EXPERT INSIGHTS

Securities fraud litigation in Europe

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In June of 2019, Burford Capital and Fideres Partners LLP co-hosted a seminar in London for asset managers and securities fraud litigation experts. Ahead of that seminar, Burford Director Michael Sternhell invited panelists to address questions surrounding the legal frameworks, damages quantifications and group action regimes of securities fraud litigation across jurisdictions.

Europe has become an increasingly attractive venue for institutional investors to pursue recoveries against issuers accused of fraud. What makes Europe so attractive?

NADINE HERRMANN: The marked uptick in shareholder litigation in Europe is perhaps because investors are finally becoming more assertive and taking action against corporate wrongdoing. Volkswagen and its highly problematic approach to emission standards could easily have been the straw that broke the camel's back (at least for Germany). I think, though, that the reasons are more prosaic than a heroic uprising by suppressed shareholders.

One key reason is the reduced accessibility of US class actions after *Morrison v National Australia Bank*, the 2010 Supreme Court case. I suspect all VW cases would have been litigated in the US in a pre-*Morrison* world. After *Morrison*, US courts lack jurisdiction for cases brought by non-US investors who purchased stock in foreign companies on foreign exchanges.

A second reason is the availability of financing for large-scale litigation (which may have been another consequence of *Morrison* as there are investment needs that must be met) and a higher predictability of costs in continental Europe. Though large-scale litigation will always come with a heavy price tag, litigation in continental Europe can be surprisingly affordable, mainly because there is no pre-trial discovery and because of statutory fee schedules limiting adverse cost risks.

A third reason for the increase in investor litigation in Europe is that it is less crowded than the US. Those who serve the market, specialist law firms, funders, will be able to find more, and perhaps better, opportunities.

Finally, I think the political climate in Europe favors new solutions to corporate scandals.

MARCEL EVERS: As far as the Netherlands is concerned, it is a reliable and efficient judicial system. Courts are experienced in handling complex group or class actions. Legislation has been implemented to facilitate collective settlement of mass claims and representative collective actions, and this process continues. Dutch courts also recognize assignment of claims to a special purpose vehicle (SPV) that acts as claimant. Finally, in the

Netherlands there is very little risk of incurring adverse costs. A losing party will not be ordered to reimburse the actual legal costs of the winning party but only a generic fixed fee that is a fraction of the actual legal costs.

SIMON BUSHELL: The increased interest across Europe in shareholder claims brought collectively is based first and foremost on the EU's transparency regime which has been adopted widely. The way certain EU Member States have implemented these laws has reinforced the strength of their securities markets and made shareholder claims viable. At the end of the day, shareholders have limited options when it comes to a choice of EU Member States in which to bring claims because the default is going to be the place of domicile of the issuer. Generally speaking, the UK, Germany and the Netherlands are leading the charge, but significant claims have also been brought recently in Denmark.

As collective shareholder redress becomes more commonplace, institutional investors will inevitably see such claims as a necessary feature of their business, both in terms of protecting investor assets and fostering better corporate governance in general. The EU continues to develop the law in relation to collective actions, although the law of England & Wales remains ahead of the game.

What are the most significant challenges institutional investors face when pursuing securities fraud litigation in Europe?

NADINE HERRMANN: Although this is changing, the German litigation system is perfect for solving individual disputes between two parties. Capital markets litigation was, a few years ago, a niche for smallish firms or even for one-lawyer outfits that brought cases on behalf of retail investors. This caused a certain institutional complacency: Cases were brought by amateurs who gained a reputation among retail investors for being highly visible but without the skills to defeat the corporate defense machine. The sums involved were usually puny. That structure still exists. Many visible players are, essentially, ambulance chasing consumer advocates.

The most significant challenge is thus to overcome a structural bias against highly professional claimants represented by lawyers who meet the corporate defense machine on a level playing field. Claimants must match that level of professionalism and convince judges that the old comfy days of small-time investor lawsuits against a local savings and loan bank are over. To break up that quaint structure all it takes is a significant win in a closely watched securities case.

MARCEL EVERS: Assuming Dutch courts have jurisdiction, a primary challenge is the question of which law they will have to apply in international securities fraud cases. The applicable law shall be the law of the country in which the damage occurs. Locating damages in securities fraud litigation can be quite hard, for this is a matter governed by European law. Furthermore, under Dutch law, claimants are required to present and substantiate their entire case—including damages—in the writ of summons, the first court document in a case. This is also usually a challenge.

SIMON BUSHELL: One of the major challenges in the UK to any large-scale litigation is cost. Under the English system, the loser generally pays the winner's costs. This can be a major deterrent to any claimant nervous of running out of funds to pursue the claim to the very end if necessary. Corporate and banking institutions facing significant shareholder claims will typically seek to mount robust, and sometimes quite technical, defenses. Overall, these defendants' objectives will be to delay and complicate the process in order to drain the claimants of financial resource and create potential disharmony amongst a potentially disparate group of shareholders. Often, the defendants will be entitled to security for their costs, to be provided by the claimants

at an early stage, thus tying up capital for a long period. Where security is provided by a funder or via ATE insurance (paid for by a funder), the potential cost of capital eats into the damages eventually recovered. This, in turn, makes settlement more difficult. As the market evolves, judges will become ever more vigilant in looking out for defendants wishing to stifle claims by deploying these tactics. Claimants themselves will come to recognize that when a large claim is funded, the scale of deployed capital is double-edged.

Sophisticated investors may use investment strategies that could make it difficult to prove they directly relied on an issuer's misstatements when making an investment decision. In Europe, are investors required to prove reliance and how do they typically do so?

NADINE HERRMANN: Sophisticated, algorithm- or index-based trading and investment strategies are commonplace. An individual misleading statement may not have caused an investment decision in a traditional sense.

Luckily, to recoup the so-called share price inflator an investor need not prove reliance in Germany. The share price inflator is a category of damages. In capital markets cases it is the most important one. Under this approach, an investor may recoup the differential between the price he paid for securities affected by misleading information and the price these securities would have traded for without the misleading information or without the omission of material information. These share price inflator losses may be calculated by economists with relative ease based on the share price movement after the "true" facts became public. Reliance on the misleading or omitted information is not needed.

Only to recoup rescission level (or transaction) losses will an investor have to prove reliance and causation. Under this category of losses, an investor must claim that the security in question would not have been purchased had the investor been aware of the "true" information. Under precedent, the standard to prove reliance for this type of losses is considerable. Courts routinely hold that investment decisions are complex and informed by a range of rational and sometimes irrational factors. To identify the single cause for an investment decision is very difficult, especially for institutional investors with sophisticated investment processes. It is not impossible, though, if the information in question is material enough. Widespread, systematic fraud in an investment target's organization may well supersede any other investment consideration.

MARCEL EVERS: Under Dutch law, a concept somewhat similar to the fraud-on-the-market-theory developed that does not require an investor to prove individual reliance. In its landmark 2009 decision *World Online International NV*, the Supreme Court applied this concept—and an assumption of the "average investor"—in a case concerning prospectus liability. It is not entirely certain if this concept also applies to other forms of misrepresentation, but the signs are positive, and the Amsterdam court has already done so. In the 2015 *Landis v North American Co.* case, the Amsterdam District Court explicitly found that investors did not have to prove individual reliance in relation to misleading financial statements. It was sufficient to show that the share price has been influenced by the misrepresentation.

SIMON BUSHELL: In the UK, reliance is not necessary in a prospectus claim under S. 90 of FSMA 2000. However, it is a feature in claims brought relating to published information under S. 90A of FSMA. There is no doubt that reliance is a key battleground in these cases. The test is that the information relied on should be a real and substantial but not necessarily decisive factor in determining the investment decision. It is therefore important that investors can show that published information was considered, and notes made to reflect the assessment of that information on the relevant company's financial position and prospects. For passive investors this is particularly difficult absent a fraud-on-

the-market theory, which to date has not been recognized by the English Courts. In common law claims for fraudulent misrepresentation, there can be a presumption of reliance, but that presumption is not found in FSMA.

Pre-trial discovery is generally limited in jurisdictions outside the US. How can institutional investors obtain proof that an issuer committed fraud?

NADINE HERRMANN: Pre-trial discovery is an important tool and I would love to have it available in Germany. However, discovery is not a silver bullet that will magically transform a losing case into a winner. If you are starting without substantial evidence, you will have trouble winning on either side of the pond. Admittedly, in the US some corporate defendants with something to hide might entertain the idea of settlement if faced with the possibility that their secrets could be exposed through discovery.

When discovery is not available in your jurisdiction—as in Germany—a possible solution can be to file an application for discovery in the US in support of your domestic case. If the defendant can be "found" in the US, discovery under Sec. 1782 of the US Code is a viable option. Another option in Germany can be to win access to criminal law case files in parallel criminal investigations. That is cumbersome but not necessarily futile.

MARCEL EVERS: Investors that jointly hold securities representing at least one percent of the capital of the issuer or at least €20 million based on the stock price at the day prior to filing have the authority to request that the Enterprise Chamber of the Amsterdam Court of Appeal order an investigation into the policy and affairs of the issuer. This is a very powerful tool and in almost all securities fraud cases such action is initiated prior or in addition to an action for damages. The Enterprise Chamber can order such investigation if there are valid reasons to doubt the correctness of the policy of the issuer. The investigators appointed by the court have direct access to the entire administration, books and records (e.g., email accounts) of the company. Also, directors and former directors are obliged to cooperate. The investigators must record their findings in an inquiry report. In securities fraud cases the report is usually made publicly available by the court. On the basis of this report, the Enterprise Chamber can establish mismanagement, hold individual directors responsible and order measures to be taken.

Asset managers may have concerns about their investment personnel devoting time and attention to supporting a litigation rather than managing investments. How much ongoing involvement can investors expect if they join a shareholder litigation in Europe?

NADINE HERRMANN: As reliance and causation are not needed for the typical case based on share price inflator losses, the management can expect to be able to continue their usual business with minimal time demands. The support for the litigation (expert opinions on damages, analysis of account statements, confirmations by custodians about shareholdings, etc.) will typically be handled by service providers instructed by the lead counsel with support from a litigation funder. The asset manager needs only to provide the relevant trading data and confirmations. Non-EU asset managers will also need to provide counsel with corporate information regarding legal existence and proper representation so that standing can be proved. As nearly all these cases will be funded, the investors need not worry about having to spend significant time on the litigation effort. They will be kept informed—usually through a steering committee—but the day-to-day management is handled by others.

MARCEL EVERS: Time spent by asset managers and other clients on these cases in general is concentrated in the beginning of the proceedings; it takes some time to substantiate a claim. If a claimant does not furnish sufficient facts to substantiate its claim, the court will reject it. The burden of proof lies with the claimant. It is advisable to engage professional parties that know what to assemble, how and when, and to present an event study at the outset.

The efforts thereafter usually are relatively limited.

SIMON BUSHELL: Institutional shareholders can participate as much or as little as they like in the management of the ongoing litigation. However, there must be an appropriate decision-making body and governance structure in place in any class action or group litigation. In very large cases that decision-making body may represent several different claimant groups, which adds to the complexity. It is highly advisable to put this in place at the outset. This will help to avoid delays and other potential complications. There is of course a balance to strike between not being bogged down in the day-to-day management of the claim, and ceding control altogether. Key decisions such as settlement should be reserved to individual claimants.

The Rotterdam District Court took an expansive view of jurisdiction in the recent case against Petrobras. Do you think the court's decision will lead to an increase in securities litigation filed in the Netherlands? Is it possible the legislature could step in to reverse that trend?

MARCEL EVERS: The *Petrobras* case demonstrates that the Dutch courts accept jurisdiction rather quickly if there is a link with the Netherlands, in that case based on the fact that two of the defendants were Dutch subsidiaries of Petrobras. For a specific type of cases—this concerns representative foundations initiating class actions—there is legislation underway that will somewhat reverse this. Under this future legislation, such foundations can only pursue claims before the Dutch courts if there is a sufficient link with the Dutch jurisdiction. This is the case when the represented investors are predominantly domiciled in the Netherlands; the issuer is domiciled in the Netherlands and additional circumstances create a sufficient link with the Dutch jurisdiction; or if the event giving rise to the damage can be located in the Netherlands. This legislation is expected to enter into force soon.

The Amsterdam Court of Appeals finally approved a €1.3 billion class-wide settlement of investor claims against Fortis last year under the WCAM. The process took nearly two years. What are some of the lessons learned from the Fortis *case for institutional investors thinking about pursuing claims in the Netherlands?*

MARCEL EVERS: At least two lessons: The court denied that active claimants were treated better than inactive claimants in the settlement. It ruled that the "free-rider problem" is inherent to the Dutch collective action system. The court also gave some consideration to the position of investors only having holder shares. Although the court approved that some compensation is paid for holder

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shares in this settlement, it noted that it is highly questionable whether holders of only holder shares actually have suffered damages and would have been able to successfully pursue a claim in a court case.

Securities fraud damages methodologies in the US have evolved over decades and been tested in thousands of cases. What approaches have been used in recent cases in Europe and how do they differ from prevailing methodologies used in US cases?

MARKUS NIEMEIER: There have been more than 5,000 securities fraud cases filed in the US and although the damages framework in the US keeps evolving, the basic principles are well established.

Two key principles underpin US-style damages methodologies: First, the efficient market theory, which establishes that if a financial market is efficient it incorporates any new piece of information released by a company in the price of securities; and second, the market reliance principle, as courts have long held that investors are implicitly assumed to rely on any statements released by listed companies. This principle is essential for proving common damages on a class action basis.

Across Europe we don't have such established methodologies because there have been very few filings to date, and almost none of them have been tested in court.

The upshot of this is that economists still look at the US for guidance and employ event studies to determine damages. US-style event studies are regularly used as a benchmark to assess "indicative damages" in European securities claims. Other methodologies have been used in the past, such as fundamental valuations, but those are often looked at in addition to, and not instead of, event studies.

Unlike in the US, certain European jurisdictions recognize so-called "holder claims" by shareholders that purchased shares before the fraud occurred and held their shares until the fraud was disclosed. How are damages calculated on holder claims?

MARKUS NIEMEIER: Holder claims are brought by investors alleging that they retained the securities they purchased previously in reliance on the defendant's misstatements and suffered damages when the share price fell after the truth emerged. Holder claims therefore present an exception to the usual rule in securities fraud cases that only investors alleging they bought or sold securities in reliance on a misstatement or omission may sue.

Damages for holder claims can be approached in different ways. One possible avenue is by looking at out of pocket losses. Following this approach, we would still apply event study methodology and adjust those out of pocket losses for sector and market movements in order to arrive at "excess" out of pocket losses.

What role have experts played in recent European securities fraud settlements?

MARKUS NIEMEIER: There haven't been many European securities fraud cases to date, and even fewer settlements. However, in the few cases that we are aware of, experts have played an important role in providing forensic analysis to identify the correct set of disclosure dates, estimating damages, as well as opining on the reasonableness of the settlement agreement.

In terms of damages quantification, experts have typically run US-style event studies, and for opinions on the overall settlement amount, comparisons were drawn with other (typically US) securities fraud settlements and the amounts achieved in those cases.

SIMON BUSHELL

As Partner at Signature Litigation, Simon Bushell specializes in international commercial litigation and arbitration, including civil fraud and asset tracing. Previously, he was the chair of the London Litigation practice of Latham & Watkins and a partner at Herbert Smith Freehills. Simon has over 28 years of experience in high stakes commercial litigation.

MARCEL EVERS

As Founding Partner of Evers Soerjatin, Marcel Evers represents corporates, shareholders, directors and supervisory directors in corporate law disputes and urgent crisis situations. He frequently litigates before the Dutch Enterprise Chamber, the civil court and in arbitration.

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Dr. Nadine Herrmann is Managing Partner of Quinn Emanuel Urquhart & Sullivan's Hamburg office and chair of the firm's EU and German Competition Law Practice. She authored a textbook on EU competition and German competition law and is internationally recognized as an expert litigator.

MARKUS NIEMEIER

Since joining Fideres as a Partner in 2016, Markus Niemeier has acted as a consulting expert in over 15 cases. He previously was Managing Director of Credit Suisse's Emerging Markets Financing Group, overseeing the management of its corporate loan portfolio and large credit derivatives portfolios.

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