

What do funds have to lose?

To enlist new clients, US law firms are looking abroad, recruiting European institutional investors to act as plaintiffs in securities class action suits. **Stephanie Schwartz-Driver** reports

‘The number of securities class action suits in American courts has been growing consistently, a fact that those foreign companies listed on US exchanges are well aware of. According to the Stanford University Securities Class Action Clearinghouse, there were 327 securities class action lawsuits filed in 2001, an increase of 60% over the previous year. (The involvement of foreign companies is also growing – 22 were named in securities class actions in 2002, up from 15 the previous year.)

This exponential growth is in part caused by the fallout from the passage of the Private Securities Litigation Reform Act (PSLRA), passed by a Republican-dominated Congress in 1995, over President Clinton’s veto. This established that the lead plaintiff in a securities class action suit has to be the individual or, more likely, the institution that has incurred the largest loss. The ongoing globalisation of investment means that the lead plaintiff in a securities class action increasingly may be European or other international investors.

The dollar amount of settlements has been growing dramatically, along with the number of cases. Before the adoption of the PSLRA in 1995, the average settlement was less than \$7m – by 2003, it had risen to a startling \$25m and has continued to grow since then. From 2003 to 2004 the average settlement size increased by another 25%, according to Washington DC-based Cornerstone Research.

Cornerstone found that in cases where the lead plaintiff was an



Check: ‘really no catch’

institutional investor, the settlements were much higher – a median settlement value of \$10.1m against \$4.9m without an institution at the lead. In the latest case involving a non-US listed company to reach a conclusion, Dutch retailer Ahold settled in a Maryland court for \$1.1bn at the end of November, and that was negotiated down significantly from what the plaintiffs were originally seeking.

With the PSLRA, Congress had hoped to control the number of cases – and also to rein in law firms, on the assumption that large institutional investors would cap their legal fees. Legal fees are now negotiated – but the number of cases has grown, settlements have increased, and American law firms involved in securities class actions are extending their reach overseas.’

‘Most cases – “99%” in the words of one lawyer – settle out of court. Yet it is not a quick process by any means. Only 48% of class actions

reached a settlement within five years of first filing, according to a study by NERA Economic Consulting. However, it is the law firm that finds itself out of pocket, not the plaintiff.

All securities class action suits in the US are conducted on a contingency basis. This means that the law firm covers the costs of bringing the case and only recoups its expenses – and charges its fee – if the case is won.’

‘Another factor limiting the risk for clients is the fact that there is no ‘loser pays’ rule in the US.’

‘The law firms do more than just make the financial investment upfront. They also bear the burden of the workload, according to Hubertus Becker, legal counsel for Activest, a German fund manager that has served as plaintiff in several US class action suits. “It is not expensive – the law firm handles all the costs, so we do not pay any money.” Nor is it time-consuming: Becker estimates that he only puts in around one hour a week in looking after the fund’s role in the US courts. “If we were to do it on our own, I do not think it would be so easy. There is a lot of paperwork,” all handled in New York by its law firm.

“There really is no catch” for non-US institutional investors who chose to be plaintiffs in US securities class action suits, says Darren Check, partner and director of institutional relations for Schiffrin & Barroway, based near Philadelphia. “Sometimes we have to convince them of that. The big fear is that the American lawyers are coming over trying to make money off of them.”

The firm “almost fell into” working with European investors “by accident”, says Check. Around two and half years ago, the firm was contacted by a Swiss bank regarding a case against a US company. “This was our wake-up call,” he explains. Since then the firm has taken what it terms “an educational approach” to growing its international client base, running seminars, speaking at conferences and meeting with

potential clients. Initial efforts focused on Scandinavia, Germany, Austria, the UK and Italy, and the firm has more recently ventured into France, Belgium and the Netherlands.’

‘There is more than just money involved in securities class actions. Such suits often have a corporate governance angle. So in addition to financial recompense, investors can gain a PR advantage, particularly in their home country, by taking part in US securities class actions.’

‘Opinion is pretty evenly split among investors,” according to Check of Schiffrin & Barroway. “Some want corporate governance reforms; some just want their money back,” he notes, pointing out that “there are only certain cases in which you can get corporate reforms. A lot of cases are just about getting your losses back”.

Even as US law firms are actively prospecting for business from overseas clients, they are also seeing legal changes abroad to open courts to similar class actions suits.

In Germany, class action suits are now possible, although the system is geared more towards retail investors – Deutsche Telekom is the first big case to hit the courts, and there are others in the pipeline. And in January, Canadian law is also changing to come more into line with the American system.

Hubertus Becker of Activest has a positive impression of the American system of securities class actions. “Sometimes it is not easy to understand, but we are getting more used to it. I think it’s a really good system.”

These changes are also smoothing conditions for the American law firms, suggests Check of Schiffrin and Barroway. The firm has strategic partnerships in Europe that help build its client base and has found growing interest from potential partners. “With the laws changing, they not only are able to provide additional services to their clients, but they are also able to learn about the process,” he says.’