

## United States Securities Class Actions

### I. INTRODUCTION

Well over a hundred securities class actions are filed in the United States each year. The federal courts effectively have become the exclusive venue for U.S. securities fraud class actions since the enactment of the Securities Litigation Uniform Standards Act of 1998 (SLUSA).

Securities class actions are quite complex. The relevant statutes are often not clear, the body of case law is immense, the procedures are unusual, and the law of damages is uncertain and difficult to apply. Accounting and financial experts are often necessary; insurance disputes sometimes arise; and vast numbers of documents may need to be produced for inspection and numerous witnesses interrogated during the process known as pre-trial discovery. Defense costs can quickly run into the millions of dollars.

Although a court appoints one or more representatives of the class (usually, the lead plaintiffs), the action is in reality controlled by class counsel. Class counsel will bear the expenses of the litigation and receive payment of fees and expenses from any amount recovered on behalf of the class. If the class recovers nothing, counsel receives nothing. Except in extraordinary circumstances and with limited exceptions, a defendant will not receive reimbursement for attorneys fees and expenses even if successful.

Almost all securities class actions settle before trial. According to Cornerstone Research, in 2009, there were 103 settlements of federal securities class actions, involving \$3.8 billion in total settlement funds, with a median settlement amount of \$8 million. Statistical studies show that the median time for settlement is approximately three years following the filing of the class action.

### II. THE BASICS OF A SECURITIES CLAIM

U.S. securities class actions may allege a number of claims, including, for example, the alleged violation of U.S. securities laws based on misrepresentations concerning the operative company's financial and business condition. The principal claim is often one of securities fraud under Section 10(b) of the Exchange Act of 1934 and Rule 10b-5 of the United States Securities and Exchange Commission (the "SEC") adopted under the Exchange Act. These provisions prohibit fraud by any "person" in connection with the purchase or sale of a security. The elements of a private right of action for damages under these provisions are: "(1) a material misrepresentation (or omission); (2) scienter, *i.e.*, a wrongful state of mind; (3) a connection with the purchase or sale of a security; (4) reliance, often referred to in cases involving public securities markets (fraud-on-the-market cases) as 'transaction causation,' (non-conclusively presuming that the price of a publicly traded share reflects a material misrepresentation and that plaintiffs have relied upon that misrepresentation as long as they would not have bought the share in its absence); (5) economic loss; and (6) 'loss causation,' *i.e.*, a causal connection between the material misrepresentation and the loss." *Dura Pharms., Inc. v. Broudo*, 544 U.S. 336, 245 (2005).

A misrepresentation is “material” if there is “a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the ‘total mix’ of information made available.” *Basic Inc. v. Levinson*, 485 U.S. 224, 231-32 (1988). “Scienter” is an “intent to deceive, manipulate, or defraud.” *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 (1976).

Under the Private Securities Litigation Reform Act of 1995 (the “PSLRA”), a plaintiff in a securities fraud case must “state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind.” 15 U.S.C.A. § 78u-4(b)(2). In 2007, the Supreme Court held that in order to qualify as “strong,” “an inference of scienter must be more than merely plausible or reasonable — it must be cogent and at least as compelling as any opposing inference of nonfraudulent intent.” *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 313-14 (2007). In many circuits, a plaintiff may raise a strong inference of scienter in either of two ways: “(a) by alleging facts to show that defendants had both motive and opportunity to commit fraud, or (b) by alleging facts that constitute strong circumstantial evidence of conscious misbehavior or recklessness.” *Kalnit v. Eichler*, 264 F.3d 131, 138-39 (2d Cir. 2001); *GSC Partners CDO Fund v. Washington*, 368 F.3d 228, 237 (3d Cir. 2004). Other Circuits, for example, take a “totality of circumstances” approach, to which a showing of motive and opportunity may be relevant, but is not dispositive.

Class actions generally rely on the “fraud-on-the-market” presumption to show reliance. That presumption, adopted by the Supreme Court in *Basic Inc. v. Levinson*, 485 U.S. 224 (1988), provides that investors who bought or sold a security did so in reliance on the integrity of the market price of that security. To invoke the presumption, the plaintiff must show that the market on which the securities traded was “open and developed” and “efficient” in the sense that “the price of a company’s stock is determined by the available material information regarding the company and its business [and] [m]isleading statements will therefore defraud purchasers of stock even if the purchasers do not directly rely on the misstatements.” *Basic Inc.*, 485 U.S. at 241-42.

### III. LIABILITY OF THE CORPORATION

A corporation may be liable for violations of the Exchange Act. Section 3(a)(9) of the Exchange Act defines a “person” to include “a corporation.” Under Section 20(a) of the Exchange Act, a person who controls any person liable under the Exchange Act may be liable jointly and severally with and to the same extent as the controlled person to any person to whom the controlled person is liable, unless the controlling person acted in good faith and did not induce the violation. In addition, some courts have held that liability for violations of Rule 10b-5 may be predicated on the tort law doctrine of respondeat superior, which renders an employer liable for wrongs by an employee committed within the scope of employment or pursuant to apparent authority.

### IV. TIMELINE OF SECURITIES CLASS ACTIONS

Once a securities class action is filed, the law firm representing the plaintiff who has filed the class action generally publishes notice that the class action has been filed. Plaintiffs (both the one who has filed the class action and any other class member) then have 60 days to file lead plaintiff motions. Based on those motions, the court will appoint lead plaintiffs who will be authorized to select lead counsel and file a consolidated amended complaint. Speaking generally, the court will appoint the applicant with the largest losses. Defendants generally have no role in the appointment process, while the various plaintiff groups generally challenge one another’s credentials. Usually, where multiple lawsuits have been filed, the lawsuits are consolidated into a single lawsuit. The lead plaintiff then files a consolidated complaint, which usually includes new claims and defendants.

As a general rule, all discovery is stayed pending a motion to dismiss a securities fraud action, though Defendants remain obligated to preserve all potentially relevant documents. The preservation of documents generally entails the drafting and distribution of a litigation hold notice, the interviewing of key custodians and IT personnel to identify the possible locations of potentially relevant information, the disabling of certain auto delete and other Out-

look or server functions, the maintenance of back-up tapes, and the imaging of hard drives and copying of databases and paper documents by a third-party e-discovery vendor (or, if appropriate, the defendant's IT department).

Any defendant may move to dismiss the action for a variety of reasons, including, for example, lack of jurisdiction and/or failure to state a claim upon which relief may be granted. Once the motion is fully briefed, the Court will likely set a date for oral argument on the motions and will then rule on the motions. The ruling could come anywhere from two or three months to over a year following oral argument.

If the case is dismissed without prejudice, an amended complaint could be refiled and the parties would begin the entire process over. If it is dismissed with prejudice, an appeal could be taken. If some or all of the case survives the motion to dismiss, then discovery would begin in accordance with a scheduling order to be issued by the court (which would likely first be agreed to by the parties). Discovery would include, among other things, document collection, review and productions, interrogatories, export reports/discovery and depositions, and would likely last more than a year, if not several years.

At some point after discovery begins, lead plaintiffs will ask the Court to permit the action to proceed as an action on behalf of one or more classes. This process, known as "certification," takes some time to complete. Once a class is certified, all class members will be bound by the outcome of the action, whether favorable or unfavorable, save for members who choose to "opt out" from the class. In practice, very few class members opt out, but those who do are free to bring their own lawsuits. Such an individual lawsuit would be attractive only to investors who made very large purchases during the period of the fraud.

Upon the conclusion of discovery, Plaintiffs and Defendants would file motions for summary judgment, which motions would be briefed. The Court would decide whether to grant the motions in whole, in part or not at all. If the motions are granted, the "losing" party can appeal. If some or all of the case survives, preparation would begin for trial. The parties would then participate in the trial and engage in various post-trial motion practice.

#### IV. SETTLEMENT

Very few securities class actions go to trial. If they do go to trial, a jury would determine the facts, and the judge would decide issues of law. Almost all cases settle prior to trial. The settlement process usually involves a mediation involving counsel for all interested parties, including insurers. Any settlement must be approved by the court, following notice to all class members and a hearing at which class members have an opportunity to argue that the settlement is inadequate. Settlements are rarely disapproved.

Settlement discussions can begin at any time but typically do not occur until disposition of motions to dismiss the consolidated amended complaint and any further amended complaints, a process that could take a year or more. In many cases, settlement discussions do not conclude until the plaintiffs have taken substantial discovery and the court has ruled on motions for summary judgment. In that event, a case may not settle for five years or more. Statistical studies show that the median time for settlement is approximately three years following the filing of the class action.

As mentioned, measuring damages is difficult, and damages can reach very high levels. Plaintiffs often use several methods to try to calculate damages, including for example, a method known as the "constant dollar inflation model." This method uses public information to measure the decline in a company's stock following the alleged "corrective disclosure" (*i.e.*, the disclosure alleged to have revealed the alleged fraud) and assumes that that decrease is the actual amount of artificial inflation that was present in the stock price throughout the period of the alleged fraud. All such methods are preliminary, general and based on a number of assumptions. Fortunately, securities class actions almost always settle for a small percentage of estimated damages.