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UK Not on Road to US-Style Litigation

Werner R. Kranenburg[ˆ] *says the differences in company law are too great for American-type securities class actions to develop in the UK*

The aim of the Company Law Reform Bill, currently in passage through Parliament, is to clarify and simplify certain areas of existing company law.

Debate among corporate lawyers has focused on those measures that are designed to further the government's objective to "enhance shareholder engagement and a long-term investment culture". They are also asking whether these reforms should be considered as a step towards a US-style approach of private enforcement of securities laws in the UK. Arguably not, for the following reasons.

In the US, a securities class action is an action against the company by a lead plaintiff, a shareholder, on behalf of the class of shareholders who are similarly situated. The leading statute in this area of law is the Private Securities Litigation Reform Act 1995 (PSLRA). A derivative action, on the other hand, is one against directors, management or other shareholders by a shareholder on behalf of the company.

The securities class action, once it has passed the first hurdle of the inevitable motion to dismiss, usually ends with a monetary settlement for the class of shareholders, subject to court approval, and could include terms covering corporate governance. The aim of the derivate action is not a monetary settlement for the plaintiff but implementation of or amendments to the company's corporate governance principles alone.

The Bill does not provide the derivative action – "derivate claims and actions by members" – with a system of shareholder representation as the PSLRA

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and Federal Rules for Civil Procedure (FedRCivP) do for US securities class actions. The shareholder in a derivative action does not seek relief from directors of the company for itself directly, rather, by statute, on behalf of the company, though the court, when considering whether to continue the claim, must take into account the possibility "that the member could pursue [the claim] *in his own right rather than on behalf of the company*" (emphasis added). Even so, it could thus be argued that the proposed reforms in the UK more resemble the US derivative action and not the separate shareholder class action, which is far more prevalent and draws most attention (and criticism).

Another difference is the scope of limitations upon which an action can be brought, which is arguably more limited in the Bill than in the US as it is only further to directors' acts or omissions involving "negligence, default, breach of duty or breach of trust". The shareholder bringing the action is under the statutory duty to "promote the success of the company" and act "in good faith".

Lawyers' fees are specifically provided for in the PSLRA and in the FedRCivP for bringing and continuing an action, but not in the Bill, or in the UK's civil procedure rules governing a group litigation order (GLO), a procedure that allows for consolidation of claims and which contains a specific rule for derivative claims. In the US, securities class actions and derivative actions are funded by lead plaintiff's counsel and the fee is contingent on, and in case of a plaintiff's win paid for by, the settlement fund or defendant, respectively, not by the plaintiff or the class win or lose.

Though the GLO does provide for the court's discretion in awarding the claimant indemnity against costs incurred in the claim, counsel's inability to fund an action for contingency fees here may make all the difference.

Also, it must be noted that the now-codified derivative action already existed, as did the GLO and, for minority shareholders in particular, protection could be found in the form of s.459 of the Companies Act 1985, as amended, which too may be the basis for a derivative claim.

The proposed reforms clarify and simplify the law, which may well contribute to shareholders' increased awareness and use of their rights as they already existed. Regardless of whether one views US securities litigation as the corporate law equivalent of "ambulance chasing" or, justly, as an example of how private enforcement of the law should work, this, of course, can only be a good development for shareholders.

The current reforms however will not directly lead to the import of US-style litigation: the differences in the types of action available are simply too great.