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STRENGTHENING INVESTOR CONFIDENCE IN EUROPE: U.S.-STYLE SECURITIES CLASS ACTIONS AND THE *ACQUIS COMMUNAUTAIRE*

STEFANO M. GRACE

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I. INTRODUCTION

Law and economics scholars provide strong empirical evidence that effective disclosure laws and the availability of private enforcement mechanisms benefit securities markets through encouraging issuers to provide more reliable information to market participants and promoting investor confidence.[1] As the European Union (EU)[2] strives to build a single securities market among its

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1. *See* Rafael La Porta, Florencio Lopez-de-Silanes & Andre Shleifer, *What Works in Securities Laws?*, 61 J. FIN. 1 (Feb. 2006) (noting procedural rules in common law countries provide greater incentives for issuers to provide truthful information to market participants through private enforcement and that private enforcement in turn promotes shareholder wealth); *see also* Katharina Pistor, Martin Raiser & Stanislaw Gelfer, *Law & Finance in Transition Economies*, 8 ECON. OF TRANSITION 2, 325 (2000) (noting the importance of private enforcement measures in transitioning economies).

2. It is worth noting the European Union is not yet a legal entity, a status that the adoption of the constitutional treaty recently voted down in France and the Netherlands, would have provided. The current powers of the EU are granted through a series of treaties

member states through the *acquis communautaire*,[3] it faces growing concerns regarding investor protections and strengthening corporate governance in Europe.[4] Recent corporate scandals in Europe[5] have affected individual investors on a large scale with similar injuries.[6] This has led to a recent shift in the role of enforcement in several EU member states, from solely state and public consumer group enforcement mechanisms to the inclusion of private enforcement.[7] As a result, European member states are increasingly adopting variations of U.S.-style securities class action[8] mechanisms that may soon help restore investor confidence and provide greater protections against corporate malfeasance in Europe.[9] The European Ministers of Justice have also called for EU-wide reforms to provide for U.S.-style securities class action devices and private enforcement mechanisms, and such reforms may soon become a reality in light of the current trend of EU member states amending procedural rules to facilitate private enforcement through securities class actions in Europe.[10]

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comprising the European Community. *See* Europa, The EU at a Glance, http://europa.eu.int/abc/history/index_en.htm (last visited March 3, 2006).

3. Europa, European Commission: Justice and Home Affairs Glossary, http://europa.eu.int/comm/justice_home/glossary/glossary_a_en.htm (last visited Apr. 3, 2006) (defining *acquis communautaire* as the "entire body of legislation of the European Communities and Union, of which a significant body relates to justice and home affairs" and noting that "[a]pplicant countries must accept the *acquis* before they can join the EU").

4. *See, e.g.*, Mark Wegener & Peter Fitzpatrick, *Europe Gets Litigious: Class Actions and Competition Enforcement May Change Europe's Legal Culture*, LEGALTIMES, May 23, 2005 (noting the shift in Europe to protect investors in light of recent financial scandals and efforts in the U.S. to restrict class action litigation); *see also* Europa, European Commission: Internal Market – Securities & Investment Funds, http://europa.eu.int/comm/internal_market/securities/index_en.htm (last visited Apr. 3, 2006) (noting the aim of EU directives under the European Commission's Financial Services Action Plan is to "ensure the development of a single securities market").

5. References to Europe in this article apply generally to the European Union and its member states, as this article focuses on the efforts to promote a single securities market within the European Union.

6. Kerry Capell, Gail Edmondson, Carol Matlack, Ariane Sains, Jack Ewing & Juliane von Reppert-Bismarck, *Europe's Old Ways Die Fast*, BUSINESSWEEK, May 17, 2004, *available at* http://www.businessweek.com/magazine/content/04_20/b3883018.htm (discussing recent corporate scandals in Europe and the relatively quick response to reform old business practices).

7. *See generally* Linda A. Willett, *U.S.-style Class Actions in Europe: A Growing Threat?*, 9 BRIEFLY (June 2005), *available at* http://www.nlcpi.org/books/pdf/BRIEFLY_Jun05.pdf (discussing the shift in enforcement mechanisms in Europe).

8. *See generally* 5 JAMES WM. MOORE ET AL., MOORE'S FEDERAL PRACTICE ¶ 23.02 (2005) (noting the purpose of the U.S. class action mechanism "is to make multi-party litigation expeditious and economic").

9. *See, e.g.*, Brendan Malkin, *UK Firms Gear Up as Class Action Culture Hits Europe*, THE LAWYER, Feb. 7, 2005, *available at* http://www.thelawyer.com/cgi-bin/item.cgi?id= 113914&d=122&h=24&f=46.

10. *Concern Grows over Exposure to U.S. Lawsuits*, FINANCIAL TIMES, May 30, 2005, *available at* http://news.ft.com/cms/s/f55c94f8-d0a6-11d9-abb8-00000e2511c8.html.

While the debate continues at the Community[11] level, individual EU member states have begun implementing class action legislation.[12] However, current procedural devices vary with regard to the kinds of enforcement mechanisms that are available to individual investors in EU member states. As the European Commission works to implement pan-European securities regulations,[13] a directive on class action procedural rules would likely benefit EU member states as they attempt to provide legal certainty[14] for market participants and restore investor confidence in Europe.[15] Additional EU member states will likely recognize the benefits of private enforce mechanisms leading to greater natural convergence[16] among EU member states, and unification of law[17] may soon follow through the development of the *acquis communautaire.* When adopting securities class action mechanisms, EU member states have taken divergent approaches in an attempt to avoid the

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11. Community refers to the European Union and its member states collectively as they are "governed by the Treaty establishing the European Communities." European Commission: Justice and Home Affairs Glossary, http://europa.eu.int/comm/justice_home/glossary/glossary_c_en.htm (last visited Apr. 3, 2006).

12. Quinn Emanuel, Trial Lawyers: Practice Description, Class Actions Abroad: Opening Pandora's Box?, http://www.quinnemanuel.com/news/article_detail.aspx?recid=6 (last visited Apr. 3, 2006) (discussing recent developments to introduce class action mechanisms in Europe and other countries).

13. *See, e.g.*, Europa, European Commission: Internal Market—Financial Services Action Plan, http://europa.eu.int/comm/internal_market/finances/actionplan/index_en.htm (last visited Apr. 3, 2006) (setting forth a plan to adopt legislative measures in support of a single EU securities market); *see also* EILÍS FERRAN, BUILDING AN EU SECURITIES MARKET, 1-5 (2004).

14. *See, e.g.*, Thomas D. Rowe, Jr., *Debates Over Group Litigation in Comparative Perspective: What Can We Learn From Each Other?*, 11 DUKE J. OF COMP. & INT'L L. 157, 158 (noting the importance of legal certainty in "national and international markets and financial systems" and that the absence of "enforceable rule of law can hinder investment and growth"). Further noting, that public enforcement is more effective at stopping rather than preventing conduct, but even though private enforcement is more effective at remedying and preventing harmful conduct it is often not worth pursuing when individual claims are small. *Id.*

15. *Id.* (noting also that a class action mechanism can enable aggregation of claims to seek a remedy for harm caused that is otherwise too small to seek individually).

16. At first glance it might appear that the convergence is a form of legal transplant, but it is more likely driven by the shift in societal needs and recognition that the state cannot act alone in meeting those needs. Further, some class action mechanisms may be borrowed in part from the U.S. model, yet no EU member state has transplanted the U.S. model as a whole. *See generally* John Henry Merryman, *On the Convergence (and) Divergence of the Civil Law and the Common Law*, 17 STAN J. INT'L L. 35, 359-73, 387-88 (1981), *quoted in* JOHN HENRY MERRYMAN, DAVID S. CLARK & JOHN O. HALEY, THE CIVIL LAW TRADITION: EUROPE, LATIN AMERICA, AND EAST ASIA, CASES AND MATERIALS 17 (LexisNexis ed., 1994) (discussing different kinds of divergence and convergence that occur in adoption of legal systems). Merryman further notes that while civil law codes are much older than common law codes and arguably more developed, there still exists convergence in both directions. *Id.* at 17-18.

17. This is often referred to as "hard convergence" in the context of international treaties such as those of the European Community. *See* Mark Bauer, Professor of Law, Stetson University College of Law, Class Lecture in International and Comparative Competition (Antitrust) Law, Estonia Summer Abroad Program 2 (Aug. 8, 2005) (on file with author).

procedural flaws of U.S.-style securities class actions.[18] However, EU member states can learn from recent attempts in the U.S. to curb such procedural abuses in securities class action litigation, and should consider new forms of private enforcement mechanisms as they seek to restore investor confidence and promote more efficient securities markets in Europe.

This article examines the recent trend to adopt variations of U.S.-style class action mechanisms in Europe in an effort to provide greater investor protections while avoiding abuses of the devices seen in the United States. This Note considers the divergence of procedural mechanisms and emphasizes that greater convergence will likely follow as the EU strives to build a single securities market and seeks better corporate governance. Part II provides a brief overview of the perceived deficiencies of the U.S. class action model and reluctance to adopt certain procedural elements in EU member states. Part III considers the shift in Europe away from exclusive state enforcement measures towards private enforcement, examining the recent class action mechanisms adopted in Sweden and the Netherlands, the class action proposal in France, and attempts to avoid the feared "legal blackmail"[19] and "floodgate" effects of the U.S. class action model. Part IV examines the German "model case proceeding" for capital markets and its apparent attempt to protect German issuers from U.S.-style securities litigation through a new class action approach. Part V looks at recent trends in the United States to limit the perceived abusive use of U.S. class action devices in securities litigation, as well as the lessons that EU member states can learn from these measures. This article concludes that while EU member states have recently adopted diverging class action mechanisms to provide greater private enforcement in Europe, future harmonization efforts to promote a single securities market at the EU level will likely create greater convergence in Europe through unification of laws.

II. OVERVIEW OF CONCERNS IN EUROPE WITH U.S.-STYLE SECURITIES CLASS ACTIONS

As the *acquis communautaire* and legal systems of EU member states continue to evolve, the European Commission and Ministers of Justice in Europe have expressed growing concern that it

18. *See infra* Part III.

19. This espouses the view that plaintiff lawyers abuse U.S. class action devices as leverage to obtain large settlements from corporate defendants based on non-meritorious claims. *See, e.g.*, Oikeusministeriö, Introducing Class Actions in Finland?, at 3. (Fin.), http://www.om.fi/14421.htm.

has become increasingly difficult for public authorities to police and monitor corporate misconduct.[20] These concerns are supported by recent empirical studies noting that strong private enforcement measures help mitigate agency costs of aligning the interests of management with those of the outside shareholders.[21] Such measures promote greater disclosure and deter management from expropriating resources for personal gain.[22] Private enforcement has thus, been recognized as a means of addressing these concerns, yet fears of becoming overly litigious and cultural considerations have led to questioning certain elements of the U.S. class action model.[23] The primary concern among EU member states is that certain mechanisms of the U.S. model encourage "legal blackmail" and conflicts of interests for attorneys litigating such claims.[24] These concerns primarily involve the U.S. model's: (1) contingency fee; (2) "opt-out" provision of Rule 23(b)(3); and (3) rejection of the "loser pays" rule (or the "English rule"). The reluctance to adopt these procedural mechanisms in Europe is further supported by the substantial debate regarding the value of these mechanisms and recent attempts to limit abuse of class action devices in the United States.[25] These devices are often enhanced by discovery devices, punitive damage awards and attorney advertising, which are predominantly features of the U.S. judicial system and are generally not available in EU member states.[26]

A combination of the devices that comprise the U.S. class action model makes U.S. courts attractive to foreign plaintiffs seeking recovery. However, the adoption of such procedural devices in EU member states may soon pave the way for greater investor pro-

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20. Quinn Emanuel, *supra* note 12; *see also* Concern Grows over Exposure to U.S. Lawsuits, *supra* note 10.

21. *See* La Porta, Lopez-de-Silanes & Shleifer, *supra* note 1.

22. *Id.*

23. *See, e.g.*, Hon. Roberth Nordh, Group Actions: The Swedish Approach, Cour de Cassation, http://www.courdecassation.fr/manifestations/colloques/Colloques2005/actions_collectives/judge_nordh.pdf (discussing the impact of globalization over the past 20-30 years as creating a new need in society for revamping old civil codes that did not foresee the kinds of disputes societies face today). Judge Nordh co-led the Swedish commission that examined the need for revisions to the Swedish civil code. He notes further revisions to the current Swedish model will likely be necessary to promote access to justice. *Id.* at 7.

24. *See generally* Willett, *supra* note 7 (discussing reservations in Europe to adopt U.S. class action mechanisms).

25. *See, e.g.*, Private Securities Litigation Reform Act of 1995, 15 U.S.C. § 78u-4 (2005); Securities Litigation Uniform Standards Act of 1998, 15 U.S.C. § 77p (2005); Class Action Fairness Act of 2005, 28 U.S.C. §§ 1711-15 (2005).

26. *See* John H. Beisner & Charles E. Borden, Expanding Private Causes of Action: Lessons from the U.S. Litigation Experience, O'Melveny & Myers LLP, http://www.omm.com/webdata/content/newsevents/beisnerpdf2.pdf (last visited Apr. 3, 2006) (noting lack of availability of these devices in Europe serves as an added obstacle to plaintiffs and plaintiff firms).

tections in Europe.[27] Empirical evidence suggests that issuers who cross-list on U.S. securities markets achieve permanent increases in stock value and greater liquidity on home exchanges.[28] Cross-listing allows firms to signal to investors that it has implemented the stricter corporate governance procedures required to withstand the strong private enforcement mechanisms in the United States, thus, mitigating agency costs.[29] Lord Denning provided the following view commonly espoused by opponents of the U.S. class action model:

> As a moth is drawn to the light, so is a litigant drawn to the United States. If he can only get his case into their courts, he stands to win a fortune. At no cost to himself, and at no risk of having to pay anything to the other side. The lawyers there will conduct the case "on spec" as we say, or on a "contingency fee" as they say. The lawyers will charge the litigant nothing for their services but instead they will take forty percent of the damages, if they win the case in court, or out of court on a settlement. If they lose, the litigant will have nothing to pay to the other side. The courts in the United States have no such cost deterrent as we have. There is also in the United States a right to trial by jury. These are prone to award fabulous damages. They are notoriously sympathetic and know that the lawyers will take their forty percent before the plaintiff gets anything. All this means that the defendant can be readily forced into a settlement. The plaintiff holds all the cards.[30]

As long as adequate private enforcement mechanisms are unavailable in Europe, European investors will likely continue to seek protection under U.S. securities laws when possible[31] because of the procedural appeal noted by Lord Denning. Thus, as dis-

27. *Id.*

28. Piotr Korezak & Martin T. Bohl, *Empirical Evidence on Cross-Listed Stocks of Central and Eastern European Countries*, 6 EMERGING MARKETS REV. 121, 122 (2005); *see also* John C. Coffee, Jr., *Racing Towards the Top? The Impact of Cross-Listing and Stock Market Competition on International Corporate Governance*, 102 COLUM. L. REV. 1757 (2002).

29. Coffee, *supra* note 28, at 1763-64.

30. *See* BERNHARD GROSSFELD, THE STRENGTHS AND WEAKNESSES OF COMPARATIVE LAW 67-68 (Tony Weir trans., Oxford Press 1990) (quoting Lord Alfred Thompson Denning).

31. *See infra* Part V (noting U.S. courts are often willing to exercise extraterritorial jurisdiction over foreign plaintiffs, even where securities were purchased or sold on a foreign exchange where elements of the conduct or effects test are met).

cussed in Part IV, there may soon be a shift in Europe to prevent non-EU judicial systems from binding absent class members in securities disputes pertaining to European issuers.[32] Such action would be to protect European issuers from the abuse of U.S.-style class action mechanisms that EU member states have sought to avoid. However, this may lead to increased forum shopping within EU member states for judicial systems with the most plaintiff-friendly procedural devices as Europe creates a single securities market.

A. Contingency Fees and No-Win-No-Pay Rules

While usage of contingency fees is most prevalent in the United States and Canada, a growing number of EU member states permit risk agreements such as "no-win-no-pay" rules, typically not tied to a percentage of the awards or only partially tied to the awards, and limited contingency fee arrangements that could promote a U.S.-style class action culture in the EU.[33] Estonia, Hungary and Latvia currently permit unrestricted contingency fee agreements, while Greece caps such agreements at 20 percent of the recovery, and the Czech Republic, Finland, France, Lithuania, Slovakia and Sweden permit limited forms of contingency fee agreements.[34] Ireland, Malta and the United Kingdom permit "no-win-no-pay" agreements not tied to a percentage of award recoveries.[35] However, other member states such as Germany, the Netherlands and Italy have rejected such fee agreements.[36] Absent a harmonizing directive, this divergence will likely make jurisdictions that permit forms of contingency or "no-win-no-pay" fee agreements more attractive as private enforcement actions become more prevalent in Europe.

One of the primary criticisms of contingency fee arrangements, especially in the context of securities class actions, is the perceived windfall for attorneys who arguably receive more than their hourly

32. *See infra* Part IV (noting the German attempt to limit extraterritorial jurisdiction over German issuers).

33. *See, e.g.*, Christopher Hodges, *Multi-Party Actions: A European Approach*, 11 DUKE J. COMP. & INT'L L. 321, 341-42 (2001).

34. *See* Europa, Comparative Report Prepared by Ashurst for the Competition Directorate General, 103-04 (Aug. 31, 2004), *available at* http://europa.eu.int/comm/competition/antitrust/others/private_enforcement/comparative_report_clean_en.pdf.

35. France permits fees based partially on a percentage of the award, while Sweden only permits risk agreements in the class action context. *See id.* at 104; *see also* Willett, *supra* note 7, at 15-16; Hodges, *supra* note 33, at 341.

36. Comparative Report, *supra* note 34, at 104.

rate for winning a case.[37] Such fees are often seen as creating a conflict of interest because attorneys may choose to settle for less than is in the client's interest to avoid perceived risks or to favor entrepreneurial incentives.[38] However, a common justification for permitting contingency fees is to provide greater access to justice for those who could not otherwise afford the often high costs of litigation by providing incentives for attorneys to represent such clients.[39] In most state-centered EU member states, free public legal assistance is available for those who can show a need for assistance and the "loser pays" rule is also often suspended for actions against the state.[40] Yet, such state assistance is not expressly available in cases of securities litigation and would not likely cover the high costs of litigating securities claims.[41]

B. FRCP Rule 23(b)(3) "Opt-Out" Provision

A predominant feature of the U.S. class action model that provides for private enforcement is the *res judicata* binding effect of the "opt-out" provision under Rule 23(b)(3) of the Federal Rules of Civil Procedure.[42] While "opt-out" provisions have previously been non-existent in Europe, the Dutch parliament recently adopted the first "opt-out" class action device in Europe that closely resembles the U.S. class action mechanism. The Dutch provision displays a shift among EU member states towards favoring finality regarding disputed questions of law or fact.[43] As with Rule 23(b)(3) proceed-

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37. U.S. contingency fee arrangements typically award 33.3% of any recovery to the plaintiff's attorney, but in the securities litigation context the median fee award is substantially lower at 22% percent of the recovery. *See* Theodore Eisenberg & Geoffrey P. Miller, Attorneys Fees in Class Action Settlements: An Empirical Study, Cornell Leg. Stud. Research Paper No. 04-01, 12, 33 (Sept. 24, 2003), http://ssrn.com/abstract=456600 (last visited March 28, 2006); *see also* Kent Davis, *The International View of Attorney Fees in Civil Suits: Why is the United States the "Odd Man Out" in How it Pays its Lawyers?*, 16 ARIZ. J. INT'L & COMP. L. 361 (1999).

38. *See* Herbert M. Kritzer, *2002 Institute for Law and Economic Policy Litigation Conference: Litigation in a Free Society: Seven Dogged Myths Concerning Contingency Fees*, 80 WASH. U. L. Q. 739, 741 (2002); *see also* Hodges, *supra* note 33, at 341.

39. *Id.*

40. *See* Willett, *supra* note 7, at 12.

41. *Id.*

42. Prior to class certification under Rule 23, the representative parties must first meet the prerequisites of Rule 23(a): (1) joinder is impracticable; (2) a common question of law or fact exists; (3) there is typicality with the class; and (4) a fair and adequate protection of class interests is ensured, and second meet the notice and opportunity to opt-out of a Rule 23(b)(3) proceeding. Fed. R. Civ. Proc. 23(a); *see also* JACK H. FRIEDENTHAL, MARY KAY KANE & ARTHUR R. MILLER, CIVIL. PROC. § 16.2 (2d ed. 1993) (explaining the elements of Rule 23). The pre-1966 Rule 23 required an "opt-in" approach seen as an obstacle to finality as it did not resolve all claims against the defendant, exposing them to possible further liabilities and discouraging settlements. *Id.*

43. This is evident from recent criticisms of the "opt-in" device in Sweden as it does not encourage settlement or finality of claims. The German model also seeks to address

ings, absent class members must "opt-out" or be bound by the *res judicata* binding effect of the courts ruling.[44]

European scholars have often criticized the binding effect of Rule 23 based on the perception that it may deprive absent class members of adequate determination of their individualized claims that are not entirely common to the class, further noting that the device provides lawyers with too much leverage that may encourage large corporate defendants to settle "speculative claims" in the form of "legal blackmail."[45] However, the "opt-out" provision also has clear benefits as it promotes the interests of: (1) economy by litigating a single claim and avoiding litigation of multiple cases at a greater expense; (2) consistency by avoiding differing outcomes of separate trials; and (3) finality by resolving all claims against the defendant once and for all.[46] Such a device in Europe will likely promote private enforcement through aggregating claims, thus helping mitigate agency costs on European exchanges.[47]

C. Loser Pays Rule and FRCP Rule 11

The "loser pays" rule or "English rule" in Europe is often seen as one of the biggest deterrents of non-meritorious litigation, but critics argue that the rule limits access to justice by increasing financial barriers to bringing small claims.[48] The "English rule" is the predominant rule in Europe, and only one EU member state, Luxembourg, has rejected the rule requiring each party to pay their own litigation costs similar to the American approach.[49] This could become an important factor if Luxembourg adopts a class action mechanism, or if an EU directive is implemented harmonizing procedural rules in Europe, as Luxembourg courts would likely become more attractive to individual investors because there would be less risk if the plaintiff's suit ultimately fails.[50]

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these concerns through a different binding mechanism. *See* Quinn Emanuel, *supra* note 12; *see also* Beisner & Borden, *supra* note 26, at 7.

44. *See* Beisner & Borden, *supra* note 26, at 7.

45. *See, e.g., id*; *see also* Nordh, *supra* note 23; Kritzer, *supra* note 38. This argument lends support for the German "model proceeding" measure that tries to address the individualized elements of each claim separately. *See infra* Part IV.

46. Edward F. Sherman, *American Class Actions: Significant Features and Developing Alternatives in Foreign Legal Systems*, 215 F.R.D. 130, 132 (2003).

47. *See, e.g.*, Korezak & Bohl, *supra* note 28.

48. *See, e.g.*, Kritzer, *supra* note 38.

49. Comparative Report, *supra* note 34, at 104-05 (noting while the general rule in the Netherlands is that each party pays its own costs, the court may make an exception for payment of partial fees).

50. For comparison, in a recent suit against Railtrack, 55,000 shareholders in Britain brought a group action represented by an association and the High Court judge denied a request to cap shareholders' potential liability for the defendant's fees and the case was subsequently placed on hold in light of the risk to shareholders (fees were estimated to

In the United States, rejection of the "English rule" facilitates greater access to justice, yet it is often criticized because the substantial costs of litigation may lead a defendant to settle non-meritorious cases.[51] Conversely, the "English rule" that is predominant in Europe is often viewed as a substantial obstacle to litigating small claims that are meritorious as it often blocks access to justice due to the potential high risk of having to pay the defendant's fees.[52] Courts in the United States use Rule 11 sanctions as a mechanism for punishing non-meritorious suits by making the attorney pay some or all of the other side's fees.[53] However, Rule 11 is not as substantial a deterrent as the "loser pays" rule and is not frequently utilized.[54] As EU member states continue to adopt class action mechanisms, the "loser pays" rule may continue to be a substantial deterrent to private investor enforcement measures in Europe.[55]

III.SHIFTS IN EUROPE TOWARDS U.S.-STYLE SECURITIES IV.CLASS ACTIONS

While "representative actions" are arguably not new to Europe, the shift from public to private enforcement is a relatively new phenomenon with regard to representative actions.[56] Current trends in EU member states to adopt class action mechanisms that provide for private enforcement and recovery of damages in securities cases may soon lead to greater corporate governance in the EU.[57] As Europe recently experienced its own share of large scale corporate scandals with Royal Ahold in the Netherlands (misstating financials), "France's Vivendi Universal (opaque accounting, princely compensation), Marconi and Cable & Wireless in Britain (totally somnolent boards), Ireland's Elan Corp. (really creative accounting), Deutsche Telekom in Germany (addicted to debt), and

reach more than $2.3 million). Ted Allen, Interest in Class Actions Grows Outside the U.S., Securities Litigation Watch (June 14, 2005), *available at* http://slw.issproxy.com/securities_litigation_blo/2005/06/the_state_of_fo.html.

51. *See* Willett, *supra* note 7, at 13.

52. *Id.*

53. *Id*; *see also* Fed. R. Civ. Proc. 11.

54. *See* Willett, *supra* note 7, at 13.

55. *See* Allen, *supra* note 50.

56. *See* Willett, *supra* note 7; *see also* William B. Fisch, *European Analogues to the Class Action: Group Action in France and Germany*, 27 AM. J. COMP. L. 51 (1979) (comparing earlier forms of group actions in France and Germany to the U.S. class action mechanism).

57. *See* PricewaterhouseCoopers LLP, 2004 Securities Litigation Study 6 (Mar. 31, 2005), *available at* http://www.10b5.com/2004_study.pdf (last visited Apr. 3, 2006) (indicating a rise in private securities class action litigation in the U.S. with 203 cases filed in 2004, noting the rise in private securities class actions against foreign issuers accounted for nearly 15% of the cases).

ABB in Sweden (for a staid engineering company, they sure knew how to make a golden parachute)" European bourses and shareholders were greatly affected.[58] The scandals led to further decline of voter confidence in Europe.[59]

When examining the decisions of a specific country to adopt new procedural mechanisms for private enforcement, it is worth noting in general terms the different kinds of political economies that exist and may influence the process. The United States is often considered a heavily market-centered political economy that discourages government regulation, and when the government does regulate, it favors supplementing public enforcement with private rights of action.[60] However, Western European social welfare states, like France and Germany, are considered substantially more state-centered political economies that historically favor government regulation and public enforcement measures.[61] By contrast the United Kingdom emphasizes a mix of the state-centered and market-centered political economies that often helps ease a shift towards market-centered goals in Europe.[62] The mixed traits of the United Kingdom are often seen as an attribute to European harmonization, as they promote unity with state-centered political economies in Europe while also often raising market-centered goals.[63]

A notable shift in representative action occurred in 1998 in Europe with the adoption of a European Commission Directive seeking greater protection for consumer interests and providing for qualified public group actions in addition to state enforcement measures.[64] While no EU member state has adopted a true U.S.-style class action model, in 2002 Sweden was arguably the first EU member state to enact a similar mechanism permitting private enforcement through an aggregated class action device, signaling a shift in Europe to address the current needs of society through re-

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58. Kerry Capell, Gail Edmondson & David Fairlamb, *Opening Up the Boardroom*, BUSINESSWEEK, May 19, 2003, *available at* http://www.businessweek.com/magazine/content/03_20/b3833015_mz047.htm (last visited Mar. 28, 2006) (quoting cover text referring to recent changes in corporate governance in Europe in the wake of these large scale scandals).

59. *Id.*

60. John C. Reitz, *Symposium: Interrogating Globalization: The Impact On Human Rights: Doubts About Convergence: Political Economy as an Impediment to Globalization*, 12 TRANSNAT'L L. & CONTEMP. PROBS. 139, 141 (2002).

61. *Id.* at 141-42.

62. *Id.* at 142.

63. *See generally id.* at 143 (noting the United Kingdom has aligned with decision-making measures in the EU because of its state-centered tendencies, but has been the lone dissenter on issues of political economy. The latter can be attributed to its market-centered tendencies).

64. *See* Quinn Emanuel, *supra* note 12.

visions to their civil codes.[65] However, the Swedish mechanism more closely resembles the pre-1966 Rule 23 provision in the United States, as it provides for an "opt-in" class device.[66] The Netherlands recently adopted a class action device that closely resembles the current Rule 23(b)(3) provision in the United States providing for binding absent class members through an "opt-out" provision.[67] The United Kingdom[68] recently changed its interpretation of representative actions that have existed for over two hundred years, and France and others[69] are considering adopting similar U.S.-style class action devices. In stark contrast, however, Germany recently adopted a substantially different class action device for securities disputes that differs greatly from the U.S.-style class action device.[70] The Germany model further seeks to limit application of the U.S.-style class action devices against German issuers.[71] As additional EU member states consider adopting class action devices, there will be a greater need for a harmonizing directive at the EU level to ensure equal treatment of market participants in Europe's single securities market and to avoid forum shopping within the EU.

A. *EU Directives: A Sign of More to Come Through the Acquis Communautaire*

As the European Commission continues to enact directives to create a single securities market and promote cross-border securities transactions in Europe through the *acquis communautaire*,

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65. *Id.*
66. *Id.*
67. *Id.*
68. While the United Kingdom has permitted "representative actions" for over 200 years, application of the rule had been limited by courts adopting a narrow interpretation of the procedural rules (requiring claims to be identical). However, in 2000 with the adoption of new procedural rules the court now permits consolidation of claims, which is a step in the direction of U.S.-style class actions. *See id.*
69. Spain has adopted an approach similar to the "opt-in" association representation mechanism in the United Kingdom, Norway (not a member state of the EU, but part of the European Economic Area) has followed the Swedish model and Finland and Italy are currently considering adopting U.S.-style class action measures. *See* Beisner & Borden, *supra* note 26, at 8-9.
70. *Country Reports: Europe: Germany: Shareholder Actions Facilitated Under Two Newly Adopted Laws*, 11 World Sec. L. Rep. 8 (Aug. 2005), http://pubs.bna.com/ip/ bna/wsl.nsf/f89826265796c0c985256fa9006a29a8/d2f49aba1646590b8525705f0066eef0?OpenDocument; *see also* Burkhard Schneider, *Country Reports: Europe: Germany: Germany's Proposed Capital Investors' Model Proceeding Law May Require Revision To Achieve Goals*, 11 World Sec. L. Rep. 5 (May 2005), *available at* http://pubs.bna.com/NWSSTND/IP/BNA/wsl.nsf/SearchAllView/30F5585EFC08DDD585257004006F9A4F?Open&highlight=GERMANY (discussing draft proposals) [Hereinafter referred to collectively as "World Sec. L. Rep"].
71. *Id.*

the Commission has also presented a number of draft directives to protect individual investors and provide checks on corporate behavior in Europe.[72] The Commission's goals to promote investor confidence and encourage disclosure of information in an effort to strengthen the securities market would be further enhanced by private enforcement mechanisms in Europe.[73]

In 1998, the European Commission shifted away from traditional state enforcement measures in Europe through the adoption of a harmonizing directive "on the injunctions for the protection of consumers' interests" through group actions.[74] The directive required each EU member state to enact national laws by the end of 2000 providing for minimum standards for group actions by "qualified entities" in Europe, such as approved consumer associations.[75] While the shift did not endorse U.S.-style class actions or private attorney generals, it introduced public group actions for injunctive or declaratory relief by actors other than the state.[76] The Commission further adopted a regulation for recognition and enforcement of judgments among EU member states.[77] Under current EU legislation, courts of EU member states must recognize judgments issued by courts of other EU member states.[78] This is important as it promotes an environment for forum shopping within the EU and allows individual EU member states to decide how to treat non-EU judgments.

B. Sweden: Adoption of Elements of the Pre-1966 U.S. Class Action Model

The adoption of a class action device in Sweden began a shift in Europe to allow private rights of action for securities disputes

72. *See* Securities & Investment Funds, *supra* note 4 (providing an overview of EU harmonization directives to be implemented by member states); *see also* Europa, European Commission: Internal Market – Company Law & Corporate Governance, http://europa.eu.int/comm/internal_market/company/index_en.htm (last visited Apr. 3, 2006) (providing an overview of proposed EU harmonization directives on cross-border transactions, disclosure requirements and shareholder rights). The current Company Law & Corporate Governance Action Plan calls for implementation of harmonization directives by 2010 and consultation documents call for greater private enforcement mechanisms and harmonization of class action devices. *Id.*

73. *See* Hsianmin Chen, *The EBRD and Corporate Governance Reform in Central and Eastern Europe and the CIS*, EBRD 6 (2004) (discussing the Commission's basis for adopting the action plan).

74. Council Directive 98/27, 1998 O.J. (L 166/51) (EC), *available at* http://europa.eu.int/comm/consumers/policy/developments/acce_just/acce_just09_en.pdf.

75. *Id.*; *see also* Quinn Emanuel, *supra* note 12; Beisner & Borden, *supra* note 26, at 6.

76. *See* Quinn Emanuel, *supra* note 12.

77. Counsel Regulation (EC) No. 44/2001 of 22 Dec. 2000, 2001 O.J. (L 12/1), *available at* http://europa.eu.int/eur-lex/pri/en/oj/dat/2001/l_012/l_01220010116en00010023.pdf.

78. *See* Beisner & Borden, *supra* note 26, at 6.

and to ease procedural rules to allow for greater recovery.[79] In the early 1990s, the Swedish Parliament (*Sveriges Riksdag*), commissioned a working group to determine the need for an aggregated representative action mechanism.[80] After the ABB scandal, where ABB's CEO received a $78 million severance package after he stepped down in late 1996 without the knowledge of the ABB board, and other corporate scandals in Europe, the Swedish government recognized the increased need for private enforcement.[81] Like other critics in Europe, *Sveriges Riksdag* was skeptical of the U.S. approach, yet it recognized a need to protect investor confidence and encourage private enforcement in Sweden.[82] The Swedish working group noted the incentives in the United States to abuse the U.S.-style class action devices, yet it looked to Australia and Canada[83] as examples of countries that have adopted variations of the device without creating a market for frivolous lawsuits.[84] The working group further acknowledged that the "loser pays" rules in Australia and Canada serve as an added deterrent to the abuse in the United States.[85]

In June of 2002, *Sveriges Riksdag* passed the *Lag om Grupprättegång* ("Group Proceeding Act"), which went into effect on January 1, 2003. [86] The Act provides for private group actions (class actions) in Sweden similar to U.S.-style class actions in all areas of civil law where a legal issue could otherwise be litigated, including private causes of action in securities disputes.[87] While the Group Proceeding Act requires standing to bring a class action, the Act simply requires that the class representative be a member

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79. *See* Nordh, *supra* note 23.

80. *Id.*

81. Stanley Reed & Ariane Saines, *Outraged in Europe Over ABB*, BUSINESSWEEK, March 4, 2002, *available at* http://www.businessweek.com/magazine/content/02_09/b3772140.htm (quoting Swedish Prime Minister Goran Persson as saying "I have great difficulty understanding how [Barnevik] could have done something so lacking in judgment"). The article further discusses the uproar caused in Sweden by labor unions blaming layoffs on the severance package and the claims by the Swedish Shareholders Association calling the action "obscene." *Id.*

82. *See, e.g.*, Sveriges Advokatsamfund, Till Justitiedepartementet, http://www.advokatsamfundet.se/platform/components/upload/consume/streamFile.asp?id= 692 (last visited Apr. 3, 2006) (discussing concerns with the proposed Group Proceeding Act).

83. While Australia and Canada have both adopted "opt-out" provisions, both countries implement the "loser pays" rule, which serves as a substantial obstacle to class action litigation. *See* Quinn Emanuel, *supra* note 12.

84. *See* Nordh, *supra* note 23, at 8.

85. *Id.*

86. § 1 Lag om Grupprättegång (Svensk författningssamling [SFS] 2002:559) (Swed.), *available at* http://www.notisum.se/rnp/sls/lag/20020599.HTM (last visited Apr. 3, 2006). The law also provides for group actions brought on behalf of consumer organizations and public groups. The statute notes that group refers to the "persons for whom the plaintiff brings the action" commonly referred to as the "class" in the United States. *Id.*

87. *Id.*

of the class with common or similar claims.[88] Thus, unlike Rule 23, the Swedish model does not require class certification.[89] More notably, the Act implements an "opt-in" provision similar to the pre-1966 Rule 23 provision,[90] only binding members of the class who choose to become part of the proceeding.[91] The class representative may enter a settlement agreement on behalf of the class, yet it will only have a binding effect on all class members if the court approves the settlement.[92] Sweden further adopts the "loser pays" rule whereby the class representative together with other members of the class who intervene in the suit bear the risk of having to pay the defendant's costs if the suit fails.[93]

As part of the *Lag om Grupprättegång*, *Sveriges Riksdag* added an additional provision allowing for "risk agreements" as a limited contingency fee arrangement based primarily on a higher hourly rate.[94] Moreover, the new fee arrangement provision only applies in the context of the new class action device.[95] Despite the relatively new Swedish class action mechanism, there has been minimal usage of the rule for private actions.[96] Critics of the Swedish class action model opposed the adoption of the measure on the grounds that it would encourage forum shopping and create a European class action culture.[97] The "loser pays" rule and "opt-in" mechanism have served as deterrents to use of the class action device in Sweden.[98] While some favor the rule, recent criticism notes that cultural and sociological shifts indicate a demand for an "opt-out" provision to provide greater incentive for settlement and finality.[99] As the class action procedural devices continue to shift towards more favorable measures for plaintiffs, it is more likely that greater corporate governance will be achieved in Europe.

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88. *Id.* at §§ 4-8.

89. *See* Nordh, *supra* note 23, at 4-5.

90. *See* Edward H. Cooper, *Class Action Advice in the Form of Questions*, 11 DUKE J. OF COMP. & INT'L L. 215, 256 (discussing implications of the 1966 amendment to Rule 23 in the United States).

91. *Id.* at 4; *see also* Nordh, *supra* note 23, at 5.

92. Lag om Grupprättegång, *supra* note 86, § 26.

93. *See* Nordh, *supra* note 23, at 5.

94. Lag om Grupprättegång, *supra* note 86, §§ 38-40; *see also* Nordh, *supra* note 20, at 5.

95. Lag om Grupprättegång, *supra* note 86, § 40.

96. *See* Nordh, *supra* note 23, at 7.

97. The International Class Action: Comments on the Geneva Group Action Debates, 1 Class Action L. Rep. 9 (Aug. 25, 2000).

98. *See* Sveriges Advokatsamfund, *supra* note 82, at 8.

99. *Id.* (noting the initial recommendation was for an "opt-out" class action mechanism).

C. The Netherlands: A Closer Step towards the U.S. Class Action Model

The Dutch Parliament recently passed the Act on the Collective Statement of Mass Claims in the Netherlands that closely resembles the U.S. Rule 23(b)(3) class action mechanism.[100] This new provision comes in the wake of several corporate scandals that affected Dutch investors, including Royal Ahold and Royal Dutch Shell.[101] Unlike the Swedish model, the Dutch have adopted an "opt-out" provision that will enable a group representative to seek a binding settlement for all absent class members and will further provide for damage awards.[102] A feature of the Dutch Act distinguishing it from the U.S. class action model is that it does not provide for a named class representative, but instead requires the suit to be brought by a representative association.[103] This could arguably be an attempt to avoid the professional plaintiff problem, as it requires forming a group to represent the claims of the class.[104]

While in the U.S. corporations typically oppose class action measures, the Dutch Act received substantial praise from the Dutch business community largely because of its binding effect and finality.[105] The provision is welcomed as a means of providing finality for meritorious claims.[106] Unlike the Swedish and U.S. models, the Dutch government has rejected all forms of contingency fee agreements as conflicts of interest for the class counsel.[107] The Dutch apply the "loser pays" rule, further diverging from the U.S.-style class action model.[108] The absence of contingency fees and the risks associated with the "loser pays" rule may still serve as a deterrent in the Netherlands, but this new class action device furthers the shift towards U.S.-style private enforcement measures and will likely promote greater efficiency because of its binding effect.

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100. Quinn Emanuel, *supra* note 12.

101. *See* Beisner & Borden, *supra* note 26, at 7.

102. *Id.; see also* Quinn Emanuel, *supra* note 12.

103. Beisner & Borden, *supra* note 26, at 8.

104. *Id.*

105. *Id.*

106. Global Legal Group, The International Comparative Legal Guide: Product Liability 2005: Class Actions in the EU 4, http://www.iclg.co.uk/khadmin/Publications/pdf/498.pdf (last visited Apr. 3, 2006).

107. Justitie, Dutch Government is Against a 'No-Win-No-Fee' System (Mar. 4, 2005), http://www.justitie.nl/english/press/press_releases/archive/archive_2005/%5C50309Dutch_Government_is_against_a_nowinnofee_system.asp; *see also* Comparative Report, *supra* note 34, at 104.

108. *See* Comparative Report, *supra* note 34, at 105.

D. France: Reinforcing the Shift

French law currently provides for *action representation conjointe* ("action in joint representation") permitting claimants to bring an action as a group, provided each individual claimant must plead their own claim and each claim is evaluated separately.[109] However, in 2005 French President Jacques Chirac announced plans to permit class action law suits in an effort to protect consumers and investors in France.[110] After the turmoil of the Vivendi Universal corporate scandal, President Chirac noted that the class action device will cover securities litigation in an effort to protect investors and promote investor confidence in France.[111] The French government has sought comments and advice from class action consultants around the world, including Sweden, Canada, the Netherlands and the United States, and has indicated that it will likely adopt a Canadian-style class action model.[112] Like the U.S. model, it provides for private representative actions and an "opt-out" device.[113] However, Canada retains the "loser pays" rule. Thus, the French will likely adopt an "opt-out" approach, while retaining the "loser pays" rule.[114] As one commentator recently noted, "[i]f France has it, then it wants everyone else to have it too."[115] The French approach could have a significant affect on private enforcement in Europe if an "opt-out" device is adopted as France provides for partial contingency arrangements tied to damages awards. If the French succeed at providing a strong private enforcement device it will likely lead to improved corporate governance and serve to promote investor confidence in France.

V. GERMAN MODEL PROCEEDINGS ACT & REJECTION OF U.S.-STYLE CLASS ACTIONS

The German approach is of great significance as it can be seen as an express rejection of U.S.-style class action mechanism by the *Bundesregeirung* (German Federal Government) and the

109. *See* Global Legal Group, *supra* note 105, at 4.

110. Mondaq, Canada: Davies Lawyers Called To France For Important Class Action Conference, Apr. 21, 2005, http://www.mondaq.com/content/pr_article.asp?pr_id=1639.

111. Allen, *supra* note 51.

112. *Id.*

113. *See* Global Legal Group, *supra* note 106, at 4.

114. *See Id.*

115. Peggy Hollinger, *France Mulls Allowing Class-Action Suits*, FINANCIAL TIMES, Jan. 7, 2005.

Bundestag (German Federal Parliament).[116] It represents greater divergence in the approaches taken in Europe to remedy investors injuries arising in today's global economy and place checks on corporate behavior in Europe, yet the German model could serve as an alternative approach that other countries could build upon in the future. The new device can be likened to the manner by which Germans codified German law as they attempted to capture the *Volksgeist*[117] (national character) and be innovative through change while not divorcing themselves from their past too quickly.[118] Here the Germans appear to be heavily influenced by protecting issuers, rather than providing greater enforcement for investors.

Since 2000, Germany has experienced a large backlash in shareholder confidence in light of recent corporate scandals, notably Deutsche Telekom, and a drastic decline in the number of Germans investing domestically by more than 26 percent.[119] In an effort to restore investor confidence, Germany enacted two laws that became effective November 1, 2005, making it easier to bring private actions to recover losses and introducing an innovative class action mechanism.[120] The first Act, *Gesetz zur Unternehmensintegrität und Modernisierung des Anfechtungsrechts* (Integrity of Businesses and Modernization of the Rules on Shareholder Actions Act or "UMAG"), provides a private right of action and amends the German business judgment rule.[121] The second Act, *Kapitalanleger-Musterverfahrensgesetz* (Capital Investor's Model Proceeding Act or "KapMuG"), provides for a model procedure as a "test case" to allow courts to issue a binding ruling on common elements of claims.[122] The KapMuG further provides for an *elektronischer bundesanzeiger* (online central litigation registry) where plaintiffs can seek information on common complaints, law firms

116. *Id.*

117. *See* University of Virginia, Dictionary of History of Ideas, *Volksgeist*, http://etext.lib.virginia.edu/cgi-local/DHI/dhi.cgi?id=dv4-66 (providing a history of the term *Volksgeist*); *see also* Tahirih V. Lee, Class Lecture in Comparative Law at Florida State University, College of Law (Sept. 1, 2005) (on file with author).

118. *See* Lee, *supra* note 117.

119. Zurich, Industry Insight: New Laws and a New Landscape in Europe, Nov. 2005, http://www.zurich.com/main/productsandsolutions/industryinsight/2005/november2005/industryinsight20051026_003.htm (last visited Apr. 3, 2006) (discussing new laws in Germany and corporate scandals leading up to their enactment). The article further notes that 15,000 shareholders brought actions against Deutsche Telekom for its failure to disclose risks in its prospectus. *Id.*

120. *Id.*

121. *Gesetz zur Unternehmensintegrität und Modernisierung des Anfechtungsrechts* [Integrity of Businesses and Modernization of the Rules on Shareholder Actions Act], BRDrucks 15/5092 (July 8, 2005).

122. *Kapitalanleger-Musterverfahrensgesetz* [Capital Investor's Model Proceeding Act], BRDrucks 15/5093 (July 8, 2005).

can monitor claims, and notice can be effected electronically on the class.[123] However, unique elements of each claim and requests for damages must be litigated individually.[124]

Under the KapMuG, a plaintiff may seek a model proceeding to determine a common question of law or fact, and all related proceedings will be suspended for a four-month notice period.[125] If at least ten similar petitions are made within the notice period, a model proceeding will commence and the other proceedings will remain suspended pending its outcome.[126] The determination of the proceeding is binding with *res judicata* effect on all parties with claims pertaining to the decided issue of law or fact, like that of Rule 23(b)(3) except there is no "opt-out" option under German law.[127]

Another important element of the new German Capital Investor's Model Proceeding Act is that it expressly rejects upholding judgments against German issuers issued by non-EU member state jurisdictions.[128] One commentator notes that this is an effort to expressly limit U.S. class action litigation against German issuers.[129] This will likely have an impact on U.S. Courts that are often willing to exercise extraterritorial subject matter jurisdiction over securities class action suits with *conduct* in the United States or with *effects* impacting investors in the U.S. or U.S. securities markets, and on the American court's analysis regarding binding absent German class members in disputes against German issuers.[130] This rule could negatively affect the benefits associated with cross-listing of German issuers' shares in the form of depository receipts on U.S. exchanges, if doing so does not provide protections for purchasers in the German market.[131] Critics of the Kap-

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123. *See* World Sec. L. Rep., *supra* note 70.

124. *Id.*

125. *Id.*

126. Kapitalanleger-Musterverfahrensgesetz, supra note 122.

127. *See* World Sec. L. Rep., *supra* note 70. It is worth noting that Rule 23(b)(3) includes an "opt-out" option as a matter of fairness to ensure due process for individual plaintiffs. Recent criticism of the Act points out that it fails to provide adequate due process to absent class members (which is also the basis for adopting the "opt-out" approach in other countries); *see also* European Group for Investor Protections, Fostering an Appropraite Regime for Shareholders Rights – Second Consultation by the Services of the Internal Market Directorate General, July 15, 2005, http://forum.europa.eu.int/irc/DownLoad/k4eXA9JHmgG-phOO1C4B-dAl6fk2p4nUqi8Ju4Fx-BCSO0MtEmBq64hPz04u-AdRuqN2GrGuypb4pq1Cq6z/egip_en.pdf (last visited Apr. 3, 2006).

128. *Id.*

129. *Id.*

130. *See infra* Part V (noting U.S. courts are often willing to bind absent foreign class members if foreign courts will likely recognize the U.S. judgment – this is done in part as a matter of fairness to the defendant in an effort to prevent defending a second claim by dissatisfied absent class members). However, it is unlikely that this will affect the court's analysis when the claims involve American residents.

131. *See generally* Coffee, *supra* note 28.

MuG claim that it will not substantially reduce costs to plaintiffs because there is no real aggregation of claims and point out that the 15,000 Deutsche Telekom cases will take years to litigate with large costs to the individual investors.[132] Thus, it likely will not decrease the burden on the courts because parties must still file their individual claims and prove certain elements to obtain recovery.[133] The "loser pays" rule applies and Germany does not permit contingency fee arrangements, thus limiting access to private enforcement necessary to mitigate agency costs.[134]

It is also important to note that this model is seen as an alternative approach to common class action mechanisms and could lead to greater tensions at the EU level as the European Commission attempts to harmonize minimum standards to protect investors across a common securities market and to provide access to justice. Further, unlike other class action models, the German approach is specifically designed for use in securities litigation and does not apply to other areas of substantive German law.[135] Germany traditionally has a highly technical and highly organized code system, and this may further explain why this model is not fully plaintiff-centric but rather focused on improving investor confidence while protecting issuers.[136]

VI. LESSONS FROM RECENT CLASS ACTION REFORMS IN THE UNITED STATES

As Europe attempts to provide greater investor protections and strengthen its securities markets through private enforcement measures, it is worth noting the failures and successes of the American private enforcement measures as well as learning from recent attempts to curb abuses in U.S. securities class action litigation. Under the common law legal system in the United States, courts have recognized an implied private right of action creating private attorney generals[137] for enforcement of U.S. securities

132. *See* World Sec. L. Rep., *supra* note 70; *see also* European Group for Investor Protections, *supra* note 127 (calling for private enforcement measures at the EU level and claiming that the new German class action model is inadequate to promote investor rights and protect the market).

133. *Id.*

134. *Id.*

135. *Id.*

136. *See, e.g.*, Tahirih V. Lee, Class Lecture in Comparative Law at Florida State University, College of Law (Sept. 6, 2005) (on file with author) (discussing Germany's civil code).

137. *See* 1 HERBERT NEWBERG & ALBA CONTE, NEWBERG ON CLASS ACTIONS §§ 1.06, at 1-19 (3d ed. 1992) (discussing the "private attorney general" notion that is unique to American jurisprudence).

laws, and the U.S. Supreme Court has upheld such rights despite the apparent silence of Congress on the matter of not codifying such a right.[138] The private attorney generals frequently supplement public enforcement measures of the Securities and Exchange Commission because of the Commission's limited resources and inability to closely police corporate behavior together with their deterrent effects.[139] Empirical data shows that the U.S. private enforcement model promotes disclosure by issuers mitigating agency costs and the information asymmetry in U.S. securities markets.[140] However, the perceived abuses of the U.S. class action model have led to much debate and several attempts to restrict class action lawsuits in the United States over the past decade.[141] The Private Securities Litigation Reform Act of 1995 ("PSLRA") and Securities Litigation Uniform Standards Act of 1998 ("SLUSA") sought to address some of these concerns while also addressing procedural mechanisms such as discovery, sanctions and avoiding compassionate juries of state courts that are often seen as features that promote non-meritorious suits.[142]

The PSLRA created heightened pleading standards requiring plaintiffs to set forth facts with specificity and to prove loss causation, placing a greater burden on the plaintiff at the outset to limit frivolous lawsuits.[143] Further, PSLRA enacted additional requirements for securities class action litigation.[144] First, it created

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138. *See, e.g.*, Kardon v. Nat'l Gypsum Co., 69 F. Supp 512 (E.D. Pa. 1946); Superintendent of Ins. V. Bankers Life & Cas. Co, 404 U.S. 6, 13 n.9 (1971), *noted in* DONNA M. NAGY, RICHARD W. PAINTER & MARGARET V. SACHS, SECURITIES LITIGATION AND ENFORCEMENT: CASES AND MATERIALS 414 (West 2003) (acknowledging the implied private Rule 10b-5 right of action in a footnote).

139. This theory is often widely criticized due to its effect of punishing the firm's shareholders by requiring large sunk costs in litigation and settlements of often frivolous strike suits. *See, e.g.*, Ilana T. Buschkin, *The Viability of Class Action Lawsuits in a Globalized Economy—Permitting Foreign Claimants to be Members of Class Action Lawsuits in the U.S. Federal Courts*, 90 CORNELL L. REV. 1563 (Sept. 2005).

140. *See* Coffee, *supra* note 28.

141. *See, e.g.*, Private Securities Litigation Reform Act of 1995, 15 U.S.C. § 78u-4 (2005); Securities Litigation Uniform Standards Act of 1998, 15 U.S.C. § 77p (2005); Class Action Fairness Act of 2005, 28 U.S.C. §§ 1711-15 (2005); *see also* Joseph A. Grundfest, *Why Disimply?*, HARV. L. REV. 727, 742-43 (1995); Roberta Romano, *The Shareholder Suit: Litigation Without Foundation?*, 7 J.L. ECON. & ORG. 55, 84 (1991); Janet Cooper Alexader, *Do the Merits Matter? A Study of Settlements in Securities Class Actions*, 43 STAN. L. REV. 497, 522-57 (1991); *cf* James D. Cox, *Making Securities Fraud Class Actions Virtuous*, 39 ARIZ. L. REV. 497 (1997); Joel Seligman, *The Merits Do Matter: A Comment on Professor Grundfest's "Disimplying Private Rights of Action Under the Federal Securities Laws: The Commission's Authority,"* 108 HARV. L. REV. 438 (1994), *noted in* NAGY, PAINTER & SACHS, *supra* note 138, at 395.

142. *See generally* Private Litigation Under the Federal Securities Laws: Hearings Before the Subcomm. on Sec. of the Senate Comm. on Banking, Housing, and Urban Affairs, 103d Cong., 1st Sess. (1993); *see also* Beisner & Borden, *supra* note 26, at 13-14.

143. 15 U.S.C. § 78u-4(a); *see also* NAGY, PAINTER & SACHS, *supra* note 138, at 395-404.

144. 15 U.S.C. § 78u-4(a).

a presumption in favor of the plaintiff with the largest claim who seeks appointment as lead plaintiff in order to avoid the professional plaintiff problem and end the race to the courthouse, while ensuring the class is adequately represented.[145] The Act further shifts control of the litigation to the lead plaintiff, allowing the lead plaintiff to select the class counsel.[146] Second, it requires increased scrutiny by judges of attorney fees awarded in settlement agreements to ensure that fees are not excessive in proportion to recovery.[147] Third, it created an automatic stay of discovery during the pendency of a motion by the defense to dismiss the action.[148] Finally, it requires courts to issue a written finding regarding compliance with Rule 11 of the Federal Rules of Civil Procedure and apply sanctions if a violation of the rule is noted.[149] The SLUSA further limited securities class actions by preempting state law class action litigation that concerns nationally covered securities and staying discovery of any state proceedings when a federal action is pending.[150] This was an effort to limit sympathetic jury awards, provide access to punitive damages, and circumvent discovery stays.[151]

Despite Congress' efforts, securities class action settlements are at an all time high and the number of actions against foreign issuers continues to climb in the United States.[152] It is worth noting that U.S. courts are often willing to recognize implied extraterritorial subject matter jurisdiction over claims involving foreign issuers under the conduct or effects tests,[153] even where the is-

145. *Id.*

146. *Id.* The lead plaintiff provision has created incentives for U.S. plaintiff's firms to seek large institutional investors in Europe who have U.S. securities in their portfolios to seek lead plaintiff appointment, enabling them to appoint the firm as lead counsel; *see, e.g.*, Mary Jacoby, *Courting Abroad: For the Tort Bar, A New Client Base: European Investors*, WALL ST. J., Sept. 3, 2005, at A1, *available at* http://users1.wsj.com/lmda/do/checkLogin?a=t&d=wsj&sd=users1&url=http%3A%2F%2Fonline.wsj.com%2Farticle%2FSB1125622347 66929791.html.

147. 15 U.S.C. § 78u-4(a); *see also* NAGY, PAINTER & SACHS, *supra* note 138, at 396-97.

148. 15 U.S.C. § 78u-4(a).

149. *Id.*

150. NAGY, PAINTER & SACHS, *supra* note 138, at 419-22; *see also* 15 U.S.C. § 77p.

151. NAGY, PAINTER & SACHS, *supra* note 138, at 419-22.

152. *See* PricewaterhouseCoopers LLP, *supra* note 57; *see also* PricewaterhouseCoopers LLP, 2003 Foreign Securities Litigation Study (Sept. 27, 2004), *available at* http://www.10b5.com/2003_foreign_sl.pdf (last visited Apr. 3, 2006).

153. The "conduct" test examines whether any conduct occurring within the United States played a part in perpetrating a securities fraud on investors abroad and the "effects" test examines actions occurring outside the United States that have caused "foreseeable and substantial harm to interests in the United States" in the form of harm to either American markets or investors. *See* Kauthar SDN BHD v. Sternberg, 149 F.3d 659 (7th Cir. 1998) (discussing application of the conduct and effects test and noting that the two tests are sometimes applied together).

suer's securities are not traded in the United States.[154] Moreover, courts are often willing to certify classes binding absent foreign class members under Rule 23(b)(3).[155] Thus, foreign plaintiffs often find American courts more attractive than courts of their home countries. As the EU considers the expansion of private enforcement measures and amendments to its procedural rules, a careful examination of the American securities litigation experience is worthwhile. Even though the securities class action culture in the United States is often perceived as frivolous, empirical evidence shows that it benefits growth of securities markets by mitigating agency costs and leading to maximization of shareholder wealth.[156]

VII. CONCLUSION

As EU member states continue to recognize the important role of private enforcement in promoting a more efficient securities market, U.S.-style class action devices will likely become more prevalent in Europe. Differing goals among EU member states will continue the current trend of adopting diverging class action models across Europe as each EU member state attempts to limit abuse of representative actions while providing greater enforcement mechanisms. The shift towards permitting contingency fees or "no-win-no-pay" agreements and binding class action devices will likely make private enforcement more feasible in Europe, but the prevalent "loser pays" rules will continue to deter wide-spread use of such devices in the near future.

As the European Commission works to promote a single securities market in Europe through the adoption of increased disclosure requirements and shareholder protections, legislation at the Community level harmonizing private enforcement mechanisms would further these goals and lead to greater convergence of procedural rules in Europe through the *acquis communautaire*. EU member states should continue to learn from the perceived benefits and abuses of the U.S.-style class action procedural devices as they seek greater private enforcement through securities litigation in Europe.

Absent harmonizing legislation in Europe to address these concerns, we may see additional countries adopt new procedural

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154. *Id.* (discussing requirements of the conduct and effects tests among circuit courts); *see also* Adam J. Levitt, Christopher Hinton, *Foreign Investors Serving as Lead Plaintiffs in U.S.-Based Securities Cases: Part II of II*, 12 Assoc. of Trial Lawyers of America, International Practice Section Newsletter 3 (forthcoming, Spring 2006).

155. Levitt & Hinton, *supra* note 153, at 3.

156. Coffee, *supra* note 28; *see also* La Porta, Lopez-de-Silanes & Shleifer, *supra* note 1.

approaches, like Germany, in an attempt to protect their issuers from U.S.-style class action devices while seeking to provide private enforcement through new measures. However, as the new class action models in Europe continue to diverge, the divergence may lead to increased forum shopping within Europe in light of the European regulation requiring recognition of judgments among EU member states. Regardless of the ultimate approach that each EU member state adopts, the goal should be to seek private enforcement mechanisms that promote greater disclosure by issuers in Europe and mitigate agency costs between minority shareholders and firm management or controlling shareholders. Better corporate governance should be encouraged in Europe through strong disclosure rules coupled with adequate private enforcement mechanisms to help align interests of firm management and shareholders.