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EUROPEAN D&O INSURANCE MARKET

Reforms Cause a Shifting Landscape

October 2011

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Reforms Cause a Shifting Landscape

Executive summary

REM, the rock band, proclaims in one of their hit singles "It's the end of the world as we know it…and I feel fine," which could be the mantra of the European corporate culture. Relative to the US legal system and corporate culture, Europe had long conducted business in a climate of opaque management visibility and limited shareholder legal remedies. Accounting scandals and corporate governance shortfalls in Europe by companies such as Royal Dutch Shell and Parmalat, however, cost investors billions of Euros. The subsequent outrage led to tectonic shifts in governance standards and access to justice throughout Europe. The credit crisis, rife with scandals such as Madoff's Ponzi scheme, has further propelled governance changes promoting sustainability. Governments across Europe have passed laws requiring new disclosures, enhanced shareholder protections, and greater transparency, and many have developed a formal structure for collective action proceedings. The progression toward implementing collective action mechanisms, and the degree of liberalization, is in varying stages by country. The clear trend, however, is toward a more collective-friendly civil legal system in most countries.

As European directors and officers are placed increasingly under the microscope of transparency, and as litigation remedies become more readily available for shareholders, the number of suits against corporate boards and managers is expected to expand. New corporate governance rules more clearly define responsibilities, providing more obstacles for directors and officers to trip over, revealing a maze of potential liabilities. Although many companies might respond to heightened transparency and the availability of more litigation remedies by becoming conservative, these new potential pitfalls amplify risks to directors and officers. Tougher regulations and refocused enforcement efforts brought about by the backlash to the credit crisis may result in increased claims.

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Globalization has caught up with the European corporate culture, and it is indeed "the end of the world as we know it"

Additionally, companies doing business in the US, and particularly those whose shares trade on US exchanges, are exposed to the dangers of the US class-action-prone legal system. The *Morrison v. National Australia Bank* Supreme Court decision may have limited shareholder lawsuits in US courts to those shareholders who purchased shares traded on US exchanges, but suits filed against European companies in US courts remain on the rise. The implicit foreign company protection assumed for so many years in the US has long passed. The Morrison case will, however, shift more lawsuits to other court systems, and the Netherlands is highly touted as an alternative to US courts.

Globalization has caught up with the European corporate culture, and it is indeed "the end of the world as we know it" with localized safe harbors for directors and officers vanished. Previously thought a luxury of large companies, directors & officers (D&O) liability insurance in Europe is primed for robust growth across companies of all sizes as it is increasingly viewed as essential. Changes to laws governing executive responsibilities, increased cross-border regulator vigor, and greater access to collective litigation will drive this growth. Most European corporate leaders and shareholders alike should "feel fine" about these changes, as this modernization of the corporate climate and legal systems should lead to more stable, sustainable growth, and perhaps serve as a model for potential US sustainability efforts.

Lawsuits promote demand for D&O Insurance

Some believe that a blizzard of shareholder suits in Europe is inevitable given stricter corporate governance laws and reforms to the legal systems of many countries. Most observers, however, believe that safeguards instilled in the collective action reforms in all European countries will avoid the abuses endemic to the US system. Nonetheless, the number of shareholder suits filed in European courts was substantially up following the reforms, and remain historically high. Using securities suits as a proxy for shareholder suits, and looking at large securities suits, since 2005, 68 large securities suits were filed in European courts against European companies, and their directors and officers. Of this total, 21 suits, or 31 percent, were filed in 2009 alone, largely due to 18 Madoff-related cases. Despite the falloff in Madoff-related cases, securities suits filed in European courts remained above pre-credit crisis levels at 11 new filings in 2010 and 2011 is on pace for 16 suits. Of the total 68 cases, 40 were specifically collective action suits. For cases settled since 2005, the average settlement per case was a substantial €75 million ($101 million).[1]

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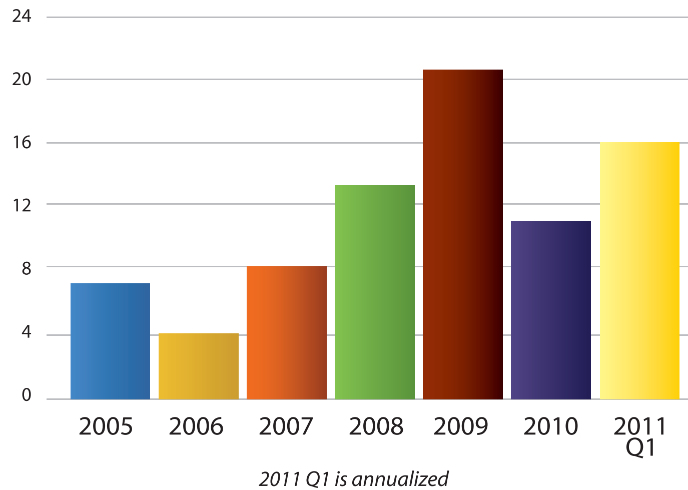

Most large companies in Europe have some form of coverage for their directors and officers

Many of these suits are shareholder suits, and likely would be covered by D&O insurance if coverage were purchased, but lawsuits from other parties also can invoke coverage under D&O policies. Regulatory actions can trigger defense cost provisions. Enforcement activities by securities regulators, which already were on the upswing prior to 2007, gained momentum from the global credit crisis, exposing companies and their directors and officers to mounting costs associated with investigations and lawsuits. Additionally, securities regulators around the world have stepped up their efforts to work in concert, leading to dozens of coordinated cross-border investigations in recent years. The increase in recent regulatory activity, invigorated by cross-border cooperation, can be further impetus for shareholder collective actions. Private parties other than shareholders can bring suits that could be covered under D&O policies, such as D&O claims triggered by lawsuits filed by competitors, creditors, business partners and employees. Suits from these parties are increasingly common, but thus far, have rarely resulted in insurance payments.

Most large companies in Europe have some form of coverage for their directors and officers. Many directors are refusing to serve on boards without adequate coverage in place. Despite this growing demand for D&O insurance, the perceived level of D&O coverage needed varies among countries, and most mid- to small-sized public companies remain without it. This compares to close to a 100-percent penetration rate of US public companies. The relatively lower penetration rates in Europe among smaller public companies represent a once-in-a-lifetime growth potential for providers of D&O insurance policies. As is recognized in the US, D&O insurance is also vital for board members of private companies, and their European counterparts will soon demand protection, as well.

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A number of high-profile corporate scandals triggered worldwide governance and transparency reforms

The D&O market in Europe is estimated by Advisen to have been worth €1.37 billion ($2.0 billion) in written premium in 2008, up from €1.01 billion ($1.25 billion) in 2004. In contrast, the US D&O market is estimated by Advisen to have been about €4.7 billion ($6.8 billion) in written premium in 2008, down from €5.85 billion ($7.25 billion) in 2004. During this period, the European D&O market demonstrated an outsized compound annual growth rate (CAGR) of 7.9 percent in terms of Euros, despite a soft global commercial insurance market due to overcapacity. This growth reflects an increase in the overall D&O market in Europe, and not individual premiums. The US market, on the other hand, shrunk during this period due to this soft insurance market, causing premiums to fall. Shortly after the emergence of the economic crisis, and particularly in 2009, D&O premiums for financial institutions in Europe spiked because the financial services sector saw the lion's share of D&O claims. D&O premiums in Europe for non-financial sector companies have been flat to slightly lower over the past couple of years due to the global soft insurance market, and premiums for the financial services sector have settled since the initial spike.

Other types of management liability lines, other than D&O insurance, have been growing in Europe as well, such as fiduciary liability, errors & omissions (E&O) coverage, and employment practices liability insurance (EPLI). EPLI has been an active line for some European-based insurers, particularly those with US-based subsidiaries and joint ventures. Furthermore, management liability "clash" scenarios – in which one underlying cause of loss triggers recoveries under a number of separate policies and coverages – have now emerged in Europe. In addition to D&O liability coverage, E&O coverage for auditors, investment banks, and other outside parties involved in the activities of the company may come into play.

The EU promotes corporate governance reforms

A number of high-profile corporate scandals triggered worldwide governance and transparency reforms. In the US, the Sarbanes-Oxley Act was passed in 2002. In the EU Company Law and Corporate Governance Action Plan 2003 (Action Plan 2003), the European Commission recommended Member States to develop best corporate governance practices for publicly traded companies. The Plan gives top priority to strengthening shareholder rights and third party protections. It also creates a framework to address issues such as internal controls, transparency, and the roles of auditors, banks and other third parties. One immediate objective is to "clarify the collective responsibility of the board members for financial statements and key non-financial information."

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The EU has been reviewing the progress of its call for corporate governance changes, and issued a public consultation and "green paper" in April 2011

In response to the call for stricter corporate governance practices, many countries in the EU have developed new corporate governance codes, such as: The Tabaksblat Code in the Netherlands (2004); Cromme Code in Germany (2003); and Le Gouvernement d'Entreprise des Societes Cotees in France (2003). The most significant difference between corporate governance approaches in the US and Europe is that the US system is prescriptive and rules-based, while codes of European countries are principles-based and rely on the "comply or explain" principle. The "comply or explain" principle means that companies are allowed to deviate from their national code if an explanation is provided in annual reports.

Green paper. The EU has been reviewing the progress of its call for corporate governance changes, and issued a public consultation and "green paper" in April 2011. The onslaught of the credit crisis since the Action Plan 2003 was released provided a further impetus for the green paper, particularly concerning possible governance policies that could promote long-term, sustainable growth. The green paper addresses the composition and effectiveness of the board of directors, including the role of the chairman being clearly defined, board evaluation, remuneration considerations such as mandatory disclosure, and the need for a risk management process for all companies. The paper also considers how to encourage greater shareholder engagement and focus on long-term performance in an age when short-term stock ownership is on the rise. For example, it reconsiders regulations that might improve transparency yet encourage short-term stock ownership. Finally, the green paper examines how to improve the effectiveness of the "comply or explain" principle for corporate governance regulations, such as ways to improve the quality of statements issued by companies and the monitoring of those statements by authorities.

The green paper also raises two broad questions for public consultation. The first question refers to whether corporate governance measures should consider the size of companies, which recognizes that current regulations could pose a greater burden on smaller companies. The second question raises the issue of whether corporate governance should be promoted at the EU level for the largest private companies. The public consultation period extended until late July 2011, and in light of the feedback the EU Commission is considering next steps, both legislative and non-legislative, as well as running an impact assessment. More EU corporate governance requirements on Member States are likely to result.

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The EU encourages effective collective redress systems

Several Member States have already taken steps toward reforming their legal systems

Various EU measures include an obligation of Member States to implement legislation that provides for collective actions to be taken by consumer representative bodies to protect the rights of consumers in specific circumstances. It is not always clear how these EU measures apply to shareholder suits as these types of suits are not directly mentioned. In shareholder collective action cases, however, shareholders are generally assumed to be consumers under consumer protection laws, and investor associations are usually the representative bodies. The remedies available are typically limited to injunctive relief rather than monetary claims. A considerable debate has ensued within the EU over the level of pressure the EU should place on Member States to implement reforms. The reforms being debated would potentially provide a mechanism for collective damages with possible monetary claims, as well as deal with the problems of funding mass claims of low value.

Several Member States have already taken steps toward reforming their legal systems, but not all have done so, resulting in uneven legal protections across the EU, with the majority of Member States having no collective action remedy for damages at all. The EU has commissioned numerous studies to help evaluate the possibility of any EU-wide initiatives regarding collective redress. One such study, the so-called "Evaluation Study"[2] released in August 2008, concluded that mechanisms varied widely for those with collective procedures, and overall the mechanisms are used in few cases. The European Commission has concluded that this patchwork of laws creates a "justice gap" where consumers and businesses have different rights depending on their location, and businesses could seek out Member States with favorable laws. Furthermore, a separate "Problem Study,"[3] also released in August 2008, looked at problems faced by those pursuing a claim, and found barriers to access to justice, particularly for small claims.

To promote more consistent consumer protections throughout the EU, and perhaps more consistent shareholder protections, the EU released its Consumer Policy Strategy 2007-2013. Speaking about the strategy in November 2007, the EU Commissioner for Consumer Protection, Meglena Kuneva, said at a conference in Lisbon, Portugal, "To those who have come all the way to Lisbon to hear the words 'class action,' let me be clear from the start: there will not be any. Not in Europe, not under my watch." She was using the word "class action" to mean US-style class actions. Ms. Kuneva did express the need for a more harmonized system within the EU for dealing with collective redress, called collective actions as a group. The EU, however, does not have fully fledged initiatives mandating specific requirements of

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"Collective action" is a broader set that refers to lawsuits where plaintiffs act in concert to bring a suit whether through shareholder associations, representative litigation or other means

Member States. It instead has announced a number of benchmarks for an effective collective redress system, against which all Member States will be assessed. If Member States do not meet these benchmarks, then EU actions will be considered.

In November 2008, the Commission published a green paper about the concerns of uneven access to justice among Member States. It concluded that all systems have their strengths and weaknesses, but none are ideal for all types of claims. The paper also suggests possible EU actions, ranging from no action to a binding EU measure to ensure a collective redress procedure exists in all Member States. The green paper, however, rejected the "toxic cocktail" of the combination of contingency fees, punitive damages, pre-trial discovery procedures, and an opt-out mechanism, all integral to the US class action system. In May 2009, the Commission published a discussion paper taking account of the responses to the green paper during the consultation period, and set forth a refined set of options ranging from no EU action to a harmonized EU-wide collective redress mechanism. It is unclear is any of the proposals will move forward at this time.

Class Action versus Collective Action. Class action suits are de rigueur in the US when shareholders sue a corporation and its directors and officers. In a class action suit, everyone who allegedly suffered a loss is treated as a member of a "class," and the lawsuit seeks to recover damages on behalf of the class.

US-style class actions are virtually unknown in Europe. While "class action" is frequently used by writers to describe any sort of legal action by a group of plaintiffs, a distinction should be maintained between "class action" and "collective action" suits. "Class action" should be used in the US context of all claimants who have allegedly suffered a loss being treated as a single class, whether or not they have individually filed suit, and are represented by a lead plaintiff. Contingency fee arrangements are linked to US-style class actions because plaintiff fees are paid out of the settlement amount and not paid when plaintiffs lose, removing the risk of bringing a claim. "Collective action" is a broader set that refers to lawsuits where plaintiffs act in concert to bring a suit whether through shareholder associations, representative litigation or other means. The nature of collective action lawsuits varies significantly from country to country.

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Corporate governance and litigation changes throughout Europe

The basic tenets of these debates consider if private damage claims should supplement regulatory enforcement, and how to balance availability while avoiding the perceived excesses and abuses of the US-style system

Most changes to corporate governance laws and collective action reforms are occuring at the country level in Europe. Country level changes have occurred perhaps partially due to EU pressure, but it is more likely that each country is reacting to the same pressures placed on the EU as a whole. In the wake of highly publicized accounting scandals and the credit crisis, governments faced a strong public outcry for transparency of corporate activities and enhanced shareholder rights. The credit crisis further amplified the outcry for governance changes, as many see a major cause of the crisis being corporate management and certain shareholders seeking short-term gains at the expense of long-term viability. Certain countries have made changes to corporate governance requirements that attempt to focus management, and shareholders, on long-term growth, such as the amended German Corporate Governance Code (Cromme Code) in May 2010 and Borsa Italiana's revised Code that took effect in March 2011. Additionally, the outcry called for reforms to seemingly apathetic legal systems, often inaccessible to the masses, to provide recourse to those who suffer losses due to management misconduct.

Compared to the US, the legal systems of all European countries provide less vigorous tools for shareholders to collectively pursue claims against companies and their directors and officers. Most countries have procedural impediments that make it more difficult, more risky, and more expensive for plaintiffs to pursue litigation – such as bans on contigency fees, "loser-pays" rules requiring that the losing party pay for all or part of the winning party's legal costs, and the lack of pre-trial discovery often needed to build cases. A number of countries, however, have implemented official mechanisms that permit collective actions in various forms, differing by country. Others are actively debating legal "modernization" reforms, while certain countries appear unlikely to make changes anytime soon. The general trend is for reformed systems that make it easier for aggrieved shareholders to collectively bring suits. Europeans have been wary that reforms opening their legal systems to more collective actions could lead to US-style class actions, expressing concern that they may lead to the perceived "excesses" of the US litigation environment.

The basic tenets of these debates consider if private damage claims should supplement regulatory enforcement, and how to balance availability while avoiding the perceived excesses and abuses of the US-style system. It is important to note that in Europe the goal of increasing access to justice as a driver of legal reforms is often less important than the goal of utilizing the private litigation system as a quasi-regulatory mechanism. Collective action reforms in Europe have progressed most rapidly when the reforms are seen as supplemen-

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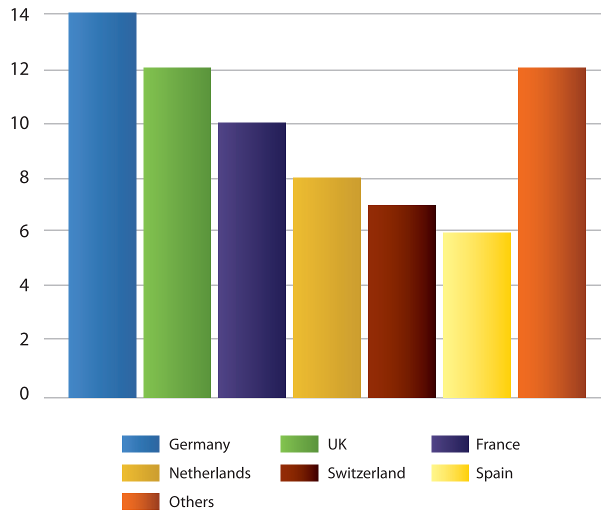

tal to the regulatory structure, promoting social justice. Some countries have Ombudsmen, acting as a kind of "big brother." Others, such as the UK, are considering varying levels of access to legal remedies by industry, depending on the degree of regulation, where the less regulated industries would be more subject to collective suits. Many countries have judicial checks on collective actions, where proposed collective actions are vetted by a court, considering, among other issues, whether the claim can be resolved more cost-effectively through regulatory actions or Ombudsmen. In the US, litigation is viewed as an individual right, with personal gain as the only consideration beyond legal merit, and regulators act on their own tracks independent of private litigation.

Reforms in many countries may have had an impact on securities litigation in Europe, although much of the increase can be attributed to the credit crisis and Madoff-related cases. From 2005 through the first quarter of 2011, 72 percent of the 68 large cases filed occurred since 2008, and the majority since 2009. Madoff-related cases were in fact responsible for 22 of the 68 cases, but it was the reforms that opened the door to these cases. Although securities litigation in 2010 and Q1 2011 is off the Madoff-influenced high of 2009, the number of new suits remains significantly above the pre-2008 levels. Many Madoff-related cases are more likely to be covered by E&O policies, rather than D&O policies, assuming that insurance coverage is in place at all. During this timeframe, Germany saw the most cases (14), followed by the UK (12), France (9), The Netherlands (8), Switzerland (7), and Spain (6).

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Not all of these large payouts are covered by D&O liability insurance

Some staggering payouts have occurred in recent years. In January 2007, Dexia, the Franco-Belgian Bank, settled in Dutch courts for €400 million ($520 million), for compensation to Dutch customers after Dutch investor associations sued for alleged mis-selling of investment products. Unilever settled in German courts with the Netherlands Investors Association for €305 million ($396 million) in March 2007. Then in May 2009, Royal Dutch Shell settled in Dutch courts for €270 million ($375 million) for overstating oil reserves, paying European shareholders. This was a landmark case because the Amsterdam Court of Appeal held that it had jurisdiction to hear the case and issue a decision for non-US claimants despite that a case was already well on its way in US courts. The US court then declared itself not competent to hear the claims of non-US shareholders, in part considering the settlement for non-US investors in Dutch courts.

Not all of these large payouts are covered by D&O liability insurance. Thus, not all affect insurers' loss ratios and attitudes toward capacity, which means that some of these cases will not directly contribute to a capacity-driven "hard" D&O insurance market. They are, however, indicative of the trend of increased settlements in Europe and impact attitudes about the likelihood of needing this insurance.

United Kingdom

The UK has experienced some of the most sweeping changes in corporate governance and the accountability of directors and officers. In November 2006, The Companies Act 2006 was passed, and came into force in October 2007, replacing the Company Act 1985. It is a comprehensive code of company law, and it replaced and codified the principal common law regarding equitable duties of directors, placing a new emphasis on corporate social responsibility.

The Companies Act 2006 may lead to an increase in claims against directors and officers:

- The Act gave shareholders a statutory right to pursue claims against directors for misfeasance on behalf of the company, using derivative actions. Previously, derivative actions were allowed, but the statute ordained very narrow grounds on which a shareholder could file a derivative lawsuit against management of a company.
- Publicly traded companies need to disclose information about environmental issues. Shareholders may file a lawsuit if management is suspected to have under- or over-prioritized environmental concerns regarding the company's health. The Waste Electrical and Electronic Equipment (WEEE) directive, applicable since July 2007 in the UK,

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Despite the increased exposure to liability, directors and officers can rejoice from parts of the Companies Act

adds to this concern. The Environmental Liability Directive (ELD) 2009, coming into law almost two years after the EU deadline, extends the EU's "polluter pays" principle, and established liability for firms that damage the environment. The ELD compounds concerns arising from the Companies Act.

- From October 2008, certain additional duties for directors and officers came into play, including the duty to avoid conflicts of interest, the duty to deny payment in any form from third parties, and the duty to disclose any interests in proposed transactions.

Shareholders' awareness is heightened by the Act's extensive reporting requirements. Companies must provide an expanded business review to keep shareholders and other stakeholders informed of the company's operations. It also requires directors and officers to demonstrate regard for the effect the company's operations have on the community and environment. This transparency exposes the company to shareholder derivative actions, and environmental laws like the WEEE and ELD exacerbates these concerns.

While the Act potentially increases the liability of directors and officers, safeguards will prevent D&O claims from rising to US levels. For example, claimants must get the permission of the court to proceed in a derivative action. The court's evaluation will entail whether the claimants are acting in good faith, which is likely to preclude derivative actions by political or environmental campaigners who have purchased shares in the company primarily to pursue their political/environmental agenda. English courts have also articulated decisions similar to the US "business judgment rule." The US business judgment rule states that directors are not liable for taking wrong business decisions in cases where no personal interests are involved in the decision and where the director has made an informed decision in the company's best interests. Although the UK has no such expressed rule, the courts have been reluctant to interfere with the business judgment of directors and officers. Furthermore, any recovery in favor of the claimants in a derivative action is payable to the company so that litigants should not be tempted by expectations of a personal windfall.

Despite the increased exposure to liability, directors and officers can rejoice from parts of the Companies Act. The Act extends the ability of companies to indemnify directors, allowing indemnification in actions brought by third parties, covering both legal and financial cost of any civil action. Companies are also permitted to pay defence costs in criminal cases, provided that the director is not convicted. Even defense costs of civil claims brought by the company can be covered as long as judgment is not given against the director. Criminal penalties and penalties imposed by regulatory bodies, however, are not permitted to be indemnified by companies.

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The Corporate Manslaughter and Corporate Homicide Act 2007 came into effect in April 2008

The Act also brings into force the EU's Transparency Obligations Directive, which is intended to enhance transparency by establishing rules for financial reporting and the disclosure of major shareholdings for public companies in the EU. It provides the Financial Services Authority (FSA) with enhanced authorities to implement the requirements of the Directive, and the FSA has indeed laid down additional reporting guidelines. In accordance with the Directive, the FSA has imposed obligations on public companies regarding financial reporting, disclosure of major acquisitions (and divestitures), and the dissemination of information to shareholders and the general public. The Directive further strengthens shareholders' positions in the event financial reports contain any misleading and false information, and the Act introduces a statutory compensation scheme for such events. On the other hand, the Directive also creates a reasonably safe harbor for directors and officers that abide by the rules, and are neither reckless nor fraudulent.

The newly elected government announced in June 2010 its plans to dismantle the FSA, which is expected to be completed by 2012. Much of its authority will go to the Bank of England, which includes enforcement of reporting requirements among other issues concerning corporate governance. The same corporate governance rules apply, but which entity would make a better enforcer is debatable.

Other acts affecting corporate governance. The UK Extradition Act 2003 enables UK citizens to be extradited to category-2 countries, which are major trading partners outside of the EU. The US is by far the highest user of this facility, and it does not require UK courts to ascertain the existence of prima facie. Coverage for costs incurred in extradition proceedings is increasingly common in UK D&O policies, driven substantially by the well-publicized extradition case of the NatWest Three.

The Corporate Manslaughter and Corporate Homicide Act 2007 came into effect in April 2008. The Act enables prosecutions of corporate manslaughter against the company and gross negligence manslaughter against individual managers, where management styles lead to serious health and safety failings that result in fatalities. It refers to any entity operating in the UK, focuses on senior management, and the duty of care applies to parties beyond employees to visitors, consumers, and anyone affected by the organization's commercial activities. The wide scope of the duty of care has undoubtedly caught many companies off guard. Successful prosecutions under this Act are likely to become the basis for civil action against these companies and their management. Although no individual liability exists for corporate manslaughter, the Act pressures investigators to consider additional health and safety charges against individuals, which further exposes these individuals to fines and loss of positions.

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Much like other European countries, contingency fees are not permitted in the UK

The Bribery Act 2010 brought UK law mostly in line with the US Foreign Corrupt Practices Act 1977. It attempts to prevent bribery in both the public and private sector. Penalties under the Act include imprisonment for up to 10 years and an unlimited fine. The unlimited fine can be incurred by the company, as well as loss of contracts and confiscation orders. The does introduce a statutory defense if the company can demonstrate that adequate anti-corruption systems are in place. Effective risk management systems are vital for companies securing contracts in high-risk markets, as securing D&O coverage could be difficult given this Act. Furthermore, payment of the coverage could be denied, as paying bribes to secure contracts could be considered a moral hazard.

Collective actions. Though US style class action suits are not allowed under English law, collective action can be brought about in the form of Representative Actions and Group Litigation Orders (GLOs). A Representative Action is applicable in circumstances in which more than one person has the "same interest in a claim." One or more of the persons who have that same interest acts as representatives of any other persons who have that interest. Unless the court otherwise directs, any judgment or order given is binding on all persons represented in the claim. However, all cases need to be individually tried. The Companies Act 2006 may lead to an increase in Representative Actions.

GLOs, added to civil procedure rules in May 2000, provide for the case management of many claims as a group that give rise to "common or related issues of fact or law," and a significant number of claims exist or are likely to come about. Claims by an unspecified mass of claimants are not permitted; the GLO regime instead requires claimants to "opt in" by filing individual claims before they can be entered on the Group Register. Judgments and orders under a GLO are binding on all parties on the GLO Register. A factor working against collective shareholder actions is the courts' reluctance to award a GLO until all other ways of litigation have been explored. Furthermore, loser-pay rules might discourage individual filings, and they can cause the source of any potential compensation to be unstable and leading to court cancellations of the GLO. All trials are by a judge, without the benefit of a sympathetic jury. Punitive, or exemplary, damages are available, but rarely awarded – and are mostly awarded when the defendant is judged to have calculated the profits for the act in question to be greater than the compensation recovered.

Much like other European countries, contingency fees are not permitted in the UK. Compared to the US, where conventions state "no win, no fees," this is a more expensive proposition for European shareholders and claimants at large. The UK, however, permits fees, funding, and insurance options that effectively remove the effects of restrictions on contingency fees. Conditional fee arrangements are permitted, wherein a bonus or additional success fee to the

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The more regulated sectors of the economy, such as public utilities and finance, would be less susceptible to collective actions.

lawyers depends upon the outcome. Third party funding of legal expenses is also available from some professional funding firms, hedge funds and private investors, where payment for the funding is a substantial portion of the winnings. Loser-pay rules require the claimant to pay the defendant's legal fees, but After the Event (ATE) Insurance circumvents this requirement in practice, removing the risk of losing. ATE Insurance covers these legal costs in the event of losing, and the premiums for this insurance are generally deferred until the conclusion of the case and are only payable on success.

Modernization debate. A debate has ensued regarding possible wholesale revamping of collective action rules, and possibly bringing about a system more akin to the US class action system. In December 2008, the Civil Justice Council (CJC), a body charged with advising the UK government regarding modernization of its civil justice system, released a report stating that existing collective action mechanisms do not provide sufficient access to justice. The CJC proposed an "opt-out" collective action system, allowing lawyers to bring a class action on behalf of multiple claimants without being retained or individually identifying them. Beside the obvious negatives of more and larger claims that this opt-out system poses for potential defendants, potentially leading to a proliferation of claims without merit, a benefit for defendants cited by the CJC is that it provides a sense of finality in respect to potential claimants unless they have opted out.

The government, however, rejected this proposal in July 2009. Instead, the government believed that collective rights of action should only be extended where policymakers of a particular sector find a need and that it is more cost-effective than alternative means, such as individual claims and increased regulatory intervention. The more regulated sectors of the economy, such as public utilities and finance, would be less susceptible to collective actions. Regulatory bodies could be given increased powers to act on the behalf of consumers, such as the authority to order compensation. This could mean that directors and officers could be exposed to collective action liability without the benefit of judicial impartiality, although it is likely that regulatory authorities would have resources to pursue only the largest cases. In the end, this system would result in different exposure to collective action liabilities for defendants sector by sector.

If a government department deems more access to collective actions to be advantageous for their sector, legislation could be introduced by that department defining the specific bodies that may bring collective actions. For all collective action cases, the government's view was that all requested collective actions should be vetted by the courts before giving permission. The court should consider the legal merit of the claim, whether non-court mechanisms can resolve the matter more cost-effectively, and if the representative body could meet defense

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The American "business judgment rule" was incorporated into the AktG, which defers to directors' decisions made in good faith for the best interests of the company

cost obligations if they lose. The government's view is that the court should have the flexibility to determine whether the action should be brought on an opt-in or opt-out basis depending on the circumstances of the case.

In 2010, the government and Parliament were considering a bill for the financial services industry, eventually becoming the Financial Services Act 2010, which would have granted courts the ability to authorize collective proceedings for financial services claims. Before passage of the Act in April 2010, however, this provision was removed during the "wash up" process in order to make the bill more appealing for quick passage prior to Parliament being dissolved. The current Conservative-led coalition government is unlikely to pass a collective action reform law.

Germany

In 2002, the Committee on Corporate Governance, chaired by Dr. Gerhard Cromme, produced The German Corporate Governance Code, often referred to as the Cromme Report or the Cromme Code. The Cromme Code changed the German corporate governance system, clarifying shareholders' rights in Germany's dual board system. It harmonizes a wide variety of laws and regulations, and contains recommendations for complying with international best practices on corporate governance. The Code was amended in June 2005, handling issues regarding shareholder meeting, cooperation between the management board and supervisory board, conflicts of interest and management compensation disclosure, independent board member requirements, transparency, and auditor independence. In May 2010, the Code was amended again with an aim to make German corporate governance transparent and understandable. It clarifies the obligations of the Management Board and Supervisory Board to ensure the continued existence of the enterprise through sustainable growth.

The Law on Corporate Integrity and Modernization of Shareholder Lawsuits (UMAG), which became effective November 2005, significantly amended the German Stock Corporation Act (Aktiengesetz, or AktG) with regard to potential liability of directors – both providing directors with important protections as well as making them more vulnerable to shareholder lawsuits. The American "business judgment rule" was incorporated into the AktG, which defers to directors' decisions made in good faith for the best interests of the company. In order to pursue liability claims against the supervisory board or management of a company, shareholders now need to hold only a one percent nominal stake in a stock corporation or own listed shares with a market value of at least €100,000. Previously the hurdle was 10 percent or €1 million.

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Punitive damages are not awarded; in fact, punitive damages awarded in foreign jurisdictions are not enforceable in Germany

Collective actions. In November 2005, the Gesetz zur Einführung von Kapitalanleger-Musterverfahren (KapMuG), or the Capital Markets Model Case Act, came into force. It enables associations and interest groups to request lead case treatment in securities lawsuits against companies for compensation of damages due to "false, misleading or omitted public capital market information" and claims due to contractual performance. A Model Case Proceeding is selected by the trial court and sent to the appellate court for early resolution of key issues of fact and law, and a representative case is selected.

As an opt-in system, KapMuG is only available to parties who have already filed suit and does not permit a claim to be brought in the name of an unknown group of claimants. A precondition to lead case treatment is that at least 10 individual claims must have been filed in similar securities cases against the defendant. At the end of the lead case trial, the court issues a representative order concerning the matters in common, which is binding upon all related cases. Individual questions of fact and law then are addressed by the courts of first instance.

KapMuG was initially set for a five-year trial period, sun-setting in November 2010, but this has since been expanded through November 2012. Legislators can either prolong it, or have its rules incorporated into the Code of Civil Procedure. While the law makes collective shareholder suits easier to pursue in Germany, it restricts the choice of the more "claimant-friendly" US jurisdiction for collective action by German investors. The need for a collective action procedure was recognized after several thousand lawsuits were filed by Deutsche Telekom shareholders. Overall 14,447 shareholders filed claims against Deutsche Telekom alleging overstatement of the value of real estate in the company's prospectus by €2.8 billion ($3.4 billion).

Despite this loosening of restrictions on group litigation, the German system provides many road bumps to access in addition to the 10-case minimum, the opt-in system, and the requirement that representative cases can only be requested by recognized associations, which were put in place to avoid abuses. Punitive damages are not awarded; in fact, punitive damages awarded in foreign jurisdictions are not enforceable in Germany. Loser-pay rules apply, meaning that the losing party must pay the legal fees of the winning party. The German Act on Lawyers' Remuneration severely restricts contingency and conditional fees. Some changes, however, have occurred regarding fees. In March 2007, the German Federal Constitutional Court ruled that a previous across-the-board prohibition on contingency fees was unconstitutional. In response, a new law took effect in July 2008, which allows lawyers to agree to contingency and conditional fees in circumstances where the client would not have put forward the claim in court, either due to insufficient funds or is unwilling to bear the risk. Third-party funding is increasingly available in exchange for a share of the potential winnings.

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Netherlands

In practice, this is not materially different than in the US, since most cases are settled and the court must approve settlement of securities class action suits.

The Tablaksblat Code, the Dutch corporate governance code, became effective in December 2004, with a revised Code taking effect in January 2009. It encompasses a code of conduct, best practices, and guidelines for declaring remuneration of managers to which listed companies should refer in their annual report. The Code is also based on the Dutch standard that a company is a long-term alliance with all stakeholders, and the directors and officers need to consider these interests with the goal of ensuring continuity of the company. Companies must indicate to what extent they have complied with the principles and best practices provisions, as it is an "apply or explain principle" law as is common in Europe. Similar to Germany, the Code is tailored to the Netherlands' two-board corporate management model. The revised Code contains rules for one-board models.

Collective actions. The Dutch Civil Code (Burgerlijk Wetboek) allows collective actions by associations and foundations on behalf of injured parties for securities, competition, and product liability claims to recover incurred damages. The 2005 Act on Collective Settlement of Mass Damages (CSMDA – also called the Act on the Collective Settlement of Mass Claims) has a provision for associations and foundations to initiate negotiations on settlement with defendants, which then may be approved and declared binding by the Amsterdam Court of Appeal. As opposed to the US system where the plaintiff asks the court to order the defendant to pay compensation, the parties in the Dutch system jointly present their settlement to the Court of Appeal for it to be binding, which avoids "blackmail settlements" common in the US. Cash settlements are awarded only if the Court of Appeal approved the settlement between the parties. In practice, this is not materially different than in the US, since most cases are settled and the court must approve settlement of securities class action suits. The plaintiff group can ask the court to make a decision in law about any disagreements of how the law applies, which limits the denial of liability by defendants when they are most likely at fault. Additionally, defendant companies feel incentives to settle because defending individual cases is costly, and a mass settlement brings a sense of finality. Settling also limits reputation damage.

This Act came into effect in July 2005 and is applicable to Dutch and all other European Union citizens. Before the CSMDA, no cash settlements were allowed, only injunctive and declaratory relief. Individuals cannot act as plaintiffs in collective actions, as this function is reserved for associations and foundations. These organizations represent themselves, and not as a representative of the members of the organization. If cash settlements are awarded,

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The Dutch system offers more access to collective proceedings than most other European systems

then the organization decides how to divvy up the cash among its members. Interestingly, it is an opt-out system like in the US, which means that all affected parties that choose not to opt out are represented by the collective action case, and are bound by the decision.

CSMDA has led to some of the largest settlements in Europe, and comparable to the highest settlements in the US. It was invoked and applied by non-US investors against Royal Dutch Shell in which investors alleged that Royal Dutch Shell had overstated its oil reserves between 1997 and 2003. The settlement of €270 million ($375 million) was approved by the Court of Appeal in May 2009, in this landmark case where the Dutch court claimed jurisdiction for non-US investors and the US court conceded. In another recent high profile case, in January 2007, Dexia, the Franco-Belgian bank, agreed to pay €400 million ($520 million) in compensation to Dutch customers after Dutch investor associations sued for alleged mis-selling of investment products. The Morrison v. National Australia Bank Ltd Supreme Court decision, in which the Court ruled that investors who purchased securities on non-US exchanges cannot bring suits under federal securities laws, will likely bring more suits to the Netherlands, as non-US shareholders look for a similar forum. This topic is discussed more extensively later in this report.

Dutch collective actions have received a great deal of attention from analysts and the Netherlands is reportedly well regarded by the European Commission for its system of collective redress, suggesting that the Dutch system may provide a pan-European model for the future. The Dutch system offers more access to collective proceedings than most other European systems, but with significant controls on excessive litigation; the prohibition against individual plaintiffs is not the least of them. Under Dutch law, loser-pays rules are flexible, as it depends on the judge's discretion to decide which party is liable to bear the other party's legal costs. In practice, the losing party usually pays a fraction of the total legal fees of the winner. The lack of punitive damages is aimed to keep settlements under control and avoid the perceived excesses of the American system, as is the absence of jury trials.

Contingency fee arrangements for lawyers are not allowed. In 2008, however, the government began a pilot scheme to study the effects of permitting "conditional/success fees" where access to justice is restricted. Conditional/success fees are hourly fees that depend on success, as opposed to contingency fees that amount to a percentage of the case payout. This pilot program is expected to take five years to complete. Litigation funding through private parties is forbidden, and is expected to remain the same in the near future.

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Italy

In March 2010, Borsa Italiana approved a revised version of part of the Code on remuneration of directors and key personnel

After the Parmalat collapse – called "one of the largest and most brazen corporate financial frauds in history" by US securities regulators – Italy began to focus on reforms in corporate and securities laws, as well as on greater powers for regulatory authorities. In March 2006, the Italian Stock Exchange, Borsa Italiana, announced guidelines for more a comprehensive and demanding Corporate Governance Code to replace the Corporate Governance Code of 1999 and its amendment in 2002. The updated Code focused on corporate governance for listed companies.

The Code stresses the importance of independent directors and discourages the concentration of power in a CEO or other single individual. It proposes a restriction on the number of boards on which directors can be a member – widely perceived as a weakness in Italian corporate governance since control is concentrated in a small number of individuals through complex cross-ownership structures. The Act recommends the creation of remuneration, nomination and internal control committees of the board of directors. Board members are charged with increasing shareholders' participation in meetings, which would lead to improved investor communication. In March 2010, Borsa Italiana approved a revised version of part of the Code on remuneration of directors and key personnel. It took effect in March 2011, and listed companies are encouraged to apply the revisions by the end of their fiscal year that begins in 2011. The revisions focus on setting remuneration of directors and officers so that it encourages long-term growth, and the establishment of a remuneration committee.

Borsa Italiana monitors the implementation of the Code. The guidelines of this Code, however, are voluntary, but strongly recommended for listed companies. If companies do not implement any part of the Code, then they must supply adequate explanations for their decision not to do so in an annual "report on the corporate governance." This report specifically provides information on internal functions, including on the internal committee and internal dealing systems, as well as directors' remuneration and the degree of their independence.

The Investor Protection Act came into force in Italy in January 2006. The Act amends and supplements various provisions of Italian securities and corporate laws relating to matters such as (1) the appointment of directors and statutory auditors, (2) the responsibility for preparing financial information, (3) the appointment and dismissal of outside auditors, the scope of their audit, and the range of non-audit services they can provide, (4) disclosure relating to affiliates located in certain blacklisted jurisdictions, and (5) the criminal penalties that attach to the violation of these laws. New rules were introduced to encourage

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Just when the matter seemed settled, in reliably Italian fashion, the Act became the source of heated debate and political dramatics

shareholder activism. Shareholders with a minimum of 2.5 percent of the capital stock of listed companies may add matters to the shareholders' meeting agenda. Also the percentage of capital stock shareholders must hold for launching derivative actions against company directors was lowered from 5 percent to 2.5 percent.

Collective actions. Up until recently, no Italian legislation enabled the filing of collective action claims for damages, although Representative Actions brought by associations have been available for injunctive relief. Any number of claimants could have launch an action against the same defendant with the same writ of summons, but in such cases, each claim was treated as separate. Since July 2006, however, parliamentarians reacting to huge monetary losses to investors from the Cirio and Parmalat scandals proposed over a dozen collective action bills. Despite resistance from associations like the Association of Italian Banks (ABI) and Association of Italian Insurance Companies (ANIA), the Financial Act was passed in December 2007.

The Financial Act created a new article, 140-bis, to the Consumers' Code, providing a new collective action for damages, or monetary relief. It was meant to take effect on 29 June 2008. In addition to individuals gaining the right to bring such actions, the article recognizes 16 accredited consumers associations with a national presence in Italy with the right to bring collective actions on behalf of their class. It also allows for ad hoc committees that sufficiently represent collective interests of a class, as determined by judges. It was designed as an opt-in system, where claimants had until the liability decision to opt in.

Just when the matter seemed settled, in reliably Italian fashion, the Act became the source of heated debate and political dramatics. When the right-of-center government took over in April 2008, led by Prime Minister Berlusconi, the Act was suspended until 1 January 2009, to introduce reforms. Debate on the issue, however, raged past this date, and a new implementation date was set for 1 July 2009. To little surprise, reform efforts continued past this date, establishing 1 January 2010, as the new date of implementation. On 23 July 2009, the Collective Redress Act was passed. It took effect 15 August 2009, but lawsuits could not begin until 1 January 2010.

The changes made to the original Act mostly make it more defendant-friendly. A critical sticking point for Berlusconi and his supporters in business was to exclude retroactive application of the law, which would mean that any violations before 15 August 2009 are not subject to this law. The reforms allow defendants to appeal an order certifying a class within 30 days of the order, and the court will rule within 40 days. The opt-in status now applies to those that opt in within 120 days from the expiration of the term set for publicity of the class; as the previous rule allowed claimants to opt in up until the final judgment. Finally, the new

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France does not have a formal system for collective action proceedings. In general, only claims brought by individuals are actionable before French courts

Act establishes that no other collective action can be brought against the same defendant based on the same set of facts.

Some factors in Italian law temper shareholder lawsuits. Loser-pays rules apply, which acts as a deterrent for claimants to file suits. As in Germany, Italy also does not allow pre-trial discovery, there are no juries in Italian litigations, and punitive damages are not contemplated nor those awarded in foreign judgments enforceable. Third party funding of lawsuits is not found in Italy, but contingency and conditional fees have been allowed since July 2007.

France

In August 2003, the Financial Security Law of France became effective, which amended the principle source of corporate governance standard: the French Commercial Code and the French Financial and Monetary Code. It prohibits statutory auditors from providing certain non-audit services and defines certain criteria for the independence of auditors. Shortly after, in October 2003, a report called Le Gouvernement d'Entreprise des Societes Cotees was published and altered the same two corporate governance codes. It provides guidelines for the functioning of the board of directors, including independence criteria, and composition requirements of the compensation and nominating committees. Corporate management structures, as well as the rights of shareholders, are covered by the report.

In January 2011, the government passed a law requiring that at least 40 percent of the board of directors, or supervisory board, should comprise of women by 2017, with an intermediate step of 20 percent by 2014. The composition of women as of March 2011, according to corporate governance consultant GovernmentMetrics International, was 12.8 percent, up from 8.4 percent in 2009, apparently in anticipation of the law's passage.[4] France joins Norway and Spain with similar laws, and a number of other countries are debating the issue of quotas.

Collective actions. France does not have a formal system for collective action proceedings. In general, only claims brought by individuals are actionable before French courts. However, under certain circumstances group proceedings are allowed by associations nationally approved by the Ministry of Economy and Finance. Nationally-approved associations can launch representative proceedings provided their request is approved by the Financial Market Authority following consultation. Associations launching collective action proceedings must have at least 200 members and must have been formed for at least six months. Approved associations can sue for collective injunction relief in specific areas of the law. To bring actions for damages, two or more members must have requested this action in writing and assigned

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When President Nicolas Sarkozy took office, he instructed the Economy Minister to create "a French style class action," but also said he would "avoid any excess similar to the US style class action."

powers of attorney to the association to bring claims on their behalf. Damages are granted to the association as a whole and not on an individual basis.

The French system is an opt-in system with limited advertising for plaintiffs permitted because it is considered solicitation, with newspaper ads often the sole means of communicating with potential claimants. However, the president of the French civil court of first instance and the president of the French commercial court of first instance can now authorize an association to reach out to investors. Punitive damages are not allowed, keeping awards under control, as does the lack of juries for civil trials. Contingency fees are prohibited, but third-party funding is permitted as long as the funding party enters into a contract directly with the plaintiff, and does not directly pay the lawyers' fees. Loser-pay rules are at the discretion of the judge.

When President Nicolas Sarkozy took office, he instructed the Economy Minister to create "a French style class action," but also said he would "avoid any excess similar to the US style class action." Since these comments, multiple bills have been introduced to the National Assembly, and all have either been rejected or left for dead. Some were opt-in proposals and some were opt-out, and all used associations as the primary gateway for collective redress. A Senate information working group released a report on collective actions in May 2010 recommending the introduction of a group action system into French law. In this recommendation, group actions would be limited to economic damages, excluding bodily injuries included in the abandoned Government Bill of 2008, but compensation awards would not be capped. The proposed system would have an opt-in mechanism.

OTHER COUNTRIES

Austria

A debate has been enduring whether to adopt a formal collective action system. An amendment to the Austrian Code of Civil Procedure (Zivilprozessordnung) was supposed to take effect in January 2008. Opposition from the Austrian Chamber of Commerce, Austrian Trade Union, and Ministry of Economics derailed the plans. It defined the minimum number of

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In rare cases, the court can decide to include those who do not opt in, but only for actions brought by designated public authorities like a consumer ombudsman.

claimants of similar questions of fact or law, it was to be an opt-in system, and a group representative would have been nominated.

Group claims can occur under Austrian law in four ways:

- Consolidation of individual cases pending;
- Joinder by parties – required high degree of similarity, and claimants must file suits first;
- Model case – all parties, including defendants, must cooperate; and courts do not need to abide by precedents set; and
- Consumer organizations – in specific cases, consumer organizations can file a case on behalf of its members.

Denmark

Effective January 2008, a formal collective action system was established under the Danish Administration of Justice Act. It provides access to courts for individuals with claims too small to litigate separately. Claims must be similar and attributed to a number of persons. The court must find the class device is the best way to manage the litigation. It is an opt-in system, and the class member must be identifiable and capable of being given notice. In rare cases, the court can decide to include those who do not opt in, but only for actions brought by designated public authorities like a consumer ombudsman.

Finland

In October 2007, a limited system of collective actions was adopted through the Finnish Class Action Act. The system addresses consumer disputes, and claims can only be brought by the Consumer Ombudsman, with an exception for cases resulting from the conduct of issuers of securities. Some means of merging connected cases is allowed, but are not actual collective action cases as each case is brought individually, and each plaintiff and defendant must present their own case. A "pilot case" is often chosen as representative, while the others are left pending awaiting the outcome of the pilot case.

It uses an opt-in mechanism where each member of the group brings their own claims against the defendant. Juries are not permitted in the Finnish court system, and it does not recognize punitive damages, keeping damages under control. Loser-pay rules apply to all costs including attorney fees, where the court decides the extent litigation costs are reasonable. Contingency fees are allowed, but the Consumer Ombudsman does not charge group members.

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For decades, Norwegian law permitted representative litigation brought by organizations in their own name.

Norway

In 2003, Norway became the first country to pass quotas for the percentage of women sitting on boards of directors, which was set for 40 percent by 2006. In 2011, however, the percentage of women lags the law's goal at 35.6 percent.[5]

For decades, Norwegian law permitted representative litigation brought by organizations in their own name. In January 2008, a new collective action law was put in place by the Dispute Act 2005. It gives standing to class members through relevant public and private associations. It is an opt-in system, but the court can order an opt-out approach.

Spain

In 2007, Spain joined Norway with quotas for the percentage of boards of directors consisting of women. For public companies with greater than 250 employees, boards will need to consist of 40 percent women by 2015. In 2011, the percentage of women on boards was at 9.3 percent, up from 6.9 percent in 2009.[6]

The Spanish Civil Procedure Law 2000 made amendments to civil law, expanding the availability of group litigation. The law allows environmental claims by individuals and organizations, as well as collective compensation orders in criminal cases. It instituted a system whereby certain consumer associations can exercise a legal action on behalf of consumers who have sustained injuries or suffered a loss as a consequence of others.

The law allows for collective consumer claims by consumer associations through an opt-in system with a public calling. Civil court trials in Spain are before a judge, and punitive damages are not recoverable under Spanish law, both keeping a lid on abundantly large awards. Loser-pay rules keep unwarranted lawsuits to a minimum. In November 2008, the Spanish Supreme Court overturned a ban on contingency fees, making them fully valid in Spain.

Sweden

The Group Proceedings Act of 2002, brought into force in January 2003, instituted broad group litigation rights. The Act permits private, public, and organization collective actions, which may assert all types of civil causes of action. It marked the first vehicle in Europe for

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It is neither an opt-in or opt-out system because parties need to decide from the outset to file their claims as a joinder, although courts can decide to join claims filed separately.

bringing private individually-driven collective actions, in addition to association and public collective actions seen elsewhere in Europe. Parties may seek damages, as well as injunctive and declaratory relief. It has an opt-in mechanism, and loser-pay rules apply. Agreements on conditional fees may be approved by the court, but contingency fees are not permitted.

Switzerland

The government proposed a new federal code of civil procedure in 2006, which would have established a formal collective action system. This proposal was rejected, and much resistance remains, making it unlikely that a new code will be considered anytime soon. Group claims can occur under the current system in four ways, all of which are restricted by the courts: (1) association suits; (2) administrative association suits (challenges to government decisions); (3) shareholder litigation; and (4) ioinder (parties agree to be bound by the results).

It is neither an opt-in or opt-out system because parties need to decide from the outset to file their claims as a joinder, although courts can decide to join claims filed separately. Punitive damages are not recognized in Swiss law, and no jury trials in any civil actions. Conditional and contingency fees are not permitted. The court will award reasonable compensation for the costs of the proceedings to the winner as loser-pay rules apply, but the court has some discretion.

Demise of F-cubed suits could push cases to Europe

Twists to litigation risks in US courts in recent years were the so-called foreign-cubed (f-cubed) securities lawsuits. These were cases with foreign plaintiffs suing foreign companies, whose shares were purchased on foreign exchanges, in US courts. F-cubed cases usually involved non-US companies with certain securities trading on US exchanges such as American Depository Receipts (ADRs).

In October 2008, the Second US Circuit Court of Appeals, in Morrison v. National Australia Bank Ltd., dismissed the plaintiffs in this f-cubed case, but refused to adopt a bright-line rule barring these types of cases. The plaintiffs were dismissed because the heart of the wrongful conduct, the court decided, occurred outside of the US. The court claimed that f-cubed cases should proceed if wrongful conduct occurs in the US, or if the conduct has a

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With fewer lawsuits allowed in US courts, plaintiffs will most likely seek out newly reformed European forums for their complaints.

substantial effect in the US or upon a US citizen. Then in June 2010, the US Supreme Court weighed in, which affirmed the results but not the reasoning of the Second Circuit. The Court unambiguously concluded that Section 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5, the underlying laws for most federal securities lawsuits, do not apply to the purchase of securities on foreign exchanges. So purchasers of such securities cannot bring federal securities fraud lawsuits under these laws.

The Supreme Court also rejected the opinion that a different test should apply when the fraud involves significant conduct in the US that is critical to the success of the fraud. The suggestion was that such a test would prevent the US from becoming a "Barbary Coast" for frauds envisioned abroad. Justice Scalia gleefully observed that "while there is no reason to believe the United States has become the Barbary Coast for those perpetrating frauds on foreign securities markets, some fear that it has become the Shangri-La of class action litigation for lawyers representing those allegedly cheated in foreign securities markets."[7]

Since this Supreme Court decision, the scope of its findings has been extended in several District Court decisions. In September 2010, in a class action against Societe Generale arising from the Kerviel trading losses, ADRs were not considered as US traded securities as they are predominantly foreign securities transactions. In January 2011, in a suit against the Royal Bank of Scotland, a judge rejected the argument that the Exchange Act applies whenever any security is listed on US exchanges. A different district judge came to a similar conclusion in March 2011 in a suit against Infineon. The case against the Royal Bank of Scotland also extended Morrison to preclude foreign share purchases under the Securities Act of 1933.

With fewer lawsuits allowed in US courts, plaintiffs will most likely seek out newly reformed European forums for their complaints. The Netherlands, with a similar collective redress system to the US, and widely seen as the most likely destination. When Dutch retailer Royal Ahold settled in US courts for €880 million ($1.1 billion), in June 2006, an association under Dutch law to represent class member sued Ahold, claiming they were not bound by the agreement. In June 2010, the Amsterdam District Court ruled that the settlement would be recognized in the Netherlands, and the primary reason given was that proceedings for class action settlements in the US are similar to the Netherland's system for collective settlements.

Post-Morrison, a case similar to the Ahold case in US courts would likely not include non-US shareholders who purchased shares on non-US exchanges, but the Dutch court system seems willing to pick up the slack for the entire EU. The May 2009 Royal Dutch Shell settlement in Dutch courts, for €270 million ($375 million), paid European shareholders because the Amsterdam Court of Appeal held that it had jurisdiction to hear the case and issue a decision

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As court systems reform and allow greater access to collective redress across Europe, other courts could become more favor-able forums for litigators.

for non-US claimants. The US court, pre-Morrison, declared itself not competent to hear the claims of non-US shareholders, in part considering the settlement for non-US investors in Dutch courts.

In light of Morrison, the Southern District Court of New York reversed a class action settlement agreed upon shortly before the Supreme Court Decision, in case against Converium (now SCOR Holdings), a Swiss reinsurer. The district court's decided that it only had jurisdiction to declare the class action settlement binding on shareholders residing in the US and those who purchased securities in the US. This US settlement, for €61.3 million ($84.6 million $75 million from SCOR and $9.6 million from previous owner Zurich Financial Services), included American Depository Shares (ADS), which contradicts subsequent district rulings regarding ADRs. In November 2010, the Amsterdam Court of Appeal provisionally rules in favor of the settlement for non-US investors, amounting to €23 million ($32 million) for SCOR and €13.3 million ($18.4 million) for Zurich Financial Services.

The reasoning given from the Dutch court was that the Dutch settlement complemented the US class action settlement, and that only the Netherlands could have a settlement declared binding on the whole class within the EU. The court claimed jurisdiction to declare the settlement binding on all non-US class members, even outside of the Netherlands. It reasoned that it could hold the settlement binding for shareholders living within EU Member States, but outside the Netherlands, because the Brussels I Regulation gives recognition to judgments in other Member States. The Lugano Convention does the same between EU Member States and Switzerland, Iceland, and Norway. It might be argued, however, that such a decision violates autonomy and undermines public order in other Member States.

Coordinated proceedings in various European courts could develop if courts in EU Member States do not recognize decisions made in the Amsterdam Court of Appeal. As court systems reform and allow greater access to collective redress across Europe, other courts could become more favorable forums for litigators. Although the Netherland's system is considered closest to the US class action system, it lacks some key drivers of large prolific settlements in US courts, namely contingency fees, punitive damages, and jury trials, and it has loser-pay rules.

Rising exposure to suits in US despite Morrison

Collective action proceedings in Europe have become more common and large payments more widespread, but the land of milk and honey, for trial lawyers and plaintiffs, remains the US despite the Morrison decision. The US legal system makes it far easier for plaintiffs

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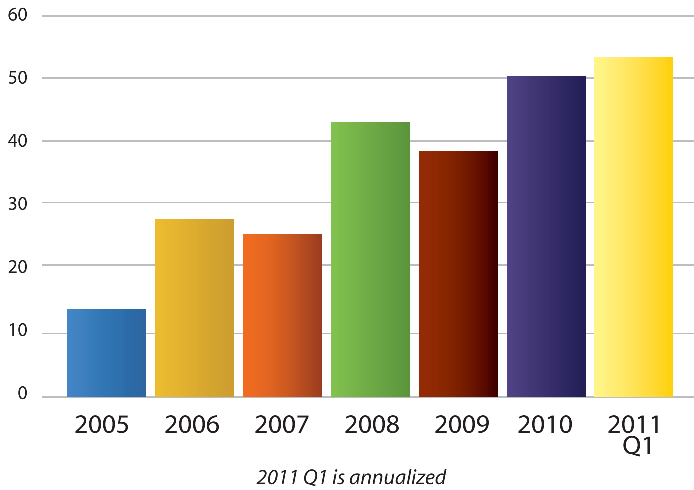
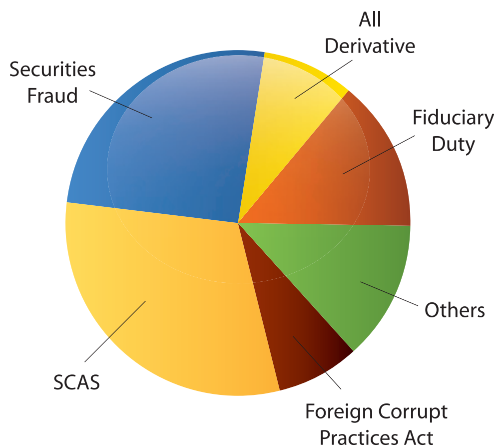
to pursue cases, and contingency fees make it nearly risk-free. The ease with which plaintiffs can sue, as well as a plethora of experienced legal professionals more than willing to lend a helping hand, leads to shareholders being much more likely to pursue cases in the US than in Europe. European companies doing business in the US are vulnerable to legal action in the US, especially if their shares are traded on US exchanges, regardless of home country rules. The number of securities lawsuits filed against European companies and their shareholders in US courts has mushroomed in recent years, growing from 15 suits in 2005 to 44 in 2008, 50 in 2010, and at an annualized rate of 52 in Q1 2011. Growth in new suit filings occurred in 2010 and Q1 2011 despite the falloff in credit crisis- and Madoff-related suits, which dominated 2008 and 2009. Of all suits filed since 2005, 68 percent of them were filed since 2008.



2011 Q1 is annualized

The makeup of cases filed against European companies looks somewhat similar to those filed against US companies, but more heavily weighted toward securities class action suits (SCAS). Of the 212 securities cases filed against European companies in US courts from 2005 to Q1 2011, 79 are SCAS and 73 are securities fraud cases. Advisen defines securities fraud cases as suits charging violations of securities fraud laws filed by regulators or law enforcement agencies. They also include cases brought by private parties alleging violations of securities laws that are not styled as class actions.



The days that cases were dismissed merely because the defendant is a foreign company, subject to foreign laws, is a relic of the past. As globalization of business models march forward, so do exposures to jurisdictions around the world, and the US court system is the leading concern. Cases are being settled and awarded for substantial sums, as well. The average settlement/awarded amount per securities case filed against European companies in US courts, from 2005 to Q1 2011, was €60 million ($81 million). This average includes 112 cases, further evidence that these cases are not being dismissed easily merely due to their non-US homeland. Of the 112 securities suits settled/awarded, 11 were over €75 million ($100 million), consisting of six SCAS and five securities fraud suits.

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In fact, Dutch courts upheld the verdict in the Netherlands, claiming that a group of Dutch shareholders did not make timely use of the opt-out facility.

Large US settlements and precedents

Among the European companies paying large securities class action settlements in the US, although not all insured losses, are: Swiss fire, security and engineering products company (formerly global conglomerate) Tyco International (settled in December 2007 for €2.2 billion – $3 billion), Dutch food retailer Royal Ahold NV (settled in June 2006 for €880 million – $1.1 billion), and Austrian financial services firm BAWAG PSK Versicherug AG (settled in June 2007 for €595 million – $815 million in two related cases). The €2.2-billion settlement by Tyco International is questionably a European company settlement because the company moved its headquarters from Bermuda to Switzerland after a company breakup in 2009 – two years after the behemoth-sized settlement. The suit was a SCAS brought by shareholders that dealt with the scandal surrounding former chairman and CEO Dennis Kozlowski. The suit claimed that the company's directors and officers artificially propped up its share price with false and misleading information, borrowed unauthorized loans from the company, and funded a fraudulent bonus scheme.

The €880-million settlement by Royal Ahold is of particular interest because it remains a record for settlements by non-US companies in US courts, and is up there with the raciest of US-company settlements. It was sparked by disclosures in 2003 of accounting problems at Royal Ahold's US subsidiary. The lawsuit raised red flags beyond its settlement value due to the reach of shareholders that could benefit from its payout. Even before Morrison, most suits filed in the US were subject to only shareholders who purchased the shares on US exchanges. This pre-Morrison case, however, saw all qualified shareholders around the world, regardless of where their shares were purchased, split the settlement. In fact, Dutch courts upheld the verdict in the Netherlands, claiming that a group of Dutch shareholders did not make timely use of the opt-out facility. The prospect that European companies could be held liable to shareholders around the world in US courts is unsettling at best for their directors and officers. In addition to suits brought by US shareholders, before Morrison it was becoming increasingly common for US class action law firms to solicit European shareholders to join them in legal battles in the US.

In December 2008, Siemens AG settled with the US Department of Justice (DOJ) for €310 million ($450 million) in criminal fines, and with the US Securities and Exchange Commission (SEC) for €240 million ($350 million) in disgorgement of profits. These settlements are not part of the average settlement numbers above because they are not securities suits, but are business practice proceedings. They resulted from pleading guilty to violating the internal controls and book and records provision of the US Foreign Corrupt Practices Act

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The shareholder plaintiffs sought damages on behalf of the company, along with changes in corporate governance.

(FCPA). Siemens violated the FCPA by funding $1.36 billion in bribes to foreign officials in conjunction with a vast array of contracts, including the United Nation's Iraq oil-for-food program, telecommunications equipment in Nigeria and Bangladesh, and medical devices in China, Russia, and Vietnam. DOJ and SEC official worked closely with the Munich Public Prosecutor's Office, which in turn settled with Siemens for €390 million ($569 million) in fines and disgorgement of profits. This cross-border collaboration is a sign of regulatory efforts to come, with many countries sharing resources and information in their investigations. In addition to triggering possible defense cost provisions in D&O policies, these enhanced regulatory activities coordinated worldwide will often encourage suits from shareholders and others. The Siemens case is also a sobering example of a non-US company being held liable for violating a US law concerning business conduct outside the United States.

A case filed in 2006 and settled in February 2009 against directors and executives of British Petroleum (BP) in the Superior Court of Alaska gives non-US companies an additional reason to be concerned – the threat of shareholder derivative suits, litigated in US courts, compelling non-US companies to accept American-style corporate governance structures. The defendants, including Peter Sutherland, chairman, and Lord Browne of Madingley, Group CE, are alleged to have violated environmental and safety laws, breached their fiduciary duty of care, exposed the company to fines, inflicted damage to the reputation of the company, and permitted lax internal controls, leading to a "drastic diminution in the value of [BP's] assets." The allegations arose from accidents at Prudhoe Bay, Texas City and elsewhere. The shareholder plaintiffs sought damages on behalf of the company, along with changes in corporate governance. Demands included a shareholder vote to change the articles of association to reduce the number of executive directors on the BP board to two, essentially imposing a US-style board consisting largely of non-executive directors. In the eventual settlement, BP agreed to allow tighter oversight by its largest investors, and set up a Group Financial Risks Committee chaired by the company's CFO.

A similar case filed against BP in New York, also in 2006, was dismissed by a federal judge in Manhattan on the grounds that there was no basis for that type of derivative action under British law at the time that the case was filed. However, the UK Companies Act 2006 has more liberal provisions concerning derivative actions, and such suits against UK companies, and companies in other countries permitting shareholder derivative suits, may be more likely to succeed in the future.

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D&O coverage is viewed in Europe principally as providing protection for defense costs, and less so for the costs of large settlements.

The European D&O insurance market

Advisen estimates the value of the European D&O market, measured by written premium, to have been approximately €1.37 billion ($2.0 billion) in 2008. The overall growing D&O market in Europe, resulting in a robust CAGR of 7.9 percent from 2004 to 2008, has been a result of expanding coverage levels across more companies. Premium growth, on the other hand, has been tempered by falling rate levels, driven by a general state of overcapacity in the global insurance market and increasing competition in the European D&O market. Although the Great Recession kept the overall global insurance market "soft" in 2009, the D&O market was one of the few areas of slight increases in average premium, but that was due almost entirely to higher premiums in the financial institution arena. D&O premiums for financial services companies grew strongly because they have seen the bulk of the D&O claims since the onset of the economic crisis. Premiums in the European D&O market have been down since 2009, as premiums for financial services companies have eased and overcapacity in the global insurance market remains an issue. As the global economy recovers, and rising demand for insurance eats into the overcapacity, premiums across all types of insurance are expected to rise somewhat. This eventual return to growth for all insurance products, in conjunction with growing demand for D&O insurance in Europe, is sure to increase European D&O premiums in future years.

D&O coverage is viewed in Europe principally as providing protection for defense costs, and less so for the costs of large settlements. Consequently, the perceived value is lower than if large settlements were more widely regarded as a threat, and in turn the price paid reflects this value. As more suits settle for higher amounts, the threat will become more real, and this higher perceived value should translate into higher prices.

D&O insurance market growth will vary between countries depending largely on specific laws regarding collective action litigation, executive liability, and director and officer indemnity. In Romania, for example, a law passed in December 2006 made D&O insurance mandatory for all directors of joint stock companies and all subsidiaries of foreign companies. Perhaps the country with the greatest growth potential is the UK, with a combination of new tough liability laws and more access to collective litigation than many other European countries.

UK leading D&O insurance growth. In the UK, the Companies Act 2006 allows companies to protect directors by indemnifying them from action brought by third parties, covering both legal costs and the financial costs of adverse judgments. This widening of companies' powers to indemnify is reflected in the usual D&O policy terms. Directors are being advised to ensure that they have both an agreement to indemnify and complementary D&O cover. Direc-

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How these changes affect the regulatory imprint, and burdens, on the market is yet to be seen.

tors are also being advised to seek policies structured such that each director has a separate interest in the insurance that could not be tainted by the misconduct of another director.

The increased number of investigations and prosecutions in the UK, driven by public anger and fueled by newly fortified resources available to fight fraud, has revved up demand for D&O insurance, and will most certainly continue to do so. In 2009, the FSA won a Court of Appeal judgment, ruling that the FSA could bring prosecutions for offenses that were not specifically part of the UK Financial Services and Markets Act (FSMA) 2000, the law that governs financial markets and endowed the FSA with enhanced authority. This judgment, upheld by the Supreme Court in July 2010, upholds an expansive view of the FSA's criminal enforcement powers, as it concludes that the regulator has the power to prosecute offenses beyond those referred to in the FSMA. Regulators are also encouraging private legal actions as a way of promoting public policy. Loser-pay rules have always tempered private litigation, but the proliferation of third-party funding firms backed by hedge funds has eliminated much of the upfront costs.

In June 2010, a month before that Supreme Court ruling, the newly elected Conservative-led coalition government announced plans to break up the FSA, with expectations of completion by 2012. Most of its authority will become consolidated within the umbrella of powers held by the Bank of England, with other responsibilities going to other new agencies. The Financial Conduct Authority, previously known as the Consumer Protection and Markets Authority, will regulate financial firms providing services to consumers. The Prudential Regulatory Authority, as a subsidiary to the Bank of England, will carry out the prudential regulations of financial firms, including banks, investment banks, building societies, and insurance companies. The government claims that consolidating powers under the Bank of England will help to avoid another financial crisis, which it blamed on the lack of oversight by the Labour Party. Critics claim that separating the consumer protection regulator will weaken its effectiveness and leave consumers with little support. How these changes affect the regulatory imprint, and burdens, on the market is yet to be seen. The disarray that could ensue during transition could result in fewer enforcement actions, but the potential for confusion is more likely a reason for more D&O liability coverage.

Many insurance industry leaders feel that the UK is in an increasingly litigious environment. Industry leaders estimated the UK D&O insurance market in 2009 at over 500 million (about €550 million or $820 million) in annual premium income.[8] Lackluster demand for D&O policies is not an issue for insurers in the UK, as a more pressing concern is dealing with the growing complexity of liability for global companies. The litigation trends in the UK could be seen as a microcosm for the trends in the rest of Europe, just in varying degrees.

D&O insurance, however, is a catastrophe cover, where most of the risk is on the top end, in high limits.

Waking a sleeping giant? In Germany, with much stricter litigation laws, the D&O insurance market was estimated at €367 million ($540 million) in premiums, according to a 2008 Towers Perrin D&O insurance study. The D&O insurance market in Germany was in a trough for several years before the credit crisis. Shortly after the credit crisis hit, however, rates mushroomed. German insurance industry leaders estimated that D&O liability policy rates on 2009 renewals increased 5 percent to 10 percent for non-financial accounts, and 50 percent to 500 percent for financial institutions.[9]

A law passed in 2009, the Act on the Adequacy of Managerial Salaries (or Act on the Appropriateness of Management Board Compensation), could encourage more D&O insurance coverage in Germany. For some time before its passage, the German Corporate Governance Code recommended that listed companies agree to an "adequate" deductible to be borne by the directors protected by the policy. By imposing a personal interest, it is thought to motivate directors to avoid claims altogether. In practice, many German companies circumvented the requirement by merely explaining in their annual filings the opinion that a deductible would not improve director responsibility.

In August 2009, the Act was enacted in Germany, which is an attempt to align management structures with a management style that focused on long-term sustainable development of their companies. The Act also requires publicly traded companies in Germany that purchase D&O insurance to impose personal deductibles on directors and officers, amounting to 10 percent of coverage, but capped at 150 percent of annual fixed compensation. At first glance, this might appear to be a negative for insurance companies, perhaps mandating less insurance for companies to purchase. D&O insurance, however, is a catastrophe cover, where most of the risk is on the top end, in high limits. The largest insurers in Germany, from Zurich to Ace, have claimed that they will not apply discounts for these deductibles because little risk has been removed. They will, however, gladly develop new coverage to insure the deductible separately at the directors' and officers' expense, which is not precluded by the law.

Large company growth, small company renaissance. Most large companies in Europe now have D&O liability insurance coverage in some form. Expanded liability and growing collective action options in most countries have amplified the potential for larger damages, which has enhanced demand for higher limits. Evolving types of D&O policies sought will also build upon opportunities for insurers. A common practice in Europe is to purchase policies protecting all directors and officers, and often the company itself, in one package of coverages subject to a single policy limit. Recent court decisions in some countries have made severability a key issue, as the fraudulent actions of a single officer could wipe out the coverage for all others. Likewise, payments under the policy to corporate insureds could

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Global policies, local restrictions. D&O policies providing global coverage are common, but a growing number of countries require some policies to be issued locally, such as in Romania.

exhaust coverage for the individual directors and officers. Policies with severability provisions have been offered, but courts in Spain and Germany have not recognized these provisions, and have voided entire D&O policies because of the actions of one director. These developments have sparked heightened interest in individual policies, an opportunity for insurers to expand D&O coverage for large companies.

Small- to medium-sized companies provide the largest long-term opportunity for a growing D&O insurance market in Europe. While D&O insurance is well-established among the largest firms, small- and medium-sized firms need to understand that they need cover, as well. This area is just beginning to develop in the UK, and all but untapped in the rest of Europe. As recognized in the US, even executives and partners of private firms need coverage because lawsuits come from sources other than shareholders, and this is particularly true in a world with enhanced corporate governance standards. Germany could see much growth in this area, as it remains largely a private-company dominated economy.

Global policies, local restrictions. D&O policies providing global coverage are common, but a growing number of countries require some policies to be issued locally, such as in Romania. Companies are demanding an arrangement with local, admitted insurers for D&O coverage in countries outside of their headquarters' country, as part of global D&O programs. These programs can be tricky as they require a local presence for issuance requirements, while considering multi-jurisdictional exposures. Certain larger insurers, such as ACE, Zurich Financial, and AIG have promoted special multi-jurisdictional policy wordings, as well as the need for experienced local legal counsel to deal with claims. These restrictions could prove to be a barrier to entry in certain markets. At the same time, they could provide an opportunity for global insurers as these restrictions add yet another wrinkle to the complex mosaic of global liability exposures, requiring the expertise of adept insurers and their legal counsel.

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NOTES:

1. Lawsuit numbers in this report were compiled from Advisen's Master Significant Case and Action Database (MSCAd), which tracks significant lawsuits filed against companies and their directors and officers, as well as other significant events. MSCAd is the most complete and accurate database of potentially significant losses, class actions, suits, cases, events, and fines, consisting of over 90,000 events and $4.5 trillion in aggregate losses.

2. "Evaluation of the effectiveness and efficiency of collective redress mechanisms in the European Union" Civic Consulting and Oxford Economics, European Commission DG SANCO, August 26, 2008.

3. "Study regarding the problems faced by consumers in obtaining redress for infringements of consumer protection legislation, and the economic consequences of such problems" Civic Consulting of the Consumer Policy Evaluation Consortium, GHK, Van Dijk Management Consulting, European Commission DG SANCO, August 26, 2008.

4. "2011 Women on Boards," GovernanceMetrics International, March 2011.

5. "2011 Women on Boards," GovernanceMetrics International, March 2011.
6. "2011 Women on Boards," GovernanceMetrics International, March 2011.
7. Supreme Court of the United States, Morrison v. National Australia Bank Ltd. et al., Region 561 US_(2010), slip op No. 08-1191, June 24, 2010.

8. "Economic Downturn Likely to Spur UK D&O Market," BestWire, February 2009.
9. "German Legislation Could Spur New D&O Liability Coverage," BusinessInsurance.com, July 19, 2009.

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