

Pensions Audit Sub Committee

2.30 p.m., Tuesday, 16 December 2014

Class Actions

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|--------------------------|-----|
| Item number | 5.7 |
| Report number | |
| Executive/routine | |
| Wards | All |

Executive summary

This report provides an annual update on the Funds' class action activity. A class action is where a group (a class) sues another party. Typically, these actions happen in the US. The type of class action relevant to the Funds is when a group of shareholders collectively sue a company in order to recover a loss in share value, or to exert influence on the company. Since 2006 the fund has received US\$3.0 million in class action compensation. US\$139k has been received since the last update to Committee in December 2013.

Links

Coalition pledges

Council outcomes

CO26 – The Council engages with stakeholders and works in partnerships to improve services and deliver agreed objectives.

Single Outcome Agreement

Class Actions

Recommendations

- 1.1 Committee is requested to:
- note the update on class actions; and
 - highlight any points that it would like to raise at the Pensions Committee on 17 December 2014.

Background

- 2.1 In shareholder class actions one or more investors agree to act as lead plaintiff(s). A law firm acts on behalf of the class with the lead plaintiffs being treated as the representatives of the class. The cases can take several years to be heard by the courts and can be settled out of court. In the United States, cases are typically taken on a no win, no fee basis.
- 2.2 If a class action case is won, the compensation fund, net of legal fees approved by the court, is distributed to eligible shareholders who make a claim within the relevant time limit. Any shareholder that held shares during the class period is entitled to make a claim. The shareholders who lodge a claim share the compensation in proportion to the loss suffered. As shareholder, the Lothian Pension Fund claims for compensation on all relevant class action settlements.
- 2.3 In addition, the Lothian Pension Fund may act as lead plaintiff on a number of class actions, holding company management to account and aiming to deter future fraud and/or loss of shareholder value. This is consistent with its approach to environment, social and governance issues. Also, by acting as a lead plaintiff, the Fund may be in a position to influence the terms of the settlement.
- 2.4 A court ruling in the case of Morrison vs. National Australia Bank (NAB) in 2010 has narrowed the ability of investors to seek redress under the laws of the US, particularly where shares are purchased on non-US stock exchanges.

Main report

Compensation

- 3.1 Compensation received by the Fund from class actions is shown in the table below.

| Financial Year | US\$ (000's) |
|------------------------|--------------|
| Prior to 31/03/11 | 1,823 |
| 2011/12 | 317 |
| 2012/13 | 483 |
| 2013/14 | 287 |
| 2014/15 [1] | 59 |
| TOTAL [1] | 2,969 |
| [1] To 31 October 2014 | |

- 3.2 The last Committee report in December 2013 contained figures to 31 October 2013. In the remainder of that financial year a further \$80k was received. There have been 11 settlements so far this financial year, with a total value of \$59k. Included in this figure are two payments from Citigroup totalling \$37k.

Lead Plaintiff Cases

- 3.3 All cases where the Fund was acting as lead plaintiff have now concluded. Summaries of the most recent cases are included Appendix 1. Compensation has been received from one of these cases but was minimal, \$4.7k.

Impact of the Morrison ruling

- 3.4 The Morrison vs. NAB ruling continues to impacts on the Fund's ability to claim for compensation in the US. As a result of the ruling investors are increasingly looking to obtain compensation through other jurisdictions where the legal process may require investors to "opt-in" to the case prior to the trial if they wish to participate.
- 3.5 Officers have reviewed a small number of such cases. Considerations have included the estimated financial loss, potential for recovery, the resource needed to monitor the case and the risk of further detriment to the Fund.
- 3.6 Lothian Pension Fund will consider the potential benefits and risks on a case by case basis.

Measures of success

- 4.1 Success will be measured by the number of actions successfully pursued and the compensation received.

Financial impact

- 5.1 US class actions are conducted on a no win no fee basis. In the event of a case being won, the courts approve the legal costs which are deducted from the compensation fund. The Fund has recovered \$3.0m in compensation from class actions.

Risk, policy, compliance and governance impact

- 6.1 The class action activity detailed in this report is undertaken as part of the Environmental Social and Governance (ESG) activity of the Fund which is expected to reduce risk. Class action activity is contributes to Fund stewardship and governance responsibilities.

Equalities impact

- 7.1 There are no adverse equalities impacts arising from this report.

Sustainability impact

- 8.1 Class action activity is undertaken as part of the ESG activity of the Fund which is expected to contribute to the sustainability of the Fund's investments.

Consultation and engagement

- 9.1 The Consultative Panel for the Lothian Pension Funds, comprising employer and member representatives, is integral to the governance of the Funds. Regular updates on class actions have been provided to stakeholders.

Background reading / external references

None

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Single Outcome Agreement

Appendices Appendix 1 – Class Actions

Summaries of the cases where Lothian Pension Fund has been a lead plaintiff are outlined below:

- The case against **Lehman Brothers** was in relation to false financial statements and mismanagement at the company prior to the collapse of the bank. The case consisted of separate claims against certain officers, the directors, underwriters and auditors. The case was filed in 2008 and the estimated loss to the Fund was \$4.7m. Shares were purchased in the US. In August 2011, the case against the company officers and directors agreed to a settlement of \$90m and the case against the Underwriters settled for \$426m. In May 2012 the court gave final approval to the \$90m settlement with Lehman directors and officers and \$426m with the underwriters. Subsequently, the case against Lehman's accountants Ernst & Young (E&Y) settled for \$90m. Although Lothian was lead plaintiff in the overall case it was not named as a class representative for the E&Y case because of the court's ruling severely limiting the class period against E&Y. Whilst the settlements achieved are sizeable in monetary terms, they are a relatively small proportion of the overall shareholders' losses. This, together with the fact that the Fund's trading in stock (and not any of the offering underwritten by the Underwriters) meant that it qualified for recovery in only the claim against the directors and officers. This resulted in a recovery for the Fund of \$4.7k, which was received in December 2013.
- The Fund had an estimated loss of \$2.0m due to holdings in the company **Wyeth**. The case was premised on Wyeth's (now Pfizer, as a result of a merger) misrepresentations of clinical trial results for the investigational Alzheimer's drug, bapineuzumab. The Fund was appointed co-lead plaintiff (along with Italian investment fund, Arca) in September 2010. In the summer of 2011, defendants moved to dismiss the case and were successful. An amended complaint was lodged but this was dismissed. An appeal brief was then lodged with the US Court of Appeals in Boston, and argument took place on September 9, 2013. In June 2014 the court decided against the appeal. This was not unexpected as misrepresentation is difficult to prove. The case is now closed.
- The case against **Genzyme** was filed in 2009 and the Fund's losses are estimated to be \$3.1m. The case relates to its failure to disclose issues at one of its manufacturing facilities that caused the company to halt production of two of its top selling drugs due to contamination. The case was dismissed. However an appeal was lodged, as new information became available. In June 2014 the Court of Appeal denied the appeal against dismissal and denied leave to amend the complaint. The case is now closed.