KEY POINTS

- The UK has seen a rise in collective securities actions, an important development aligned with international trends.
- Third-party litigation funding, institutional investor activity and public regulatory activity are significant factors, balanced by limits placed on effective collective action by the opt-in GLO procedure.
- The courts' approach to questions of reliance and the appropriate measure of damages, including the use of financial economic evidence, will be important in shaping the future role of private collective securities actions in the UK.

Feature

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Collective action and securities law in the UK: recent and anticipated developments and international trends

This article considers the rise in collective securities actions in the UK, factors contributing to that rise, and future developments that will help determine the longer-term significance of such actions.

INTRODUCTION

The UK has recently seen a marked rise in high-value collective securities actions. This represents an important development, aligned with longer-term trends in similar jurisdictions including the US and Australia. The future direction of such actions is of undoubted importance for institutional and individual investors, issuers, directors and officers, advisors and other market participants. This article considers the rise of such actions, beginning with specific examples and considering factors contributing to that rise. It then turns to consider future developments that will help shape the role private collective securities actions play within the broader context of private and public enforcement of UK securities law.

SECURITIES ACTIONS IN THE UK

The most common claims brought in collective securities actions allege misstatements or omissions in disclosures required of companies trading in regulated markets. These can be in respect of securities issued in the primary market (such as a misstatement in a prospectus) or traded in the secondary market (such as an unlawful omission from a listed company's quarterly report).

In the UK, such claims are most likely to be brought under ss 90 and 90A of the Financial Services and Markets Act 2000 (FSMA). Section 90 provides a statutory remedy for misstatements and omissions in listing particulars and prospectuses. Section 90A provides a (more limited) statutory remedy for misstatements and omissions in periodic and episodic disclosures in relation to securities traded on certain markets.

The presumptive vehicle for collective securities actions is the Group Litigation Order (GLO) procedure in Pt 19 of the Civil Procedure Rules. This procedure allows a court to group and manage multiple claims giving rise to common or related issues of fact or law using specified procedures. Its principal effect is to bind all parties in relation to common or related issues. Claimants must, however, affirmatively opt in by filing a claim form and becoming a party. In that respect, it differs from the well-known US-style class action, as further explained below.

EXAMPLES

Two recent examples are actions brought by groups of shareholders against the Royal Bank of Scotland (RBS) under s 90 of FSMA and Tesco under s 90A.

Royal Bank of Scotland

On 22 April 2008, RBS announced a £12bn rights issue. This capital raising took place just months before RBS's near-collapse, leading to a dramatic decline in the share price and, ultimately, a £45bn government bailout.

In the course of 2013, five groups of claimants commenced claims totalling some £4bn against RBS and its former directors. The claims were the subject of a GLO in December 2013. The claimants alleged that RBS misrepresented its financial position in the prospectus in breach of s 90 of FSMA.

In 2016, RBS announced it had reached a settlement with four of the five shareholder groups, representing 77% of the claims by value. The fifth group's claim, in excess of £1bn, is scheduled to be heard later this year.

Tesco

On 22 September 2014, Tesco announced that it believed it had overstated its profits guidance by an estimated £250m. Its share price sharply declined following the announcement. The Serious Fraud Office (SFO) subsequently commenced an investigation into three former directors of the company. In September 2016, the SFO charged the three former directors with accounting fraud.

Within a month of Tesco's announcement, class action proceedings were commenced against Tesco and certain of its directors in US federal courts in respect of Tesco American Depository Receipts (ADRs). The US has a highly developed class action framework and class action proceedings would typically follow an accounting overstatement and share price decline of this magnitude. In December 2015, the federal court approved a $12m settlement.

In October 2016, a group of institutional shareholders commenced a claim against Tesco in England under s 90A of FSMA, claiming losses related to the overstatement of profits and subsequent decline in the share price. The claim is funded by a third-party litigation funder. Further funded claims by separate groups of institutional shareholders and, in time, a GLO, are expected.[1]

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On 28 March 2017, the Financial Conduct Authority (FCA) announced that Tesco had acknowledged engaging in market abuse in relation to its overstated expected profits and agreed to a restitution scheme to compensate investors. Eligibility for, and the scope of compensation under, the scheme are tightly circumscribed. The scheme is nonetheless significant, representing the first time the FCA has exercised its powers to require a listed company to pay compensation for market abuse.

Simultaneously on 28 March 2017, the SFO announced it had entered into a deferred prosecution agreement (DPA) with Tesco Stores Limited relating to false accounting in 2014.[2]

Other cases

The RBS and Tesco actions are recent examples of forms of securities litigation that are prevalent in jurisdictions with more established collective action frameworks. Other analogous actions in the UK include claims by certain shareholders in Lloyds in relation to its January 2009 acquisition of HBOS.

Nevertheless, collective securities actions in the UK remain few in number, both in absolute terms and as a proportion of GLOs. This stands in marked contrast to the US, Canada and Australia, in which securities class actions represent firmly established features of their respective class action regimes.

FACTORS CONTRIBUTING TO THE RISE OF COLLECTIVE SECURITIES ACTIONS

Collective securities actions in the UK are, however, on the rise. It remains premature to attempt firm conclusions as to the factors contributing to, and the broader trajectory of, this trend. With that caveat, we consider the following factors to be both significant and consonant with international trends.

Third-party litigation funding

One obvious factor is the rise of third-party litigation funding, including after-the-event (ATE) insurance to protect against the risk of an adverse costs award.

Large-scale securities litigation is expensive, particularly as a proportion of an investor's loss where (as is common in securities claims) losses are widely dispersed. In addition, claimants in England are exposed to the risk of an adverse costs award if unsuccessful. The costs of defending against a collective securities action can be considerable, as illustrated by the over £100m that RBS is reported to have spent defending against its shareholder claim. The English rule that costs follow the event is frequently cited as an important reason for the slower uptake of collective action mechanisms in the UK as compared to similar mechanisms in the US.

The continued rise and acceptability of third-party litigation funding is likely to facilitate collective securities actions in the UK. This would follow trends in Australia, where the rise of third-party litigation funding and ATE insurance has contributed to a sharp rise in class action filings generally and securities class action filings in particular.

The role of institutional investors

Institutional investors have long used litigation, strategically and selectively, to recover losses and maintain market discipline. Institutional investors have played a central and active role in both the RBS and Tesco actions.

One important feature of this has been the formation of small and cohesive groups of institutional investors as part of wider GLO-governed litigation. In the RBS litigation, for example, RBS reached settlements with several smaller (but high-value) groups of institutional investors while the claims of a much larger group of more than 27,000 investors, who rejected the settlement offered, continue.

This bears some analogy to the increasing prevalence of "opt-out cases" in US securities litigation. This refers to the phenomenon where certain investors or groups of investors, typically large institutions, elect to opt out of class-wide securities litigation in order to pursue separate claims. The advantages can include greater influence over the course of the proceedings and the prospect of an improved financial outcome. This may be of heightened significance in the context of a very large, and correspondingly unwieldy, group action.

Interrelationship with public enforcement

One further factor that will affect the course of collective securities actions in the UK is the emerging relationship between private securities litigation and the actions of public enforcement bodies, notably the FCA and SFO.

The optimal relationship between public and private enforcement of securities law is the subject of debate. In the US, the Securities and Exchange Commission has long viewed private securities litigation as a necessary adjunct to its enforcement programme. The Australian Securities and Investments Commission has also expressed support (if more cautiously) for class actions in enforcing securities law. By contrast, the UK has charted a more modest course for private securities claims, with a corresponding reliance on increased public regulatory powers.

The actions taken by public regulators in an individual case will, however, have a significant impact on investors' strategy and prospects in individual or collective actions for relief. One obvious example is the ability to use factual findings recorded in a DPA, which, depending on the circumstances, a company may not be able to dispute. In addition, the statement of facts required as part of a DPA may provide a detailed roadmap for litigants, including as to what internal company documents exist and might be sought in disclosure.

Limitations of the English "opt-in" model

The above factors can, generally, be regarded as having contributed to the rise of collective securities actions in the UK. One important qualification, however, relates to the "opt-in" nature of the GLO procedure. This will continue to place limits on the prevalence of such litigation.

In a GLO, each claimant must affirmatively opt in to the action by filing a claim form and becoming a party. In the US, subject to certification by a court, a claimant can bring a class action on behalf of a defined class. Class members are then required affirmatively to opt out of the class in order not to be bound by the judgment. Similarly, the UK Competition Appeal Tribunal now provides, subject to certification, for opt-out collective actions for damages under the Competition Act 1998.

There have been sporadic calls for a broader opt-out collective action procedure in the UK that would extend to securities claims, but not, as yet, the necessary appetite. In the meantime, the opt-in nature of the GLO procedure will continue to limit the prevalence of collective securities actions in the UK.

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SIGNIFICANCE AND FUTURE DEVELOPMENTS

The role of collective securities actions is unquestionably significant for market participants and their advisors. Looking forward, there are a number of potential developments that will help bring this role into sharper focus.

Reliance

One important issue that frequently arises in securities actions is the traditional requirement that an investor prove reliance on an alleged misstatement in order to claim compensation for loss suffered as a result. This issue becomes all the more acute in the context of collective securities actions, in which reliance is frequently sought to be established or substituted for on a class- or group-wide basis. The question of reliance is the subject of notably divergent approaches in different jurisdictions. In the US, the Supreme Court recently affirmed that the reliance requirement can be satisfied on a class-wide basis by a (rebuttable) presumption that the price of stock traded in an efficient market reflects all publicly available information, including material misstatements, and that the typical investor trades in reliance on the integrity of that market price. In Australia, it was recently held that, even in the absence of direct reliance, indirect causation could be established by showing that the conduct complained of deceived the market in which the shares traded, artificially inflating the price.

Section 90 of FSMA (governing listing particulars and prospectuses) does not impose a reliance requirement. Section 90A of FSMA (governing periodic and episodic disclosures), by contrast, does require that the person suffering loss "acquired, continued to hold or disposed of the relevant securities … in reliance on the information in question" and that such reliance was reasonable. The English courts have not yet considered the precise contours of this statutory requirement. The manner in which it is determined will have a significant impact on the efficacy of the private right of action in s 90A.

Loss causation and quantification

Both ss 90 and 90A of FSMA expressly provide for compensation for persons who have suffered loss as a result of untrue or misleading statements or omissions. The appropriate measure of damages, however, remains unsettled.

In particular, there is an important question whether the appropriate measure is that applying in the tort of deceit or in negligence. The deceit measure is the more generous, allowing recovery of all loss suffered as a direct consequence of the fraudulently induced transaction. The negligent misstatement measure, by contrast, would confine damages to the consequences of the statement being false or misleading.

The courts' approach to loss causation and quantification will have a significant impact on the viability of collective securities actions in the UK. On either approach, complex issues as to the causation and quantification of loss are likely to arise.

Expert evidence

In the US, parties have made substantial use of financial economics in determining issues such as the materiality of alleged misstatements and how causation is to be established where an investor alleges it has suffered loss. Such analysis typically considers the observable impact on a company's share price of disclosure of corrective information (such as restated accounts or media exposure) and seeks to distinguish it from unrelated market and industry factors.

Notably, the analytical tools developed and refined in US securities class actions are increasingly being argued and applied elsewhere. In Australia, for example, financial economic evidence is frequently deployed in securities class actions on such issues as reliance and causation, often drawing on US expertise.

Financial economic evidence will undoubtedly be relied on by both claimants and defendants in collective securities actions in the UK. Its application will, of course, need to be tailored to the specific statutory context of ss 90 and 90A of FSMA.

International context

Finally, a notable feature of collective securities actions is the increasingly international context in which loss is suffered, liability determined and redress sought and obtained.

In the Tesco claim, for example, class proceedings were commenced (and settled) in respect of Tesco ADRs in the US, proceedings have been commenced in the UK seeking redress for a group of specified claimants, and a Dutch foundation (or "*stichting*") has been established seeking a pan-European class settlement.

This trend towards multi-jurisdictional recovery, including by large institutional investors, is driven in part by the US Supreme Court's decision in *Morrison v National Australia Bank* 561 US 247 (2010). In *Morrison*, the court found definitively that securities traded outside the US are not within US jurisdiction. This has led investors to seek other fora. The UK courts' approach to determining compensation for investor losses under ss 90 and 90A of FSMA will contribute in significant part to the viability and attractiveness of the UK as a forum in which to seek redress.

CONCLUSION

The long-term role of collective securities actions in enforcing UK securities law remains uncertain. However, the recent rise in such actions, alongside the continued increase in third-party litigation funding and public regulatory activity, suggests a significant role, if ultimately limited by the opt-in nature of the GLO procedure. From here, much will depend on the courts' approach to questions of reliance and the appropriate measure of damages, including the use of financial economic evidence. ■

1 Disclosure: Boies Schiller Flexner (UK) LLP and Fideres Capital are assembling a group of institutional investors to pursue collective proceedings against Tesco.

2 The DPA concerns only the potential criminal liability of Tesco Stores Limited and does not address whether liability of any sort attaches to Tesco PLC or any employee or agent of Tesco PLC or Tesco Stores Limited.

Further Reading:

- Collective proceedings and financial markets claims [2017] 4 JIBFL 241.
- Class actions: setting the criteria [2009] 6 JIBFL 313.
- Lexis PSL: Banking & Finance: Class action in Europe: comparative law and EC law considerations.