AIG

Rise of the European shareholder class action?

AIG Europe statistics reflect how shareholder class actions, once predominantly a feature in the US, are taking off in Europe... but in a uniquely European fashion.

Shareholder class actions – or collective redress – are on the rise in Europe, with a number of converging factors behind the phenomenon. This includes the rise of shareholder associations and litigation funders and the precedent set by several high-profile cases currently working their way through the courts.

In April 2016, AIG Europe carried out an analysis of 50 large shareholder claims (over $500,000) under its Commercial D&O policies, which developed between 1 September 2008 and 30 November 2015. While those claims do not include Financial Institutions D&O, they do, in many instances, reflect the post-financial crisis environment.

The results demonstrate a growing trend towards European collective shareholder claims, with 60% of shareholder claims brought outside the US, versus 40% that involved a shareholder claim in whole or in part in the US. Currently, Denmark, the UK and the Netherlands are emerging as prominent jurisdictions for such claims, although France, Germany and Sweden have also had shareholder actions.

Statistics by Loss Location

40%	60%
Shareholder claims with a US element	Ex-US shareholder claims

Perhaps unsurprisingly, the biggest claims payouts during this seven-year period involved those with a US element. These were responsible for 65% of the total AIG losses incurred.

We have identified a number of drivers behind the growing popularity of collective redress amongst European shareholders. It is the confluence of these different factors that is likely to lead to more European shareholder claims in the future, particularly if the judgments of current high-profile cases are found in favour of the plaintiff or significant settlement pay-outs are obtained.

A perfect storm: How Europe is embracing shareholder class actions

The Morrison Ruling

The 2010 decision by the US Supreme Court in *Morrison v National Australia Bank* made it clear that US courts do not accept jurisdiction for so-called "F-cubed" lawsuits brought by foreign plaintiffs, against foreign defendants, concerning securities traded on a foreign exchange. With the judgment, access to US securities class actions was limited for non-US shareholders seeking to recover losses, opening up the possibility of the European courts for shareholder redress. It has also resulted in a number of US law firms opening offices within Europe to benefit from this expected shift.

Class-action frameworks

While there is no direct equivalent to the US class action, several European jurisdictions have similar mechanisms in place. In England and Wales, the Group Litigation Order is the most common "opt in" system, while France introduced "group actions" in 2014. Class actions by shareholders have taken firm root in the Dutch judicial system, which currently allows for two collective redress mechanisms – the Dutch Civil Code (Burgerlijk Wetboek; BW), and the 2005 Dutch Act on Collective Settlements Mass Damages (Wet collectieve afhandeling massaschade; WCAM). Indeed, the Netherlands has frequently been mooted as the preferred forum for class actions in Europe. However, the October 2016 dismissal of a collective action against BP arising from Deepwater Horizon raises questions over its future as a global class action centre. If the Netherlands will not resolve cases on a global basis, this could result in a company facing multiple class actions in various jurisdictions if it has shareholders from multiple countries.

UK Jackson reforms

Reforms introduced by Lord Justice Jackson in April 2013 (LASPO Act 2012) included changes to the way that litigation is funded. Damages-based agreements are now permitted in most civil cases, and it is anticipated that this could result in a greater number of collective action lawsuits in the future because of the increased financial incentives.

Litigation funding and after-the-event insurance

The "opt in" versus "opt out" nature of European class actions and "loser pays" approach to litigation funding means European shareholders have historically been significantly less litigious than their US counterparts. However, the growth in after-the-event (ATE) insurance and third-party funding for cases involving multiple claimants is going some way towards reducing these financial concerns.

Litigation funding is a significant factor in encouraging groups of European shareholders to bring actions against companies and their directors for perceived wrongdoing. Recent years have seen a shift away from an ad hoc, opportunistic approach to bringing shareholder actions towards more active and efficient methods of pulling together groups of claimants by litigation funders and law firms.

This is particularly true for cases where shareholders, lawyers and funders believe they will have a better chance of establishing liability (e.g. where regulatory penalties have already been imposed or a successful action has been brought in the US).

Shareholder associations

The rise of shareholder associations has been effective on two fronts in encouraging shareholder class actions in Europe. Firstly, through their ability to amass significant groups of shareholders to bring an action and secondly, through their ability to resolve the funding dilemma by asking members to make a contribution in order to bring an action. In cases where thousands of shareholders are willing to participate, these contributions are minimal (in some instances less than €100).

Regulatory action

Regulators have stepped up their enforcement activity in the aftermath of the financial crisis and are increasingly willing to cooperate across borders in investigations that concern multinational organisations. This enhanced oversight has prompted shareholder class actions in Europe in some instances, although it should be noted European shareholders remain significantly less likely to sue than their US counterparts. As an example, two of AIG Europe's largest ongoing securities claims have arisen following investigations under the US Foreign Corrupt Practices Act (FCPA).

High-profile shareholder actions

A number of high-profile shareholder class actions are currently working their way through the European courts. The progress of these cases is being watched closely and depending on their outcome it could pave the way for similar shareholder actions to be brought in the future. However, while the incidence of European class actions is likely to continue to rise, there is no suggestion that any "floodgates" are set to open.

Among these "test cases" are shareholder actions being brought in the UK against banking group RBS and supermarket giant Tesco. The Tesco lawsuit is putting to the test changes made in 2010 to Section 90A of the Financial Service and Markets Act regarding liability for issuers of public statements to the market.

Other high-profile shareholder actions in Europe include a €40bn claim in Germany against carmaker Volkswagen for its emissions-rigging scandal, one against Fortis (now Ageas) in Belgium and the Netherlands, and against Danish fuel supplier OW Bunker. There are a variety of reasons for these collective actions, including accounting irregularities and inadequate/ untimely disclosure.

Reasons for bringing a class action

AIG Europe's claims statistics indicate some of the main structural drivers behind European shareholder class actions. Inadequate or untimely disclosure was the primary driver in just over a quarter (26%) of commercial D&O shareholder claims. In many cases these actions involved a secondary driver, most commonly:

- Anti-trust investigation;
- Bribery investigation;
- Problems around US Food and Drug Administration (FDA) new drug approval process (in the case of claims brought against Pharmaceutical companies and their D&O);
- Financial difficulties/insolvency of the Insured; and
- Insider trading.

Shareholder claims brought against pharmaceutical companies for inadequate disclosure are a classic example. Companies may, for instance, seek investment for research and development into a new wonder drug, but may make inaccurate statements about the status of obtaining US FDA approval.

Eight percent of all AIG Europe's commercial D&O shareholder claims between 2008 and 2015 were brought against pharmaceutical companies. However, this was surpassed by the frequency of claims brought against the Tech & Telecom (10%), Manufacturing (12%) and Construction & Real Estate (14%) sectors.

The second and third main drivers for commercial D&O shareholder claims were accounting fraud/irregularities (14%) and M&A bump up claims (8%).

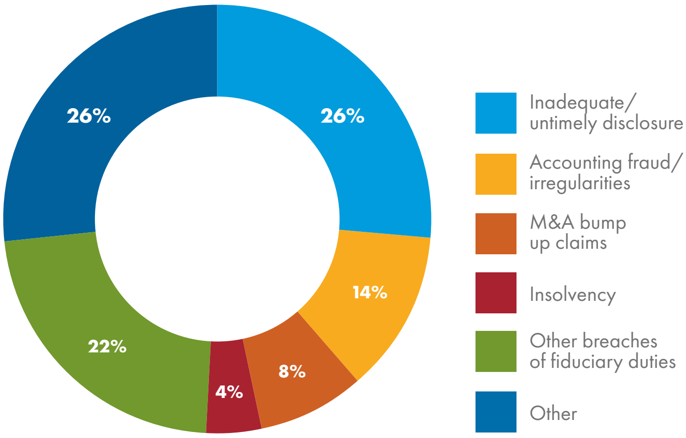
From a severity perspective, claims involving inadequate/untimely disclosure and accounting fraud/irregularities involved the highest claims payouts, at 42.8% and 27.1% of total loss incurred respectively.

Bankruptcy/insolvency was the primary driver in just four percent of cases, although actions brought by shareholders for inadequate/untimely disclosure also involved insolvency in some cases. Following the financial crisis the incidence of insolvency increased significantly and there was also the phenomenon of zombie companies, firms trading profitably but struggling to pay off significant debts. Some claims were made against directors for losses sustained by creditors because they had continued to trade while technically insolvent.

While it is true to say that European directors and officers of companies that do not have a US presence remain significantly less exposed than their US counterparts, they should not rule out the possibility of highly complex shareholder actions in the future. Companies with a turnover of $20 billion or more are most vulnerable to costly litigation, with such claims currently accounting for just over one third of AIG commercial D&O shareholder claims payouts (against a claims frequency of 10%).

Turnover	D&O Claims Frequency (% of total cases)	Severity by size of business (% of total incurred)
$0-$500M	46%	30%
$500M-$1BN	10%	4%
$1BN-$5BN	10%	8%
$5BN+	34%	58%

Statistics by Structural Driver for the Claim



In addition to the cost, the complexity is also increasing. Firms are increasingly faced with a combination of regulatory investigation and shareholder actions, forcing them and their senior management to navigate a long, complicated and frequently-expensive legal process.

The growing availability of litigation funding and ability of shareholder associations to bring collective actions that are backed by thousands of claimants has removed some of the previous barriers and resulted in a more litigious environment. One example of an increasingly influential association is VEB in the Netherlands.

The Dutch shareholders' lobby's core activities are to provide support (including collective redress) to its members. The not-for-profit association represents 42,000 retail members, who pay as little as €60 a year to participate in the group's actions. It currently represents over one million Dutch investors and there are an additional 3,000 business members and 250 investment club members.

Meanwhile, the range of high-profile cases currently working their way through the courts could heighten the appetite for other shareholder groups to take a similar path. Should these lawsuits prove successful and lucrative they are likely to raise the profile of shareholder associations, attracting new members and eager litigation funders, creating even greater momentum for collective redress actions of the future.

Class Action Case Study 1

A UK law firm behind at least one other class action style claim in the UK is suing our insured for losses caused by alleged breaches of the FSMA. That litigation, supported by a litigation funder, is not the only action the insured is facing. The SFO has commenced an investigation into the insured's activity and the insured was also the subject of a shareholder claim in the US, which was settled without admission of liability in order to cap its losses. Given that the insured's securities are only traded over the counter in the US and not on any US exchange, one could have assumed that the Morrison decision (see page 3) would make such a claim impossible. However, it seems that such claims are still being pursued, and the insured was forced to incur costs defending and settling.

Class Action Case Study 2

Just months after its IPO, our insured filed for bankruptcy, resulting in the company's shareholders suffering an almost total loss on investments. It is alleged that the company's failure was due to significant losses arising from fraud and poor internal controls in one of the insured's overseas operations. The Danish Shareholders Association has brought an action against former company directors on behalf of thousands of former shareholders. They claim they were misled by the insured's prospectus, which presented the firm as a stable and conservative company rather than one that was highly dependent on market fluctuations. Deminor, the Belgian based shareholder representative group, is also bringing actions on behalf of a number of investors, and has included a number of parties including the insured, its auditor, and other parties involved in the IPO as defendants.

About the author
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Methodology

In April 2016, AIG Europe carried out an analysis of 50 large shareholder claims under its Commercial D&O policies between 1 September 2008 and 30 November 2015. The claims reviewed had a value exceeding $500,000.

N.B. The claims do not include Financial Institutions D&O, but do in many instances reflect the post-financial crisis environment.

Contacts

AIG has dedicated D&O Claims and underwriting capabilities across Europe. Our experienced team deals with more than 5,000 D&O claims per year. For more information, contact your local AIG office.

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