FENWICK & WEST LLP

Securities Litigation Alert

February 14, 2005

Recent Trends In Securities Litigation: Perspectives From Plaintiffs And Regulators

The 2005 D&O Liability and Insurance Symposium in New York, sponsored by the Professional Liability Underwriting Society, featured a panel of top plaintiffs' lawyers, defense counsel and SEC Staff analyzing recent trends in securities litigation. Panelists included: **Susan S. Muck**, a securities litigation partner at Fenwick & West LLP who defends class actions, derivative actions and SEC proceedings; **Joan McKown**, Chief Counsel of the SEC's Enforcement Division; and two of the nation's leading class action lawyers, **William S. Lerach** (who represents the University of California in the *Enron* litigation) and **Max W. Berger** (lead counsel in the *Worldcom* and *Cendant cases*). The panel's consensus was that the securities litigation landscape is changing rapidly, the emergence of large institutional plaintiffs accounts for many of these changes, and both plaintiffs and regulators are increasingly focused on individual officers and directors.

Both Mr. Lerach and Mr. Berger emphasized that class action strategy is now driven largely by institutional shareholder plaintiffs. It was the institutional plaintiffs in *Enron* and *Worldcom* who refused to settle with the outside directors unless they made individual contributions that would not be repaid by indemnification or insurance. Indeed, some institutional plaintiffs are apparently targeting particular corporate officers and directors and offering plaintiffs' counsel a premium if money is collected from those persons. Plaintiffs' firms are also being offered substantial incentives to recover proceeds from alleged insider trading (as much as 50% of any such "disgorgement"). The institutional plaintiffs are also often insisting on corporate remedial measures (such as option pricing mechanisms, audit and other committee memberships, etc.) as a condition to any class action settlement.

Mr. Lerach and Mr. Berger indicated that *Enron* and *Worldcom* do not necessarily portend payment by individuals in most securities class actions. However, they noted that over 75% of the current class actions are headed up by institutional plaintiffs, who are much more active in settlement discussions and aggressive in seeking individual contributions. In bankruptcy situations, Mr. Berger said that where the facts are especially bad or the board was "asleep at the switch," plaintiffs will seek to have directors pay out of their own pockets. Similarly, Ms. McKown noted that, in connection with SEC settlements, the Enforcement Division Staff is increasingly insisting that payments be made by individual defendants without corporate indemnification or reimbursement.

Institutional plaintiffs are also insisting on recovering a larger percentage of claimed damages in settlements. Average settlements increased substantially last year (according to some studies, a jump of more than 75% over the 2003 average), and 2005 numbers are expected to be even higher. Mr. Lerach stated that, in his view, a $40 million settlement is "no longer considered a big one," and settlements in excess of $100 million are "matter of fact." He and Mr. Berger both indicated that, in their opinion, one of the Big Four accounting firms could potentially be out of business by next year as a result of upcoming trials.

Further illustrating the ways in which institutional plaintiffs have changed the securities litigation environment, Mr. Berger revealed that his firm retained a prominent investment bank in the *Cendant* case to run business models for the purpose of determining how much the Company could pay in settlement without negatively impacting its business or long-term stock price. Before representing institutions, it would have been inconceivable for his firm to retain an investment bank on such a project. Now, however, we can expect plaintiffs' firms to run similar analyses in negotiating settlements with large corporate defendants.

Mr. Lerach and Mr. Berger both opined that courts around the country have become more hospitable to plaintiffs in the last few years. The Ninth Circuit (which includes California) was specifically identified as becoming less "defense-friendly," which presumably helps explain why securities case filings in California increased by 80% in 2004. However, Ms. Muck noted that most courts are still willing to look critically at plaintiffs' theories and allegations, as required by the Private Securities Litigation Reform Act ("PSLRA"). In particular, she discussed "loss causation" — the requirement that purported losses be linked to revelation of wrongdoing — and predicted that the Supreme Court would use the pending *Dura Pharmaceuticals* case to make clear that plaintiffs bear the burden of pleading specific facts showing that a company's stock decline was actually caused by disclosure of the fraud they allege. Ms. Muck also pointed to the Second Circuit's recent *Merrill Lynch* decision, which made clear that: (a) a case cannot proceed beyond the pleading stage unless plaintiffs establish that the specific misrepresentations at issue (rather than other factors) caused their losses; and (b) plaintiffs cannot evade the strict pleading requirements of the PSLRA by arguing that defendants engaged in market manipulation (a tactic plaintiffs have employed with some success in the last several years).

There was general agreement among plaintiffs' and defense counsel that we will see an increase in individual securities actions brought by large shareholders seeking a much greater recovery than that typically afforded in class actions. The recent rise in derivative suits is also expected to continue (the majority of securities class actions filed in California over the last year have been accompanied by virtually identical derivative cases). Mr. Lerach and Mr. Berger expressed the view that recent Delaware decisions have made such cases much harder to defend. Ms. Muck disagreed, noting that courts in Delaware and California are still generally vigilant about requiring plaintiffs to show why pre-suit demand on a corporation's board of directors should be excused, and continue to show great deference when independent special litigation committees determine that pursuing litigation is not in the company's best interests.

It also appears there is greater communication between the SEC and the plaintiffs' bar. Ms. McKown confirmed that the Enforcement Division is increasingly following up on issues raised by plaintiffs' lawyers, which means that more and more companies may find themselves dealing simultaneously with overlapping private lawsuits and regulatory proceedings. Financial restatements and accounting fraud continue to be primary areas of emphasis for the SEC, with more individuals likely to be charged in the coming months. Ms. McKown and Ms. Muck also discussed the fact that the SEC is closely scrutinizing work performed by lawyers in connection with internal investigations (which are on the rise in the post-Sarbanes-Oxley era), and it is not uncommon for the Staff to request an interview with counsel for the purpose of describing the nature, scope and findings of such investigations.

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