

FALKIRK COUNCIL

Subject: CLASS AND GROUP ACTIONS
Meeting: JOINT MEETING OF THE PENSIONS PANEL AND COMMITTEE
Date: 12 MARCH 2015
Author: CHIEF FINANCE OFFICER

1. INTRODUCTION

- 1.1 This report provides the Pensions Committee and Pensions Panel with information regarding two litigations in which the Fund may be eligible to participate.
- 1.2 The two companies concerned are Petroleo Brasileiro (Petrobras) and Tesco plc.

2. CLASS ACTIONS AND GROUP ACTIONS

- 2.1 From time to time, pension funds may feel justified in taking legal action against the companies in which they have invested. Usually, such action will be undertaken in conjunction with other investors in what are known as Class or Group Actions. Evidence shows that by working collectively, investors can obtain a better settlement than by bringing individual actions. It is also argued that the practice of taking collective action in the face of corporate malpractice can help maintain good standards of corporate governance.
- 2.2 A “Class Action” generally describes the situation where a group of investors take action against a publicly traded company under US federal law.. The “Class Members” will usually have purchased shares at a time when the company’s value was inflated through some form of alleged misrepresentation. The Class is represented by an attorney who bears the cost if the action is lost, but shares in the proceeds if the action is successful. Despite legal challenges, the doctrine of “presumption of reliance”, which deems that investors are entitled to rely on the integrity of the market when purchasing a security, still prevails.
- 2.3 For UK investors, it is important to note that only shares purchased on US Exchanges are covered by US Securities laws.
- 2.4 A “Group Action” tends to describe collective legal action that is not covered by US Class proceedings. With Group Actions brought in the UK, reliance on misstatements has to be proved and the loser of the action potentially has to bear the costs (rather than these being borne by a legal firm).
- 2.5 The Fund is advised on Class and Group litigation by international law firm Robbins Geller Rudman and Dowd.
- 2.6 Funds arguably owe a fiduciary duty to their stakeholders to engage in these types of legal actions in order to maximise fund income. However, participation has to be tempered with an assessment of the potential risks versus likely returns and the resource implications of supporting the action.

- 2.7 The legal complexities of constructing a Class or Group Action mean that investors may be asked at short notice for a final decision as to whether or not to participate.

3. PETROLEO BRASILEIRO S.A. (PETROBRAS)

- 3.1 Petrobras is a Brazilian multinational energy company, which owns oil tankers and refineries as well as being a major distributor of oil products. It was formerly part of the portfolio managed for the Fund by Aberdeen Asset Management.
- 3.2 The complaint alleges that Petrobras has violated the terms of the Securities and Exchange Acts by issuing false and misleading statements causing its share price to trade at artificially inflated values. Allegations of money laundering, bribery and corruption have surfaced, involving both senior officials of Petrobras and Brazilian politicians. There has also been delays in filing accounts and, as a result, the share price has fallen by around 50%.
- 3.3 An action is being brought in the US and will therefore be covered by the US litigation rules. The loss to the Falkirk Fund has been calculated initially by Robbins Geller at \$7m.
- 3.4 PIRC Ltd, who exercise voting rights on behalf of the Fund, have voted against company motions at past Petrobras AGMs on grounds of poor governance and the failure of a minority director to sign the accounts.

4. TESCO

- 4.1 Tesco is the well-known UK grocery retailer. In September, it emerged that Tesco had overstated its profits by £263m. A number of senior executives were suspended and the matter is now being investigated by the Financial Conduct Authority and the Serious Fraud Office. The news flow has caused the share price to more than halve in value.
- 4.2 Robbins Geller are seeking to orchestrate a Group Action for institutional investors with litigants having an option to participate. The case would be brought in the High Court of London. Investors who held shares between April 2013 and October 2014 would be eligible to join the action.
- 4.3 Tesco is part of Falkirk's ongoing investments within the Schroder UK Equity portfolio. The estimated loss based on the fall in share price between April 2013 and October 2014 is around £2m.
- 4.4 Unlike US Class Actions, the Fund Manager - in this case Schroder - would have to be able to prove that they had relied on Tesco's Accounts when purchasing the Tesco shares. Discussions would therefore have to take place with Schroder to determine if they were able to produce the necessary evidence and if they were prepared to disclose it.
- 4.5 Prior to being asked to join any action, a QC would be appointed to review the case and give an opinion on the chances of a successful outcome. "After the Event" insurance would be arranged in order to cover the risk of adverse costs.

5. CONCLUSION

- 5.1 The Fund's litigation adviser has indicated that legal action is being contemplated against two of the Fund's investee companies.
- 5.2 It is anticipated that the Fund will be asked to join legal actions in the coming weeks.
- 5.3 Before reaching a decision to join one or other of the actions, an assessment of risk and return will require to be undertaken.

6. RECOMMENDATIONS

- 6.1 **The Pensions Committee and Pensions Panel are asked to note the contents of this report and invited to comment.**
- 6.2 **The Pensions Committee is asked:**
 - i) to consider joining these actions, and if supportive of joining,
 - ii) to delegate the final decision on participating to the Chief Finance Officer

Chief Finance Officer

Date: 1 March 2015

Contact Officer: Alastair McGirr

LIST OF BACKGROUND PAPERS

NIL