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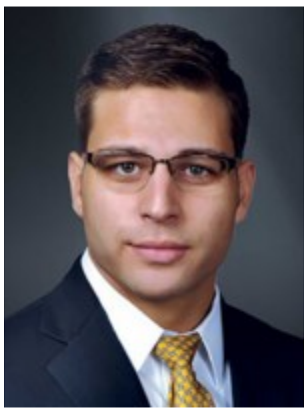
Overseas Securities Litigation Is Coming Of Age



Law360, New York (February 18, 2016, 10:17 AM ET) -- More than five years ago, the U.S. Supreme Court limited the scope of United States securities laws in Morrison v. National Australia Bank Ltd.[1] The decision effectively barred plaintiffs from asserting claims in the United States over foreign companies traded on non-U.S. exchanges. As a result, Morrison drastically reduced investor protections for nearly all securities purchased on a foreign exchange.

Although momentous, Morrison did not immediately trigger a sea change in securities litigation. Even in 2015, the majority of worldwide securities actions were still filed within U.S. jurisdictions. Yet due to Morrison’s preclusive effect, there are increasingly more instances where U.S. investors have no recourse but to pursue securities claims in foreign courts. Historically, this entailed many practical hurdles and yielded limited methods of recovery.

But this is beginning to change. Due to a combination of factors, global securities litigation is developing quickly and becoming a viable recovery method for investor-plaintiffs. The reasons behind this are interrelated but can be distilled into three categories: (1) increased investor protections through enhanced substantive foreign securities laws, (2) increased capital commitments from litigators and third-party funders, and (3) recent, unprecedented multinational scandals whose affects have been felt by investors throughout global markets.

Investor protections in Europe have grown out of a desire to instill confidence and ensure stability in the EU’s capital markets. While EU member states have long had securities laws, private enforcement mechanisms were lacking, and methods to pursue claims on a classwide basis were nearly nonexistent.

Germany enacted its Capital Market Model Proceedings Act (abbreviated as “KapMug,” from the German Gesetz über Musterverfahren in kapitalmarktrechtlichen Streitigkeiten) in 2005, which introduced a collective action procedure for pursuing claims in Germany’s capital markets. KapMug was initially envisioned as a legal experiment, and the law contained a built-in sunset provision, which set termination for 2010. Many believed that collective redress actions under KapMug would be too difficult in practice and that collective actions are simply incompatible with the European legal tradition. But after successful application (and a major litigation victory for plaintiffs in the Hypo Real Estate Holding AG case), KapMug was renewed through 2020 with modifications to encourage settlements. Many countries have followed in establishing avenues for collective actions, including Japan (2013), France (2014) and Belgium (2014).

Most non-U.S. jurisdictions prohibit contingent fee arrangements, and losing parties normally must pay the legal fees and costs of the prevailing parties (the “loser pays” rule). But through the increased deployment of resources in international securities claims (whether through self-funded actions or those financed by third-party funders), investors are increasingly able to mitigate risk while simultaneously achieving greater access to courts.

Third-party litigation funding is well-established in many countries and has grown exponentially in recent years. This growth has given rise to a competitive environment amongst funders, which in turn has provided investor-plaintiffs with more options at a lower overall cost.

The increasing presence of U.S.-based plaintiffs firms abroad is also helpful, and evinces a growing commitment to pursue international claims. This movement is due in large part to recent high profile cases that transcend national borders, epitomized by the Volkswagen emissions scandal.

Known for its low-emission vehicles and eco-conscious branding, Volkswagen admitted on Sept. 20, 2015, that its emissions numbers were the product of widespread manipulation. Volkswagen used specially designed software in millions of its vehicles to deceive emissions tests and evade regulators. This revelation shocked investors around the world, and Volkswagen’s shares plummeted, ultimately erasing more than €25 billion of its market capitalization.

Volkswagen’s shares are listed on the Frankfurt stock exchange in Germany, and many U.S. investors acquired Volkswagen shares through the Frankfurt exchange. As purchasers of shares in a foreign company on a foreign exchange, these shareholders are precluded by Morrison from bringing actions in the U.S. As a result, many investors have sought redress in German courts.

Utilizing the KapMug collective action provisions, U.S.-based shareholders are now in the process of pursuing securities fraud claims against Volkswagen in Germany. Proceeding mainly through § 37b of the German Securities Trading Act, a provision of which establishes liability of an issuer for withholding material information from investors, American investor-plaintiffs have partnered with European law firms and litigation funders seeking recovery for their economic damages.

Litigation funders cover the cost of proceedings in exchange for a share of the recovery. This amount varies, although it is generally within the range of American contingent fee structures. Because of the “loser pays” rule, litigation funding has become an important tool in facilitating securities litigation in non-U.S. courts and has become a prominent feature in international litigation. Third-party funders also play the role of coordinator among plaintiffs and provide access to legal resources wherever a claim is proceeding, facilitating access to courts. As the Volkswagen case demonstrates, U.S. shareholders seeking damages for potential securities fraud may have no recourse but to participate in a foreign action.

A key difference between U.S. and foreign securities fraud class actions is that, while U.S. class actions are often “opt-out,” meaning shareholders are automatically included in a class unless they choose not to participate, foreign actions are often “opt-in.” In opt-in actions, shareholders will not be included in the recovery unless they formally join the litigation. Thus it can be difficult, and potentially costly, to navigate an international case without proper diligence. To this end, U.S. plaintiffs firms are increasingly becoming the liaison between U.S. investors, funding entities and foreign litigation attorneys. U.S. firms also aid in identifying recovery opportunities, understanding the mechanics of funding agreements, and supervising actions after filing.

Volkswagen is just one of several recent international scandals that has rocked global markets. In 2014, Tesco PLC, a U.K.-based grocery chain, was found to have overstated its profits by £263 million through a massive accounting fraud. Also in 2014, Petrobras, the Brazilian oil and gas producer and one of the world’s largest petroleum suppliers, was revealed to be a central figure in a pervasive, multiyear bribery and money laundering scheme. Both companies sold American depositary receipts (ADRs) to U.S. investors, who brought securities claims in the U.S., only to find their claims stifled by Morrison.

These recent transnational cases will not be the last. International securities litigation is coming of age, though many touchstone issues have yet to be decided. The basic framework for investor protection in the EU is taking shape, giving rise to a more claimant-friendly environment. For global investors, having the right support to navigate this environment is critical to a successful recovery effort.

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