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Slaughter and May Podcast

The rise of shareholder group litigation and how to avoid it

Roland Turnill	Hello and welcome to the Slaughter and May podcast. I'm Roland Turnill, the head of Slaughter and May's M&A practice. I'm joined by two of my partners in our Disputes and Investigations group, Efstathios Michael and Camilla Sanger. We're going to be talking about the rise of shareholder group litigation and some of the issues listed companies should be thinking about, including how to avoid it in the first place. Camilla, let's start by explaining what we mean by "shareholder group actions".
Camilla Sanger	Thanks Roland. We're talking about claims that are brought by large numbers of shareholders against listed companies seeking compensation for misleading market announcements. You often hear these referred to as class actions, which is the term used in the US. That's convenient shorthand, but as we're going to discuss, it can also be a bit misleading, because there are big differences in the way, from a procedural perspective, that these kinds of cases are brought in England.
Roland Turnill	Let's put that to one side for a moment and talk first about the substantive laws designed to protect shareholders from misleading statements and omissions. We'll focus on two of the most important, which are in sections 90 and 90A of FSMA. Let's start with section 90 – that one relates to prospectuses.
Camilla Sanger	That's right. Now section 90 says that where an investor has acquired securities to which a prospectus applies and they go on to suffer loss in circumstances where there is an untrue or misleading statement in, or omission from, that prospectus, then they are entitled to compensation from the people who produced it. That means the company itself and the directors most obviously, but potentially others too. Now one of the things about section 90 that makes it so useful for investors is that there is no need to show that they relied on the relevant statement or omission in the prospectus when they decided to buy the shares. If an investor can show there was something wrong with the prospectus, the defendants will only avoid liability if they can convince the court that they were not negligent.
Roland Turnill	And what about section 90A?
Camilla Sanger	Well that's broader in scope: it applies to other market announcements. But it's much less claimant-friendly. It only bites where the relevant misleading statement or omission was made knowingly or recklessly, and was actually relied on by the investor in making a decision to buy, sell or hold their shares. And it's only the company that can be made liable, not its directors.

Roland Turnill	Aside from these two sections, are there other options for aggrieved investors?
Camilla Sanger	Potentially, yes, - claims for misrepresentation, for example. But these are older common law claims, not purpose-built for securities claims like sections 90 and 90A, and they tend to be a lot more difficult for investors to bring and win.
Roland Turnill	Ok, so given the nature of those claims under FSMA, which have been around for a long time - 20 years in the case of section 90 - you might expect to see quite a few cases and judgments. But that's not the case, is it?
Camilla Sanger	No, you're right. Very few claims have been brought under section 90 or section 90A, and none have got to trial, let alone reached judgment. The highest profile claim under section 90 was brought by thousands of institutional and retail investors against RBS and its directors in relation to the prospectus for its 2008 rights issue during the financial crisis. That case settled before trial in 2017. In respect of section 90A, a number of investors sued Tesco for losses said to arise from overstated profits in 2014. That case was due to go to trial around now but it settled late in the summer.
Roland Turnill	Efstathios, can you tell us why you think we haven't seen more claims go all the way?
Efstathios Michael	Sure, I think there are three reasons that stand out for me. First, there's the uncertainty over the scope and operation of sections 90 and 90A. There's a vicious circle here: because they haven't been tested in court, that uncertainty remains and carries with it an increased risk for would-be claimants. That can act as a brake on these kinds of claims. Second, the procedural mechanism for bringing large group actions is quite unwieldy in this country. Outside the sphere of competition law, there's no direct equivalent of a US-style, opt-out class action. The closest we have is the representative action, in which one claimant brings a claim on behalf of a group. But each member of the group must still show that they share the same interest in the claim, which the courts have traditionally taken a strict line on. That only leaves group litigation orders, which are simply a means by which the court organises a large number of related claims – there's still a requirement for each affected person to issue and establish their own claim. Thirdly, this kind of litigation is expensive, not least because of the points I've just mentioned. But also because these tend to be big complex claims with plenty of scope for contested expert evidence and often very large volumes of potentially relevant documents to review.
Roland Turnill	But do you think that there could be more claims could be on the horizon?

Efstathios Michael	Yes, I think there's no doubt about that. The question is how many will get off the ground. Our experience is that it looks like an increasing number could.
Roland Turnill	And what's behind that?
	Again, a number of reasons, many of them interconnected. I'll focus on two. First, the litigation funding industry has grown hugely over the last few years. That's been driven by a wall of money looking for high returns at a time when more traditional investments have been returning low yields. Funders, supported by law firms specialising in claimant litigation, keep a close eye on the market, monitoring and identifying potential claims and then in due course actively recruiting investors to join group actions. And because these claims will only be economically viable if there's scope for a large award of damages, institutional investors, with their large shareholdings, are a prime target. And that's my second point: the increasing willingness of fund managers to participate in these kinds of claims. The pitch that funders and claimant firms make to these kinds of institutions has two limbs. First, they tell them as custodians of other people's money, they have a particular responsibility to consider joining shareholder group claims. Second, they say that there's no financial risk to the institution in joining the claim. That's because funders almost always operate on a non-recourse basis so that they're only paid if the claim is successful, and insurance covers the risk of an order to pay the defendant's costs. Of course the validity of those arguments will need to be weighed carefully against a number of factors, including the nature and apparent strength of the claim and the allegations it makes. It's important to remember that section 90A claims, for example, will usually involve serious allegations of dishonesty against the directors of listed companies and so really shouldn't be made likely.
Roland Turnill	So how should listed companies, as potential defendants to these kinds of claims, be thinking about their strategy?
Efstathios Michael	Of course every claim is different and needs to be assessed on its particular merits, but there's no doubt that these kinds of claim have a particular and special dynamic for claimants as well as defendants. Focusing on the defendant side. This is not "traditional" litigation, in which you have one or a few claimants who are directly and closely engaged with the dispute and its conduct. In other words, this is very much lawyer lead litigation and a corporate defendant may find itself facing dozens, hundreds, or even thousands of claims, some more sophisticated than others. And rather than one set of lawyers, there could be a number, each representing a different claimant group. And in addition, of course, there are the funders and the insurers, who naturally have a close interest in the claim and its prospects.

	All that creates a new and very different dynamic. Understanding the potentially different incentives of each of these actors and how they interrelate can be challenging, but it is vital in order to pursue an effective defence strategy and to secure the best outcome, including considerations of whether and when to enter into settlement discussions that might be appropriate.
Roland Turnill	Thanks Efstathios. So let's finish off by taking a step back and considering what listed companies can do to try to avoid this kind of litigation arising in the first place. And when I do that I'm going to focus very much on ordinary course market announcements rather than prospectus', as prospectus' have very much their own regime for verification and for ensuring that directors and companies are properly protected. Many shareholder claims on market announcements relate to the overstatement of profits or assets, or the understatement of costs or liabilities, or to a failure to disclose adequately the risks involved in a transaction or of a situation. Misstatements and omissions of this kind occur for a variety of reasons often quite complicated, so it's difficult to give general advice on how you avoid them. But there are some points that are worth making. The first is to adopt a robust approach to the drafting and verification of significant market announcements. High-risk or forward-looking statements need particularly close attention, and will need to incorporate appropriate disclaimers, as well as an explanation of assumptions used in the case of forecasts. If nothing else, this approach should help to address any allegation that a misstatement was made knowingly or recklessly, which is of course one of the foundations of section 90A liability. But as well as verifying and documenting the detail, it's important that companies step back and look at whether what they're saying is, overall, fair and balanced. Are shareholders being given everything they need to make a proper assessment of the matter in question? And finally, have a plan in place to deal with the possibility of shareholder claims. Take legal advice if a claim is first intimated and certainly before entering into any discussion with the relevant shareholder or shareholders. That same caution should apply to internal communications – remember that if a claim is issued, all relevant documents will be disclosable to the claimants unless there is a valid claim to privilege. That brings us to the end of our podcast. Thank you for listening. If you would like any more information about anything that we've discussed today, please do feel free to reach out to one of us or to your usual Slaughter and May contact.