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**INVESTORS' CLAIMS IN THE FACE OF THE DRAMATIC FALL OF
COMPANY VALUE IN THE U.S.A. AND SPAIN: CLASS ACTIONS,
STANDING TO BE SUED AND LIABILITY ASSUMPTIONS**

Speakers:

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Summary by Carlos Valls

Investors' Claims in the Face of the Dramatic Fall of Company Value in the U.S.A. and Spain: Class Actions, Standing to be Sued and Liability Assumptions

Summary of the conference held on July 2nd, 2009, at the Il lustre Colegi d' Advocats de Barcelona (Barcelona Bar Association) in Barcelona, Spain, with presentations by Marvin L. Frank, attorney from New York, Francisco Peláez, attorney and Director of the Litigation Department at ESADE (School of Business Administration and Management), and Carlos Valls, attorney.

1. Summary of Marvin L. Frank's Presentation
(partner MURRAY, FRANK & SAILER LLP, New York)

This conference is about the civil lawsuits carried out in the U.S. against the issuers of securities listed and traded in official markets who provided false or deceitful information artificially inflating the price of their securities.

The success of such claims will result in greater market transparency and safety, which often explains why some investors choose to bear the added cost of investing directly in a U.S. Stock Exchange.

Under no circumstance do such lawsuits purport to be an insurance against the risks inherent to the investment; they focus, instead, only on the cases in which a fraud has been committed; that is to say, there was falsity, deceit, or omission when releasing information.

For the purposes of the legal claim, such fraud is measured from the date when the first materially false and misleading statement was disseminated to the financial markets and ends when the truth was revealed or disclosed causing the share price to fall to the level at which it should have traded absent the fraud (the "class period"). Therefore, if an investor purchased and sold during the class period (before the fraud was revealed to the public), he was not damaged and has no legal standing to sue.

U.S. Courts may even accept "F-cubed cases"; where the company is Foreign (*i.e.*, non-U.S. based), and where the plaintiff is Foreign (not a U.S. citizen), and where the plaintiff purchased the security on a Foreign stock exchange. There has to be some connection to the

U.S., however, so in such cases U.S. Courts look to the effects of the fraud on the U.S. and the conduct of the company in the U.S. (*e.g.*, the VIVENDI case).

Securities fraud cases may include all kinds of securities (capital or debt issuances, or mixed products), although each security type requires an independent class representative or plaintiff.

Regarding the standing to sue, the U.S. procedural system admits any investor in securities who has been a victim of false information, and therefore it is recommended – given the nature of “class actions” – that European investors (and therefore, Spanish investors as well), act as plaintiffs through U.S. specialized attorneys.

As for the defendants, they could include the company issuing the securities (unless it is in bankruptcy), the directors and senior officers, and, depending on the case, others including the company’s auditors, underwriters, and, infrequently, the company’s attorneys.

Liability in securities fraud cases depends on the following circumstances: in the case of the first issuance of securities to be traded in an official market (an “IPO”), the information brochure (the “Registration Statement” and its “Prospectus”) and its truthfulness are governed by the Securities Act of 1933 which establishes a principle of strict liability; in the case of the regular information provided by security issuers once their securities are traded regularly in the official markets, such information and its truthfulness are regulated by the Securities Exchange Act of 1934, which requires that for the issuer to be liable fraud must be proved (*i.e.*, the plaintiff must prove “scienter,” that defendants acted knowingly or recklessly; negligence is not sufficient).

The advantages of the U.S. procedural system for these matters may be briefly described as follows:

- Class actions are more flexible and ensure that fraud does not go unpunished.

- It is an “opt-out system” (as opposed to the European “opt-in” system), in which all affected persons are included in the lawsuit by default, until persons expressly choose not to participate.¹
- Attorneys’ fees are a percentage of the total damages eventually obtained from the defendants, and the client does not need to make an initial payment (“*quota litis*” system). In such cases, U.S. attorneys even pay in advance for the expenses related to the suit, such as experts’ fees, etc.
- Securities fraud cases include the “discovery” phase or exchange of documentation between the parties, which is comprehensive.²
- Securities fraud cases may ultimately be tried before a jury, implying that none of the parties may be certain about the eventual outcome, which in turn usually leads to negotiated settlements.
- Such cases are beneficial for the economy because they force companies to develop codes of ethics and to comply with corporate liability regulations. Furthermore, the financial and exchange markets are encouraged to be more transparent and efficient.

Marvin Frank finished his presentation recommending that both individual investors and institutional investors keep track of lawsuits (to check regularly whether cases have been filed against companies in which they have invested), and he reminded the audience that such

¹ In Spain, as was later verified by Francisco Peláez, the system is almost the opposite. For a group to be represented, it is required that more than 50% of the affected people opt expressly for the lawsuit, unless they are represented by a representative Consumers and Users’ Association.

² That would be an institution remotely equal to our Diligencias Preliminares (Preliminary Proceedings), Arts. 256 and ss. of the Civil Procedure Act (“LEC,” Ley de Enjuiciamiento Civil), except that in our code this possibility is voluntary and must be requested by the party and unilaterally, whereas in the U.S. it is a compulsory phase to which litigant parties must mutually submit. This documentary exchange limits the ability for formal defense of the party producing the false or deceitful information, since it allows for a very detailed analysis of the circumstances, documentation and decisions made in respect of such false or deceitful information. The probabilities for proving, therefore, that (a) said information was false or deceitful, and that (b) there was “fraud” or “scienter” in the acting, are much higher with the “discovery” institution (with the disadvantage of the strong increase in the procedure cost).

services are provided by law firms like his own. He further recommended – especially to institutional investors – that it may sometimes be advisable to withdraw from a class action and file a suit individually (because a higher compensation may be awarded). Finally, he urged investors to resort to specialists such as Murray, Frank & Sailer LLP. This decision is particularly valuable if no other investor is representing a certain type of security, because it would activate at no cost the standing to sue of all the investors in such a security.

2. Summary of Francisco Peláez’s Presentation (VIALEGIS partner, Barcelona)

Class action regulations in the U.S. open great opportunities. In Spain the possibilities are limited even more so if we consider that, before the current LEC, the Spanish Law of Civil Procedure, (Act 1/2.000, of January 7th), there was no regulation whatsoever for group actions, except for the programmatic statement of Article 7 of the Organic Law of the Judicial Power, which was never applied.

Under the current LEC, class actions are part of our code for the first time, although in a partial and limited way, as indicated below.

The starting point for this new regulation is the clash between concrete reality and procedural laws. Since the previous LEC provided only for lawsuits between private individuals, there was a legal loophole for such situations – massive-contracts – where private individuals had no incentive to act against big companies for relatively minor claims.

In order to make up for this shortfall, the new LEC has introduced concise and formal regulations, which do not have the flexibility of the American law, and which are additionally burdened by the lack of experience of our courts regarding their application.

Specifically, the new regulations have the following characteristics:

- Collectively, only consumers and users’ groups are entitled to file actions (it is still to be determined if investors might be considered as “consumers and users” groups).³
- In Article 6.1.7º of the LEC the ability of consumers and users’ groups is materialized, demanding that (1) the class, that is to say, every one of its members, be

³ This matter is dealt with in Carlos Valls’s presentation.

perfectly determined or be easily determined and (2) the majority of such class should file action.

This regulation leads us to believe that it is unlikely that a member would take the initiative to unite the rest and to incur the expenses associated with this effort, let alone an attorneys' office, given that gaining the adhesion of the majority is too uncertain (particularly if the group is large) to make an investment to initiate actions. Therefore, even though the law allows for class actions, in fact there is no real incentive for someone to act as a unifying agent.

The LEC provides a second solution: to give prominence to consumers and users' associations, granting them legal standing to advocate for general interests (Art. 11, LEC). Such solution chosen by the LEC was not the only option: instead of choosing the regular procedure, adjusting it to the nature of the case in order to fit the standing to sue of consumers and users' associations, lawmakers could have chosen to create a special procedure for these cases. In following the general path, Judges may find it more difficult to apply, since they have the added obstacle of having to abstain from going through the regular proceeding.

In turn, the acting consumers and users' association may take two paths: the advocacy of group interests, in which affected people can be determined, and the advocacy of diffuse interests, in which private individuals are not initially identifiable.

The LEC also demands quite clearly that such associations prove to be representative. The solution offered by the Courts is to deem as "representative" the members of the Council regulated in Article 4 of the current Consumers and Users' Act.

In practice, the acknowledgment of such representative quality in a few associations has given them excessive importance, which has led to a lack of control of their activities which are not always directed to fulfill the purpose for which they were created.

Application by our Courts of these specific rules for class actions in the normal procedure is creating problems derived from the lack of familiarity, when notifying the affected people when they have been identified (for *res judicata* purposes), or during press releases in the case of diffuse interests.

In short, lack of clarity of the current regulation and lack of experience (and jurisprudence) is frequently causing procedures to be invalidated for nullity reasons or for being non-executable.

3. Summary of Carlos Valls's Presentation (IURIS VALLS Abogados partner, Barcelona)

The presentation deals with three specific aspects: the determination of the de facto assumption, the subject matter of this conference; the deeming of investors as “consumers and users” in order to determine applicability of LEC regulations regarding class actions, which was previously discussed by Francisco Peláez; and the analysis of the issuer’s liability according to Spanish legislation.

The de facto assumption deals specifically with the damage that false or deceitful information released by an issuer of securities traded in an official market may cause to an investor once such false or deceitful information is revealed, and the fall in their price due to said disclosure.

On the other hand, such assumption does not stipulate the relationship between an investor and the financial institution through which such securities were purchased, which are governed by other regulations (UE’s MIFID, Markets in Financial Instruments Directive, mainly Directive 2004/39/CE of April 21, Act 47/2007 of December 19, and Royal Decree 217/2008 of February 15).

Regarding the consideration of investors as “consumers and users,” both in the definition of Art. 3 of the Consumers and Users Act (“LCU,” Royal Legislative Decree 1/2007, of November 16) and in the LCU’s Explanatory Statement itself, the definition is broad enough to initially allow them to be included in such category.

In fact, Article 3 of the LCU establishes that “consumers and users are those individuals or legal entities who act in spheres which do not involve corporate or professional activities.”

On the other hand, the Explanatory Statement indicates that “Consumers and users, as defined by this act, are those individuals or legal entities who act in spheres which do not involve corporate or professional activities. That is, they engage in consumption

relationships for private purposes, hiring goods and services as end consumers without including them, directly or indirectly, in production or trading processes, or in services to third parties.”

It should be added that the MIFID Directive (and the legislation implementing it in Spain) makes a distinction between professional customers and retailers: professional customers are those who “have the experience, knowledge and qualification required to make their own investment decisions, and to correctly assess the risks inherent to such decisions”; retailers, on the other hand, are those who, by exclusion, are not included in the definition of professionals (Art. 4.11 and 4.12 of Directive 2004/39/CE).

Therefore, we can conclude that pursuant to MIFID regulations, non-professional investors are deemed to be parties who deserve special protection – the same ratio legis set forth in LCU – which would reinforce the argument that investors should be deemed as “consumers and users” when applying LEC rules to class actions.

It might be objected that LCU uses a language specifically oriented to consumption and the exchange of concrete, tangible products (Explanatory Statement: “... anyone who engages in a consumption relationship”; Art. 6, definition of “Product” as “any personal property according to the provisions of Article 335 of the Civil Code” (which in turn are defined as “things which can be owned (...) which can be transported from one place to another without being damaged”; the LCU emphasizes the (physical) security of Products, etc.).

This is a more concrete approach to the definition of a consumer or user which might be used as an argument against investors (investors are purchasers of securities which are financial assets that by nature are of a far less concrete quality and are not “consumption” objects as such). Now, it is considered that both LEC’s ratio legis, by incorporating class actions regulations, and by opting for the solution of limiting them to consumers and users’ groups, and the LCU itself, by attempting to reinforce the position of the weakest in the case of massive contracts, work in favor of adopting an inclusive interpretation of the “consumer and user” quality of investors (retailers, according to MIFID Rules) for this purpose.

Regarding issuer liability, Spanish legislation also makes a distinction between the primary market (that is, the information appearing in a brochure about a new issuance of securities Royal Decree-Law 5/2005, of March 11, on Current Reforms to Foster Productivity and

Improve Public Contracting, which implements Directive 2009/71/CE, among others, regarding liability in the creation and publication of information brochures for the admission in the trading of public securities traded in a regulated market) and the secondary market (compulsory regular information Act 6/2007, of April 12, on the reform of the Stock Market Act (LMV), implementing for this purpose Directive 2004/109/CE of December 15 about harmonization of transparency requirements regarding information about the issuers of securities who are accepted in a regulated market).

In the case of the information provided in the brochure, Art. 28 of the LMV (modified by Royal Decree-Law 5/2005, of March 11) sets forth an issuer's liability for "damages they may have caused to holders of purchased securities as a result of false information or omission in the brochure's relevant information," and it refers to the specific conditions established in its regulations to determine liability.

Royal Decree 1310/2005, of November 4 further develops this liability set forth in Art. 28 of the LMV, in Articles 36 and 37, establishing the obligation to compensate people who purchased securities in good faith for damages caused by false information, unless the people responsible for issuing the information brochure had taken prompt corrective action. Therefore, the burden of the proof demonstrating prompt corrective action falls on the defendant.

In the case of the secondary market, said Act 6/2007 also establishes the general liability of the issuer and its administrators for "all damages that might have been caused to the holders of securities as a result of information which does not provide a truthful image of the issuer," and also refers to its regulations for the specific regulation of said liability.

The rule further developing it is the Royal Decree 1362/2007, of October 19, which establishes an objective liability (Arts. 10 and 17) given that anyone "who has suffered economic damages as a direct result of the content which does not provide a truthful image of the capital stock" may file suit.

It should be emphasized that:

- For the first time, this specific liability which was previously ruled by the general provisions of the law (for example, Art. 1902 of the Civil Code) is now regulated.

- It is an objective liability, separated from the general principle of liability based on fraud or negligence.
- As a legal technique, it seems arguable that the general principle of extra contractual liability based on fraud or negligence established in the Civil Code may be modified to make it objective by means of regulations.
- Objective liability may be of special interest to the insurance sector.

As a final comment, the lack of procedural flexibility to carry out class actions may make regulations regarding issuer liability for providing false or deceitful information – although they are more rigorous than American regulations, which except for specific cases of the primary market, usually requires that the plaintiff prove fraud or scienter – not applicable in practice, with the exception of individual claims. Therefore, we can safely state that the obstacles present in our legislation, as we have discussed, may provide a certain degree of impunity for the issuers of securities traded in official markets, as compared to the punishment provided for in the U.S. legislation for those actions, as Marvin Frank has stated.