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Speaker's Name(s): Julianna Ryan

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<u>RIMS Convention</u>

Orlando, Florida

April 25-30, 1993

Session: *Cross Border D&O - It's A Mad, Mad, Mad World*

IN 203 - Thursday 2:00 p.m. - 4:00 p.m.

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My role in this presentation is to provide an outline of the D&O claims environment in the United States today. I will start with an overview of the types of claims made against directors and officers in 1992 and then discuss what we see as trends over the next few years.

First, let's look at whether the small, medium or large company is more likely to be a recipient of a D&O claim. **[Slide #1]**. As you can see, the number of D&O claims against the large and medium companies are continuing to level off, and we are now beginning to note a leveling off for the smaller companies as well. Of course, the figures we see here do not reflect the fact that certain *types* of claims are increasing, while other types are decreasing as we will discuss later. By and large, the larger companies are more susceptible to D&O claims and are also more likely to be the recipient of claims by multiple claimants.

Next we see the *types* of companies more likely to see their directors and officers sued. **[Slide #2]**. Banks suffer the greatest number of D&O claims, although this has decreased from

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prior years. Other types of corporations have picked up the slack with a slight increase in D&O claims from recent years. Products manufacturers of all types continue to face a significant percentage of overall claims.

As we will see in a minute, the more shareholders, the more claims. Companies that experience change of control transactions, including mergers, acquisitions or divestitures, also remain likely targets. Such corporate reorganizations are strongly aligned with higher claims susceptibility.

[Slide #3] The unrest in the economy has resulted in an increased number of U.S. companies experiencing an after-tax loss; usually a precursor for laying blame against the directors and officers. This year, Wyatt reports that approximately one third of the companies experiencing an after-tax loss during any of the past five years reported one or more claims.

Now let's look at who is most likely to make a claim. **[Slide #4]**. As has been the case for many years, shareholders remain the single largest group of D&O claimants and are the source of 52% of all D&O claims in the U.S. Although there has been a sharp decline in the newsworthy mergers, acquisitions, leveraged buy-outs and corporate reorganizations since the 1980's, more ordinary corporate structurings, acquisitions and divestitures continue to be the

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source of the most significant concentration of shareholder claims.

Claims by employees come in a distant second, closely followed by claims by the company's customers and clients.

Compared with 1991's figures, 1992 saw an increase in claims by customers and clients, the government and other third parties.

What is not shown by the pie graph is the fluctuation in claims made against different business classes. While shareholders were the most prevalent source of claims for most types of businesses, for real estate and construction companies, for example, competitor/supplier claims were just as likely as shareholder claims.

Another example is the fact that claims against non-banking financial companies are more likely to be made by employees or customers, rather than shareholders. And for straight banking institutions, claims are most frequently made by customers, than by shareholders or employees.

It is not much solace to directors and officers that their corporation is also named as a defendant in about three quarters of the cases. **[Slide #5]**.

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[Slide #6]. The shareholder claims are the most costly, followed by employee and then competitor claims. The low figure indicated for customer claims does not reflect the fact that in many claims by customers, the type of relief achieved is often non-monetary.

[Slide #7]. As with all types of litigation in the United States, defense costs are often just as significant a factor as the ultimate resolution value of the claim. "Closed by litigation" means that the directors and officers were dismissed by pre-trial motion practice (which, as you will note, costs almost as much as proceeding to trial).

What makes the U.S. a hotbed of claims against directors and officers? **[Slide #8].** In the U.S., anyone can sue anyone else for anything. With very few exceptions, claimants need not seek administrative relief or governmental "permission" before filing suit against a director and officer. The exceptions involve certain circumstances when suing the government where administrative remedies must be pursued first; and certain employee claims must first be screened by the EEOC.

Because attorneys have an opportunity to collect up to one third of the amounts recovered, plus their costs, there is great incentive to pursue claims. Since each side bears its own costs under the American system, plaintiffs' attorneys may be less likely

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to scrutinize the merits of prospective claims. Likewise, class actions allow claimants with not much to sue over individually, group together in order to make the action "worth it". While I have included the unavailability of pretrial adjudication on my list, I have seen recent reports of a decided increase in alternate dispute resolution in D&O litigation, including arbitration and both non-binding and binding mediation.

The jury system in the United States presents the most unpredictable risk of the legal system, which may account for the fact that a very small percentage of D&O claims proceed to trial.

Trial or not, defense costs incurred in defending D&O claims are significantly higher than other types of claims; presumably because of the complexity of the subject matter (in most cases these are not slip and fall or auto cases) and the document discovery in some cases is mind boggling. Personal reputations are often at issue and this tends to lengthen the litigation and intensify the battle. Both factors increase defense costs.

Another aspect of the U.S. legal system that propagates claims against directors and officers is the proliferation of liability-imposing legislation. We have federal, state and local laws to protect investors, shareholders, consumers, competitors, employees, minorities, the disabled and the environment. These laws are fuel

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for D&O claims, in addition to the multitude of common law causes of action.

These factors may be the reason why the U.S. leads the way in D&O claims, and why the U.S. claims environment is used as a gauge of what is to come in the rest of the world.

Typical Claims

What are D&O claims likely to be about these days?

[Slide #9]. This is a list of just a few of the types of federal laws that impose duties and responsibilities upon corporate directors and officers, and thus expose them to liability.

Historically and currently, shareholder claims are most likely to arise from threatened changes in corporate control. Because shareholders may view litigation as an ordinary exercise of their control over the company, D&O litigation often goes hand-in-hand with contests over corporate control and other major corporate transactions. **[Slide #10].** Based upon 1992's data, directors and officers of companies undergoing changes in control are still most likely to be targets of claims.

An up and coming category, however, is claims of inadequate or inaccurate disclosures (in quarterly reports, other filings with

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the SEC, press releases or statements made by the directors and officers personally in connection with corporate transactions and day to day business activities).

Although personal misdeeds such as conflicts of interest, misappropriation of trade secrets and insider trading often receive much notoriety, these claims are not made in great number. This goes for claims challenging executive compensation as well, although compensation claims are often a part of what shareholders complain about in change of control situations.

From these 1992 statistics, we expect to see an increase in disclosure claims, claims arising from poor financial performance, and increased challenges to executive compensation (in light of recent scrutiny in this area and new reporting requirements).

Employee claims generally allege wrongful termination or other types of discrimination. The typical wrongful termination claim includes allegations of breach of employment contract, harassment, humiliation, defamation and discrimination.

Claims against directors and officers by customers are generally contract disputes or challenges to the veracity of product literature.

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Claims by competitors on the other hand, tend to focus on business interference and deceptive trade practices. Antitrust claims against directors and officers are few which generally reflects the decline in antitrust litigation during the previous administration. Although we have not included antitrust claims against directors and officers as a trend for the future, we continue to watch the White House to determine whether the Attorney General intends to beef up this aspect of federal regulation.

Environmental claims are generally made by the government or other third-parties such as neighboring property owners.

Trends

Shareholder Claims

[Slide #11] It is expected that shareholder claims will continue to constitute the largest segment of claims against directors and officers. The areas of shareholder complaint may become less concentrated in change in control situations, and more focused on disclosure issues. The recent influx of claims involving director and officer responsibility to disclose "soft" information is expected to continue.

Soft information is defined as information which is speculative, contingent or not known without absolute certainty.

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Examples include financial information (such as asset appraisals, earnings and cash flow projections) and also non-financial information (such as the existence of merger negotiations or acquisition proposals). Basically, soft information is not a set of figures or undisputed statistic or factual information. Rather, it is usually looking-forward projections or "forecast" information.

In the 1970's the SEC actually *prohibited* management from communicating soft information to its shareholders for fear that it was not based on clear information and could be misleading. The SEC, with the prompting of the courts, gradually made a 180 degree swing towards *requiring* disclosure of soft information (such as ongoing merger negotiations) in certain circumstances such as the merger and acquisition context.

In the 1980's the big issue was the *materiality* of soft information such as preliminary merger negotiations. With the 1988 case of Basic v. Levinson, the courts adopted a case-by-case approach to determine when soft information reaches a degree of materiality requiring disclosure to shareholders. The cases following Basic all revolve around particular circumstances under which soft information should be disclosed.

We are now seeing a renewed interest by the plaintiffs' bar and the courts in the question of when soft information must be

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disclosed. The issue arises these days less often in merger situations, and more often in other types of corporate transactions in which the shareholders are asked to make determinations based upon the company's financial prospects.

The latest case, in the United States Court of Appeals for the Ninth Circuit (Levitt v. Lyondell), concerned press releases attributing a decline in earnings to problems associated with a certain plant. The company issued a prospectus and other documents representing that the company would continue to operate profitably and generate earnings, even though management was aware of contrary internal projections (given to its bank) indicating that the revenue would be below last year's levels. The internal projections (the "soft information") was not disclosed to the shareholders.

The Court held that the company is not obligated to disclose all financial projections; some can remain confidential if there is some possibility that public disclosure would be harmful to the company. In this case, the Court decided that even though the bank who was concerned about security of its loan might require the corporation to provide a worse-case prediction, such prediction might not be in the best interests of the market, the company's plans for the future, or the investors.

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As companies struggle out of their recession mode, and others continue to suffer increased debt loads or even insolvency, an increased number of shareholder claims of "poor performance" are anticipated.

Speaking of poor performance, the Federal Deposit Insurance Corporation (FDIC) has issued its own statement on what it expects of bank directors and officers. [The FDIC, as you know, is often a plaintiff in suits against directors and officers of failed financial institutions]. The FDIC's guidelines in general, are as vague as D&O duties under common law; the agency requires bank directors to act with "care" and "loyalty". Several paragraphs of the FDIC's guidelines, however, outline the procedure in which the FDIC follows in bringing lawsuits against banking directors and officers. The FDIC distinguishes between duties owed by inside versus outside directors, noting that inside directors are often officers and thus liable for failings in day-to-day operations, while outside directors can assume such liability if they fail to correct problems raised by regulators, auditors or outside counsel. The FDIC says it will sue outside directors when they fail to satisfy duties of "candor, personal honesty and integrity", as well as duties to act "as prudent and diligent business persons".

New regulations promulgated by the Securities and Exchange Commission requiring more detailed disclosure of executive compensation, continue the trend of heightened awareness of

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management compensation issues. Although much of the information the SEC now requires be reported to shareholders, could always be found in various (sometimes not so apparent) places in annual reports and other filings, the information must now be concentrated in one location and impliedly compared with the financial performance of the company. Linking compensation to company performance is an indicator of increased shareholder suits on this issue. If the company is experiencing a decline in profits at the same time the executive compensation increases, the shareholders are going to complain.

Large compensation packages were accepted by shareholders as a normal course of doing business and attracting talent in the 1980's. In the current political climate of scaling back and financial sacrifice, the media is already cued into this issue. When IBM managed to lure Louis Gerstner away from RJR Nabicso, the fact that his base salary would be $2,000,000 made headline news. Even though his total pay package is actually valued at about $3.5 million, the figure would not have caused raised eyebrows even a few years ago. Now, some view Gerstner's deal as unfairly lucrative when juxtaposed with the loss of more than 250,000 IBM jobs in New York State alone.

ITT greatly reduced its 1992 executive pay after the 1990 and 1991 figures drew criticism from shareholders. The company also restructured its compensation plans to connect executive pay more

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closely to corporate performance. As a result, the executives received only a modest pay increase in 1993.

New rules from the Financial Accounting Standards Board (FASB) will further highlight the impact of executive compensation upon a company's bottom line. The new FASB rules will force businesses to deduct the value of employee stock options from their earnings. The rule will not be implemented until 1997. In more or less confirmation that this will engender future shareholder claims, the move was supported by shareholder groups (who consider stock option packages for top executives to be excessive for the most part) and opposed by business groups, institutional investors, compensation consultants and the six major accounting firms.

Stock options being the most popular form of executive pay, they are currently the only major type of compensation that isn't deducted from reported profits. The industry expects that this will especially effect start-up or small high-technology companies that may be unable to pay high monetary salaries and rely largely upon stock option grants to attract talent.

The SEC has also promulgated new requirements as to disclosure of environmental liability. Failure to comply can subject a company and its directors and officers to the imposition of fines as well as spur civil action by investors. The Commission has also vowed to step up enforcement actions based upon lacking or

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misleading environmental disclosures in annual reports. We are already seeing more claims of inadequate disclosure of environmental problems or responsibilities. A federal judge recently found that a company's proxy statement violated SEC rules because it omitted material facts about the company's environmental record, even though that information was otherwise available in separate SEC filings. Strict scrutiny of environmental disclosures lays the groundwork for claims against those responsible for corporate disclosures.

The final notable trend we are predicting in shareholder claims are those arising from proxy reforms. The new proxy rules mark the advent of new shareholder communication with management. Under the old proxy rules, shareholders wishing to solicit proxies or comment on a management solicitation had to fit their activities into a predetermined framework designed to control content and tactics. Under the new liberalized rules, many of the formalities have been abandoned and shareholders are allowed to investigate new ways to pressure corporate management through the aggressive use of the solicitation process. Shareholders will be freer to act together. Activities such as withholding votes for directors or opposing management proposals will seem like a free-for-all when compared with the old formalized method.

Most important with regard to the projection of claims against directors and officers, industry experts expect that the new proxy

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rules will act as a psychological boost to shareholders. They view the freedom under the new proxy rules as the SEC's stamp of approval for them to take a larger role in managing the company. As a result, corporations may find themselves increasingly on the defensive in many areas of corporate governance. The more optimistic view, however, is that by providing shareholders with a forum for dissention and opportunities for new control, the need to sue management to achieve shareholder goals might even diminish.

Environmental Claims

[Slide #12]. There seems to be an overwhelming number of indicators that environmental claims against directors and officers will increase. First, based upon a spate of recent decisions, the federal courts are making it more than clear that CERCLA, as well as a variety of other environmental laws, clearly provides for a cause of action against the directors and officers of a company that may be considered a "potential responsible party" for an environmental impairment or threatened impairment. Although the statute does not explicitly provide for claims against "directors and officers", they have been held by the courts to be "owners/operators" - one of the categories of persons who are subject to strict liability under the statute. This means that a claimant under CERCLA need not prove any fault whatsoever on the part of the director or officer. As long as the director or officer can be deemed to have sufficient managerial or supervisory

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control over the company's operations, that individual can be just as liable for the entire costs of the investigation, cleanup, ongoing monitoring costs and reimbursement of the government's response costs, as the corporation itself or any of the other PRPs.

Second, the beefed-up EPA and implementation of Gore-dominated philosophies in the new administration (including seeking funding from new and different sources), are part of the game plan. The clout of Katie McGinty, for example, has oil executives shaking in their boots. Ms. McGinty and Vice President Gore scored a recent victory over the State, Justice and Defense Departments when President Clinton decided against appealing the Federal Appeals Court decision that extended jurisdiction of U.S. environmental laws beyond U.S. borders. The case itself concerned only the Antarctica (technically an international zone), but the decision is expected to have broader applications overseas.

We have already spoken about possible shareholder actions against directors and officers arising out of financial losses a company may suffer as a result of pollution laws. Aside from disclosure claims, claims against the directors and officers can arise from the perception that insufficient loss prevention measurers were at fault for allowing the impairment to happen in the first place; or, on the back end, that management and the directors did not do enough quickly enough to salvage the company's reputation and minimize the resulting financial impact.

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Employment Claims

[Slide #13]. Employment related claims are expected to increase in view of corporate shuffling during the recession and recovery, and the resulting firings, layoffs, transfers and decreased promotions. Wrongful termination claims usually have their genesis in breach of contract, or some sort of alleged discrimination. Because certain of the federal and state laws prohibiting discrimination now provide for recovery of monetary compensatory damages, the plaintiffs' bar is expected to develop a new-found interest in this type of claim.

In view of spate of suits last year by American employees against Japanese employers, we expect this to be an area of continuing exposure to foreign companies doing business in the U.S. Examples incude the $4.8 million verdict in the Quasar suit and the settlement with Sumitomo requiring the company to give wage increases and back pay awards to 130 employees. Because company policy is often established by home office executives overseas, the prospect of bringing non-U.S. directors and officers into the fray is great.

Sexual harassment complaints lodged with the EEOC climbed to 1,608 in the fourth quarter of 1992, from 1,244 the year before. The Wall Street Journal reports that total discrimination charges

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brought under various federal laws are expected to increase about 30% in the fiscal year ending September 30, 1993.

In addition, the vagaries of the Americans With Disability Act is proving to be a boon to plaintiffs' lawyers. The ADA was passed in 1990 to bar discrimination against disabled people in public accommodations and in the workplace. The law has engendered the expected flurry of lawsuits challenging hiring practices, benefits decisions etc. No one expected, however, the Act to be the source of the far-ranging lawsuits we are beginning to see.

Since October, the number of ADA claims against employers has averaged about 1,000 a month, which is actually below what had been expected. The language of the ADA, however, makes it prone to numerous judicial interpretations, including what exactly is required by "reasonable accommodations" for a worker's disability, and what constitutes "undue hardship" on the employer. These suits are expected to affect directors and officers who formulate and implement hiring, promotion, training and firing procedures.

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SEGMENT NUMBER TWO

D&O Claim Implications For Non-U.S. Directors and Officers

[Slide #14]. I have already spoken about the types of D&O claims common in the United States today and what types of claims are expected in the future. Now, I would like to talk a bit about how non-U.S. directors and officers are drawn into D&O claims brought in the United States. For the most part, the potential for this type of claim depends largely on the means of doing business in the United States. The greater the contacts, in number and degree, between the non-U.S. director and officer and the American forum, the more likely the possibility of claim against the directors and officers. Thus, directors and officers of non-U.S. companies that are directly doing business or conducting transactions in the United States, or seek access as to American capital markets, or enter into joint venture agreements or acquire American businesses, and even those companies that do business only through wholly-owned subsidiaries, all face potential liability under American law.

Doing Business Through Wholly-owned Subsidiaries

[Slide #15]. Many non-U.S. corporations who avoid American capital markets altogether, nonetheless do business in the United States through wholly-owned subsidiaries. In most circumstances,

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this can avoid requirements of the SEC and the potential liabilities that arise in connection with equity shareholders and the disclosure and anti-fraud provisions of the Federal Securities Laws. However, doing business through a wholly-owned subsidiary does not eliminate potential liability of the non-U.S. directors and officers altogether (and obviously, the directors and officers of the subsidiary face all of the risks and exposures that exist in the U.S. today).

As a recent example, a large Japanese automobile manufacturer and its corporate officials were sued in the United States in a legal battle with executives of its car rental subsidiary. The Japanese company had purchased an 80% interest in the family-owned American car rental company. As a part of the transaction, four seats on the American's six-member Board were filled by managers from the Japanese company, while Americans who had previously owned all of the company retained senior executive positions and ran the company on a day-to-day basis.

When the Japanese company suspended the American President and his three children from their executive positions (purportedly for bugging the offices of a Japanese manager working at the company and for misappropriating funds), the American executives filed a $60 million lawsuit against the Japanese parent company. Through this suit, the American executives joined all of the Japanese executives who sat on the Board of the car rental subsidiary, as

Donación de AGERS al Centro de Documentación de FUNDACIÓN MAPFRE

well as other executives who had a hand in purchasing the company or in managing the subsidiary. The case is still pending and the plaintiffs are contending that the Japanese parent company was attempting to deprive them of income, using the subsidiary to dump Japanese cars in the United States and "trying to throw American families out of their jobs."

Even when the parent has less contact than this, the directors and officers of a non-U.S. parent company face the potential for claim by U.S. plaintiffs, particularly when the non-U.S. corporation is involved in merger and acquisition activities in the United States. A large number of these claims will be generated by the shareholders of the target or merged corporations and are often "strike suits" complaining about the adequacy of the consideration paid for the company. In this regard, it has been increasingly common for shareholders to name the acquiror, and thus the directors and officers of the acquiror, alleging that they have aided and abetted the breaches of fiduciary duty by the target company's board of directors.

I should say that this does not usually make a particularly compelling case, nor are we aware of any situations where the acquiring company and its directors and officers have actually been found liable to the shareholders of the acquired company. Nonetheless, there is certainly some potential for exposure in this

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regard, if for no other reason, because of the substantial costs involved in defending such actions.

Many non-U.S. corporations may believe that by doing business in the United States through wholly-owned subsidiaries, they have effectively insulated themselves from claims against both the parent corporation and its directors and officers. It is probably more accurate to say that this method of doing business in the United States discourages claims against the directors and officers of the parent, but certainly does not preclude such claims.

Liability of Parent Corporations and Their Directors and Officers

Under American law, there are numerous legal theories supporting the imposition of liability against a parent corporation, and its directors and officers, based upon the conduct of a wholly-owned subsidiary. To begin with, the parent corporation may be liable for its *direct, active conduct* in particular business transactions. This would occur when the employees, officers and directors of the parent corporation themselves are actively and personally involved, on behalf of the parent corporation, in transactions in the United States.

Secondly, there is the often cited legal theory that the subsidiary corporation may be acting as the *agent* of the parent corporation. Unc[illegible] l agent, the

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principal party may be liable for the acts of its agent. In order for such liability to be imposed, it must be shown that there is a close connection between the relationship of the two corporations and the claim sued upon. The question is then whether the actions of the subsidiary were carried out at the direction and pursuant to the specific instructions of the alleged principal corporation. If these criteria are met, then the parent corporation may be found liable for the acts of the principal. Likewise, if a director of officer is an active participant in directing the allegedly wrongful conduct, he or she can also become a target of the claim.

A third basis upon which a parent corporation, and its directors and officers (as well as its shareholders), can be liable for the conduct of a subsidiary is found in the *"alter-ego"* theory. This theory is sometimes referred to as "disregarding the corporate entity" or "piercing the corporate veil". Under this theory, the parent corporation is indirectly liable for the conduct of the subsidiary.

Generally speaking, an alter-ego relationship will exist where a corporate parent exercises complete domination and control over its subsidiary. Where such complete domination and control can be demonstrated, the parent corporation can be found liable for the conduct of the subsidiary, as can the directors and officers of the parent. Generally, in order to invoke the alter-ego theory, the party must demonstrate that the defendant's use of the subsidiary

Donación de AGERS al Centro de Documentación de FUNDACIÓN MAPFRE

corporation worked a fraud or injustice upon the claimant. In other words, the injured party must show some connection between its injury and the parent corporation's improper manner of doing business through the subsidiary.

I should note that the alter-ego theory of liability is an exception to the general rule that under ordinary circumstances, a parent corporation will not be held liable for the obligations of its subsidiary. In keeping with this general rule, the courts usually impose the burden of proof upon the party claiming injury to demonstrate that there was some misuse of the corporate relationship of parent and subsidiary.

Claims Under the Securities Laws

[Slide #16]. The easiest opportunity to hold a non-U.S. director and officer into an American litigation exists where the non-U.S. corporation is actively trading its stock on an American stock exchange. Under American law, this would subject the corporation and its directors and officers to the jurisdiction of the American courts and the American securities laws.

To avoid being subject to extra-territorial application of the securities laws, the non-U.S. corporation may choose not seek access to the American capital markets through use of the American exchanges. This does not necessarily mean, however, that the

Donación de AGERS al Centro de Documentación de FUNDACIÓN MAPFRE

American securities laws will have no application whatsoever to stock transactions on non-American markets.

The federal securities laws were intended to afford protections to both American investors and to the United States securities markets. The question then arises as to whether jurisdiction of the American courts, pursuant to the federal securities laws, should be exercised with respect to transnational transactions involving stocks which are not traded on an American exchange.

American courts exercise jurisdiction over extra-territorial conduct (i.e. conduct outside of the United States) under two circumstances. First, in circumstances when the extra-territorial conduct has had detrimental effects within the United States ("the effects test"). Secondly, where the fraudulent or detrimental conduct of non-U.S. persons actually happens within the United States ("the conducts test").

Jurisdiction under the "conducts test" can be based on misrepresentations made in the U.S. even though they involve foreign securities traded only on foreign markets. The courts have required, however, the fraudulent conduct actually take place in the United States and that the U.S. conduct not be "merely preparatory" to the actual fraud that may take place elsewhere. In this regard, foreign investors residing in the United States are

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protected by the federal securities laws to the same extent as American citizens, and this, of course, broadens the range of possible plaintiffs against non-U.S. directors and officers.

The point worth noting is that the American courts have found that the securities laws (particularly the anti-fraud provisions of Section 10(b) of the Exchange Act of 1934), protect against fraud in the sale or purchase of securities *whether or not* they are traded on U.S. exchanges. One of the prominent cases concerning extra-territorial application of American securities laws is the case of Leasco Data v. Maxwell. In that case, it was alleged that foreign nationals, residents of Great Britain, travelled to the United States and fraudulently induced American investors to purchase stock of a foreign corporation, which stock was traded on the British National Exchange. In the course of the transaction, there were numerous correspondences, telephone calls and meetings that took place in a variety of locations, including the United States, Canada and Great Britain. A contract was actually signed in the United States and subsequently, the U.S. investors, through the use of their wholly-owned subsidiary, an Netherlands Antilles corporation, purchased the stock from the British citizens.

The defrauded American investors subsequently brought suit in the U.S. and the defendants included various foreign nationals and corporations. The court found that jurisdiction was appropriate over all of the non-U.S. defendants, except one. Finding that the

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defendants had carried out significant conduct within American territory, including conduct which was "an essential link" in inducing the fraudulent transaction, the court found that although the impact on the American shareholder may not alone have been enough, the fact that some of the misconduct had occurred in the U.S. was enough to hold the non-U.S. defendants into the U.S. litigation.

Thus, although the transaction was clearly intended to be fully consummated in England and involved the stock of a foreign corporation traded on the British exchange, the court exercised jurisdiction under the securities laws because the defendants' conduct was within the American forum, combined with the fact that the defrauded investors were American citizens (albeit acting through a foreign subsidiary).

In sum, it should not be assumed, simply because a transaction involves a foreign corporation the stock for which is traded on a foreign market, that such transaction cannot be made the subject of securities fraud actions in the United States. To the contrary, to the extent that conduct amounting to the fraud takes place within the United States, or, alternatively or in combination, the subjects of the fraud are American citizens, it is arguable that such transactions are subject to the jurisdiction of the American courts.

Donación de AGERS al Centro de Documentación de FUNDACIÓN MAPFRE

Therefore, if a non-U.S. corporation decides to have its stock traded on an American market, the directors and officers would be subject to jurisdiction here. Likewise, should a non-U.S. corporation and its directors and officers do business with American investors or carry out transactions by conduct within the American forum, they too will be subject to jurisdiction of the American courts and the Federal Securities Laws.

American Depository Receipts

[Back to Slide #14]. The dissemination of American Depository Receipts ("ADRs") is another potential source of D&O liability in the U.S. ADRs are considered a negotiable certificate certifying that a stated number of securities of a foreign issuer corporation are deposited with an American bank or its foreign affiliate or correspondent. They may be freely traded within the U.S. on the over-the-counter market or, under certain circumstances, on a national exchange. ADRs may be "sponsored" or "unsponsored" depending upon the arrangement between the corporate issuer and the institution which holds shares in the foreign corporation as a depository.

As a general rule, the foreign issuers of sponsored ADRs are deemed to be entering the U.S. market "voluntarily" and, therefore, are required to register the issued ADRs with the SEC in a manner similar to that of securities issued by American public

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corporations. The foreign issuer may seek an exemption from certain SEC registration requirements if the issuer does not intend to raise capital in the U.S. through an equity offering or if the ADRs are intended to be traded on an over-the counter market.

The unsponsored ADR arrangement is where the foreign issuer assumes no obligations and the depository's transaction fees are paid directly by the ADR holders; there is no privity between the foreign issuer and the depository bank. Typically, under this scenario the foreign issuer is deemed to have "involuntarily" entered the U.S. market. Because of this "involuntary" entry, the SEC allows unsponsored ADRs to be exempted from full registration requirements.

Notwithstanding potential exemption from compliance with SEC registration requirements, foreign issuers of ADRs are subject to the proscriptions of the American securities laws, including the anti-fraud statutes. Thus, where an American court can exercise jurisdiction over a foreign issuer of ADRs or its directors and officers, it may adjudicate such party's liability under the securities laws.

Some 800 foreign companies from over 30 countries have issued ADRs, including Sony (which trades on the New York Stock Exchange) and Toyota (which is traded over-the-counter).

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i) Examples of ADR Generated D&O Claims

- Saatchi & Saatchi Co. PLC, London, the British advertising giant, and 11 of its past and present directors and officers were sued in 1990. The complaint alleged that Saatchi, et al. artificially inflated the price of its ADRs by a series of false or misleading optimistic financial statements. Saatchi ADRs dropped in value from a 1987 high of more than $33 to $14 ADR in March of 1989 after an announcement of "substantially lower" profits. Saatchi lost $92 million in fiscal 1989 after posting a $217 million profit the previous year.

The action filed in the U.S. District Court for the Central District of California charged that Saatchi's officers failed to disclose problems caused by an aggressive acquisition of advertising and consulting firms beginning in 1985. Among the problems were serious conflicts of interest causing the loss of clients and management defections. The class action complaint contained allegations that Saatchi's directors and officers violated the anti-fraud provisions of Section 10(b) of the 1934 Act.

In a 1987 case, the California District Court held that a foreign issuer of sponsored ADRs was subject to the court's jurisdiction because the foreign issuer availed itself of the privileges and protections of the U.S. and its government in

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registering with, and transacting business under the auspices of, the SEC. Thus, foreign issuers of ADRS and their directors and officers face potential liability and exposure in American courts arising from the purchase and sale of ADRs by American securityholders. The likelihood of being hauled into court in the U.S. is substantially increased where corporate activity, including sales, mergers, and acquisitions, directly or indirectly, effect the rights of ADR holders and the value of the ADRs.

Jurisdictional Considerations

The state of incorporation and the places where a corporation does business will also impact non-U.S. directors and officers, should litigation arise.

For purposes of federal court venue, a corporation is generally subject to jurisdiction in the state where it is incorporated or where it has its principal place of business. The question of whether a state court or federal court in any particular state can exercise jurisdiction, is essentially a question of whether or not that party is "doing business" or "transacting business" in that jurisdiction such that he should reasonably anticipate his conduct to have consequences there. While this is a simplification of the legal test of jurisdiction, it is fair to say that jurisdiction can be exercised wherever a

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corporation has sufficient contacts (ie. offices, personnel and business transactions) within a particular forum.

As a general proposition, most states have specific statutes providing that the directors of the corporation are subject to the jurisdiction of the courts of that state in which the company is incorporated, regardless of whether they are physically present in that forum. Thus, for example, the directors of a wholly-owned German corporation, incorporated in the state of Delaware, are subject to the jurisdiction of the Delaware courts *even if they are never present there*.

A California Appellate Court has recently addressed the issue of jurisdiction over a director and officer of a foreign corporation and imposed jurisdiction over the President of a Japanese parent corporation based upon his representation that the parent corporation would guarantee the obligations of the U.S. subsidiary doing business in California. This is a case I will mention later on, but it has particular relevance when discussing jurisdiction over non-U.S. directors and officers. The case arose from a business relationship between a California corporation and a Japanese subsidiary corporation which produced computer products. In connection with certain transactions, the American company was unwilling to extend credit to the Japanese subsidiary without a guarantee from the Japanese parent corporation. To make this guarantee, the President of the Japanese parent company travelled

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from Japan to California for one meeting with representatives of the American company. He thereafter sent a letter confirming that he would guarantee the subsidiary's obligations. Credit was extended but the subsidiary went bankrupt and the American company sued the Japanese parent company in California.

The court determined that it had jurisdiction over the Japanese President, holding that an officer or director of a corporation will be liable for the corporation's wrongful acts if the officer or director authorizes, directs or in some meaningful sense participates in the wrongful conduct. In fact, the court held that when a corporate officer causes a corporation to commit a wrongful act, that act may be imputed to the officer for purposes of establishing jurisdiction.

In reviewing the facts of the case, the court took note of the fact that the Japanese officer had been present in California and had sent a letter representing the guarantee from Japan to California.

The courts in New York have also held that a parent corporation can be present in the state for purposes of jurisdiction due to only the activities of its subsidiary, provided, however, that the activities amount to more than a mere parent-subsidiary relationship. If the subsidiary "performs all the business" or if a parent company has its own employees present

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in the jurisdiction, the case may be brought against the directors and officers of the parent in that jurisdiction. Furthermore, if the court should find that the subsidiary is in fact, although not in name, a branch of the parent, jurisdiction will also be exercised.

A recent decision where an American court exercised jurisdiction over a Japanese parent corporation provides an instructive list of factors that the court considered supportative of the exercise of jurisdiction. The persuasive circumstances included the following:

1. The Japanese parent's U.S. subsidiary was one of seven overseas offices;

2. The subsidiary was mentioned as a "branch" office on certain corporate documents;

3. Several key employees of the U.S. subsidiary were former employees of the corporate parent;

4. At a deposition, an employee of the subsidiary testified that managers of the subsidiary sometimes work for two-three years for the subsidiary and then resumed employment with the parent corporation.

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5. Copies of various corporate documents, including financial documents were routinely sent to the parent company by the subsidiary;

6. The subsidiary accounted for 20% of the parent company's total sales;

7. The Japanese parent acted as a guarantor of certain bank loans granted to the subsidiary;

8. The members of the Boards of Directors of the two corporations overlapped.

The more we delve into this subject, the more apparent it becomes that the relationship between the parent and the subsidiary can confer jurisdiction over the parent in American courts and therefore can give rise to liability for both the non-U.S. parent corporation and its directors and officers.

U.S. Claims Against Non-U.S. Directors and Officers

[Discussion of cases on Slide #17]

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AREAS OF FORECASTED CLAIMS

[Slide #18]

Patent Infringement

Because D&O claims tend to evolve out of the controversies in which the corporate entities are embroiled, we can forecast what may be the targeted areas for D&O claims in the future. When looking at foreign corporations doing business in the United States, the types of claims likely to be brought against the non-U.S. corporation directors and officers will generally arise from the legal problems the non-U.S. corporation is facing in the United States. For example, it is a growing trend in American courts to award multi-million dollar recoveries to American corporations complaining of patent infringement by non-U.S. companies.

Examples include litigations brought last year by American manufacturers against Japanese manufacturers:

- Comair Rotron, the leading American designer and manufacturer of cooling fans for computers, was awarded $21 million and in a patent infringement case against Matsushita, the global conglomerate selling under the Panasonic brand.

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- Wang sued Mitsubishi in Federal Court in Los Angeles last year alleging that Mitsubishi had infringed on patents on memory devices for personal computers.

- Texas Instruments, Inc. filed a lawsuit against Fujitsu, Ltd. accusing the Japanese Company of infringement of Texas Instrument's Japanese Kilby patent covering integrated circuits made and sold in Japan. This suit was filed in Tokyo District Court. Texas Instruments also sued Sanyo Electric Company seeking to stop Sanyo from using semi-conductor technology without a license.

- Last year, Sega Enterprises, Ltd. settled a patten infringement case for $43 million involving video game display technology.

- Everyone is familiar with Honeywell's settlement with non-U.S. camera manufacturers over alleged infringement of patented technology for autofocus lenses (Minolta alone paid Honeywell $127.5 million).

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In each of these cases, the directors and officers of the non-U.S. manufacturer could easily have been named in these suits.

Claims Arising From Listing and Trading Stock of Non-U.S. Companies on U.S. Exchanges

Daimler-Benz AG, (Germany's biggest industrial group) is trying to become the first German company to list its shares on the New York Stock Exchange. Daimler-Benz was not allowed entry to the U.S. Stock Market before because U.S. regulators had blocked the German company for differences in accounting procedures. The SEC says that German companies generally provide two little transparency in their accounts.

For example, German companies are notorious for squirreling away cash that is not reported on the balance sheets and this has been a main complaint by foreign investors. Daimler-Benz is no exception. Last month it disclosed a 2.82 billion dollar extraordinary earnings gain in its 1992 financial statement, made up for the most part of "hidden" reserves. The disclosure itself is a sign that the company is trying to bring its reporting practices into line with the more exacting standards applied in the U.S.

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Daimler-Benz's move to be listed on the New York Exchange is likely to encourage other foreign companies which had previously been discouraged by rigorous U.S. accounting standards.

Of course, being listed on the American Exchange is a plus for non-U.S. companies seeking to raise capital in U.S. markets. The down side is that it will also subject the company's non-U.S. directors and officers to a multitude of potential claims arising out of the securities laws.

Technology Joint-Ventures

More and more, foreign corporations are tapping research and technology developed in the United States, particularly at U.S. universities, to assist in over-seas product manufacturing. Because officers and directors of the non-U.S. companies have direct involvement in contracting with the Universities or setting up joint ventures with U.S. technologies companies, this will likely be a source of increased claims against non-U.S. directors and officers.

Claims by the U.S. Government

Perhaps because of the differences in investment regulation overseas, foreign corporations doing business in the U.S. are the current target of SEC scrutiny. The latest example was the suit

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planned by the SEC against U.S. subsidiaries of Japan's Big Four Brokerage Houses for various alleged securities laws violation, including the use of unlicensed brokers. As you will recall, one of these firms, Daiwa Securities America, Inc., had a role in this Salomon Brothers treasury bond scandal last year. The brokerage firms, despite claims that the SEC was "Japan bashing", are in the process of finalizing settlements with the SEC. According to the Wall Street Journal, this was the first enforcement action taken by the SEC against any Japanese financial institution.

The SEC had also been interested in questionable "loss reimbursement" practices by Japanese brokerage firms; a procedure where favorite clients are repaid by the firms after posting security losses.

Earlier this year, the SEC sued Nikko Securities Company, a wholly owned subsidiary of a major Japanese brokerage, for violating record keeping and financial reporting provisions of the Federal Securities Laws (they allegedly concealed over $18 million in trading losses).

With the newly invigorated EPA, directors and officers of non-U.S. corporations can expect to be involved in remediation of more U.S. Superfund sites (like the U.S. v. Vivey case). Presumably, if the directors and officers have sufficient contacts with the U.S., and their corporation's product is found to be an element of the

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release or threatened release, they will be subject to liability under a variety of environmental laws.

Late last year, New York's Attorney General took aim at the car leasing advertisements run by various non-U.S. auto manufacturers. As a result of the Attorney General's allegations of "misleading and deceptive" advertisements, the State government reached a settlement with BMW whereby BMW paid for the State's investigation and agreed to change its adds (to make small-print provisions more evident). The Attorney General is now going after various other foreign car manufacturers including Honda, Volkswagen, Mazda, Daimler-Benz, Mitsubishi and Nissan.

These are just a few examples of the far-reaching arm of U.S. governmental agencies in protecting American consumers.

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