

## Securities Lawsuit Filings Dip in the First Half of 2009

After a year of heightened securities litigation activity during 2008, the number of securities lawsuit filings declined in the first-half of 2009, largely due to a drop in filings during the second quarter. In this report, we take a detailed look at the 2009 securities lawsuit filings and explain the possible reasons for the decline in the number of second quarter filings. We conclude with a discussion of what to expect in the months ahead based on the first-half trends.

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### Factual Background

According to our count, there were 94 new securities class action lawsuits filed in the first six months of 2009. Our count is slightly higher than the 87 lawsuits reported by the Stanford Law School Securities Class Action Clearinghouse in its separate analysis of the first-half filings (prepared in conjunction with Cornerstone Research)<sup>1</sup>. Although the differences between the two reports are largely definitional, marginal and relatively unimportant, what is important is that the two tallies are directionally consistent.

To follow are some key observations:

- The 94 first-half securities lawsuit filings translate to an annualized filing rate of 188, which is slightly below, but well within range, of the average number of filings of 197.7 during the 13-year period between 1996 and 2008.
- The annualized rate of 2009 filings is also below the average filing level of 204.7 for the most recent seven-year period of 2002 through 2008.
- There were 205 new filings during the twelve month period ending on June 30, 2009, which, though below the 219 new filings during the twelve month period ending on June 30, 2008, is consistent with the average annual number of filings noted above.
- There were only 35 new securities lawsuits filed during the second quarter of 2009, compared to 59 during the first quarter of this year and 56 in the second quarter of 2008.

The lower filing level during the second quarter of 2009 reflects the low number of new securities class action lawsuit filings during the months of May and June. There were just eleven new securities lawsuit filings in May and only six in June. The June filings represent the lowest monthly number of new filings since December 1996, when there were just five new securities class action filings.

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In addition to the filing activity levels, the first-half filings are characterized by the relatively unusual types of *claimants* involved. For example, as many as ten of the first-half lawsuits were filed on behalf of holders of preferred or subordinated securities, which are relatively unusual classes of claimants.

The securities class action litigation *targets* during the first-half were also unusual. An uncharacteristically high number of the first-half lawsuit defendants were entities other than public companies, including private investment partnerships, mutual funds, and other nonpublic entities. As many as sixteen of the new first-half lawsuit filings involve primary defendant entities that lack Standard Industrial Classification code (SIC) designations. Further, as many as eight of the new filings in the first-half of 2009 involve mutual funds (many of them in the Oppenheimer mutual fund family).

One characteristic that the first-half filings does have in common with the filings in the periods immediately preceding, is that the new filings continue to be concentrated in the financial sector. Though the first-half filings represent 38 different SIC Code classes, 51 of the first-half filings were against entities in the 6000 SIC Code series (Finance, Insurance and Real Estate). In addition, virtually all of the 16 actions involving entities that lacked SIC codes involve enterprises in the financial sector, so that overall more than two-thirds of the new first-half filings involve financial services entities of one kind or another.

The concentration of filings in the financial sector is largely a result of the continuing subprime and credit crisis litigation wave. By our count, 51 of the first-half filings involve subprime and credit crisis related allegations. There have now been over 190 subprime and credit crisis-related securities lawsuits since the first complaint was filed in February 2007.

Another factor contributing to the concentration of first-half securities lawsuit filings in the financial sector is the number of new securities class action lawsuits that relate to the Madoff scandal. There were 11 new Madoff-related securities lawsuits in the first-half, although there were many more duplicate Madoff-related lawsuits filed during that same period as well. Our detailed list of all of the Madoff lawsuits now runs to some 23 pages in length.

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The first-half securities lawsuit filings were filed in 26 different courts, but 45 of them, or nearly half, were filed in the Southern District of New York.

Eighteen of the first-half lawsuit filings involve foreign domiciled companies, representing ten different countries. The country with the largest number of first-half filings is the United Kingdom. However, a number of these lawsuits against foreign-domiciled companies involve multiple separate lawsuits against a single target. For example, the six lawsuits filed against U.K. companies actually involve just two different companies, Royal Bank of Scotland and Barclays.

Of the actions against U.S.-domiciled companies, the first-half lawsuits involve companies from 22 different states, with the largest number in New York (28) and California (12).

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### Discussion

Although there is a lot that might be said about the first-half filing decline and its possible causes, the mainstream media has latched onto the message that the number of securities suits is declining because the plaintiffs are "running out of people to sue." Fish have to swim, birds have to fly, and plaintiffs' lawyers make their living filing lawsuits. Just as the fish and the birds can be counted upon to continue their traditional activities, so can the plaintiffs' lawyers. The very idea that the plaintiffs have run out of targets is a flawed conclusion built on a faulty premise.

Before starting on this topic, it would be useful to review why this question matters. Once before, the idea circulated that the securities class action plaintiffs' lawyers were going out of business. This hypothesis turned out to be very wrong. It also proved to be a very expensive mistake.

After the Private Securities Litigation Reform Act (PSLRA) was enacted at the end of 1995, several D&O insurers assumed the statute's passage would mean that many fewer securities lawsuits would be filed, and so they slashed their insurance pricing. The marketplace followed. When securities litigation ramped back up, the D&O insurance industry suffered hundreds of millions of dollars in losses. The industry paid a hefty tuition to learn that what plaintiffs' lawyers do is file lawsuits. Given how expensive the lesson was, it would seem unwise to assume now that anything has changed in the past quarter.

With respect to the recent decline in securities lawsuits, it is important to revisit the facts. The number of lawsuits did not decline during the entire first six months of the year. During

the period January through April, the number of new securities lawsuit filings was more or less at normal levels. The drop took place in May and June. Now, looking at the ebb and flow of securities lawsuit filings during the last 14 years, there arguably is nothing noteworthy about a two-month decline. It could just be a blip. Indeed, just in the first weeks of the third quarter there have already been several dozen new lawsuits, with twenty new lawsuits filed in July alone, more than were filed in May and June combined.

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The other thing about the first-half of 2009 is that it was not as if the plaintiffs' lawyers were idle – they were just occupied filing litigation other than securities class actions. Among other things, they were busy filing lawsuits related to Madoff, the Stanford Financial Group and other Ponzi schemes. This other extensive litigation activity is highly relevant, because of the similarity to what happened back in the period mid-2005 to mid-2007. That was the last period when there was a sustained "lull" in new securities class action lawsuit filings. During that period as well, the plaintiffs' lawyers were otherwise engaged – filing options backdating-related shareholders' derivative lawsuits, eventually filing 168 of them.

That prior "lull" in new securities lawsuit filings motivated some observers to speculate that the move to lower securities litigation levels might represent a "permanent change". Subsequent history has shown that in fact there was no permanent change, and indeed the securities class action lawsuit activity returned with a vengeance.

One theory as to why the number of lawsuits has dipped is that the plaintiffs' lawyers are busy, not just with the Madoff lawsuits, but with the extraordinary number of lawsuits they previously filed in connection with the subprime meltdown and credit crisis. Many of these lawsuits are uncommonly complicated and – in many cases – they have entered procedurally demanding stages.

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Indeed, there is substantial evidence that the plaintiffs lawyers may be dealing with a backlog of cases. Many of the recent filings have proposed class periods that are well in the past, sometimes years in the past.

For example:

- The securities lawsuit filed on July 14, 2009 against Ambassador Group has a proposed class period cutoff date of October 23, 2007.
- The securities lawsuit filed on July 17, 2009 against Bare Escentuals has a proposed class period cutoff date of November 26, 2007.
- The securities lawsuit filed on July 22, 2009 against Accuray proposes a class period cutoff of August 19, 2008.
- The securities lawsuit filed on August 4, 2009 against Allscripts-Misys Healthcare Systems has a proposed class period cutoff date of February 13, 2008.
- The securities lawsuit filed on August 6, 2009 against Consecos has a proposed class period cut off date of March 17, 2008.
- The securities lawsuit filed on August 7, 2009 against Flotek Industries has a proposed class period cutoff date of January 23, 2008.
- The securities lawsuit filed on August 11, 2009 against Align Technology has a class period cutoff date of October 24, 2007.
- The securities lawsuit filed on August 13, 2009 against MIND C.T.I., Ltd. has a class period cutoff date of February 27, 2008.
- The securities lawsuit filed on August 13, 2009 against Sturm, Ruger & Company has class period cutoff date of October 29, 2007.

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These cases not only involve a time gap, but they also are (other than the Consecos case) all targeting companies outside the financial sector. It seems as if the plaintiffs lawyers have been so preoccupied with the race to the courthouse in lawsuits against the financial sector, that they are just now getting around to filing the cases against companies not in the financial sector. In other words, it may be that the plaintiffs' lawyers do not have a shortage of *targets*, but that they have just had a shortage of *time*.

Based on the list of third-quarter filings above, it appears likely that we could see a trend of new lawsuit filings against companies outside the financial sector for the balance of the year. Other factors could continue to drive litigation activity for the balance of the year, including recent heightened levels of SEC enforcement activity and the marketwide run-up of share prices since March, which could position some individual companies for the kind of sudden

and conspicuous share price decline that attracts the unwanted attention of the securities class action plaintiffs' attorneys. Accordingly, by year end the annual rate of new filings for 2009 could be consistent with historical norms, notwithstanding the second quarter filing lull.

One line of analysis that does merit further consideration is the suggestion that the lawsuit filings declined because of diminished stock market volatility. According to this theory, there is a correlation between overall market volatility as measured by the CBOE Volatility Index and the level of securities lawsuit activity. This theory may have something to it; it is certainly the case that an individual lawsuit is directly related to the target company's experience of volatility in its own share price. The CBOE Volatility Index has declined steadily during 2009 and is well below the elevated levels that prevailed during the second half of 2008. If this theory about the correlation between volatility and litigation activity is valid and if the lower volatility persists, then we could be in for a period of lower numbers of security lawsuits. We had a lull before, we could certainly have one again.

Because of the possibility that lower market volatility might persist for a while and might translate to reduced lawsuit filings, we hesitate to make any absolute predictions. We do however think it is prudent to avoid making any bets that the plaintiffs' lawyers will stop filing lawsuits.

### **Conclusion**

After an extended period of heightened litigation activity driven by the subprime meltdown and the credit crisis, the pace of new securities class action lawsuit filings dipped in the second quarter of 2009. It is too early to tell if this decline is a blip or whether it represents a longer term trend. Some recent evidence suggests that the second half of 2009 could witness a swing back to historical filing levels, with a return to litigation activity involving companies outside the financial sector. However, it is entirely possible that reduced stock market volatility could mean an extended period of reduced lawsuit activity. While time will tell, the most prudent approach in the interim could be simply to assume that plaintiffs' lawyers will continue to do in the future what they have done in the past, file lawsuits.

## Endnotes

<sup>1</sup>Cornerstone Research, "Securities Class Action Filings: 2009 Mid-Year Assessment," [http://securities.stanford.edu/clearinghouse\\_research/2009\\_YIR/Cornerstone\\_Research\\_Filings\\_2009\\_MidYear\\_Assessment.pdf](http://securities.stanford.edu/clearinghouse_research/2009_YIR/Cornerstone_Research_Filings_2009_MidYear_Assessment.pdf) (July 15, 2009).

*A version of this article previously appeared on The D&O Diary, the author's Internet weblog. You can access the weblog via our website at [www.oakbridgeins.com](http://www.oakbridgeins.com). To monitor developments on this and other important topics relating to directors' and officers' liability, readers are encouraged to refer to The D&O Diary regularly.*

## About the Author

This article was prepared by Kevin M. LaCroix, Esq. of OakBridge Insurance Services. Kevin has been advising clients concerning directors' and officers' liability issues for more than 27 years. Prior to joining OakBridge, Kevin was President of Genesis Professional Liability Managers, a D&O liability insurance underwriter. Kevin previously was a partner in the Washington, D.C. law firm of Ross Dixon & Bell. Kevin served as co-Chair of the PLUS D&O Symposium from 2007 through 2009. Kevin was a member of the faculty at the 2009 Stanford Law School Directors' College.

Kevin is based in OakBridge's Beachwood, Ohio office. Kevin's direct dial phone number is (216) 378-7817, and his email address is [klacroix@oakbridgeins.com](mailto:klacroix@oakbridgeins.com).

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