Recovery Responsibility

A predictive study into securities class actions

in legislatures outside the U.S.A.

GOAL Group, January 2013

- Settlements in securities class actions outside the U.S. are estimated to reach USD 8.3bn annually by 2020

- If non-participation rates seen in U.S. class actions are experienced in non-U.S. activity, USD 2.02bn of investors' rightful returns will be 'left on the table' unreclaimed each year from the end of the decade

- Because non-U.S. legislatures require participants to register at the beginning of a case, investors need to participate now to receive their rightful returns

- Any level of non-participation presents fiduciaries (trustees, custodians, fund managers, fund boards, etc) with a major legal headache, as experience in the U.S. shows they may be sued if they do not ensure investors participate in class actions

- In fact, this is already a legal risk for fiduciaries, as non-participation rates in U.S. class actions are still running at just over 24%, according to GOAL's analysis of its securities class actions database

- Growth in non-U.S. collective actions, and evidence that some custodians are restricting the geography of their class action service level, indicate that non-participation rates are likely to be at least at current U.S. case levels, and probably considerably higher

- Moreover, evidence is emerging that funds are now including the responsibility for class action identification and participation in contractual agreements with custodians

Introduction - Class actions and fiduciary duty

Over the last few years it has become clear that fund managers and custodians have a fiduciary duty to ensure that their clients participate in securities class actions that may recoup some of their investment losses. Back in 2005, over 40 mutual fund managers were reportedly sued by shareholders of those funds in class action lawsuits alleging that the funds failed to collect as much as USD 2 billion in settlement payouts to which the funds' shareholders were entitled[1]. The lawsuits claimed that the funds' failure to attempt to recover this money during the class period was a failure of fiduciary duty, was negligent, and violated the Investment Company Act of 1940. The lawsuits were seeking damages for all of the money allegedly left on the table, as well as damages and the forfeiture of all commissions or fees paid by fund shareholders.

The National Association of Pension Funds (FAPF)[2] has underlined this area of responsibility in one of its advisory documents, noting that, "…it seems self-evident that trustees have a duty to protect the assets in their scheme and should therefore at the very least not neglect opportunities to recoup losses, where the cost and effort are commensurate with the expected return. It is reasonable to expect pooled fund managers to pursue class actions on behalf of investors… Trustees should request periodic reports from their advisors on class actions…" Moreover, the former chairman of the NAPF has launched the International Institutional Tort Recovery Association (iiTRA) with the aim of helping pension funds and other investors recover their "fair share" of class action awards.

It is no surprise then, bringing the issue right up to date, that many custody RFPs (Request for Proposals) from major pension funds now include these responsibilities as contractual clauses (breach of which would naturally give legal recourse). For instance, one large U.S. fund specifies in its 2012 RFP[3] that the successful bidder "must provide timely notification of class action litigation and provision of the necessary securities information…. [and] must file claims for securities class action awards in a timely manner and carefully monitor and report to Fund as to the collection of the amounts to which the Fund is entitled."

Having established this fiduciary duty, however, the task of doing so has become a little more complex in recent years, in that class action growth outside the U.S. is taking off, and is predicted to mirror the growth of the U.S. class action scene in the early part of the 21st century. While there is no excuse for not monitoring and participating in class actions internationally (as there are a number of services commercially available that minimise the complexity and cost of this activity) it is likely that the sheer volume, and international variety, of tracking and participation will rise throughout the decade, and will become more widely applicable to a greater breadth of portfolio holdings. That, in turn, means that custodians, fund managers and trustees will have to make sure that they are on top of securities class actions right across the world.

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1 A Savett, The Importance of Best Practice and Procedures in Securities Class Action Settlements, (JDSupra) November 2009

2 NAPF, Securities Litigation – Questions for Trustees, 2007

3 Municipal Employees' Annuity and Benefit Fund of Chicago, Request for Proposal, Master Trust and Custody, Foreign Exchange, Securities Lending and Benefit Payments, 21 August 2012

Class actions go global

What, then, has caused this international diversification of class actions? In short, it seems to have been a combination of restrictions on jurisdiction definitions in the U.S. Federal courts, along with a growing desire to develop domestic class action procedures in many countries around the globe, a handful of which appear to be allowing international class actions to be tried in their courts, even if the stocks and shares in question are quoted on a non-U.S. exchange, and the case involves only a minority of domestic investors.

Recent U.S. Supreme Court activity has limited the ability of overseas plaintiffs to bring securities class action claims within the U.S.A. This blow for foreign litigants came in 2010 when the court ruled in *Morrison v. National Australia Bank* that U.S. securities laws only apply to companies listed on U.S. exchanges, wiping out the eligibility of what have become known as f-cubed actions. An f-cubed action involves a non-U.S. shareholder suing a non-U.S. company whose stock was purchased on a non-U.S. exchange, and who is bringing a case in a U.S. court.

The case concerned the 1998 purchase by National Australia Bank (NAB) of a mortgage servicing company, HomeSide Lending. In 2001, NAB announced two asset write-downs totalling USD 2.2 billion due to losses associated with HomeSide Lending. The root cause of the write-down was that HomeSide Lending's modelling of future revenues was overly optimistic to the point of fraud. However, by the time the case reached the U.S. Supreme Court, only Australian investors remained as plaintiffs. The court's decision was unanimous in stating that since both the plaintiffs and defendants were Australian the case would be better dealt with by the Australian court system. This set the legal precedent that non-U.S. plaintiffs could not progress class actions in the U.S. courts unless this involved U.S. plaintiffs or an alleged fraud had taken place in the U.S. impacting transactions on U.S. exchanges.

As a result of *Morrison*, plaintiffs are now instigating litigation in more flexible jurisdictions in Europe and overseas. This means that international companies listed on multiple exchanges are now having to defend themselves against securities class actions in multiple jurisdictions. This is further exacerbated as regulators tighten regulation following the global financial markets crisis and governments institute fiercer enforcement measures.

For example, in 2010, the United States District Court for the Southern District of New York dismissed a securities fraud suit against Fortis, a Belgium-based financial services company. Within one year of that U.S. court decision, a law firm in The Netherlands filed a foundation case[4] on behalf of non-U.S. investors against Fortis in the Utrecht Civil Court. The Dutch case, where plaintiffs included some of the largest pension funds in Europe, effectively mirrors the allegations that were dismissed in the U.S. court case.

4 Defined by Article 3:305 of the Dutch Civil Code

It is therefore important to briefly summarise the likely jurisdictions where U.S.-style securities litigation is developing, with particular emphasis on those who appear willing to admit cases involving non-U.S. investors suing a firm listed on a non-U.S. exchange.

The Netherlands

In a landmark move, a case against Royal Dutch Shell was withdrawn from a U.S. class action in order to be moved to The Netherlands, the first such class action case to be finalised within Europe. The 2005 Dutch Act on the Collective Settlement of Mass Claims (Wet collectieve afwikkeling massaschade, WCAM) meant it was possible for Shell to be ordered to pay a total of USD 450m by the Amsterdam Court of Appeals in June 2009 – compensating for misstatements between 1997 and 2003 regarding oil and gas reserves[5]. The Netherlands adoption of WCAM was specifically, "to create legally binding multi-national settlements of class action suits alleging securities fraud." As such, The Netherlands might be the new "place to be" for investors seeking large recoveries for their securities fraud claims.

Recently, the Amsterdam Court of Appeal issued a similarly important decision in the *Converium* case[6]. The decision allows and authorises the use of the WCAM Dutch collective-settlement law to settle disputes on a classwide, opt-out basis. Given that the *Morrison* ruling significantly limited the extent to which claims by non-U.S. investors can be settled in United States securities cases, the Amsterdam Court of Appeal's decision is highly significant. It provides a practical mechanism – through the use of WCAM in co-ordination with U.S. proceedings - for structuring global securities class action settlements, particularly in cases a large number of European investors are involved.

Canada

Plaintiffs' lawyers from the United States have started to obtain licenses to practice in Canada in order to take advantage of these more favorable laws for securities class actions. In addition, much discussion has centred around *Silver v. Imax*, an Ontario case which, like the Dutch examples discussed above, certified a global class of shareholders alleging misrepresentation in connection with a secondary market distribution of shares. Although similar global class actions have been certified in Canada in the past, their scale has been much more limited. With *Imax*, commentators are now opining that global classes have firmly "arrived" in the Canadian legal system, and many are going so far as to predict that, as a consequence, Ontario will become a new international centre for the resolution of global securities disputes.

In more general terms, Canadian securities class actions are sharply on the rise. At the beginning of 2012, there were a record 28 active Canadian securities class actions currently being considered by Canadian courts, estimated to represent approximately USD 15.9 billion in claims[7]. This rise may in part be ascribed to the perception that Canada securities class action legislation is similar to that in

5 Investment & Pensions Europe, Shell Ordered to Pay €316 million class action settlement, June 2009

6 The Harvard Law School Forum on Corporate Governance and Financial Regulation, S Hirst, Dutch Court Decision Impacts Global Securities Class Actions

7 The Harvard Law School Forum on Corporate Governance and Financial Regulation, P.A. Ferrillo, A New Playbook for Global Securities Litigation and Regulation, 2 Feb 2012

the U.S. and therefore plaintiffs launch parallel claims in Canadian jurisdictions increasingly as a matter of course. Amongst these similarities are comparable certification requirements, as well as the fact that primary and secondary liability is enshrined in the laws of most Canadian provinces.

The likelihood of Ontario's growth as an international securities class action centre should be tempered by statutory limitations on damages, which have a ceiling of the greater of 5 percent of the market capitalization of the company, or USD 1 million[8].

Germany

Germany passed the Capital Investors' Model Proceeding Law in 2005. This legislation serves as the primary legal authority for securities fraud class actions. Rather than providing a mechanism to certify a "class-type" claim, the German legislation instead provides for the designation or selection of a "model case". This "model case" allows common elements of claims to be litigated first, and its common rulings bind all petitioners.

In terms of litigation examples, after a similarly-styled securities lawsuit was dismissed in the U.S. following *Morrison*, a Canadian bank brought suit in Stuttgart District Court alleging that Porsche manipulated the shares of Volkswagen common stock in 2008 when it was trying to take over Volkswagen.

However, although German legislation allows class actions, major questions have been raised over the effectiveness of the process when a judgment was given in favour of Deutsche Telekom in 2012, deciding that the company did not make false or misleading statements in a prospectus for a secondary stock offering in 2000. Whereas the German system took twelve years to reach a judgement, class action litigation brought in the United States alleging liability for U.S. Investor losses over the same offering, was settled for over USD 120 million back in 2005[9]. This has to bring into question the utility and efficiency of the German procedure.

8 ibid

9 Stanford Law School Securities Class Action Cearing House, Mexico's New Class Action Law Opens a Litigation Frontier, 11 Oct, 2011; BusinessWeek, Deutsche Telekom didn't mislead 16,000 investors, court says, 16 May 2012

Other Emerging Jurisdictions

While some jurisdictions may not have as robust of a securities litigation framework as the countries mentioned above, recent developments across different regions reinforce the need for global firms to monitor potential litigation venues around the world. Australia, for instance, has a well-established history of litigation funding and has adopted legislation that is highly similar to U.S.-style securities laws[10]. Mexico, also recently amended its laws to allow consumers and investors to bring class actions[11]. The same is true of Brazil[12]. China, in an effort to attract even more investment capital into the country, is likely to introduce more stringent corporate governance and securities standards in the near term. The Hong Kong securities regulator proposed, in May 2012, that it may introduce legislation to allow class-action lawsuits to help investors seek damages[13]. The U.K. legislature does allow collective actions under Part 19.11 of the English Civil Procedure Rules, with securities actions specifically covered under Section 90 of the Financial Services Markets Act of 2000 or breach of trust under the U.K. Companies Act 2006. However, as one significant commentator has noted, "In England… adoption of a class action procedure appears to have been put aside by now"[14]. Denmark, Norway, Sweden and Finland have introduced class action legislation. Japan has a lively legislature dealing with securities class actions cases. In India, class actions have long been possible, but the difference lies in the economics of case funding, as lawyers are not permitted to charge contingence fees, and further rules on awards mean that plaintiffs who do not win an action may end up not only with investment losses but also have to bear the defendant's costs[15]. In Korea, securities class actions were given a kick start with a filing in 2009 that breathed life into the Securities Class Action Act which had until then not been exercised[16].

In conclusion, there is a growing pressure of global class action cases looking for a home in a legislature that is able to define and prosecute a global class. The current front-runners would appear to be The Netherlands and Canada, but the lively class action scene in Australia and emerging activity in Mexico could also be contenders. It is quite possible that all these legislatures could allow global securities class actions, and become regional centres for the prosecution of such cases.

10 Deborah R. Hensler, The Future of Mass Litigation: Global Class Actions and Third-Party Litigation Funding, 79 George Washington Law Review 306 (2011)

11 The D&O Diary, Class Actions in Australia and Mexico, 5 March 2012

12 A.C.Ribeiro, Class Actions in Brazil [undated]

13 BusinessWeek, Hong Kong Proposes Class Actions After Investor Concerns, 28 May 2012

14 Deborah R. Hensler, The Future of Mass Litigation: Global Class Actions and Third-Party Litigation Funding, 79 George Washington Law Review 306 (2011)

15 IndiaCorpLaw, Shareholder Activism and Class Action Lawsuits, 1 June 2009

16 Asia Law, Inhak Lee & Jun Ki Park, Securities class action landmark, Sept 2009

Non-U.S. class actions – how big will it grow?

This paper now moves on to estimate the likely size of annual non-U.S. class actions settlements by the end of the decade. This study's model for calculating future settlement levels is based on the observations that domestic class action activity is clearly growing, selected legislatures are emerging that will define and prosecute global or international class actions on behalf of international plaintiffs, regardless of where the equities in question are listed. On this basis, the authors of this report expect international securities class actions to be reaching the levels currently seen in the U.S. markets, but not until the end of the decade.

The model takes into account the fact that the U.S. experience saw total settlements reach an extraordinary peak in 2005-7[17], with pay-outs from corporate frauds such as Enron artificially boosting settlement volumes in a way that was unlikely to be replicated in the longer-term. Volumes have since fallen, and it is this more mature activity rate that has been used to model likely settlement volumes in cases against companies domiciled and/or quoted in non-U.S. markets.

Predicted annual settlement volumes for each market are estimated from a forward date of 2020, the end of the decade. Using GOAL's proprietary data and insights, combined with corroborative third party sources, the model utilises the U.S. class actions experience to estimate the size of annual settlements in other world markets after a further eight years of class actions development in these countries and in legislatures that accept international plaintiff representation and reparation. Only Chinese companies have been omitted from this study, on the basis that domestic regulation is on an uncertain development path, and that currently political considerations may exclude the effective prosecution of a securities class action outside of China.

17 Source: NERA

Company Domiciled/Quoted	Predicted Annual Class Action Settlements 2020
	U.S. $ billions
South & Central America	**USD $ 0.620 bn**
Includes: Argentina, Brazil, Chile, Colombia, Mexico and Peru	
Canada	**USD $ 0.542 bn**
Asia - Pacific (minus China)	**USD $ 3.435 bn**
Includes: Australia, India, Indonesia, Japan, Korea, Malaysia, Philippines, Singapore, Sri Lanka, Taiwan and Thailand	
Europe	**USD $ 3.288 bn**
Includes: Austria, Belgium, Cyprus, Eire, France, Germany, Greece, Hungary, Italy, Luxembourg, Malta, Netherlands, Poland, Portugal, Russia, Scandinavia, Slovenia, Spain, Switzerland, Turkey and UK	
Africa	**USD $ 0.258 bn**
Includes: Egypt, Morocco and South Africa	
Middle East	**USD $ 0.150 bn**
Includes: Israel, Jordan and Saudi Arabia	
Total World (minus China)	**USD $ 8.293 bn**

Non-participation and claims left on the table

Keeping track of the opportunities to make a claim, and the actions required to do so successfully, can be a complicated and daunting task, particularly when spread across the globe, rather than simply in the U.S.A. Such an undertaking requires timely and accurate information about the relative merits and procedural processes of the actions. It also requires the time and resources to review and evaluate relevant settlement provisions. Investors must then cross-reference these outputs against extensive individual trading activity data and then compile and submit the often complex paperwork necessary to make a valid claim. In the past, custodians, trustees and fund managers have sometimes regarded the effort (and cost) to participate as being disproportionate to the likely settlements pay-out achieved. However, this is no longer the case, with a number of service

providers automating the complex process of class action participation across all the international legislatures discussed earlier in this paper. Yet despite the availability of such services, some custodians are still not ensuring client participation in non-U.S. class actions, and there even remains a level of non-participation by eligible parties in U.S. cases. In some quarters, the class action identification and participation remains an entirely manual process, subject to incompleteness and errors that may lead to participation opportunities being missed, or claims being rejected because of inaccuracies and mistakes.

Historically, non-participation in U.S. securities class actions has cost investors and funds dearly. For instance, a previous GOAL Group report, conducted at the beginning of 2008, revealed that between 2000 and 2007 European institutional investors' non-participation in U.S. securities class actions resulted in nearly USD 3.6 billion being left on the table.

Non-participation rates have marginally improved since 2007, with GOAL Group's analysis of its class actions knowledge base showing that just slightly over 24% of possible claims are still not being filed by eligible investors. However, now that global class actions are moving away from the singular and relatively straightforward focus on a single legislature – the United States – to a multiple and complex series of legal systems spread across the world, custodians, trustees, fund boards and fund managers may once again feel daunted by the international monitoring, participation, claims and payments task. There is even a possibility, as securities class actions globalise, that non-participation rates could start to rise again, especially given that some custodians are limiting the scope of their class actions service to only a selected group of countries.

So how significant could the problem become? If a conservative view is taken – that non-participation rates neither shrink nor grow - then by 2020 (based on our predictions about the likely volume of the non-U.S. securities class action settlements by the end of the decade) USD 2.02 billion could be left unreclaimed **annually**. This estimate covers both domestic and foreign investors. Since class actions often take five to seven years to come to fruition, with settlement awarded and paid out, it is imperative that investor claims are filed now in order to secure their rightful returns. Most legislatures outside of the U.S. insist that participants in a class action must file at the start of a case, so later participation allowed in the U.S. system is not an option on the global stage.

All this leaves fiduciaries with a serious problem. There is no real excuse for failing to identify and file securities class action claims, as there a several low cost services available on the market today. As we have seen, trustee organisations are highlighting their members' responsibility to ensure eligible class actions are joined. And investment/pension funds are now incorporating class action participation into their contractual terms and conditions. This amounts to a clear and present legal risk for fiduciaries, with precedents for actual lawsuits against them existing in the United States. While legal systems, class action processes, and fiduciary responsibility law varies around the world, there is no good reason to think that the U.S. experience will not be broadly mirrored internationally. Complacency amongst fiduciaries would therefore be extremely unwise.

Conclusions

The securities class action scene outside of the U.S.A is clearly developing fast. Moreover, certain legislatures – currently The Netherlands and Canada – have defined and admitted the idea of a global 'class' where non-U.S. investors in shares listed on a non-U.S. exchange can pursue their securities class actions in those countries' courts.

The overall result of this international expansion of securities class actions is likely to be settlement volumes in non-U.S. jurisdictions that mirror the U.S. experience in the years following the millennium. This level represents a conservative estimate, ignoring as it does the huge settlements resulting from cases such as *Enron*, *Worldcom*, *Tyco*, *Cendant* and *Nortel*.

All this presents fiduciaries with a growing risk of being sued if they do not ensure their investors are included in class actions across the globe. Currently, GOAL's analysis confirms that just over 24% of admissible claims are not being filed in securities class actions. The responsibility for doing so is increasingly being included in custodian services contracts. And trustee associations have confirmed that such participation is a key responsibility of their members.

In short, there is no viable excuse for non-participation as a number of specialist service providers can now perform this function at relatively low cost. Therefore, fiduciaries who do not ensure participation are running an increasing risk of finding themselves the subject of a lawsuit from clients who have not received their rightful returns.