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Work Session:
Trends in Shareholder Litigation: Are Your Investments Protected?

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RECENT TRENDS AND DEVELOPMENTS IN SECURITIES LITIGATION

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This paper provides a general overview of several recent developments and trends concerning securities litigation in the United States and abroad. Specifically, we briefly discuss: (1) circumstances where it may be appropriate to actively pursue litigation as an individual rather than seeking appointment as a "Lead Plaintiff" or remain a passive member in class action litigation; (2) recent court rulings affirming the right of European institutional investors to serve as Lead Plaintiffs; (3) the impact of recent judicial rulings concerning statutes of repose on investors' ability to delay the decision to actively pursue individual litigation; and (4) the continued spread of securities litigation outside of the United States.

I. Individual and Opt-Out Securities Litigation

The Securities Act of 1933 (the "Securities Act") and the Securities Exchange Act of 1934 (the "Exchange Act") are the two primary federal laws that regulate securities markets and securities transactions in the United States. Claims under the Securities Act (generally applicable to securities purchased in a public offering) and Exchange Act (generally applicable to securities purchased in the secondary market, such as on a stock exchange) can be pursued as either individual actions or as class actions.

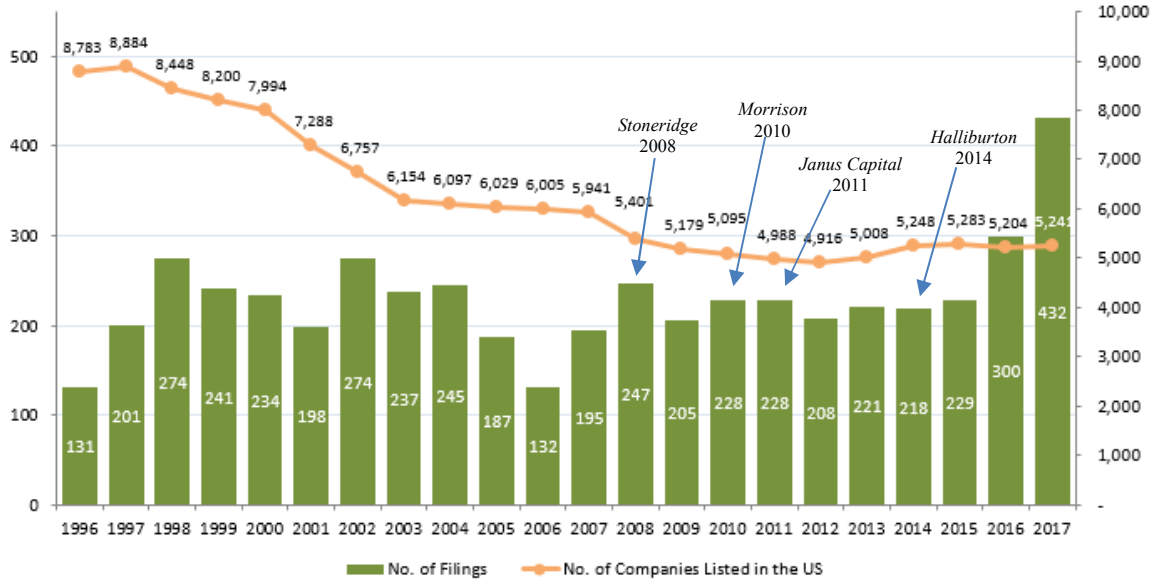
The class action mechanism, which is governed by Rule 23 of the Federal Rules of Civil Procedure, is a powerful procedural tool to hold defendants accountable for widespread damages caused to a large number of victims, particularly in securities cases where many investors may not have damages sufficient to support the cost of prosecuting individual claims.

When a class action asserting claims under the Securities Act and/or the Exchange Act is filed, an investor with potential claims typically has three options: (1) seek appointment as the Lead Plaintiff responsible for prosecuting the claims on behalf of a class of similarly situated investors; (2) remain a passive class member who will recover damages only if the Lead Plaintiff successfully litigates or settles the class action; or (3) file an individual action in order to directly litigate its own claims.

Disclaimer:

This article is intended to provide a background on shareholder class action litigation and trends, serving as a lead plaintiff, and litigating an action. However, it is not intended as a substitute for legal advice with your chosen counsel or your discussions with counsel as to the merits of each particular action you may consider. The purpose of this article is to provide general information only. Nothing herein constitutes legal advice, and prior results are no guarantee of similar outcomes in the future.

As set forth in the chart below, securities class action filings in 2017 were at their highest levels since the enactment of the Private Securities Litigation Reform Act of 1995 (the "PSLRA"):[1]



However, the higher rate of filing was accompanied by a higher dismissal rate.[2] These figures confirm the need for investors to retain counsel capable of appropriately analyzing cases and ensuing that recommendations are made with the benefit of legal and factual analysis and not strictly based on the size of market losses.

A. Serving as Lead Plaintiff

The PSLRA, 15 U.S.C. § 78u-4(a)(3) and 15 U.S.C. § 77z-1(a)(3), establishes the process which governs the appointment of the Lead Plaintiff in federal class action lawsuits asserting claims under the Securities Act and/or the Exchange Act. As an initial matter, the PSLRA requires the plaintiff filing a class action lawsuit to publish notice advising investors of the pendency of the action. The notice informs investors that any class member may apply to the court to serve as the Lead Plaintiff within sixty days of the publication of the notice. *See* 15 U.S.C. § 78u-4(a)(3)(A); 15 U.S.C. § 77z-1(a)(3)(A). The purpose of the initial notice, and the sixty-day period that follows,

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[1] Data provided by NERA Economic Consulting. Data from 2001 excludes the IPO laddering litigation. The chart also identifies landmark decisions from the Supreme Court of the United States concerning the federal securities laws: *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc., et al.*, 552 U.S. 148 (2008) (limiting third-party liability under Section 10(b) of the Exchange Act); *Morrison v. Nat'l Australia Bank Ltd., et al.*, 561 U.S. 247 (2010) (limiting extraterritorial application of the federal securities laws); *Janus Capital Grp., Inc., et al. v. First Derivative Traders*, 564 U.S. 135 (2011) (defining who "makes" a statement under the federal securities laws); *Halliburton Co., et al. v. Erica P. John Fund, Inc.*, 134 S. Ct. 2398 (2014) (reaffirming presumption of reliance under the fraud-on-the-market doctrine).

[2] *See generally* Stefan Boettrich and Svetlana Starykh, *Recent Trends in Securities Class Action Litigation: 2017 Full-Year Review*, NERA ECONOMIC CONSULTING, 2018 (58% of cases resolved in 2017 were dismissed—with 40% of cases dismissed in 2017 being dismissed within one year of filing).

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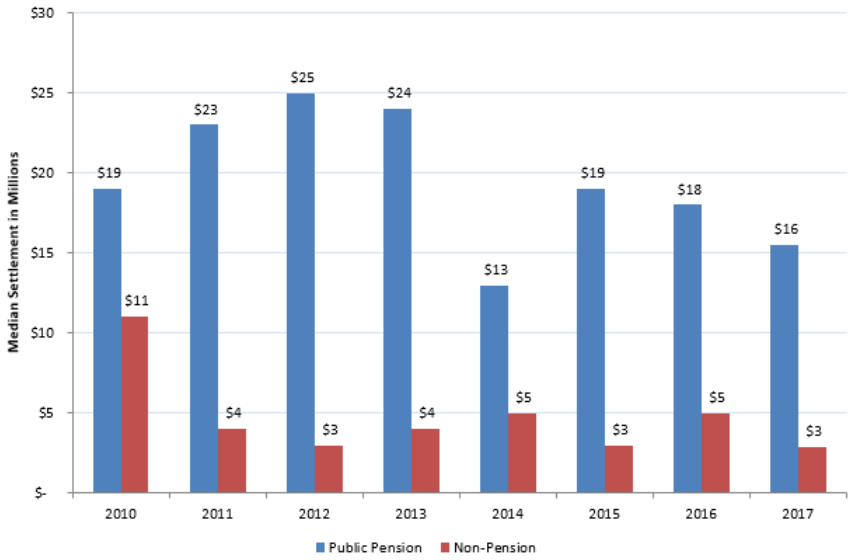
is to alert potential class members to the commencement of the litigation and to provide investors with sufficient time to analyze their losses and consider whether to move to be appointed Lead Plaintiff.

Once appointed by the court,[3] the Lead Plaintiff is responsible for managing the litigation by overseeing and monitoring the progress of the action and Lead Counsel's efforts. The Lead Plaintiff also provides input on litigation and settlement strategies. The decisions made by the Lead Plaintiff, who acts as a fiduciary for all members within a class, generally bind every passive class member. Moreover, settlement data confirms the trend showing that class action litigation under the federal securities laws led by public pension funds produces a higher median settlement than litigation led by non-pension investors:[4]



B. Courts Continue to Affirm European Investors' Ability to Act as Lead Plaintiffs

Non-U.S. institutional investors have served as Lead Plaintiffs in several historic shareholder actions in the U.S. including, for example, *In re Bank of America Securities Litigation*, which settled investors' claims for $2.4 billion and included significant corporate governance reforms. As the influence of Lead Plaintiffs domiciled outside of the United States increases, historical concerns about the appointment of non-U.S. investors continue to dwindle. For example, the court in *Boynton Beach Firefighters' Pension Fund v. HCP, Inc., et al.*, No. 16-cv-01106-JJH (N.D. Ohio Nov. 28. 2017), recently reaffirmed the right of European investment management companies to assert claims under the U.S. securities laws on behalf of their managed funds (or

[3] The PSLRA creates a rebuttable presumption that the plaintiff with the largest financial interest (of the movants seeking appointment) in the litigation should be appointed as Lead Plaintiff so long as the plaintiff is both adequate and typical of other class members. *See* 15 U.S.C. § 78u-4(a)(3)(B)(iii); 15 U.S.C. § 77z-1(a)(3)(B)(iii).

[4] 2010-2016 data provided by Cornerstone Research; 2017 data provided by Institutional Shareholder Services Inc.

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sub-funds). In *Boynton Beach*, the court appointed Société Générale Securities Services GmbH ("SocGen") as Lead Plaintiff under the PSLRA and found that SocGen had standing to assert claims in connection with purchases of the relevant securities made on behalf of three of its managed funds (the "Funds").

Article III of the United States Constitution limits federal courts' jurisdiction to hear only actual cases or controversies. This requirement typically mandates the plaintiff before the court to have personally suffered an injury-in-fact. However, courts have long recognized a "prudential exception" to Article III standing whereby one party (*e.g.*, a management company) may assert the rights of another (*e.g.*, the management company's sub-funds) based on "a close relationship with the person who possesses the right" and "a hindrance to the possessor's ability to protect" their interests. Non-U.S. investment management companies, such as SocGen and other European investment managers, often rely on this exception to assert legal claims on behalf of their managed funds (and sub-funds) in situations where the managed funds (and sub-funds) do not have an independent legal identity or the ability to act in their own name. In such cases, the managed funds (and sub-funds) must rely exclusively on their investment managers to protect their interests and to represent them in judicial proceedings.

In *Boynton Beach*, competing movants argued that SocGen lacked Article III standing—and could not serve as Lead Plaintiff—because the relevant securities were not purchased by SocGen and were, instead, purchased by the Funds. To this end, competing movants argued that SocGen could only serve as Lead Plaintiff (and bring claims in connection with the Funds' purchases of HCP securities) if SocGen received a valid assignment of claims from the Funds. The *Boynton Beach* court, consistent with a majority of courts to consider this issue, disagreed and held that "[SocGen] falls within the prudential exception to [Article III] standing and may bring these claims on behalf of its [F]unds" without an assignment of claims. In reaching this conclusion, the court first determined that the Funds "are not considered legal entities" and "cannot bring suit on their own behalf" under German law. The court further concluded that investors in the Funds also lack the ability to bring suits on behalf of the Funds. Instead, under German law, SocGen was responsible for managing the Funds' assets and was "invested with authority to sue in its own name for damages suffered by investors of its funds." As such, the court found that SocGen—like other European investment managers previously appointed as Lead Plaintiffs—had standing under the prudential exception and could serve as Lead Plaintiff on behalf of its managed Funds.

Distinct from establishing standing under the "prudential exception," management companies with funds who are able to act (*i.e.*, have legal capacity) can eliminate standing questions by executing a simple assignment of claims. Assignments permit the assignee to litigate claims under its own name and have repeatedly been accepted by courts and the United States Supreme Court as conclusive evidence of standing. To this end, *Boynton Beach* addressed the validity of SocGen's assignment of claims as an alternative basis for standing. As stated by the court, "[t]he assignee of another's claim has constitutional standing to pursue that claim, 'even when the assignee has promised to remit the proceeds of the litigation to the assignor.'" Based on U.S. Supreme Court case law, *Boynton Beach* held that SocGen's assignments were valid and provided an independent basis for its standing.

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While *Boynton Beach*'s holding is not novel, the court's analysis reaffirms the majority view that European institutional investors, consistent with the well-developed standing rules, are fully able to act as Lead Plaintiffs in U.S. securities actions.

C. Pursuing Individual or Opt-Out Claims

As an alternative to serving as a Lead Plaintiff or remaining a passive class member whose recovery will depend upon the success of the class action, investors may consider filing an individual action (also known as an "opt-out" action if a class has been certified in a companion class action) in order to pursue claims and recover losses on their own behalf and without any direct involvement from the Lead Plaintiff.

While individual litigation allows an investor to actively pursue litigation in a manner specifically designed to maximize its own recovery—potentially recovering more than the investor would have recovered as a passive class member—filing an individual action is appropriate only in a limited number of circumstances. Given the absence of certain economies of scale attendant to the class action mechanism, the filing of an individual action is typically appropriate only when an investor has suffered substantial losses and the theory of liability is particularly strong.

For example, securities claims against Petróleo Brasileiro S.A.—Petrobras ("Petrobras"),[5] American Realty Capital Properties, Inc. ("ARCP"),[6] and Perrigo Company plc[7] have prompted substantial individual litigation by institutional investors who have exited pending class actions against each company. These cases against Petrobras, ARCP, and Perrigo are noteworthy in that they involve billions of dollars in investor losses and the disclosure of facts that strongly support liability against the defendants.

1. Petrobras

Petrobras, a Brazilian state-run energy company headquartered in Rio de Janeiro, Brazil, is currently embroiled in the largest corruption scandal in Brazilian history in relation to claims of collusion between company executives, contractors, and members of the ruling "Workers' Party" over the last decade. Through a series of disclosures beginning in March 2014, investors learned that senior Petrobras officials repeatedly authorized billions of dollars in overpayments on contracts with third-party contractors in exchange for personal bribes and the payment of kickbacks to dozens of high-ranking Brazilian politicians. As a result of these admissions and the Brazilian government's ongoing investigation, Petrobras was forced to take billions of dollars in write-downs as its market capitalization value declined substantially.

In response to these disclosures, class action litigation was filed in the Southern District of New York against Petrobras and certain of its current and former officers and directors. Given the size of investors' losses and the strength of the claims against the defendants, several large

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5 *In re Petrobras Sec. Litig.*, No. 14-cv-9662 (JSR) (S.D.N.Y.).

6 *In re American Realty Capital Prop., Inc. Litig.*, No. 15-mc-0040 (AKH) (S.D.N.Y.).

7 *Roofers' Pension Fund v. Papa, et al.*, 16-cv-02805-MCA-LDW (D.N.J.).

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institutional investors filed individual actions rather than participating as passive class members in the Petrobras class action. These investors include, among others: Aberdeen; Alaska Permanent Fund Corporation; Bill & Melinda Gates Foundation; Danske Invest; Dimensional Fund Advisors; Janus Capital; John Hancock; Lord Abbett; Manning & Napier; MassMutual; New York City Employees' Retirement System; Ohio Public Employees Retirement System; PIMCO; Russell Investment; SKAGEN; State of Alaska Department Of Revenue, Treasury Division; Transamerica; and Washington State Investment Board.

The court presiding over the class action certified two classes of investors under the Exchange Act and the Securities Act on February 2, 2016, and noted that "it is not uncommon for large institutions to opt out of class actions simply so that they can improve their bargaining position if, as usually occurs, settlement discussions begin."[8] Several of the opt-out plaintiffs settled claims (and received funds) in 2016 while the class action was on appeal. The class action was preliminary settled in early 2018. It is unclear when class members will receive any settlement proceeds.

2. ARCP

ARCP, now known as VEREIT, Inc., is a real estate investment trust ("REIT") that admitted in October 2014 to falsifying its reported adjusted funds from operations ("AFFO") figures—a critical financial metric for REITs—in order to appear more profitable. Specifically, the company conceded that certain "errors" in its financial statements were "intentionally made," while other "errors" were "identified but intentionally not corrected." Several days after this announcement, ARCP's Chief Accounting Officer—who had been forced to resign in connection with the accounting scandal—filed suit against ARCP, its Chief Executive Officer, and its Chairman alleging that the Chief Executive Officer and Chairman had directed her and the former Chief Financial Officer to ignore accounting issues and manipulate quarterly financial results in order to conceal the improper accounting. These disclosures eliminated billions from the company's market capitalization value and have since resulted in the company's Chief Financial Officer being found guilty on criminal securities fraud charges and the company's Chief Accounting Officer pleading guilty to criminal securities fraud charges.

Investors have filed class action litigation against ARCP in the Southern District of New York. Like the Petrobras litigation, the claims against ARCP are particularly strong—having survived defendants' motion to dismiss[9]—and investors have suffered substantial losses. As a result, several notable institutional investors have filed individual actions, including BlackRock, PIMCO, and Vanguard.

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[8] *See In re Petrobras Sec. Litig.*, No. 14-CV-9662 (JSR), 2016 U.S. Dist. LEXIS 12286, at *23 (S.D.N.Y. Feb. 2, 2016).

[9] *See In re American Realty Capital Props., Inc. Litig.*, No. 15-mc-0040, ECF No. 167 (S.D.N.Y. Nov.6, 2015) (denying, in substantial part, defendants' motion to dismiss class allegations).

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3. Perrigo

Perrigo, a manufacturer of specialty, generic, and over-the-counter pharmaceutical and health care products, is alleged to have falsely touted its near- and long-term growth prospects in order to convince investors to reject a 2015 hostile takeover bid from Mylan N.V. ("Mylan"), a competing pharmaceutical company. In the month's following Perrigo's successful defense of Mylan's takeover attempt, investors learned that—rather than having "compelling prospects for continued growth and sustainable, long-term shareholder value"—Perrigo had concealed from investors that pricing pressures were undermining sales in its prescription pharmaceuticals divisions and that the company's recently acquired branded consumer healthcare division was significantly underperforming. Moreover, the U.S. Department of Justice has executed search warrants at Perrigo's corporate offices in connection with its investigation into price collusion in the generic drugs industry—thereby calling into question Perrigo's assurances regarding the sustainability of its generic drug pricing strategy. These disclosures have eliminated billions of dollars from Perrigo's market capitalization value and resulted in substantial losses for investors.

While class action litigation is currently pending against Perrigo in the District of New Jersey, the strength of the allegations against the company and the claims available to investors from the defendants' successful efforts to defeat Mylan's tender offer have prompted direct actions from institutional investors. To date, Carmignac Gestion, Manning & Napier, and several other institutional investors have all elected to file individual actions rather than remain passive class members.

4. Individual Recovery Premiums

Data regarding the frequency and success of individual litigation is not robust given that, unlike class action settlements, individual and opt-out settlements are privately negotiated and do not require disclosure or court approval. However, a 2013 analysis from Cornerstone Research reported that 53 percent of class actions filed between 1996 and 2011 that resulted in settlements above $500 million had related individual and/or opt-out actions.[10] This data supports the notion that investors tend to pursue individual litigation in cases with significant losses. Moreover, Cornerstone Research provided anecdotal information from the individual recoveries in several securities actions—including litigation against AOL Time Warner Inc.[11] and Qwest Communications International Inc.[12]—demonstrating that certain institutional investors that filed individual and opt-out actions recovered far greater amounts than what they would have recovered had they remained passive class members (*e.g.*, "up to 90 percent of investor losses" or "38 times the size of what they would have received without opting out").[13] The potential for individual investors to obtain premiums over absent class members was recently acknowledged by the U.S.

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[10] Amir Rozen, Joshua B. Schaeffer, and Christopher Harris, *Opt-Out Cases in Securities Class Action Settlements*, CORNERSTONE RESEARCH, 2013, at p. 1 (the "Cornerstone Report").

[11] *In re AOL Time Warner, Inc. Sec. & "ERISA" Litig.*, No. 02-md-1500 (SWK) (S.D.N.Y.).

[12] *In re Qwest Commun. Int'l Inc. Sec. Litig.*, No. 01-cv-1451-REB-CBS (D. Colo.).

[13] Cornerstone Report at p. 4.

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Supreme Court in *California Public Employees' Retirement System v. ANZ Securities, Inc*. ("*CalPERS*"), where the Court stated that "plaintiffs who opt out have considerable leverage and, as a result, may obtain outsized recoveries."[14]

Nevertheless, individual and opt-out litigation, like all forms of securities litigation, are inherently uncertain and there can be no guarantee that individual plaintiffs will obtain any recovery premium from actively litigating an individual action rather than remaining passive class members.

II. Statutes of Repose and Individual and Opt-Out Litigation

While investors are permitted to file an individual action at any time prior to the certification of a class action, the recent *CalPERS* ruling concerning statutes of repose now requires investors to act more quickly (often at the outset of the class litigation) to decide whether filing an individual action is appropriate.

Generally speaking, "statutes of limitations" set the time limit on how long a plaintiff can wait to bring suit after discovering (or after a plaintiff should have discovered) that it has a claim. On the other hand, "statutes of repose" prevent a plaintiff from bringing suit after a certain amount of time has elapsed and ***do not*** take into consideration the timing of when the plaintiff first learned that its claims could be brought or whether a defendant actively concealed its wrongdoing. In order to avoid repose issues, claims under Section 10(b) of the Exchange Act must be brought within five years of the false and misleading statement, irrespective of when or if the falsity of that statement is discovered, and claims under the Securities Act may be brought no more than three years after the security at issue was offered to the public.

Since the Supreme Court's ruling in *American Pipe & Construction Co. v. Utah*, 414 U.S. 538 (1974), federal courts have held that the statutes of ***limitations*** applicable to claims under the federal securities laws are delayed (or "tolled") for individual class members while a securities class action is pending. However, *CalPERS* fundamentally altered the rules for securities fraud claims by holding that statutes of repose are not subject to *American Pipe* tolling.[15] The Court's ruling explains that repose periods "are enacted to give more explicit and certain protection to defendants" and "effect a legislative judgment that a defendant should be free from liability after the legislatively determined period of time."[16] Thus, the Court concluded that *American Pipe*'s tolling rule cannot toll statues of repose. *CalPERS* removes any ambiguity over whether investors have the ability to assess the developments in a class action before deciding to pursue an individual action. When an action involves repose risks, delay is no longer a suitable option. As the dissent in *CalPERS* noted: "Defendants will have an incentive to slow walk discovery and other precertification proceedings so the clock will run on potential opt outs. Any class member with a

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14 137 S. Ct. 2042, 2053 (2017).

15 *Id.* at 2055.

16 *Id*. at 2049.

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material stake in a [securities] case, including every fiduciary who must safeguard investor assets, will have strong cause to file a protective claim . . . before the [repose] period expires."[17]

Given that the abbreviated window to file an individual action may prevent investors from having the benefit of a court's substantive orders when deciding whether to pursue litigation, investors and their counsel must be more proactive in analyzing whether an individual action would be favorable over passive membership in a class.

III. Foreign Securities Litigation

In June 2010, the Supreme Court of the United States held in *Morrison, et al. v. National Australia Bank Ltd., et al.*, 561 U.S. 247 (2010), that claims brought under the U.S. federal securities laws only apply to domestic securities transactions. Specifically, the Supreme Court explained that coverage under the federal securities laws requires that the transactions at issue involve a "purchase or sale made in the United States, or involve[] a security listed on a domestic exchange." *Id.* at 269-70. In doing so, the Supreme Court effectively barred investors from bringing federal securities claims in connection with securities purchased on foreign stock exchanges even if conduct in the United States was central to the defendants' fraud. *Morrison* has had a seismic impact on the U.S. federal securities laws and the volume of securities actions pursued outside of the United States by U.S. and non-U.S. investors. Moreover, the Supreme Court's decision now requires investors to actively evaluate non-U.S. litigation opinions (for securities purchased outside of the U.S.) even if similar litigation is pending in the United States.

Since the Supreme Court's decision in *Morrison*, there has been an increase in foreign securities class and collective litigation—with a particular concentration of litigation in Australia, Canada, Japan, and several European countries. According to data provided by Institutional Shareholder Services, in the four years prior to the *Morrison* decision (2006 through 2009), an average of thirty-two foreign securities class and collective actions were filed per year. In the five years immediately following the *Morrison* decision (2011 through 2015), an average of forty-two foreign securities class and collective actions were filed per year.

Most recently, significant non-U.S. litigation/arbitration has been initiated on behalf of investors in the non-U.S. traded securities of Petrobras, Volkswagen AG ("VW"), Olympus Corp. ("Olympus"), and Toshiba Corp. ("Toshiba").

A. Petrobras

In addition to claims being pursued against Petrobras in the United States (in connection with U.S.-traded securities), a large group of institutional investors who purchased certain foreign Petrobras securities (including common and preferred stock traded on BOVESPA, the Brazilian stock exchange) has initiated arbitration claims in Brazil. Brazilian arbitration became necessary

[17] *Id.* at 2058.

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after the court overseeing the U.S. action issued an order in July 2015 requiring arbitration of claims pertaining to BOVESPA-traded securities.

As noted by the court's July 2015 order, "Article 58 of Petrobras' bylaws provides that 'disputes . . . involving the Corporation, its shareholders, managers and members of the Audit Board' regarding 'the rules issued . . . by the Brazilian Securities and Exchange Commission (Comissão de Valores Mobiliários—CVM) as well as in all further rules applicable to the operation of the capital market in general,' 'shall be resolved according to the rules of the Market Arbitration Chamber.'"[18] Plaintiffs in the U.S. class action had attempted to litigate claims under Brazilian law for BOVESPA-traded securities concurrently with claims under the federal securities laws and argued that the arbitration provision was a contract of adhesion and enacted without unanimous shareholder approval. Defendants argued that Article 58 requires arbitration of BOVESPA-traded securities and moved to dismiss these claims from the U.S. case. Defendants also provided expert reports undermining the legal basis for plaintiffs' arguments against enforcement.[19] The court agreed with the defendants, stating that "under Brazilian law, Petrobras' arbitration clause is valid and enforceable against purchasers of Petrobras securities on the [BOVESPA]."[20]

Investors' arbitration against Petrobras in Brazil is governed under the rules of the Câmara de Arbitragem do Mercado ("Market Arbitration Chamber" or "MAC"). Arbitration provides a number of advantages versus litigation of claims in Brazilian courts. First, in Brazilian courts, the losing party is required to pay a portion of the prevailing party's attorneys' fees and expenses, whereas the parties to an arbitration are free to waive fee-shifting (and if the parties do not agree, the arbitrators will decide prior to proceeding with the arbitration). Second, arbitration is significantly more expeditious than litigation in Brazilian court. Third, arbitration is conducted by a panel of three arbitrators: one chosen by plaintiffs; one chosen by defendants; and one chosen by the other two arbitrators. As a result, plaintiffs are not bound by the rulings of a single judge, who may be heavily influenced by the political ramifications of the claims against Petrobras. One potential challenge to arbitration in Brazil is that the proceedings typically are conducted with limited document discovery. Nevertheless, the arbitrators may be inclined to take a more active approach to discovery if requested.

In pursuing arbitration against Petrobras, the successful recovery of investors' losses will likely hinge on whether it is possible to assert claims under Article 186 of the Brazilian Civil Code

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[18] *See In re Petrobras Sec. Litig.*, No. 14-CV-9662 JSR, 2015 U.S. Dist. LEXIS 99322, at *45 (S.D.N.Y. July 30, 2015). The Market Arbitration Chamber was apparently created by the BOVESPA to serve as a specialized forum for resolving disputes related to corporate and securities laws. *See id.* at *46.

[19] *See id.* at *50 ("Earlier this year, the Brazilian National Congress approved legislation, which was drafted by a commission of judges, arbitration experts, and government officials, providing that '[a]pproval of the addition of an arbitration agreement in the bylaws, with due regard for the quorum set out in art. 136 [of the BCL], binds all shareholders. . . .' This provision is consistent with the prevailing view among Brazilian legal scholars, as described by defendants' expert, that arbitration bylaws are valid if approved by a simple majority, are not considered contracts of adhesion, and are binding on all shareholders. Thus, the adoption of this provision provides further support for the Court's conclusion that Article 58 is valid and binding under Brazilian law.") (brackets in original).

[20] *See id.* at *46.

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for damages caused by the intentional and negligent acts of Petrobras. However, Brazilian legal experts remain divided on whether such claims are viable. As an initial matter, some experts have suggested that because claims against Petrobras concern the capital markets, Brazil's Securities and Corporate laws would apply. Critically, the Brazilian Securities and Corporate laws—which, among other things, impose significant disclosure obligations on corporations and require corporate officers to act consistently with duties of diligence and loyalty to the corporation—do not provide a private right of action against a corporation or its officers. As such, a ruling that the Brazilian Securities and Corporate laws preempt claims under the Brazilian Civil Code may effectively bar investors' individual recovery for losses suffered in connection with BOVESPA-traded securities.[21]

B. VW

1. Background

On September 18, 2015, the U.S. Environmental Protection Agency ("EPA") issued a Notice of Violation of the Clean Air Act to VW, the German automaker, in response to the discovery that VW had intentionally installed "defeat device" software in its TDI "clean diesel" engines that was designed to detect and evade emissions tests. The Notice of Violation revealed that nearly 500,000 VW diesel vehicles in the U.S. are in violation of the EPA's emission standards.

As detailed in the EPA's Notice of Violation letter, VW's "defeat device" software would detect when the vehicle's emissions were being tested and would switch the vehicle's engine into a cleaner running mode during the test. Once the emissions test concluded, the software enabled VW's vehicles to drive on the road with increased fuel economy and improved torque and acceleration but with high (and illegal) levels of pollutants. Specifically, on-road testing conducted by researchers at West Virginia University found that some VW vehicles emitted as much as forty times the legal pollution limit for nitrogen oxide ("NOx"), a particularly toxic and harmful pollutant.

In response to the EPA's Notice of Violation letter, VW admitted to this massive fraud and issued a public apology. VW's Chief Executive Officer, Martin Winterkorn, resigned under pressure, and Matthias Müller, the former Porsche chief, was named as his replacement. VW was also forced to cut its third-quarter earnings guidance and announced that it had set aside €6.5 billion ($7.3 billion) in its third-quarter accounts to help cover the costs of the scandal. However, Credit Suisse estimates that this scandal could cost VW as much as $87 billion—even more than what it cost BP to cover costs associated with the 2010 Deepwater Horizon oil spill in the Gulf of Mexico.

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[21] The Brazilian Corporate law allows investors to bring claims against a corporation's controlling shareholder or derivatively on behalf of a corporation. As such, claims could be brought against Petrobras's controlling shareholder—the Brazilian government—if it breached any of its fiduciary duties. Alternatively, derivative claims would seek to recover on behalf of Petrobras against its officers or directors. These options would be unlikely to directly remedy investors' losses.

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In fact, setting aside any fines levied against VW by U.S. states and non-U.S. regulators, VW faces EPA penalties of up to $18 billion under the Clean Air Act alone.

Investigations into VW's conduct are also occurring outside the United States. On October 8, 2015, German prosecutors and police raided VW's headquarters in order to secure documents, databases, and other evidence in support of its criminal inquiry into the emissions scandal. The European Commission has also indicated that it is in contact with VW and U.S. authorities, and governments around the world have launched inquiries and investigations, including, *inter alia*, Switzerland, Italy, India, Australia, Norway, South Africa, New Zealand, Sweden, France, and Britain. Given VW's admission that it used the manipulated diesel engine in approximately 11 million vehicles sold worldwide, VW will likely face additional fines, penalties, and lawsuits that will further depress the Company's profits and stock price in the coming years.

The foregoing disclosures resulted in a significant decline in the price of VW common stock, VW preferred stock, and Porsche stock:[22]



(source: Yahoo Finance)

2. Investor Litigation

Given that only a small fraction of VW common and preferred stock trades in the United States (as American Depositary Receipts), the vast majority of investors—those who purchased VW's common and preferred stock (or Porsche securities) on the Frankfurt Börse stock exchange in Germany—are prohibited from bringing claims in the United States even though the U.S. markets were central to the scheme and U.S. regulators revealed the fraud. To date, a large number of institutional investors who invested in VW's common and preferred stock (and Porsche securities) have retained counsel and filed claims against VW in Germany. Claims in Germany asserted causes of action under the German Securities Trading Act ("WpHG") and under German

[22] Porsche holds a significant ownership position in VW.

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civil tort law. Investors who purchased VW common stock and preferred stock American Depository Receipts separately filed suit in the United States, as permitted under *Morrison*.

The German system is an "opt-in" system: only claimants who file suit in their own name (or take active steps to join an existing suit) are able to recover. This typically, as is the case in VW, may result in multiple suits being filed, as well as multiple claimants filing one joint complaint. Moreover, if at least ten suits concerning the same subject matter are filed within a four month period and the claimants request a designation of the matter as a model case proceeding, then under Germany's Kapitalanlegermusterverfahrensgesetz (Capital Market Investors' Model Proceeding Act) ("KapMuG"), the district court may elect to refer the case to the Higher Regional Court (an appellate level court) to initiate model case proceedings. Once the case is referred to the Higher Regional Court, and if the Higher Regional Court accepts the referral order, the Higher Regional Court will select one of those cases to serve as the "model case." This model case procedure allows common elements of the claims to be litigated first, with the court's rulings on those common issues binding on all petitioners. This procedure is similar to a Group Litigation Order in the United Kingdom and results in the court issuing a declaratory judgment on the common questions of law and fact.

When a model case is designated, the claimant(s) whose case is designated as the model case will be in a position to oversee and direct the litigation of common issues. In a sense, the "model claimant" is like the Lead Plaintiff in a U.S. class action. In deciding which case to designate as the model case, and which claimant(s) to designate as the model claimant(s), the court will consider numerous factors, including the number of claimants in the case, the amount in controversy, the experience of counsel representing the claimants, the claimants' suitability to represent all those similarly situated, and whether the proposed model case covers all aspects of the claims asserted by others. Another relevant factor will be the extent to which other claimants consent (or object) to a particular claimant's designation of its case as a model case.

Those claimants who file a claim, but who are not selected as the model claimant, are automatically included in the KapMuG proceedings. However, their individual case is stayed pending the outcome of the model case and, if they so choose, the claimants may participate in the model case proceedings on a limited basis by filing briefs and attending hearings. Otherwise, these claimants have very limited influence on the case strategy.

Once the model case reaches judgment (and assuming the decision is in favor of the model claimant), all individual cases resume in order to litigate unique factual and legal issues, such as "reliance" and the amount of each claimant's damages. Similarly, if the model claimant reaches a settlement with the defendant, it can apply to have the settlement approved by the court. At that time, each claimant is given the opportunity to opt out of the settlement and, if fewer than 30% of all claimants opt out in a thirty-day period, the settlement will be binding on all claimants who did not opt out. Any settlement proceeds are available only to claimants who previously filed an individual lawsuit that was included in the model case proceedings.

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Here, the KapMuG process was triggered and Deka Investment GmbH, a German institutional investor, was selected as the model claimant. The KapMuG proceedings are currently in the briefing phase, with oral hearings currently scheduled for late 2018.

C. Japanese Actions

Since the Japanese securities laws were amended in 2004, there has been a significant increase in the volume of securities litigation filed in Japan. However, it was not until 2012—and the Olympus litigation in particular—that non-Japanese investors began to take advantage of Japan's Financial Instruments and Exchange Act ("FIEA") and started filing claims. Specifically, the post-*Morrison* environment, combined with the FIEA's provision of no-fault liability for corporations' misstatements, has made Japan an attractive venue for recovering losses, despite its opt-in mechanism which requires active participation by impacted investors.

We highlight two notable securities actions filed in Japan.

1. Olympus

In November 2011, Olympus—a large Japanese optics manufacturer—admitted to employing fraudulent accounting practices in order to conceal more than $1.5 billion in investment losses, questionable fees, and payments to criminal organizations. Among other things, Olympus admitted to using corporate acquisitions to conceal significant investment losses the Company had incurred since 1998. As a result of the scandal, several Olympus Directors, including the Company's Chairman of the Board of Directors, were forced to resign. Ultimately, the Company's Chairman, Executive Vice-President, and Auditor were found guilty for their roles in the accounting scandal and received multi-year suspended sentences.

In the wake of these disclosures, investors suffered significant losses as Olympus's stock price on the Tokyo Stock Exchange declined more than 75%. In response, approximately ninety institutional investors—including several large non-Japanese investors—who had purchased Olympus stock on the Tokyo Stock Exchange filed an action under the FIEA against Olympus in 2012 in Japan. The action settled in 2015 for approximately ¥11 billion (approximately $90 million).[23]

A separate lawsuit asserting claims on behalf of investors purchasing Olympus's American Depositary Receipts ("ADRs") was filed in the United States. Ultimately, the U.S. lawsuit—which covered only a fraction of Olympus's investors—resulted in a $2.6 million settlement.

2. Toshiba

In July 2015, Toshiba—one of Japan's largest electronics manufacturers—announced that the company had artificially inflated its pre-tax profits by more than $1.2 billion since 2008. Over

[23] *See* Olympus Corporation, *Notice Concerning Settlements of Lawsuits for Damages*, Mar. 27, 2015, http://www.olympus-global.com/en/common/pdf/td150327e.pdf.

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the following months, investors learned additional details about the accounting scandal, which has prompted Japan's Financial Services Agency to recommend substantial fines against Toshiba and its outside auditor, Ernst & Young ShinNihon LLC. Specifically, investors learned that Toshiba's President and Vice Chairman had knowledge of the inflated profits and related delays in reporting losses, and had forced Toshiba employees to meet unrealistic financial targets. Toshiba's President and Vice Chairman resigned shortly after the scandal broke and Toshiba subsequently filed a lawsuit against five former executives, including three former Chief Executive Officers, for mismanagement.

Since these disclosures—which eliminated approximately half of the company's market capitalization value and generated substantial investor losses—a number of institutional investors who purchased Toshiba stock on the Tokyo Stock Exchange retained counsel and initiated claims against Toshiba in Japan. Separately, a class action lawsuit filed in the United States on behalf of purchasers of Toshiba's ADRs—which make up a small portion of the company's outstanding stock—was dismissed under *Morrison* because Toshiba's ADRs were not traded on a U.S. stock exchange and were, instead, traded over-the-counter.

D. U.S. v. Non-U.S. Venues

In addition to the impact of the *Morrison* decision, successful results in class and collective securities litigation in certain foreign jurisdictions have increased the interest in pursuing claims in those jurisdictions. In some instances, certain foreign jurisdictions have proved to be more favorable venues than the United States for the recovery of investor's damages. For example, in 2011 and 2012, investors in Agnico-Eagle Mines Ltd. filed securities class action lawsuits against the company in the United States (on behalf of investors in the company's U.S.-traded common stock)[24] and in Canada (on behalf of investors who traded in the company's securities on the Toronto Stock Exchange and other Canadian trading platforms).[25] The U.S. action was dismissed for failure to state a claim under the U.S. securities laws while the Canadian action, which was premised on the same theory, was certified as a class action and settled for CAD$17 million.

With the increased frequency of foreign securities litigation, institutional investors are tasked with the additional need to actively monitor and evaluate non-U.S. litigation options. This obligation is particularly important given that many non-U.S. jurisdictions follow an opt-in model (rather than the opt-out model followed in the U.S.) for class and collective actions. Critically, opt-in jurisdictions do not allow investors to remain passive and collect a recovery at the end of litigation, and the failure to affirmatively opt in to the litigation may preclude recovery entirely.[26] Furthermore, non-U.S. litigation may include other risks such as: limited development of legal

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[24] *In re Agnico-Eagle Mines Ltd. Sec. Litig.*, No. 11 Civ. 7968 (JPO) (S.D.N.Y.).

[25] *AFA Livförsäkringsaktiebolag, et al. v. Agnico-Eagle Mines Ltd., et al.*, No. CV-12-448410-00CP (Ontario Sup. Ct.).

[26] Notable collective action jurisdictions—which allow investors to join together (via a variety of mechanisms) to collectively litigate securities claims—include France, Germany, Japan, the Netherlands, and the United Kingdom.

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precedents (liability, damages, *etc*.); reliance on non-U.S. lawyers without significant securities experience; varying discovery rules and obligations; and translation issues and costs.

IV. Conclusion

As discussed above, several recent decisions have radically altered the contours of class action and individual securities litigation, both in the United States and abroad. Increasingly, institutional investors are seemingly being driven by developments in U.S. case law (*e.g.*, *Morrison* and *CalPERS*) to become more aware of their litigation options in the U.S. and abroad. We believe this trend will likely continue as non-U.S. laws and procedures continue to mature and non-U.S. litigation continues to provide meaningful recoveries to active participants.

Disclaimer:

This article is intended to provide a background on shareholder class action litigation and trends, serving as a lead plaintiff, and litigating an action. However, it is not intended as a substitute for legal advice with your chosen counsel or your discussions with counsel as to the merits of each particular action you may consider. The purpose of this article is to provide general information only. Nothing herein constitutes legal advice, and prior results are no guarantee of similar outcomes in the future.

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