

LAW OF THE FINANCIAL MARKETS

Class action: Can a shareholder sue its company in a foreign court?

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European law, and French law in particular, does not offer satisfactory recourse for fair compensation of victims of market abuse. They will thus be inclined to take their dispute with their company to the United States or, to a lesser extent, to the Netherlands. Is that a satisfactory solution?

By **Hubert de Vauplane**, Director of Legal Affairs, **Crédit Agricole SA**, Associate Professor, **Paris II Panthéon-Assas University, AEDBF Europe**

and **Jean-François Poultais**, Head of the Legal Department, Products and Markets, **Amundi**

NB: The opinions expressed are those of the authors, and do not necessarily represent the opinion of their respective companies.

Some European corporations have been particularly surprised to find themselves involved in an American class action litigation (*box 1*) and, especially, related to securities fraud¹ matters, to which we will limit ourselves here. Indeed, these companies had not (or had very rarely) anticipated that the American courts would almost always declare themselves competent to judge suspicion of fraud, with the non-systematic exception of cases related to the co-called F-Cube rule². In this respect, one case was particularly symbolic for companies and European investors. It was the accounting fraud committed by the American subsidiary of Royal Ahold³ that led to a settlement between the company and its shareholders in which the majority of the beneficiaries were European shareholders. Since then, decisions about class action cases against non American-listed companies and European shareholders have multiplied (*box 2*), especially those involving French companies⁴.

TWO NOTABLE EXAMPLES OF CLASS ACTIONS

Two cases drew the attention both of specialists and the media. First was the complaint against Vivendi in which Judge Richard J. Holwell concluded, several times, that French shareholders have the right to benefit from class action procedures⁵. The second was the lawsuit against Alstom⁶ for

¹ American courts saw 169 cases in 2009, compared to 223 in 2008 and an average of slightly fewer than two hundred cases per year during the last decade.

² “Foreign Investors who Purchased Foreign Issuer’s shares on Foreign Exchanges,” literally, when the plaintiff, who is not a resident in the U.S., has purchased a non-U.S. company on a market other than the American market.

³ This was a complaint filed in 2004 in the United States which, after 3 years of trial, resulted in a global settlement of \$1.1 billion paid by Royal Ahold.

⁴ To cite only the banking sector: Barclays, Credit Suisse, Deutsche Bank, Fortis, ING, Swiss Ré, Royal Bank of Scotland, UBS, Société Générale.

⁵ The United States District Court for the Southern District of New York included in May 2007, for the first time, French, Dutch, English and American shareholders in the class, but excluded shareholders with other nationalities.

which a judge from the same court handed down the opposite decision, excluding French shareholders from the class. These two decisions raise many questions, particularly about the reasons for such a discrepancy. Without being specialists in these matters, one can assume that the fact that Alstom is not listed on the American Stock Exchange was probably a decisive factor in the decision. Also, let's not forget also that Vivendi had already been ordered to pay a fine of \$48 million in 2003 by the SEC, already broadening prospects for plaintiffs⁷. Beyond those two cases, the question of the advisability of legal actions filed, involving non-American shareholders of non-American companies, is the subject of heated debates between experts. Some advocate the universal nature of the rights of shareholders, who are entitled to demand compensation for their damages wherever they see fit, whereas others believe that the question of compensation for damages between shareholders and their company, on one hand, fall within the responsibility of the *lex societatis* and, on the other hand, they consider that the cost of these lawsuits should not be borne by the American taxpayer. However, it is important to put these questions into perspective, as the number of cases involving European companies is still low. Indeed, even though they generate a great deal of talk, there are still very few of this type of class action litigation⁸.

1. REFERENCES

The American class action

The conditions of admissibility of a class action in American law are defined by rule 23 of the Federal Rules of Civil Procedure which poses four criteria:

- *numerosity*, the fact that such a significant number of people are involved that linking the different individual requests is difficult ;
- *commonality*, there are questions of law or fact common to the members of the group;
- *typicality*, the allegations of the group representative are those of the group;
- *adequacy of representation*, the group representative represents the interests of the groups, not his or hers. In a recent decision relating to *securities* class actions, the Supreme Court of the Unites States reinforced the procedural requirements by demanding a fraudulent intent (*scienter*) of the executives or the issuer (*Tellabs Inc. v. Makor Issues & Rights*, 551 U.S. 308 – 2007).

⁶ On August 22 2008, Judge Morero, of the United States District Court for the Southern District of New York, excluded from the class the French, British and Dutch, but nevertheless, judged the class admissible for American investors for fraud within the American subsidiaries of the company: *In re Alstom SA Securities Litigation*, 253 FRD 266 (S.D.N.Y. 2008).

⁷ 12,115 investors received compensation, including 5,300 Americans, the balance being shared between 15 countries. In addition, 3,300 of those investors had acquired their security in Paris (SEC Press Release, August 11, 2008).

⁸ Out of 126 settlements in 2009, only 6 had to do with European companies.

CRITICISM OF SECURITIES CLASS ACTIONS

The criticism of class actions most often has to do with cases in the sector of major consumer goods and services. Admittedly, most of this criticism is transposable to securities class actions, such as the principle of *discovery*⁹, the existence of a ‘popular jury,’ the concept of *opting out* of the *class*, the payment of lawyers by *contingency fee*, or the rule according to which “no one shall plead by proxy,” or even the relativity of legal concepts or, finally, the fact that judges cannot render regulatory decrees. In short, there are many well-known criticisms. Focusing on stock market cases, one of the most common criticisms has to do with the disproportionate cost of the means made available by the defendant for his defense (let’s bear in mind the tens of millions of dollars of fees paid, according to Vivendi, for a particularly heavy discovery process¹⁰). The consequence is a pressure to compromise through settlements, a process too often perceived by defendants as being unfair, even a kind of blackmail or racket by people or institutions motivated solely by the lure of a juicy settlement. One must note the important difference between securities fraud cases and ordinary class actions that aim to compensate for damages related to major consumer goods or services: the difference lies in the part played by management companies with regard to investment funds. These funds are not held by the companies that manage them but by the investors who drive their managers to defend their interests, giving them primacy over their investments, including by getting involved in securities class actions. Failing this, they would undertake their responsibility under their potential *fiduciary duty*. Consequently, the compensation recovered in a securities class action benefits the investors and not the investment manager, as the latter, although it led the action, does not get any direct benefit from it. Furthermore, given their capacity as shareholders, the plaintiffs in a securities class action case should – normally – not demand excessive compensation, to avoid the risk of putting their company in a difficult position, perhaps even risking bankruptcy. The truth is too often different (in the Vivendi case, the amount claimed could be as high as \$9 billion, depending on the number of shareholders receiving compensation!), which contributes to these cases losing credibility.

NO WIN NO FEE

Another frequent criticism highlights the size of the fees paid to middlemen, in particular lawyers. Once again, the securities class action case is to be distinguished from ordinary class actions. Indeed, the more the plaintiff represents an important part of the capital (such as an investment fund), the more he is able to negotiate “reasonable” fees with the service providers, in such a way that almost all of the compensation greatly benefits those who were subjected to the prejudice, and not the middlemen. This amount is the flip side of the so-called “No win – no fee” system, under which the expenses incurred remain the responsibility of the service providers in case there is no conviction. Once again, it is true that the reality is sometimes very different from the theory, and this once again has a negative impact on the credibility of these actions.

But the most heated debates relating to recent cases focus on the appropriateness of lawsuits in American courts when the shareholders are not Americans and, in particular, regarding absent class

⁹ *Discovery*: preliminary conciliation phase; *contingency fees*: fees based on the result; *opt-out*: self-exclusion from the group.

¹⁰ Over 10 million pages of documents were reviewed by Vivendi’s lawyers to establish their relevance in relation to requests for supporting documents. In the end, more than 4 million pages of documents were produced in the New York jurisdiction.

members, that are, for all practical purposes, non-American shareholders who are potentially eligible for compensation¹¹. Indeed, in American law, the judge must determine the outline of the group of claimants, before any debate takes place about the substance of the dispute.

2. CLASS ACTION

The territorial competence of American courts

These last few months, within the context of the numerous actions filed as a result of the financial crisis, the question of the territorial competence of American courts has received often contradictory answers:

- The first judgment in these matters was October 23, 2008, when the Court of Appeals for the Second Circuit handed down its decision regarding the competence of American courts to recognize a class action initiated by *foreign-cubed* persons in the U.S. Its principle is simple: the courts are competent only if the “heart of the fraudulent activity” is located in the United States (concepts of *conduct* and *effect*): *Morisson v. National Australia Bank Ltd*, 547 F. 3d 167 (2d circ. 2008).
- The second case concerns *Vivendi*, in which Judge Holwell took as a criterion of competence of American courts the recognition of the American decision by an *exequatur* judgment: if the chances of recognition of this judgment by a foreign jurisdiction are more “likely than unlikely,” then the American judge is competent. The judge confirmed his decision on March 31, 2009 (*In re Vivendi Universal SA Securities Litigation*, 2009 WL 855 799) (S.D.N.Y. March 31, 2009). As we recall, the same jurisdiction -- but with a different judge -- had rendered an opposite judgment in *Alstom*. On August 22 2008, Judge Marero had, in effect, considered that the French courts would not grant executive power to a judgment rendered by an American court in an American opt-out class action case, and consequently, the judge excluded French shareholders from the class (*In re Alstom S.A. Securities Litigation*, 253 F.R.D 266) (S.D.N.Y. 2008). For its part, French case law did not decide on the admissibility of an American class action with regard to the French legal order, unlike Germany, which considered that this procedure was contrary to its legal order (LG Stuttgart, November 24 1999).

THE LACK OF EQUITABLE COMPENSATION FOR MARKET ABUSE IN EUROPE

Beyond this debate about the legitimacy (or not) of these actions, nevertheless, if some European shareholders of a European company feel that an action filed in American courts against their company is preferable to an action filed in Europe, this is certainly due to the fact that they are unable to find the means to obtain efficient justice on this side of the Atlantic. This once again poses the question of the introduction, or not, of a class action procedure in Europe, even if the current debates are focused more on consumer protection law than on the protection of savings. The main argument of these European shareholders lies in the means of calculation of their damages. European law -- in particular French law -- does not provide a satisfactory recourse to fair compensation of victims of market abuse and more generally, fraud committed by executives or the companies of which they are in charge. As long as positive law cannot compensate fairly for market abuse in favor of wronged shareholders -- whether it be for matters of advisability of the litigation, its length or the determination of the *quantum* of prejudice -- they will be inclined to take their dispute with the company to court in the United States. Even better, some players could even be held responsible for inaction in relation to fraud. Presumably, that is the case for management companies that are accountable to holders of securities of the mutual funds they manage. In this respect, the recent initiative taken by the AFG

¹¹ It is important to distinguish the *complaint* process from the *settlement* process, the latter being the consequence of the first. The *settlement* process takes place either after a settlement, or after a judgment. It enables the *absent class members* to be heard. Indeed, the *settlement* process -- in simple terms -- recovers that which is the object of the litigation. The *absent class member* is thus eligible to receive compensation without having requested it. Unless he/she *opts out* after a certain period of time, he/she loses their right to act.

(French Investment Fund and Asset Management Association) deserves to be highlighted. In 2009, the French management association published a didactic *vade-mecum* on the subject, aimed at French management companies. This document explains in a practical manner, the terms of declaration and perception of damages that are reserved for their use within the context of settlements in relation to American securities class actions. If the amount of compensation depends on different parameters, the compensation varies on average between 3 and 7% of the total amount of the losses calculated, and this is far from negligible.

AN ALTERNATIVE TO AMERICAN SECURITIES CLASS ACTIONS : THE DUTCH CASE

In the absence of the progress of positive law, must European shareholders seek compensation for their damages by securities fraud only before American courts? There is an alternative in Europe. It is the legislation of the Netherlands, which recently changed its legal system in this direction. There are two systems of collective action working side by side in the Netherlands:

- the Act on collective settlement of mass damages, the Dutch Act, took effect in July 2005 ;
- the Enterprise Chamber (EC), a special branch of the Court of Appeals of Amsterdam¹².

Under the process provided in the Dutch Act, the Court of Appeals of Amsterdam has the power to validate an amicable settlement for collective litigation not only for all the participants of the action but also for those who have not expressly declared that they were opting out of this settlement¹³. Thus, the Dutch Act constitutes an interesting alternative to the securities class actions of American law for European investors in European companies in cases of market abuse or more generally, of management fraud. The distinctiveness of this process lies in the fact that the parties must conclude an agreement settling their dispute under the terms of a joint motion. The validation of the Agreement by the Court of Appeals will make it impossible for a wronged third party to bring a lawsuit against the company or the executives who are parties in the agreement, except for the victims who opted out, who will be entitled to file individual lawsuits. In practice, this procedure is still too often perceived as a “second chance” for European shareholders who have been rejected from an action in the United States in relation to the definition of a class. The most prominent example in this respect is the case of the Royal Dutch Shell.

The second process, the Enterprise Chamber, is used instead in problems of corporate governance¹⁴. The action can start even though a litigation is filed simultaneously in another country. This was the case for *Royal Ahold*, in 2004, when a lawsuit had commenced in the United States and at the same time, the Association of Dutch shareholders (VEB) had initiated an action before the Enterprise Chambers with the plaintiffs of the American class action. The advantages of these two procedures are obvious. It should be noted that amongst other advantages, the risk of “blackmail” is reduced, or even nonexistent, considering the rules.

¹² See the Dutch Civil Code, Art.2:344-359BW.

¹³ Dutch Civil Code Procedure, Art. 1013ff.

¹⁴ Marieke van Hooijdonk & Peter V. Eijssvoogel, “Litigation in the Netherlands.”

Furthermore, the question of the *exequatur* of the decision of the Dutch judge does not arise, contrary to the case of the American judge.

THE ANSWER RESTS IN THE HANDS OF THE POLITICIANS

If one cannot help but be shocked to see disputes between European shareholders of European companies settled outside of their natural jurisdictional forum, and under terms that are sometimes “iniquitous,” or at the very least foreign to our continental judicial system, the reason for this certainly lies in the lack of an adequate procedure in Europe, with the Dutch process the only alternative. From now on, to avoid a multiplication of these actions in the U.S. (that might qualify as an abuse of forum shopping), the answer rests in the hands of the politicians.