two officers of a French corporation "moved their operations to New York and spent at least half of their time managing the company from the United States during a critical part of the class period." Id. at *4. Press releases alleged to have been false and misleading were issued from New York. Id. Judge Holwell concluded that such activity was sufficient to show that "the U.S.-based conduct was integral and not merely preparatory to the alleged fraud upon foreign purchasers of Vivendi shares on foreign exchanges." Id. Unlike Vivendi, this case includes no allegation or evidence that such conduct occurred in the United States.

Instead, the present suit most closely resembles In re Yukos Oil Company Securities Litigation, 2006 WL 3026024, at *10 (S.D.N.Y. Oct. 25, 2006), in which Judge Pauley concluded that the plaintiffs failed to meet the conduct test when "[a]ll of Defendants' alleged misstatements emanated from abroad." Yukos noted allegations that the defendant foreign corporation was alleged to have solicited U.S. investors via personal appearances at meetings, presentations, and industry conferences. Id. Though the complaint in that case made no allegation as to the substance of the utterances in those meetings, the plaintiffs submitted a supplemental declaration setting forth additional details concerning the meetings. Id. Judge Pauley concluded that the "recruitment of investors in the United States was merely preparatory to [defendants'] fraud abroad," and concluded that the court lacked subject matter jurisdiction over plaintiffs' claims. Id. See also Europe and Overseas Commodity Traders, 147 F.3d at 131 (noting dubious basis for subject matter jurisdiction based on "[t]he U.S. interest in

punishing an English malfeasor working at a French bank branch in London who caused no harm here . . . .").

Standing alone, the two investor presentations conducted in New York do not satisfy the conduct test. In addition, however, Lothian briefly notes that Vodafone briefed U.S. institutional shareholders, filed reports with the Securities and Exchange Commission, was followed by U.S. analysts, owned a 45-percent stake in the U.S. phone carrier Verizon Wireless, and retained the Bank of New York to serve as custodian for its American Depository Receipts program. (Lothian Mem. at 18.)

While it is true that a misleading financial statement prepared abroad and filed with the SEC may give rise to subject matter jurisdiction, see Berger, 322 F.3d at 195, Lothian does not satisfactorily explain why or how the SEC filings confer subject matter jurisdiction over this dispute. It merely notes that SEC filings exist. (Lothian Opp. Mem. at 18.) The Amended Complaint is more detailed as to the purported misrepresentations contained in Vodafone's SEC filings, even though Lothian's memo is silent about them. (See, e.g., AC ¶¶ 16, 68, 75, 94, 102, 104.) However, Morrison is again instructive. There, the Second Circuit emphasized that any misleading statements emanated from Australia, and not Florida. __ F.3d __, 2008 WL 4660742, at *7-8. Yet again, as with Morrison, id. at *8, Lothian does not purport to rely on the effects test as a basis for subject matter jurisdiction. Lothian's exclusive reliance on the conduct test returns to the original inquiry: the location of the underlying acts of fraud and their nexus to the United States. Based on the record before, it appears that any activity in the U.S. was secondary, and that, as with Morrison, __ F.3d __, 2008 WL 4660742, at *7-8, the responsibility for ensuring the accuracy of public statements lies abroad.

Certain other facts, such as Vodafone's stake in Verizon and its retention of the Bank of New York, may have been relevant if in personam jurisdiction were in dispute. Ultimately, the two New York presentations are the only evidence proffered by Lothian in support of subject matter jurisdiction. Under the most generous possible interpretation of the pleadings and the evidence, this record is insufficient to confer subject matter jurisdiction.

Based on the record before me, I conclude that the defendants' conduct in the United States was merely preparatory to any purported acts of securities fraud, and insufficient to establish subject matter jurisdiction over Lothian's claims.

Lastly, Lothian asserts in a footnote that even if it is dismissed from this case, the Court should retain supplemental jurisdiction, because the Court has original jurisdiction over the claims of U.S. purchasers who are part of the same case and controversy. (Lothian Mem. at 21 n.13.) Lothian cites no relevant authority for its proposal that the Court retains supplemental jurisdiction over jurisdictionally proper federal claims that are asserted alongside deficient ones. Indeed, in instances comparable to this one, the retention of supplemental jurisdiction has been either rejected or viewed with strong skepticism. See In re Literary Works in Electronic Databases Copyright Litigation, 509 F.3d 116, 127-28 (2d Cir. 2007) (28 U.S.C. § 1367 does not provide for supplemental jurisdiction over federal claims); In re SCOR Holding (Switzerland) AG Litigation, 537 F. Supp. 2d 556, 569 n.19 (S.D.N.Y. 2008) (dismissing claims for failing to satisfy the conduct test and noting by way of dicta that exercise of supplemental jurisdiction in such a context would be "highly doubtful"). Lothian has pointed the Court to no viable basis for retaining supplemental jurisdiction over this case.

Because this action is dismissed for lack of subject matter jurisdiction, I need not address the other grounds for dismissal raised by the defendants.

Conclusion

The defendants' motion pursuant to Rule 12(b)(1) is GRANTED. This case is dismissed for lack of subject matter jurisdiction, and the Clerk of Court is directed to enter judgment for the defendants.

SO ORDERED.

P. Kevin Castel
United States District Judge

Dated: New York, New York
November 24, 2008