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The Evolving Frontier Of Foreign Securities Litigation

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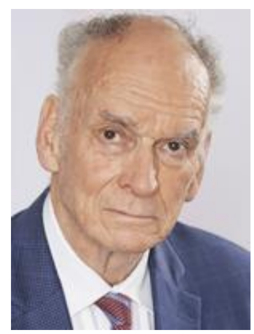

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In the wake of the U.S. Supreme Court's Morrison v. National Australia Bank[1] decision, institutional investors cannot rely on the U.S. class action system to recover for losses on securities traded on foreign exchanges. In a subset of cases involving foreign issuers, investors can pursue a U.S. class action covering trades in American depository shares, or ADS, where the foreign company's ADS trade domestically.

But even this avenue has recently come under scrutiny in Toshiba Corp. v. Automotive Industries Pension Trust Fund et al., where the defendants have filed a petition for certiorari to the U.S. Supreme Court asking the court to address whether non-sponsored ADS traded in the U.S. are beyond the reach of the Securities Exchange Act.[2]

As a result, foreign securities cases have proliferated in Europe, Asia, Australia, South America, Canada, Japan and South Africa. For example, while the ADS issue is decided in the U.S., there is current litigation pending in Japan against Toshiba raising claims under the Japanese Financial Instruments & Exchange Act, or FIEA.[3] Sometimes, as with the recent proposed foreign litigation against Steinhoff, a Dutch entity whose shares trade in Johannesburg and Frankfurt, it has been difficult to ascertain not only whether to file suit, but, if so, where. Foreign securities litigation is an ever-changing scenario. Nothing is definite. There is no set model.

Institutional investors savvy enough to navigate these foreign cases could obtain millions of dollars in recoveries. For example, several recent Australian cases have reached eight- and nine-figure settlements,[4] the recent Fortis/Ageas settlement was for over €1.2 billion, and the Tesco Compensation Scheme in the U.K. totaled £85 million. Moreover, having invested client funds in these foreign issuers, institutions arguably have a fiduciary duty to monitor and evaluate these foreign cases, and to pursue recoveries where it is reasonable to do so.

However, merely identifying opportunities for recovery can be difficult because notices of foreign cases are not far reaching. Without proper monitoring and guidance, an institution may not learn of a case or settlement until it is too late to participate. Additionally, the procedures for either joining a group action or filing an individual action vary among jurisdiction, not to mention the variances in simply filing a claim once a foreign case has settled, assuming an institution took the required steps at the beginning of the process to preserve its claim. Moreover, while foreign case proponents may suggest otherwise, these opportunities are not free from risk, such as "loser pays" provisions, direct client involvement in prosecuting the case and unexpected expenses. As a result, it is of vital importance for institutional investors to obtain an independent analysis of the merits of the case, the applicable foreign law, the institution's holding and potential losses, and the mechanics, if any, of filing a settlement claim.

Claims Filing Issues

As discussed in more detail below, there are several avenues where institutions may be able to recover by filing a claim without becoming a party plaintiff. Currently, Australia and Canada have relatively robust precedent supporting a U.S.-style class action system, and in certain instances, regulators and private plaintiffs groups have been able to reach global settlements with European issuers. For example, issuers have recently reached settlements with plaintiffs groups in the Fortis/Ageas matter in the Netherlands, and several Australian matters, including Treasury Wine, Slater & Gordon and QBE. Additionally, U.K. regulators reached a settlement for the benefit of investors in the Tesco matter.

However, filing claims in all of these matters presented unique hurdles. For example, in the U.S., institutional claimants generally only need to submit a power of attorney along with their proof of claim. By contrast, in order to file a claim in the Tesco Compensation Scheme in the U.K., a simple power of attorney granting the authority to file was not sufficient proof of authorization. The signature on the power of attorney then had to be verified from internal documents up to the board level in order to confirm that the signatories of the power of attorney had the authority to sign in the first place. If an institution has worldwide operations, obtaining the relevant documentation could require obtaining signature documents, passports copies and fund prospectuses in different languages and from entities scattered throughout the world.

Additionally, foreign claims administrators often require payment by wire and will not issue checks. However, issues with receiving payments via wire in foreign cases often arise due to the different currencies involved. Also, there seems to be a lack of universal standard for all wire instructions across currencies and across countries. Thus, wire information provided by U.S. institutions to foreign claims administrators often do not fit perfectly into the required fields, and custodians often need to be told specific details of the transaction (such as Society for Worldwide Interbank Financial Telecommunication, or SWIFT, information) in order to receive the wire. As a result, claimants must engage in a back and forth with the claims administrator and custodian in order to determine what information is mandatory and ensure a successful payment.

Of course, hurdles to filing only come into play if an institutional investor is savvy enough to identify opportunities, monitor pending actions and join the case, if necessary, at the appropriate time. Below we address some recent developments in key jurisdictions that have affected, both positively and negatively, institutional investors' ability to recover.

Australia

Representative group action litigation in Australia has evolved to resemble a typical U.S.-style opt-out class action system. A key development in Australia has been the acceptance of common fund orders. As the Federal Court of Australia explained recently in Perera v. GetSwift Limited:

A common fund order allows an open class representative proceeding to be commenced without the necessity to build a book of group members who have bargained away part of the proceeds of their claim. Instead of addressing the 'free-rider' problem by making 'funding equalisation orders' (to redistribute the additional amounts received 'in hand' by unfunded class members pro rata across the class as a whole) … the funder, who had borne the risks of the litigation, is recompensed from the common fund of proceeds obtained by the group as a whole.[5]

Additionally, Australian courts have read their collective action statutes broadly to allow judges to consider procedures that pave the way for settlements. For example, in Melbourne City Investments Pty Ltd v. Treasury Wine Estates Limited, the Full Court of the Federal Court of Australia considered a primary judge's class closure order which broke new ground in group action practice in Australia. The court noted that requiring a group member to proactively register in order to share in a settlement arguably clashed with the "opt out" nature of Australian class action claims, stating that "[i]t must be accepted that the requirement for class members to take active steps to 'register' in order to share in a settlement of a class action undercuts to some extent the opt out rationale underpinning the [Australia's group action] regime."[6]

However, it found that the court's power to make a class closure derived from section 33ZF of the Federal Court of Australia Act, which states that "the Court may, of its own motion or on application by a party or a group member, make any order the Court thinks appropriate or necessary to ensure that justice is done in the proceeding."

The Treasury Wine case is part of a growing trend in Australian securities litigation toward class proceedings similar to the U.S. model, where investors do not have to be a named plaintiff to participate in a recovery. Prior to the issuer and the representative plaintiff mediating the case, investors needed to "register" by submitting their transaction data. When the case settled after mediation, those who registered could recover from the settlement fund, but those who did not register were shut out of the settlement. Registering was not without risks, however, as the mediation could have failed. Some investors may have feared that by submitting their transaction data they were exposing themselves to the defendants and potential discovery in the event the case did not settle. However, the case did settle after mediation, and those who registered were able to recover. Since Treasury Wine, other Australian cases have followed a similar pattern, including settlements with Slater & Gordon and QBE Insurance.

European Developments

Both Germany and the Netherlands have legal mechanisms through which investors may seek to recover losses, but both systems come with some drawbacks. While the future of securities litigation in Europe remains cloudy due to developments in the Netherlands and Germany, the Volkswagen case pending in Germany may prove to be a road map for future cases.

While German law does not provide for U.S.-style class action suits, the German Capital Markets Model Case Act (KapMuG) provides an "opt-in" procedural mechanism for collective actions. Under the KapMuG procedures, if at least 10 plaintiffs file suit, then a "model plaintiff" can ask the court to approve a model proceeding in which all common questions will be decided. Assuming the court approves a list of common questions, the model case proceeds to answer those questions, and all individual proceedings are suspended. The individual elements of each stayed claim (such as damages, statute of limitations, and for some claims, reliance) are litigated individually in subsequent proceedings. Notably, while the model plaintiff's counsel drives the suit, additional plaintiffs can intervene in the case, allowing their lawyers to file briefs as well.

The KapMuG procedure is relatively new and untested. However, in order to limit their exposure, we expect German defendants may launch challenges to an institution's capacity and standing to sue. This could lead to a number of institutions, who join a case thinking they would be mostly passive participants, spending resources defending against the capacity challenges.

Meanwhile, the viability of the foundation model in the Netherlands has come into question. In 2005, the Netherlands adopted the Dutch Collective Settlements Act (Wet Collectieve Afwikkeling Massachade, abbreviated WCAM). Under this act, a Dutch foundation, also known as a "stichting," can be established in the Netherlands to represent the interests of victims of securities fraud. Such a foundation can resolve claims against a defendant in the form of a collective settlement. Under article 907, paragraph 1 of the Dutch Civil Code:

An agreement concerning the payment of compensation for damage caused by an event or similar events concluded between a foundation or association with full legal competence and one or more other parties who have committed themselves by this agreement to pay compensation for this damage may, at the joint request of the parties that concluded the agreement, be declared binding by the court on persons to whom the damage was caused so long as the foundation or association represents the interests of these persons pursuant to its articles of association.

Thus, in the Netherlands, an issuer can enter into a settlement with a foundation that represents the interests of a purportedly injured group or class of investors. In the event settlement negotiations fail, the foundation can bring a declaratory judgment-type action pursuant to article 3:305a, though plaintiffs cannot seek damages in such an action. The Amsterdam Court of Appeal can then enter an order approving the settlement or a declaration binding on all members of the group. The "class" members are given an opportunity to object to the settlement and an opportunity to opt out.[7]

The foundation model had some early success. For example, in the securities litigation involving Shell, which settled in 2008, the U.S. settlement only included securities purchased "on a United States exchange or market" or by residents or citizens of the United States if the transaction took place on an exchange or market outside of the United States.[8] Later, in 2009, the Amsterdam Court of Appeal declared binding a $340 million settlement with Shell that covered investors who purchased Shell shares on a stock exchange outside of the United States and who resided outside of the United States at the time of their purchases.

Then, in 2012 in the Converium case the Amsterdam Court of Appeals approved a $58.4 million settlement even though only a fraction of the shareholders lived in the Netherlands and the issuer was a Swiss reinsurer. Additionally, the foundation representing investors in Fortis (now known as Ageas) reached a €1.2 billion settlement in 2016. Notably, at the time of the settlement, the Dutch government controlled Fortis/Ageas, and there was mounting public pressure to settle the case.

However, with the exception of the Fortis/Ageas, Dutch foundations have had limited recent success. As a threshold matter, having a large number of shareholders participate in the foundation is an essential element of any settlement being approved by the Dutch court. Pursuant to the third paragraph of Article 907 of the Dutch Civil Code, the Dutch court "shall reject" a request that a settlement be made binding on all shareholders if, among other things, "the group of persons on whose behalf the agreement was concluded is not large enough to justify a declaration that the agreement is binding, substantial participation will give credibility to the settlement proposal."[9]

Additionally, jurisdictional questions recently have arisen. Specifically, the ability of a Dutch foundation to bring suit in the Netherlands against defendants not domiciled in the Netherlands may be limited. The Dutch court overseeing the BP PLC securities litigation in the Netherlands applied the European Court of Justice's Universal Music case to limit the ability of a foundation to bring suit against BP in the Dutch courts.[10] After settlement negotiations apparently failed, a foundation representing the interests of BP retail shareholders filed an action against BP in Amsterdam, relating to BP's alleged misstatement concerning its safety protocols leading up to the Deepwater Horizon oil spill and its alleged misstatement concerning the spill flow-rate. The foundation sought recovery for investors who had invested in BP shares through a Dutch financial intermediary or account.

Relying on the Universal Music decision, BP argued that the Dutch court did not have jurisdiction to hear the foundation's claims. The Dutch court agreed. First, it noted that because BP was domiciled in the United Kingdom, jurisdiction would only lie in the Netherlands if it was the place where the damage occurred. Looking to the Universal Music decision, the court reasoned that granting jurisdiction in the place where the damage occurred is an exception to the "main rule" that jurisdiction only lies in the place where the defendant is domiciled. It further ruled that such an exception should be construed narrowly to apply to situations where a close connection existed between the court where the claims were brought and the place where the damage occurred. It held that the mere existence of a securities account in the Netherlands did not establish a close enough connection to establish jurisdiction in the Dutch courts.

The impact of these decisions on the ability of Dutch foundations to negotiate binding settlement is still murky. The Civil Code provision allowing a Dutch foundation to effectuate a global settlement (Article 7:907-910) is different from the one allowing for a foundation to file suit (Article 3:305a), and the Dutch court's decision in BP may be limited to Article 3:305a actions. Additionally, as has been proposed for potential litigation against Steinhoff, investors may still be able to file an action by assigning their claims to a special purpose vehicle, or SPV, created for the express purpose of filing suit. A recent decision by the District Court of Amsterdam endorsed the SPV model.[11]

However, SPV participants may have to furnish to the defendants proof of the facts and circumstances demonstrating that the claims were validly assigned to the SPV by individuals with capacity to assign the claims.[12] Thus, even participation in a case through an SPV is not costless, and while an investor's participation may not become public, the defendants will be aware of the entities underlying the SPV.

What is clear is that, if preliminary settlement negotiations fail, the ability of a Dutch foundation to bring suit in the Netherlands against defendants not domiciled in the Netherlands may be severely limited. The consequences of these rulings can be unfortunate for investors who have no other realistic redress. For example, in BP, neither the U.S. Securities and Exchange Commission Fair Fund, nor the class settlement, included purchasers of BP common stock, which trades in London. The BP Foundation seemed to be a viable method for purchasers of common stock to recover some losses. For many investors, the alternative of filing a separate action without any claims under the U.S. federal securities laws was not realistic. So the rulings could inadvertently benefit many companies whose common stock is traded in jurisdiction that lack a legal mechanism similar to the U.S. class action process.

Conclusion

Institutional investors have the opportunity to recover millions of dollars by participating in foreign securities litigation settlements. However, in order to fulfill their fiduciary duty, institutions need to identify opportunities early, analyze their holdings and transactional data, and closely monitor foreign cases. Unfortunately, unlike the U.S. class action system, these foreign cases have no set pattern, and the landscape is constantly changing and evolving. For instance foundations used to be the way to go, and, until recently, one had to become a party-plaintiff in Australia to participate. In a very real sense, everyone is still learning. In the face of such variety and uncertainty, institutional investors need guidance as to which route to follow.

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[1] Morrison v. Nat'l Australia Bank, 130 S. Ct. 2869 (2010).

[2] Toshiba Corp. v. Automotive Industries Pension Trust Fund et al., No. 18-486 (U.S. pet. filed Oct. 15, 2018).

[3] Similar to claims under Section 11 of the Securities Act of 1933, FIEA claims do not require scienter or reliance. There are three elements to the cause of action under the FIEA: (1) material false statements or omissions; (2) damage; and (3) loss causation. Under the FIEA, defendant issuers have the burden of proving that they were not negligent in making the material false statement or omission.

[4] For example, litigation against Treasury Wine Estates Limited settled for $49 million (AUD), litigation against Slater & Gordon settled for $36.5 million (AUD), and litigation against QBE Insurance Group settled for $132.5 million (AUD).

[5] Perera v. GetSwift Limited [2018] FCA 732, ¶ 25.

[6] Melbourne City Investments Pty Ltd v. Treasury Wine Estates Limited, [2017] FCAFC 98; 252 FCR 1; 355 ALR 392.

[7] Importantly, under Hague Convention, the Lugano Convention and Brussels I Regulation, other Member States of the European Union as well as Switzerland, Iceland and Norway had to recognize the effect of the Dutch court's rulings on citizens of other European countries. Specifically: the Hague Convention on the Recognition and Enforcement of Foreign Judgments in Civil and Commercial Matters, Feb. 1, 1971, 1144 U.N.T.S. 249; the Convention Concerning Judicial Competence and the Execution of Decisions in Civil and Commercial Matters, Sept. 27, 1968, 1262 U.N.T.S. 153 (commonly known as the Brussels Convention), and the Convention of Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters, Sept. 16, 1988, 1988 O.J. (L319) (commonly known as the Lugano Convention).

[8] In re Royal Dutch/Shell Transport Securities Litigation, Order Approving Settlement, No. 3:04-cv-00374 (S.D.N.Y. Sept. 26, 2008), ECF No. 525.

[9] Dutch Civil Code, article 907, paragraph 3, subsection g.

[10] The Court of Justice of the European Union (CJEU) issued a decision in Universal Music International Holding BV v. Schilling, ECLI:EU:C:2016:161, Case No. C-12/15 (CJEU June 16, 2016), that limited the jurisdiction of courts in EU countries, such as the Netherlands. The Universal Music decision addressed Regulation 44/2001, under which defendants must be sued in courts of the member state where they are headquartered, or, for tort-based claims, the place where the harmful event occurred. The CJEU concluded that pure financial damage to a bank account cannot by itself give rise to jurisdiction in the member state where the bank account sits. The CJEU thus held "It is only where the other circumstances specific to the case also contribute to attributing jurisdiction to the courts for the place where a purely financial damage occurred, that such damage could, justifiably, entitle the applicant to bring the proceedings before the courts for that place" (par. 39).

[11] Equilib Netherlands B.V. v. Koninklijke Luchtvaart Maatschappij N.V., et al., Case No. C/13/486440 / HA ZA 11-944 (Amsterdam District Court Sept. 13, 2017)

[12] Id. at 20-21, ¶¶ 2.26 & 4.12-13.