

Institutional Investor

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When Big Funds Lawyer Up

CalSTRS and Texas Teachers' power move with litigation finance firms.

BY JULIE SEGAL

When a Danish pharmaceuticals giant was accused of fraud, securities litigator Irwin Schwartz knew who'd pay the price: Novo Nordisk shareholders. Many of them happened to be his clients.

Attorneys and financiers smell opportunity when a corporate scandal breaks and the company's stock plunges. If major shareholders sue the company for losses and win, the awards can be massive. Schwartz represents such shareholders — pension funds and other institutional investors with vast global stock portfolios, which inevitably own stakes in most major public companies.

Two and half years ago, Schwartz tried to rustle up interest in a case against Novo Nordisk, which was accused of misleading investors about sales and profits of its insulin drug in the U.S., among his shareholder clients. But funders didn't bite at suing Novo Nordisk on its Danish home turf, even though a class action lawsuit was unfolding in the U.S.

Then in early 2018, news broke saying that Denmark's largest bank had failed to stop a massive Russian money-laundering scheme, and that senior managers had covered it up for years. Multiple litigation funders jumped on the Danske Bank case, contacting Schwartz to gauge his clients' interest in participating. **Schwartz, founder of law firm BLA Schwartz, had another idea: Package the cases.** He told the funders



Illustration by Sam Island

that if they wanted in on Danske, he wanted them backing Novo Nordisk, too.

Danske had a higher profile, but Novo was more damaging to its investors.

"Most of our clients' losses in Novo are three to five times the losses in Danske," Schwartz says he told the funders. His argument worked.

The massive California State Teachers' Retirement System, a client of Schwartz's and a shareholder in both companies, was compelled. "We were potentially interested in the case as well, and the funders were definitely interested in us bringing our losses to their Danske Bank group," says CalSTRS general counsel Brian Bartow. "We said

we'll do Danske — if you do Novo." The funders agreed — provided enough other shareholders joined and CalSTRS agreed to help lead the case against Novo Nordisk.

As a result, big investors have banded together, including CalSTRS and the Teacher Retirement System of Texas. They're using their substantial combined losses to negotiate fees with a litigation financier for backing a case against Novo Nordisk. IMF Bentham, which has proposed to fund the case, declined to comment.

The move marks a sea change in securities litigation outside the U.S., where investors can't just sit back and passively

become part of class action lawsuits as they can in the states. This is the first time a group of institutions has banded together and reached out directly to funders. Outside financing is all but required to mount major overseas legal battles with a hope of recovering losses. Typically, institutional investors are on the receiving end of calls from litigation funders and law firms, which identify promising cases and then find plaintiffs. “Promising” for the lawyers and lenders means highly profitable — for them. Those aren’t necessarily the cases that would yield the biggest recoveries for harmed shareholders.

As news of the alleged frauds came out, for example, Danske Bank lost \$18 billion from its market capitalization, whereas Novo’s cratered by \$54 billion. If the pension-led Novo Nordisk group is successful, it could be a model for other institutions in the nascent world of international securities litigation.

The setup sounds obvious. Investors should pick cases they think are worth their time pursuing and that have negotiating power with funders. After all, with no plaintiffs, there’s no case. The average litigation funder takes nearly 30 percent of any settlement, and investors have a lot to gain by going after a better deal.

Shareholders of international stocks, however, are still struggling to efficiently learn about securities fraud cases that affect their holdings and then to get objective advice. **Schwartz, with the help of specifications from CalSTRS’ Bartow, built a separate company called Dividex in 2013 to help institutional investors manage securities litigation claims, including identifying losses and giving advice.**

The difficulties date back to 2010, when the Supreme Court ruled in *Morrison v. National Australia Bank* that securities traded outside the U.S. are no longer under U.S. jurisdiction. Pensions interested in recovering any of their plans’ international losses needed to join cases filed in foreign jurisdictions.

In the U.S., unless they opt out to be lead plaintiff, institutional investors automatically become part of a class action lawsuit when their domestic stock holdings are caught up in fraud or other litigation.

But recouping damages overseas demands much more mettle. Many foreign jurisdictions don’t allow contingency fees, where plaintiffs pay their lawyers only if they win. Funders also provide insurance to cover the risk of losing, when an institution may be on the hook for some of the winner’s legal costs.

Since he joined CalSTRS as general counsel in 2010, Bartow says he’s been waiting to get negotiating power with funders. He had it with the Novo Nordisk case. **CalSTRS sees securities litigation as an asset.** The plan became a proposed lead plaintiff a few years ago against Volkswagen and chair of the steering committee suing the automaker for fraud in emissions tests.

With Novo Nordisk, Schwartz leveraged his knowledge of client losses and the competition among litigation funders for the Danske Bank suit to get IMF Bentham on board with Novo. Then he negotiated fee structures and terms under which CalSTRS and Texas Teachers agreed to support efforts to recover losses from Novo Nordisk for the benefit of all global pension funds. The more public pension funds join the group, the lower the fee may end up being. That’s because funder fees — a percentage of any settlement — fall as the value of the settlement rises. Under the agreement public pensions in the Novo group would pay IMF Bentham based on the losses of all the institutions that ultimately participated in the case.

“It’s also easier to get a funder interested in a case” as a group, says Bartow. “The aggregated loss of a group of public pensions has economic value to the funder. It gives us leverage.” He adds, “You become a seller, not a buyer.”

Lane Arnold, assistant general counsel at Texas Teachers, has been talking

about the Novo case with other public plans in the National Association of Public Pension Attorneys discussion group. With the statute of limitations expiring as early as August 5, the time to join is nearly up.

“To the extent those plans are interested in possibly participating in the case, we’re putting our heads together to think about ways we can work together to lower fees, ultimately saving costs for plan beneficiaries,” Arnold says.

Securities litigation is a challenge for everyone, but smaller plans don’t have the resources to pursue cases as a Texas Teachers does, Lane points out. The discount in the Novo case is particularly valuable to small plans, whose limited losses would force them to pay the highest fees.

Institutions would like to see even more financing firms enter the business, but it wasn’t long ago that funders and law firms presented investors with non-negotiable, take-it-or-leave-it packages.

“In the first few years after the Supreme Court’s decision in the *Morrison* case, we would do the best we could, but we were still negotiating with existing entities and packages,” says Bartow. “You wouldn’t have multiple law firms or multiple funders competing on the same cases. There really was no market competition.”

Of course, the dearth of providers wasn’t going to last forever in a sector with fees near 30 percent. The number of litigation funders has risen as Wall Street has discovered lawsuits as a fresh source of returns uncorrelated to broader markets. Those new players are already pushing down fees. Five years ago funders dictated terms that were well above 30 percent of any settlement. Now, for some strong cases, lenders’ cuts have fallen below 20 percent.

In Lane’s mind, Texas Teachers’ fiduciary duty “compels us to negotiate better terms.” He wonders, “If we win back more money, our legal department is now a profit center. When does legal get to say we made money?”