Perspectives in Company Law and Financial Regulation

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In search of a middle ground between the perceived excesses of US-style class actions and the generally ineffective collective action procedures in Europe

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I. Introduction

There is a general recognition in Europe that the existing methods of compensating the victims of consumer fraud, anti-competitive behaviour, fraud on investors and other actions with multiple victims are inadequate. Some look longingly at the results obtained in the US class action system but in Europe most people recoil at what are viewed as its excesses.

As the limited survey in Section IV in this chapter shows, two countries in Europe have new class action laws and several others have been working around the edges of the apparent bars to class actions, both legal and cultural, in their countries to provide some effective means for large groups of claimants to obtain damage relief. Most European countries and the European Union itself allow collective or representative actions for injunctions. Even the US role of lawyer's financing class actions on a contingent fee basis is being filled in a limited way by third-party funders (albeit to date mostly in normal commercial litigation). The question remains whether these various substitutes for US class actions ('class actions lite') will provide an adequate and efficient basis for compensating large numbers of claimants without impairing procedural fairness or otherwise suffering any of the maladies associated with the US system.

Class actions have existed for a long time in the United States but were given a significant boost in 1938 when the Federal Rules of Civil

[1] The author wishes to acknowledge the help of the following: Damian Cleary, Alain Hirsch, Thomas Schmuck, George Williams and my wife, Marie-Claude Robert Hawes. However, the views expressed in this article are solely those of the author.

Procedure were amended to codify the process. US class actions have been brought primarily in securities, product liability and anti-trust actions, but are generally applicable. In the securities field, the principal focus of this essay, in 2007 there were 175 securities class actions filed – somewhat below the average of the last ten years.[2] Since 2005 there have been seven settlements of such actions for over $500 million each topped by Enron at over $7 billion.

In brief, the US class action procedures are as follows. First, an action is filed on behalf of one or more named plaintiffs. The plaintiffs' representative then must prove the class satisfies Rule 23 (see discussion of the requisites in the *Vivendi* case in Section III). After a class is certified, notice must be given to the class by direct mail and/or advertising. A class member can then 'opt out' of the class either because the member wants to bring a separate action or is not interested. Those not opting out are foreclosed from bringing their own case and are bound by the outcome of the class action whether by judgment or settlement.

Because US law permits contingent fees, most class action cases are initiated by experienced plaintiffs' counsel who underwrite all the expenses of the litigation in exchange for a percentage of the recovery which tends to be around one-quarter or one-third but can be higher and must be approved by the court at the end of the process.[3] Why are there so many US class actions? First, it has proven to be a lucrative business for plaintiffs' counsel. Second, there is a well-recognized and organized class action process including advertising for claimants. Third, there is a possibility of punitive damages which while rarely applied can influence settlements. Fourth, there is no loser pays rule as in England and other European countries so plaintiffs risk nothing and their counsel only their own expenses and time (which of course can be considerable in a protracted case). Fifth, jury trial is available, which, as a kind of wild card, presents defendants with a serious risk of losing even where they have a strong defence; such risk adds to the pressure to settle. Sixth, the fraud-on-the-market theory allows a presumption that investors relied on corporate misrepresentations even if not specifically aware of them. Seventh, derivative suits allow shareholders to sue on behalf of the corporation, albeit the recovery goes to the company but plaintiffs' counsel receives a fee. Eighth, the Securities and Exchange Commission is active in investigating and taking action against securities violations

[2] Stanford Law School Securities Class Actions, http://securities.stanford.edu/

[3] See note 6.

thus paving the way for civil suits.[4] Ninth, there are extensive discovery obligations on defendants.

The principal perceived excesses of the US class action are: (1) the contingent fee aspect which encourages lawyers to stir up litigation especially given the absence of a regime of loser pays the fees and expenses of the other side; (2) the risks associated with jury trials and the possibility, however remote, of punitive damage actions; and (3) the methods by which some counsel have obtained the clients to bring the case (resulting in at least one prominent criminal indictment brought against plaintiffs' lawyers for giving kick-backs to obtain lead clients)[5] and the bringing of frivolous class actions to obtain settlements (a practice considerably reduced since the passage of the Private Securities Litigation Reform Act of 1998 (PSLRA).[6] One of the failures of the US class actions system in securities cases that is not enough talked about in my opinion is the fact that the forms sent to potential claimants are extremely burdensome so that an individual investor with little or no idea of how much he or she might be entitled to, just dumps the forms in the wastebasket.

Using two US class actions involving European defendants, Shell and Vivendi, as a jumping-off place, this paper first examines the Shell settlement with its non-US shareholders under a relatively new Netherlands Settlement Act (Section II), and then the US District Court's analysis in *Vivendi* that led it to conclude that certain European countries inhospitable to opt-out procedures would not enforce a US court's judgment in an opt-out class action (Section III). Finally, in Section IV, I provide a brief overview of some recent developments in Europe and discuss middle

[4] Indeed in this case, Shell had agreed to pay the SEC $120 million for securities law violations and the UK Financial Services Authority £47 million for market abuse.

[5] The leading US class action securities law firm, Milberg Weiss Bershad & Shulman and two of its partners were indicted on 18 May 2006, and charged with making more than $11 million of secret payments to three individuals who served as plaintiffs in more than 150 lawsuits. Bershad and Shulman subsequently pleaded guilty and in February 2008 William Lerach, a former partner of the firm was convicted and sentence to two years in jail for his role in the scandal. On 20 March 2008, Melvyn Weiss himself pleaded guilty.

[6] Under the PSLRA, the court not only selects the lead plaintiff and thereby its counsel (mostly on the basis of the financial interest of the plaintiff) it also scrutinizes the fees in relation to reasonable hours spent and a reasonable hourly basis times some multiple (generally around 2.5 to 3.0 times but depending also on the amount of the recovery for the class – so-called lodestone test). Before the 1998 Act, there was a race to the courthouse with the winner being designated lead counsel, which explains why Milberg Weiss needed a stable of ready plaintiffs each of whom owned a few shares in many public corporations.

grounds between the perceived excesses of the US class action system and the generally ineffective collective action procedures in Europe.

As shown by my wife's companion essay in the next chapter, 'Some modest proposals to provide viable damage remedies for French investors', there also may be other interim solutions available. In her example of France, she advocates remedies for investors by: (1) utilizing the existing injunctive powers of the French *Autorite des Marches Financiers* (AMF) to order restitution to investors in exchange for not sanctioning the violators; or (2) after additional legislation, empowering the AMF through its Mediator function to determine and require restitution to investors after the AMF Commission on Sanctions has condemned persons subject to the AMF's jurisdiction.

II. The Shell Settlement

In January, 2004 and again in March, Royal Dutch Shell announced drastically revised estimates of its proven oil reserves.[7] By September 2004, domestic and foreign shareholders had filed a class action in the US.[8] In December 2004 Shell moved to dismiss the claims asserted by the non-US purchasers for lack of subject matter jurisdiction. In April 2007, Shell reached a several hundred million dollar settlement with a substantial group of European shareholders under a new Netherlands law.[9] The settlement was conditioned on the foreign shareholders being denied jurisdiction in the US case. That occurred in November 2007 in a decision by the US District Court in New Jersey.[10]

I will use the *Shell* case to illustrate: (1) the US law relative to the access of such foreign plaintiffs to the US courts; and (2) the operation of this unusual new Netherlands law that permits settlements to bind parties who do not opt out, such as shareholders, but does not permit claims for damages. In part III, I will utilize the *Vivendi* case[11] to illustrate how, when access is granted in the US, the court must still determine if shareholders from particular countries should be excluded where the opt-out provisions of US law are not likely to be enforced.

[7] See press releases by Royal Dutch Shell dated 9 January 2004 and 18 March 2004.
[8] US D.Ct. Dist. of New Jersey, Civ. No. 04–374 (JAP) (Consolidated Cases).
[9] Wet Collectieve Afwikkeling Massaschade, BW Art. 907–10 (the Civil Code of the Netherlands) and 14 Rv Art. 1013–18 (the Code of Civil Procedure of the Netherlands).
[10] In re Royal Dutch Shell Transport Securities Litigation (Royal Dutch II) 2007 US Dist. LEXIS 84434 (D.N.J. 13 November 2007).
[11] In re Vivendi Universal, SA Securities Litigation, Case 02 Civ. 5571, 23 March 2007.

A. Jurisdiction of US Courts in securities class actions over non-US plaintiffs

As noted above, there is a general feeling in Europe among both enterprises and shareholders, especially institutional ones, that the US class action system is excessive. Therefore, some European institutional investors are reluctant participants in class action suits in the US, and some would prefer, as happened in the *Shell* case, to find a European mechanism for just compensation for any securities fraud. Indeed, the European investors who participated in the Netherlands settlement opted out of the US class action. At the same time, as illustrated by the *Shell* decision of the District Court denying jurisdiction, the US courts may be narrowing the gate through which foreign plaintiffs must pass. That gate was also narrowed for foreign and US investors alike by the decision of the Supreme Court on 15 January 2008, in the *Stoneridge* case.[12] The Supreme Court held that a securities fraud lawsuit against suppliers and customers of Charter Communications, Inc., who allegedly agreed to arrangements that allowed Charter to mislead its auditors and issue a false financial statement affecting its stock price, was not tenable because the investor plaintiffs did not rely on statements or representations by such secondary actors.[13]

I now turn to the law on subject matter jurisdiction as found by the New Jersey District Court in *Shell*. After Shell petitioned the District Court to deny jurisdiction over the non-US purchasers of Shell securities, the Court appointed a retired judge as a special master to determine if the Court had jurisdiction. He issued his report in September 2007 suggesting the Court did not have subject matter jurisdiction over these claims. The District Court thereafter adopted his report and dismissed those claims.

The Securities Exchange Act of 1934 (the '34 Act) does not in any way limit the availability of its remedies for foreign purchasers. However, the courts have applied a standard test of such availability in which they seek to determine whether it was the intent of Congress to utilize the 'precious resources of the United States courts to be devoted to

[12] *Stoneridge Investment Partners, LLC* v. *Scientific-Atlanta, Inc.*, No. 06–43, 2008 WL 123801 (U.S. 15 January 2008) ('Stoneridge').

[13] See also, *Regents of the Univ. of California* v. *Credit Swiss First Boston (USA), Inc.*, No. 06–1341, *cert. denied* (US 22 January 2008) ('Enron') where the timing of the denial of certiorari after the decision in the *Stoneridge* case impliedly rejected the *Enron* plaintiffs' contention that the ruling in *Stoneridge* did not extend to financial professionals like banks.

such transactions'.[14] Although two tests have emerged for determining whether a federal court has subject matter jurisdiction over a foreign plaintiff's claim under the antifraud provisions of the securities laws, the 'conduct test' and the 'effects' test, in this case the conduct test was found to be controlling. The conduct test asks whether the 'defendant's conduct in the United States was more than merely preparatory to the fraud, and particular acts or culpable failures to act within the United States directly caused losses to foreign investors abroad'.[15] The effects test 'asks whether conduct outside the United States has had a substantial effect on American investors or securities markets'.[16] Since these non-US plaintiffs purchased outside the US there was no effect on American investors or securities markets so the effects test was not applicable.

The conduct test requires detailed attention to the facts. In the *Shell* case, the motion to dismiss for lack of subject matter jurisdiction was denied at the pleading stage of the proceeding,[17] but after extensive depositions and document production, the Special Master was able to determine that, although he had considered 'a multitude of boxes overflowing with transcripts and other exhibits . . . [he could not conclude that the plaintiffs had] satisfied the "conduct test" under the operative analysis'.[18] It is the plaintiff that bears the burden of proof. The primary areas cited by plaintiffs to support jurisdiction were: (1) Shell's investor relations activities in the US; (2) the use of a US-based Shell service organization in the estimation and calculation of proved reserves; and (3) services performed by another US-based Shell service organization which permitted Shell operating units either to maintain proved reserves bookings or to book additional proved reserves.

Although a limited amount of activity in those three areas was found, the Court determined that: (a) Shell did not engage in any fraud-related activity targeted at non-US purchasers within the US by virtue of its investor relations activities; and (b) that the activities of Shell's US-based service organizations were not related to either reporting of proved reserves or maintaining the reserves. In sum, the District Court found that plaintiffs had not shown that 'Shell engaged in conduct that amounted to more than mere preparatory acts in furtherance

[14] *Alfadda* v. *Fenn*, 935 F.2d 475, 478 (2d Cir. 1991), *cert. denied*, 502 US 1005 (1991).
[15] *Ibid.*
[16] *Robinson* v. *TCI/US West Commc'n*, 117 f.3d 900, 905 (5th Cir. 1997).
[17] Royal Dutch Shell I, 380 F. Supp. 2d at 548. (2005).
[18] Special Master's Report, 3.

of the alleged fraud as to the Non-U.S. Purchasers'.[19] Put another way, the Court held that there was insufficient evidence to show that Shell's 'conduct occurring within the borders of this nation was essential to the plan to defraud [the Non-U.S. Purchasers]'.[20]

Note that nothing in the conduct test relates to whether a finding of no jurisdiction would leave the foreign plaintiffs without a remedy. However, the District Court immediately followed its finding of 'no jurisdiction' with the observation below:

> The Court also emphasizes that this holding does not leave the Non-U.S. Purchasers without an alternative recourse to address their alleged injuries. Significantly, the Non-U.S. Purchasers can seek recovery through the [Netherlands] Settlement Agreement entered into before the Amsterdam Court of Appeals or through procedures available within their respective jurisdictions. Therefore, the result reached here does not prejudice the Non-U.S. Purchasers and ultimately serves to preserve 'the precious resources of the United States Court'. (Opinion p. 19)[21]

In short, while the Amsterdam settlement was not a requisite, the Court's finding of no jurisdiction under the conduct test, appeared to have had some influence on that determination. Accordingly, I now turn to a discussion of the Netherlands Settlement Agreement.

B. The Netherlands Settlement Agreement

The Netherlands Act on Collective Settlement of Mass Damages[22] had an unusual origin. Netherlands pharmaceutical manufacturers were faced with a flood of individual suits by victims and their families related to injuries suffered from using a synthetic hormone DES. In many cases it was not clear which pharmaceutical company's product was used by a person.[23] The manufacturers and their insurers went to the legislature

[19] Royal Dutch Shell Transport Securities Litigation (Royal Dutch II) 2007 US Dist. LEXIS 84434 (D.N.J. 13 November 2007), 19.

[20] Citing *Sec. and Exch. Comm'n* v. *Kasser*, 548, F.2d 109, at 115 (3d Cir.), *cert. denied*, *Churchill Forest Indus. Ltd* v. *Sec and Exch. Comm'n*, 431 U.S. 938 (1977).

[21] Citing *Alfadda*, (note 14, above), 935 F.2d, 478.

[22] Wet van 23 juni 2005 tot wijziging van het Burgerlijk Wetboek en het Wetboek van Burgerlijke Rechtsvordering teneinde collectieve afwikkeling van massaschades te vergemakkelijken (Wet Collectieve Afwikkeling Massaschade).

[23] The original claim was made by six daughters whose pregnant mothers had used DES. A registry was established and 18,000 people signed up out of a possible estimated 440,000 potentially affected. Interestingly, 24,700 people opted out of the settlement although it was not clear how many of them intended to pursue individual actions.

and asked for an act that would permit them to settle all the suits at the same time. After the legislature obliged, and seven years of negotiation, they settled for €38 million which was approved, as required, by the Amsterdam Court of Appeals in June 2006. Since the law was not restricted to the specific DES case, it was then used to settle a case involving retail sales of securities by Dexia Bank. That opt-out settlement was for €400 million and was approved in January 2007. The *Shell* settlement was filed in April 2007. It has not yet been approved by the Amsterdam Court of Appeals as required by the Act because it was conditioned on the US Court denying jurisdiction, which only occurred in November.

The *Shell* settlement was for $352 million plus an agreement with the US Securities and Exchange Commission to distribute $96 million of its $120 million fine to the non-US purchasers. When you add in the legal fees of $47 million agreed to in the settlement the total is about $500 million. The Netherlands Act binds all members of the class (i.e. non-US purchasers) unless they opt out of the settlement. If the deal is approved by the Netherlands court later this year as expected, it is likely to be enforceable throughout the European Union under its regulations relating to enforcement of judgments.[24] Moreover, it will establish an important precedent that is quite likely to attract other large European class action settlements because of the certainty of recovery of some damages in a relatively short time versus an uncertain wait in the US action and the cost and uncertainty of litigation in Europe.[25]

The flaw in the Netherlands Act from a plaintiff's point of view is that it only allows for settlements, not class actions for damages. Presumably, in the negotiations for such settlements, that factor will weigh in the equation. However, on the other side of the coin, if the US becomes ever more hostile to such non-US plaintiffs (and generally less open to securities law actions), the incentive for plaintiffs to settle in Europe will certainly increase. Equally, for defendants if collective actions become more prevalent, they will be more open to settlement especially if otherwise they might have to defend actions in several countries.

[24] See Council Regulation on jurisdiction and recognition and enforcement of judgments in civil and commercial matters EC No 44/2001 [2001] OJ L12/1.

[25] In fact in terms of the US Shell litigation for US plaintiffs, Shell announced on 6 March 2008, that it had reached an agreement in principle to settle that action for $79.9 million plus $2.95 million in interest. The deal is subject to the approval of the District Court of New Jersey. An additional $35 million would be paid collectively to the participants in the US class action and the Dutch settlement. See Reuters, 6 March 2008.

III. The Vivendi Case

In addition to the *Shell* decision of the District Court, there are other signs of a narrowing of the door for such plaintiffs to participate in US class actions under the securities laws. Two important decisions of the US District Court for the Southern District of New York in the *Vivendi* class action litigation provide indications, albeit in opposite directions, for non-US purchasers. In 2003 the *Vivendi* Court found that despite the fact that most of the Vivendi shares were traded on European exchanges and Vivendi was not a reporting company under the '34 Act (its securities were traded in ADR form on the NYSE), its conduct in the US[26] affected the American market for their shares which in turn was a substantial factor in the decisions of foreign investors to purchase abroad. Accordingly, non-US purchasers were entitled to bring US securities law claims.[27]

In 2007, in the same litigation, the *Vivendi* court, having decided it had subject matter jurisdiction (contrary to the finding in *Shell*), had to determine whether the claims of the non-US purchasers could proceed as part of the class action. The answer to that question was governed by Sections 23(a) and 23(b) of the Federal Rules of Civil Procedure which also had to be satisfied as to the US part of the class generally. The Court first found that the tests under Section 23(a) were satisfied. That is: numerosity of plaintiffs, commonality of questions of law or fact, typicality of claims and the adequacy of the class representatives. Under Section 23(b) the Court also was satisfied as to the predominance of common issues and generally as to the superiority of class action treatment over other forms. However, it found that the inclusion of non-US purchasers raised a question under the superiority criterion, namely whether foreign jurisdictions would preclude shareholders in such jurisdictions who had not opted out of the US action from pursuing their claims.[28] The Court determined that the standard for exclusion was 'the closer the likelihood of non-recognition is to being a "near certainty", the more appropriate it is for the court to deny certification of foreign claimants'.[29]

[26] Including statements made to analysts and investors in New York and the key fact that the CEO and CFO moved to the US allegedly to better direct operations and to correct misleading perceptions on Wall Street.

[27] In re Vivendi Universal, S.A. Securities Litigation, 381 f.Supp.2d 158 (S.D.N.Y.2003).

[28] In re Vivendi Universal, S.A. Securities Litigation 2007 WL. 861147 (S.D.N.Y. 22 March 2007) and 2007 WL 1490466, FN (S.D.N.Y. 21 May 2007).

[29] In re Vivendi Universal, S.A. Securities Litigation, 2007 WL 1490466 at 18 (S.D.N.Y., 21 May 2007).

After consideration of competing affidavits by the parties concerning the foreign law on that subject for France, England, the Netherlands, Germany and Austria, the Court concluded that Germany and Austria were not sufficiently certain to enforce such a US judgment for damages although the other countries would. Therefore it excluded investors from those two countries from the class in fairness to the defendant.

First, I summarize the *Vivendi* court's finding of likely enforceability in France, England and the Netherlands.

A. France

Given that Vivendi was based in France and the majority of the non-US shareholders were French, the Court devoted most of its attention to the law of that country. The *Vivendi* court's finding as to France illustrates how a US court is likely to approach the issue. The main points the *Vivendi* court made in deciding that French courts would give preclusive effect to a US class action judgment were:

1. While there is no treaty between the US and France for the enforcement of judgments and there has been no decision in France on any foreign class action judgment, there are French decisions enforcing foreign judgments generally (p. 38).
2. Before a foreign judgment can be enforced in France it must be subject to an *Exequatur* procedure, whereby, if recognized, the foreign judgment is incorporated in the *Exequatur* and then enforced.
3. The leading case on the grant of *Exequatur* is the *Munzer* case decided by France's highest court, the *Cour de cassation*.[30] Pursuant to that case, the four conditions that must be met are: (1) the foreign court must have proper jurisdiction; (2) the foreign court must have applied the appropriate law; (3) the decision must not contravene public policy; and (4) the decision must not be a result of *fraude a la loi* (evasion of the law) or forum shopping.
4. With respect to the jurisdictional prong, among other things, the defendants' experts pointed out that in 2002 an association of minority shareholders ('ADAM') petitioned the Paris Commercial Court to investigate the claimed fraudulent actions of Vivendi. That court found the claims were 'ill-founded' and dismissed them. Subsequently, the defendants said, the head of ADAM [Mme. Colette Neuville] stated

[30] In re Munzer, 7 January 1964, *Bull. Civ.* 1, °15.

that the dismissal caused her to introduce a class action in the US on behalf of ADAM's shareholders. Defendants argued that these events showed an attempt to evade French law. However, the *Vivendi* court ruled that because the French substantive law on securities fraud was similar to that of the US the jurisdictional prong was satisfied.

5. As to the appropriate law prong, the Court concluded that while there were procedural differences between French and American law, that aspect should be considered under the public policy prong. As to the rest, the Court held that the substantive similarities were sufficient under the doctrine of equivalence to satisfy the appropriate law prong.
6. The *Vivendi* court next addressed the public policy issue. It conceded that the fact that opt-out class actions are not currently permitted in France was some indication that such actions were contrary to French public policy. But it said the issue is whether such actions infringe the principles of universal justice. The defendants' experts argued that a number of procedural rules in France gave very clear rights to parties that required their participation individually (the 'right to be heard'). Plaintiffs' experts countered that France already authorized group actions by unions on behalf of employees. They also pointed out that shareholder associations have the right to sue companies and directors and to solicit proxies from individual shareholders (using mail and public notice) to act on their behalf.[31]

The Court said that these types of collective actions 'do not evince a fundamental hostility to the concept of collective actions'.[32] Accordingly, the Court concluded that an opt-out class judgment would not offend French concepts of international public policy. The Court went on to say that while such class actions are currently not permitted, 'it is equally clear the ground is shifting quickly'. The Court referred to then President Chirac's creation of a commission in April 2005 to study the introduction of a sort of 'class action' for relationships with consumers. Defendants pointed out that the majority of the commission members had viewed the opt-out class action as contrary to French law although

[31] In fact, during the 1990s, provisions for collective actions were enacted or amended for consumers (Art. L. 422–1 of the Consumer Code), for victims of environment violations (Environmental Code L.142–3) and for investors (Financial and Monetary Code L.452–2). However, in the case of investor associations there has been almost no activity. ADAM itself is not under that regime but under the general association law of 1901.

[32] *Vivendi*, 49.

some favoured it. The Court concluded that the views of the President and the debate on the subject 'is strong evidence that the class action model is not so contrary to public policy that its use would likely be deemed an infringement of "principles of universal justice" or contrary to "international public policy"'.[33]

The issue of the enforceability in France of a US judgment in a securities class action is probably academic in the *Vivendi* case since Vivendi has substantial assets in the US against which to satisfy any claim for damages. The situation that would be likely to present that issue would be where the defendant has insufficient assets in the US but has such assets in France.

B. England

As there is no convention or statute on the *res judicata* effect of a US class action judgment in England, the issue must be addressed under the common law. The Court concluded that 'English courts are more likely to find US courts are competent to adjudicate with finality the claims of absent class members and therefore would recognize a judgment or settlement in this action.'[34] That determination was based largely on the fact that English representative actions will bind those on whose behalf a claim is brought including persons who are not parties to the claim with the court's permission.[35]

C. Netherlands

Based on an unopposed affidavit of Professor Smit that Netherlands courts would give binding effect to a judgment in or settlement of a US class action, the *Vivendi* court included Netherlands investors in the class. As a further basis for that determination, the Court referred to recently enacted class action legislation 'in other contexts', undoubtedly a reference to the Netherlands Act on Collective Settlement of Mass Damages discussed above in relation to the *Shell* case.

Now I turn to those countries whose plaintiffs the *Vivendi* court excluded from the class because of doubts about enforceability of its judgment.

[33] *Vivendi*, 51. [34] *Vivendi*, p. 55.
[35] Rule 19.6 of the 1998 Civil Procedure Rules and Section 4(b).

D. Germany

The first hurdle for the enforcement of a US opt-out class action judgment in Germany would be Article 103 of the German Constitution, which establishes the right of a citizen to be heard and to participate in a legal proceeding. Based on the views of the parties' experts the Court concluded that there are reasonable means available to give actual notice of opt-out rights to class members, but that a US judgment would not be enforced against a class member who did not receive actual notice. The Court went on to note that, unlike France and England, Germany does not have collective actions. Even the recent Capital Markets Model Case Act does not provide for collective actions.[36] Rather, where there are multiple plaintiffs in a securities law matter, a test case can be used whose outcome will be binding on the other individual shareholder actions. Non-party shareholders, however, are not bound by the results. Thus the Court determined that 'the formalities of German law may well preclude the recognition of a judgment in the instant case'.[37]

E. Austria

Austrian law requires formal reciprocity between the foreign state and the Republic of Austria as a condition of recognition of a foreign judgment. No such treaty exists with the US, so the Court concluded that Austrian investors should be excluded from the class.[38]

The *Vivendi* court's voyage into foreign law produced determinative distinctions as to the enforceability of a US opt-out class action judgment in the five countries examined. However, the differences relied on between, for example France (would enforce) and Germany (would not), seemed to be neither apparent nor real. Both countries respect almost universally the 'right to be heard', which is enshrined in the European Convention for the Protection of Human Rights and Fundamental Freedom (ECHR) to which Germany and France are parties. Undoubtedly the fact that Vivendi was a French-based entity and the majority of its non-US shareholders were French, exerted pressure to

[36] KapMuG (16 August 2008). The Act was adopted in response to the fact that in 2003, some 15,000 shareholders of Deutsche Telecom flooded a court in Frankfurt with 2,500 suits brought by 700 attorneys alleging false statements related to its real estate in a share offering; the stock had fallen over 80%.

[37] *Vivendi,* 58. [38] *Vivendi,* 58.

include its plaintiffs in the class. As noted in part IV, the validity of that holding has been questioned by a French academic specialist who was not one of those whose affidavits were proffered by a party.

IV. Selected collective action developments in Europe

It is perhaps useful to offer a few general observations about collective actions before discussing specific developments by country:

1. The distinction between collective actions and class actions is that the former are opt-in and the latter are opt-out thus creating a class.
2. The concept of collective actions has existed for varying periods of time in many European countries. However, (a) such collective actions almost universally are limited, often to particular subject matter such as consumer fraud or unfair competition, (b) either the law itself or the government determines what organizations are authorized to bring such actions, and (c) such actions are only for injunctive relief and not damages.
3. Such collective actions for injunctive relief are of limited use and are regarded as a neither very important supplement to nor a substitute for government enforcement of the law.
4. In some situations and with increasing frequency, there has been pressure from organizations and academics to broaden the scope of collective actions to include claims for damages since government enforcement generally does not result in restitution to those injured.
5. Almost universally, those seeking to broaden the scope of collective actions also make plain their desire to avoid the perceived excesses of the US-style class action system.
6. Two European countries, Italy and Denmark have attacked the matter head on effective this year: they have enacted class action laws. What remains to be seen is if a real system for pursuing such actions will evolve especially in the absence of the contingent fee incentive which is the engine of the US system.

Some of the more recent variations short of class action laws devised to overcome the existing obstacles to collective actions include: (1) the German model case concept currently being employed in actions against Deutsche Telecom; (2) the Netherlands collective settlement law used in Shell referred to above; (3) the ad hoc attempt by a Belgium company, CDC, to pursue in Germany the claims of twenty-nine cement buyers who have assigned their claims to them; and (4) the launch of a fund in

the UK by Allianz, the German insurance company, to finance certain kinds of actions. These and other developments are discussed below.

A. Denmark's new class action law

The Danish law on class actions which went into effect on 1 January 2008, along with the new Italian law referred to next, goes a long way towards meeting the need for redress of multiple victims without any of the perceived disadvantages of the US system. Basically the law provides for a full opt-out class action where a public authority such as the Consumer Ombudsman brings the claim and an opt-in collective action by all other authorized representatives of the claimants.[39]

Thus the Ombudsman 'can sue a business on behalf of hundreds or even thousands of consumers . . . where[by] the consumer is [a] member of the group unless he or she chooses to opt our of the claim', provided the court has allowed it.[40] The court's decision in a class action has a binding effect (i.e. is *res judicata*) on the class members covered by the action, that is, all who opt in or who fail to opt out in an action where the opt-out procedure is authorized. Class actions can be brought in almost any area of the law including securities, torts, consumer fraud and anti-competitive behaviour but not family law.

The manner in which the new Act deals with the loser pays risk is instructive: unless a member of a class action group has insurance or is entitled to legal aid, the court can decide that participation is conditioned upon each member providing security for costs. However, such security will be the maximum cost that can be assessed to such member (plus any damages received if there is a partial victory). Unlike England where legal fees of a winning defendant may represent a substantial risk to plaintiffs, the costs assessed in many Continental countries such as France tend to be relatively low and more like court costs in the US.

As to who will take on such class actions in Denmark, Professor Werlauff notes that one legal chain of over seventy firms as well as one of the biggest firms have registered domain names looking to be involved in these new class actions.[41]

[39] See, 'Class Actions in Denmark – From 2008', by Professor Erik Werlauff, Aalborg University, Stanford/Oxford Conference on 'The Globalization of Class Actions' (13–14 December 2007, 'Stanford Conference').

[40] *Ibid.*, 3. [41] *Ibid.*, 7–8.

B. Italy's new class action law

In Italy, a new law goes into effect on 1 July 2008 allowing for collective actions for damages by consumer organizations.[42] A class action can be brought by an accredited association (there are currently sixteen) against any commercial, financial or insurance enterprise for damages arising from (1) standard form contracts, (2) tort liability, (3) unfair trade practices and (4) anticompetitive practices affecting a group of consumers.

To participate, consumers must opt in by writing to the association and the court decision will only be binding on those who do so. Since a consumer can opt in until the last hearing on appeal, there is a possibility consumers will wait to the last minute creating a potential substantial increase in the damages.

The court in such class actions does not award a specific amount of damages but it sets out the criteria for determining the amount to be awarded. The defendant has sixty days from the court's decision to make an offer. If either it does not make an offer or the consumers do not accept the offer, it will go to binding arbitration. One consumer organization, Adusbef, has already announced it plans to file an action against banks for using compound instead of simple interest on loans which Adusbef claims violates Italian law.[43]

C. France

In 2006, bills were introduced in the legislature for a system of collective actions for consumers. The legislation was abandoned at the end of 2007 in the light of the coming presidential and legislative elections. In July 2007 after he was elected President, M. Sarkozy instructed his Minister of Economy, Finance and Employment Mme. Lagarde and the Minister for Consumer Affairs and Tourism M. Luc Chatel (the author of one of the 2006 bills) to prepare legislation that would permit collective actions based somewhat on the American model but denominated '*class actions à la Francaise*'. He did warn against class actions that could lead to the bankruptcy of an enterprise (perhaps like the asbestos cases in the US).

[42] Amendment to Italy's Consumers Code §140bis enacted 21 December 2007. There is a story that the law was passed in the Senate only because one of its opponents pushed the wrong button and voted for it – providing the crucial margin. See, Dewey and LeBoeuf, L.L.P. Client Alert 'Class action in Italy' (4 February 2008) citing 'Class Action *per un voto*', in *II Sole 24 Ore*, 16 November 2007, 3.

[43] Reuters, 9 January 2008.

President Sarkozy, having asked M. Jacques Attali, a former key adviser of the late President Mitterrand, to lead a study of ways to grow the French economy, received his Report on 23 January 2008. Recommendation 191 was to introduce collective actions for consumers brought by their associations, provided that only those consumers opting-in would be included. The Report considered that the introduction of such actions would contribute to the confidence of consumers while at the same time avoiding moving to an American class action system. On 23 January 2008, President Sarkozy seemed to back off somewhat from such a class action proposal saying that he wanted more reflection on the subject 'because I do not want to have all the inconveniences of American society without all the advantages. I see well the intent but I see it only for certain enterprises.'[44]

In a comprehensive analysis of the French law on class actions for the Stanford Conference,[45] Professor Veronique Magnier, commented on the *Vivendi* decision holding that French courts would enforce a US opt-out judgment. She did not specifically dispute the *Vivendi* court's determination that the French concept that the identity of the plaintiff must be known[46] was really for the protection of defendants and should not apply in a securities fraud case.

However, she did question whether the opt-out procedure would be sustained in view of the 'right to be heard' guarantee under French law[47] especially given the 1989 decision of the *Conseil constitutionnel*.[48] There, the *Conseil* ruled in a decision regarding labour unions that can bring actions on behalf of employees, that each employee must be given 'the opportunity to give his assent with full knowledge of the facts and that he remain free to personally conduct the pursuit of his interest'. Professor Magnier concluded that 'the freedom of bringing or not bringing one's own action lies at the heart of this decision . . . [and] most academics have interpreted this decision as condemning any opt-out system'.[49]

An example of the difficulty in France of obtaining damages for injured consumers is the recent mobile phone case. The Competition Commission found a conspiracy to allocate market share among three

[44] www.20Minutes.fr, 23 January 2008. Remarks made in the course of commenting on the Report of the Attali Commission.
[45] Stanford Conference on 'The Globalization of Class Actions (2007) ('Magnier Report').
[46] Ibid., *Nul ne plaide par procureur.*
[47] Ibid., *Principe du contradictoire.*
[48] Dec. Cons. Const. No 89–57, 25 July 1989.
[49] Magnier Report, (note 45, above), 12–13.

mobile telephone operators who were fined substantial amounts, but no provision was made by the Commission for the victims. UFC-QUE CHOISIR, a consumer group, wanted to recover damages for consumers. It set up a website where consumers could calculate their damages and sign up for the action. After investing €500,000, less than 1% of those affected signed up.

D. Germany

While the *Vivendi* Court probably correctly excluded German plaintiffs because of the constitutional right of a citizen to be heard in court, contrary to the Court's summary, Germany does have collective actions, in one example going back to the nineteenth century.[50] In general, however, suits by consumer groups and other authorized interest groups cannot seek monetary relief but only injunctive action. There are some minor exceptions where individual consumers can assign their claims for monetary relief to an association. Under another statute, profits from unfair competition violations can be claimed from the perpetrators by certain organizations on behalf of consumers, but the recovery goes to the state not to those injured.[51] In the *CDC* case mentioned above, a lower court has upheld the representation of the claimants by the assignee, but there remain questions under the Legal Advice Act that limits the provision of legal advice to qualified persons or institutions which may be a stumbling block.[52] Another special case is where after a squeeze out, one or more minority shareholders file a challenge via a valuation proceeding (*Spruchverfahren*). The decision of the court is binding on all shareholders irrespective of whether they join the proceedings.[53]

It should also be noted that there are several disadvantages to the Capital Markets Model Case Act. The first is the time it takes for the

[50] Unfair Competition Act, UWG §3.

[51] Unfair Competition Act §10.

[52] See, Stanford Conference paper of Dr. Dietmar Baetge of the Max Planck Institute for Corporate and International Private Law, 11.

[53] As in other European countries, where a resolution put to shareholders is contested and a court voids the resolution, all shareholders are affected. In the case of resolutions that must be filed in a commercial registry, such as for share capital increases or mergers, some abuses have arisen in Germany and elsewhere involving significant and potentially harmful delays (e.g. a Nestlé share increase was delayed for two years in Switzerland by the action of some shareholders). In Germany, some legislation has aimed to reduce similar abuses, but not with full success. Here again, the action has a certain collective aspect, albeit not a collective action for damages.

courts to select the model case and have it confirmed on appeal. The second is the fact that counsel for the model plaintiff does not receive any extra compensation albeit has a special burden because it is the model. The third is that the loser pays regime applies albeit the cost is split among all plaintiffs and not just the model case plaintiff. The fourth and possibly most problematic is the fact that once the courts rule in favour of plaintiffs in the model case, other claimants can file their cases knowing there is a kind of *res judicata* in their favour and little risk of having to pay as a loser. One of the advantages of the Model Case procedure is that the court reviews the case at the pleading stage and can shut out weak claims. That Act was expressly intended as a test of that kind of procedure. It is set to expire on 1 November 2010, although Dr. Ditmar Baetge of the Max Planck Institute for Corporate and International Private Law has predicted that it will not only be made permanent but extended more broadly to collective actions of all sorts.[54]

In 1999, Dr Baetge's Institute proposed allowing claims for compensation in most collective actions and some form of opt-out class action for securities and product liability cases. To date these proposals have not been implemented by the legislature.

In March 2007 the German Supreme Court struck down the prohibition on contingent fees as unconstitutional, holding the prohibition of such fees hindered a plaintiff from enforcing his rights. The legislature is supposed to come up with a new law by mid-2008.

E. European Union

EU directives relative to a number of consumer protections include an obligation of Member States to implement collective action measures but only for injunctive relief.[55] As to the future, the EU's paper on Consumer Strategy 2007–2013 included a consideration of collective actions for damages.[56] A Commission Study led by Professor Jules Stuyck on alternative means of consumer proceedings, found that the economic

[54] See, Stanford Conference paper of Dr. Dietmar Baetge of the Max Planck Institute for Corporate and International Private Law, 8.

[55] See, for example, Council Directive 93/13/EEC [1995] OJ L95/29, art. 7.1 (unfair terms in consumer contracts). The Office of Fair Trading in the UK was able to get an injunction there against a Belgium catalogue being sent to UK residents, which injunction was then enforced in Belgium. See, Council Regulation on jurisdiction and recognition and enforcement of judgments in civil and commercial matters EC No 44/2001 [2001] OJ L12/1.

[56] COM (2007) 99, 13 March 2007.

literature about cost–benefit justification for consumer collective action did not reach a consensus. The Study identified ECHR Art. 6 and Member State constitutional guarantees of the right to be heard, as obstacles to opt-out class actions.[57]

F. England

In England, two principal methods exist for collective actions: (1) procedural rules, primarily Group Litigation Orders (GLOs);[58] and (2) statutory procedures mostly regulatory in nature in the consumer area. There have been few consumer actions by the organizations authorized to do so largely because of cost considerations. One such consumer organization, 'Which?', brought its first collective action, after a price-fixing charge by the OFT against a T-shirt maker. The defendant had been fined for price fixing by the Competition Appeal Tribunal and appeals were denied – a requisite to the commencement of the consumer organization action. The 'Which?' case will be heard by the same Tribunal. If 'Which?' is successful, consumers will provide proof of purchases to the defendants. If defendants refuse to pay, claimants will have to file their own claims.[59]

In the securities field, the UK Financial Services Authority (FSA) has among its available remedies the right to petition a court to order restitution for investors for violations of securities regulations.[60]

While there is considerable opposition in England to US-style class actions, success fees are allowed in certain circumstances but limited to 100% of the base fee and up to 25% of damages awarded.[61] A big difference from the US, however, is that the loser pays the fees of the winner; in collective actions that represents a significant deterrent to joining the action. One solution to that problem is after-the-event insurance (ATE). ATE is generally sought by claimants and/or third-party funders to insure the loser pays obligation and may in fact be required in certain circumstances. ATE insurance does not cover plaintiff's' counsel

[57] Commission Study of Alternative Means of Consumer Proceedings, Professor Jules Stuyck et al., April 2007. See also Professor Christopher Hodges, Summary of European Union Developments, Stanford Conference ('Hodges Report').

[58] Civil Procedure Rules, Part 19 III. The GLO is a procedure for centrally managing numerous cases revolving around similar claims. It is, in effect, an opt-in mechanism of collective action.

[59] The action was brought under the Enterprise Act 2002. See, 'Which? Takes legal action on overpriced replica shirt', *The Guardian*, 9 February 2007.

[60] Financial Services & Markets Act, 2000. ss 382 & 383.

[61] Conditional Fee Agreements Regulations 2000, S I 2000/692. reg. 3 (1) (a).

fees although plaintiffs' counsel will frequently work on the basis of 'no win, no fee'.[62] While obtaining ATE insurance for a group of claimants in commercial litigation would require something more bespoke than standard, there are many providers of such insurance who pride themselves on innovative products and pricing including a number of Lloyd's syndicates.[63]

Towards the end of last year, the giant German insurer, Allianz launched a fund in London to finance litigation in exchange for a percentage of the damage proceeds. And, at least one law firm has set up a working party to consider offering funding to clients. A Clifford Chance partner commenting on the Allianz fund said that third party funding 'could give class action activity in the UK and Europe a boost [and] . . . will start to chip away at the structural differences between UK and US litigation'.[64] Third-party funding in the UK is already becoming a competitive market that has even attracted hedge funds. It should be noted that while the ancient torts of champerty and maintenance are no longer crimes, they still have some viability, despite the lack of strict enforceability.

The principal advantage of third-party funding over US contingency fee class actions initiated by lawyers would seem to be that the latter is lawyer driven and stirs up litigation, whereas the former is claimant driven. Third-party funding separates the issue of lawyers' fees from that of financing the cost of the litigation. Such separation should result in more transparent and better pricing of the two different services. An area where third-party funding has been employed both in the US and England is in insolvency proceedings. There the company liquidator seeks to recover from creditors, management and professionals such as accountants of the defunct enterprise but has limited funds for doing so.

There are currently a number of entities in England ready to offer third-party funding or brokerage services. The latter seek to find the

[62] Some countries such as Switzerland prohibit such fee arrangements.

[63] At the request of a third-party funder, the Supreme Court of Switzerland struck down a Zurich cantonal law in 2004 that prohibited third-party funding and lawyers from accepting such funding with the exception of normal liability insurance coverage. The court decided that the freedom to make contracts was important for people like plaintiffs and only incidentally affected the independence of the lawyers. The court cautioned, however, that lawyers should serve the interest of the client in any conflict with third-party funders. See, *L. Gmbh* v. *Kantonsrat des Kantons Zurich*, ATF 131 I 223 (December 2004). A bill (H.R. 5463) was introduced in the US Congress in February 2008 which would make plaintiffs' counsel pay for the fees of the defendant if plaintiffs lose.

[64] www.legalweek.com, 18 October 2007.

best match for a plaintiff or its counsel with a funder who either has special expertise in the type of claim or has the most attractive financial proposal or both. One of the reasons for the activity in third-party funding in England is the support for it from the OFT[65] and the Civil Justice Council.[66] In addition to Allianz, mentioned above, third-party funding has attracted the interest of private equity and hedge funds who, as might be expected have introduced sophisticated methods of financing. In one case, the claimant, a small technology firm suing a larger one for patent infringement sold a zero-coupon note to a private equity fund, Altitude Capital Partners, and agreed to provide the fund with a percentage of the recovery that would be reduced as the amount increased.[67] While a small investor in England would have no incentive to seek out third-party funding for a collective action for securities fraud, an institutional investor might.

Is third-party funding of court litigation or arbitration an important middle-ground solution of the kind Europe has been searching for? It may well be, although there is not yet enough experience with it in England, the US and Germany. In other countries like France it may well not be permissible.[68] Moreover, if there is no structure for collective actions by numbers of claimants, the availability of funding would not matter.

V. Conclusion

The search for a middle ground between the perceived excesses of the US class action system and the current generally ineffective collective action procedures in Europe has accelerated. Class action statutes in Italy and Denmark are effective this year. While they are very European versions and are yet to be tested, they offer a useful model for other countries. The Denmark law goes farthest in (1) providing an opt-out feature if brought by the Ombudsman and approved by the court, (2) that it is applicable in

[65] In late 2007 the OFT, in relation to competition law actions, stated: 'The OFT takes the view that third-party funding is an important potential source of funding . . . third-party funding should be encouraged.' See, 'Fighting Funds' 21 January 2008, at www.thelawyer.com.

[66] The Civil Justice Council in a 2007 white paper stated that: 'third-party funding should be recognized as an acceptable option for mainstream litigation.' *Ibid*.

[67] www.legalweek.com, 18 October 2007.

[68] See, Freshfields Bruckhaus Deringer, June 2007 Client Alert, 'Class actions and third party funding of litigation', p. 2.

most areas of the law including securities actions, and (3) that it contains a method for minimizing the loser pays risk.

Other European countries have taken more indirect paths. Germany has a model case procedure. The Netherlands has an opt-out provision, but only for class action settlements not damage actions. England has adopted procedural rules for collective actions (GLOs) but they have not seen much use. On the other hand, actions by authorized consumer organizations for damages have begun and the FSA already has the power to both sanction persons subject to its jurisdiction and order restitution to investors with the approval of a court. And, third-party funding of litigation as well as ATE insurance for the loser pays risk, have become accepted and available in at least some European countries.

In the European Union the issue of the need for some form of collective action for damages has been raised and other countries such as France are debating class actions. Meanwhile, in the securities field France could allow the AMF to affect restitution to investors as proposed in my wife's companion essay, next.

As has often happened in the field of securities law, Europe lags behind the US but sometimes finds different and more moderate solutions. European countries are unlikely to settle on a single model for collective or class actions despite the efforts of the European Union to harmonize national laws. However, as more experience is gained with the variety of approaches already being taken and others that have been proposed, Europe may develop an effective middle-ground procedure for multiparty claims while avoiding the pitfalls in the US class actions system.