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An Overview Of The Securities Litigation Landscape

*The Editor interviews **Patricia Etzold**, Partner and Co-author of the PricewaterhouseCoopers 2008 Securities Litigation Study.*

Editor: Please tell our readers about the purpose of the PricewaterhouseCoopers' annual evaluation of private securities class action lawsuits.

Etzold: The purpose of the PricewaterhouseCoopers' Annual Securities Litigation Study is to analyze the prior and current class action activity in order to highlight trends and anticipate potential areas of plaintiff and regulatory focus. We have been compiling case information since 1994 and our study analyzes over 50 data points related to shareholder class actions. We believe the Study enables the reader to better understand the types of cases filed, the regulatory focus and industries and allegations most litigated against and settlements achieved.

Editor: What changes in subject matter of lawsuits have come about over the term of the PSLRA?

Etzold: The PSLRA was designed to reduce the number of frivolous securities lawsuits filed by raising the bar for what is necessary for investors to proceed with a case. It also included a number of changes including a lead plaintiff provision with the intent being to reduce the costs associated with securities class actions.

Prior to the PSLRA being passed, a case could proceed with little evidence and the use of pre-trial discovery was used to obtain more. Post-PSLRA, the subject matter itself may not have significantly changed but plaintiffs filing a securities fraud complaint did have a tougher time proceeding with a complaint. Plaintiffs had a stricter pleading requirement and an inability to gain access to additional evidence as a result of the stay of discovery while a motion to dismiss was pending.

Patricia Etzold

Editor: How did the PSLRA change the securities litigation landscape?

Etzold: I believe the PSLRA's change in procedures to appoint a lead plaintiff has had the biggest impact on the securities litigation landscape.

Prior to the PSLRA, the first investor to file a complaint was often designated as the lead plaintiff, which left open the possibility for unsophisticated investors to be named as lead plaintiffs. As a result of the PSLRA, the investor or group of investors having the largest financial stake in the case or the investor who has suffered the largest monetary loss as a result of the defendant's fraud is named the lead plaintiff. Consequently, institutional investors, such as a public or union pension fund, are frequently appointed lead plaintiffs.

The largest settlements in 2008 all had a large institutional investor as a lead plaintiff, all of which had settlements of over $100 million.

Editor: To what do you attribute the decline in accounting-related cases? Has Sarbanes-Oxley been helpful in this regard?

Etzold: I attribute the decline in accounting-related cases filed to the adoption of Sarbanes-Oxley and its impact on the sentencing guidelines attributed to white collar crimes.

Sarbanes-Oxley requires U.S. publicly traded companies to routinely assess their key internal controls and their respective effectiveness. Senior executives are now mandated to take individual responsibility for the accuracy and completeness of their corporate financial reports. Additionally, as a result of Sarbanes-Oxley, white collar convictions now carry sentences of twenty years versus prior sentences of five to ten years.

Despite the positive impact Sarbanes-Oxley has had and the decrease in accounting related cases, a faltering economy tends to encourage inappropriate behavior. I believe we will see an increase in accounting-related cases as companies struggle to earn and grow revenues. Companies are also reducing head count and that may result in procedures not being followed or short cuts being taken. Fraud tends to follow in the wake of declining economic trends.

Editor: What major industries were the target of most of the filings?

Etzold: In 2008, the financial service industry gained the most attention with 33 cases filed or 16 percent of the total cases filed in 2008. Additionally, of the cases filed which related to Fortune 500 companies, the financial services industry represented 67 percent, and 43 percent of those cases named investment banks in connection with Auction Rate Security cases. Previously, the high-technology industry had held the top spot with allegations primarily related to revenue recognition issues.

Editor: Why should companies practice enterprise risk management at all times? What areas do you recommend companies remain constantly vigilant in overseeing?

Please email the interviewee at patricia.a.etzold@us.pwc.com with questions about this interview.

Etzold: Companies should practice enterprise risk management consistently and on a regular basis to effectively evaluate the risk associated with pursuing an opportunity as it seeks to grow stakeholder value. This practice is even more important today as resources may be limited and regulators in the U.S. and abroad are increasing enforcement efforts in anti-bribery, antitrust, and economic sanction programs. Integral to violations in these areas are how the transactions have been recorded in the company's books and records and ultimately disclosed in their financial statements.

The PwC Annual Securities Litigation Study not only summarizes the year's numbers but analyzes the top issues, trends, and accounting allegations in an effort to assist corporate counsel, chief executive and financial officers enhance their enterprise risk management.

The areas that companies will want to remain especially vigilant, based on our study and the associated risks, include opportunities for growth in countries perceived to have high instances of corruption – particularly in China, Africa, and the Middle East; use of third parties in higher risk countries; internal controls particularly related to a company's procedures for preparing estimates, valuing assets and liabilities, and recognizing revenue; risks associated with reduction in head count; and effective monitoring of issues reported through company hotlines.

Editor: The report also mentions the active nature of institutional plaintiff activity such as the public and union pension funds.

Etzold: Public and union pension funds continued to be the most active of institutional investors named as lead plaintiff in 2008. Since the PSLRA and its lead plaintiff provision, we have seen an increasing number of institutional investors being named as lead plaintiff in class actions. Additionally, foreign institutional investors are also active in joining U.S. class actions.

Despite this increasing trend, some institutional investors may decide to opt out of a class action to pursue a claim. Institutional investors are evaluating whether they might be more successful in achieving a higher settlement without incurring the cost and time associated with pursuing a class action suit.

Editor: Your report indicates that the number of class actions against foreign private issuers increased significantly in 2008 over 2007. To what is this attributable?

Etzold: There were 36 class actions filed against foreign private issuers beating the last highest number of 30 cases filed in 2004. This represented a 25 percent increase over those filed in 2007. The majority of the cases related to financial crisis issues with almost half of the financial crisis cases having accounting-related allegations.

Worth noting however, is that although a case may be brought against a foreign private issuer in the U.S., it may be dismissed based on lack of jurisdiction. Currently, only the U.S. legal system affords shareholders the opportunity to seek recovery of their losses. Foreign shareholders who purchase shares of foreign U.S. listed stock on a foreign securities exchange (also known as "F-cubed") also can file actions in U.S. courts if the foreign shareholders can show evidence that the fraud was either conducted in the U.S. or had an effect in the U.S. If the class is unable to provide evidence to support U.S. conduct or effect, the court can move to dismiss the case based on lack of jurisdiction.

Editor: How have these class actions against foreign private issuers been resolved?

Etzold: If the case is dismissed based on lack of jurisdiction by U.S. courts, certain foreign shareholders may be able to look to their own courts. In 2007, Shell initiated the first-ever European class action settlement of securities fraud claims that had originated in the U.S. and related to allegations of improperly recorded oil and gas reserves. The settlement is subject to approval by a Dutch Court and covers non-U.S. purchasers of Shell stock, including institutional investors in countries such as the Netherlands, the United Kingdom, Germany, and Sweden.

Only time will tell whether continued dismissal of cases in the U.S. resulting from a lack of jurisdiction will ultimately force foreign legal systems to develop some form of resolution for shareholders in their own countries, especially in the cases where pension funds have suffered significant losses.

Editor: Would you summarize some of the other key outcomes of the study?

Etzold: I think it is important for companies to know that regulatory cross-border cooperation is at an all-time high with the SEC making 556 requests to foreign regulators for assistance and cooperating with 454 requests from foreign regulators for enforcement assistance in 2008. Many of the investigations were linked to possible wrongdoing in the subprime area but cross-border cooperation is also frequently seen in investigations related to alleged violations of the FCPA.

FCPA-related cross-border cooperation was most evident in a matter concerning a large global company where parallel investigations were run by the SEC, the DOJ, and regulatory authorities in Germany, and Italy. Ultimately, the matter was settled in December for a combined international settlement of $1.6 billion. The U.S. portion, ($800 million) was the largest FCPA settlement and it was the first time the DOJ had criminally charged a company with internal control violations. The DOJ cautioned companies that it, along with other regulators, would continue to crack down around the globe on FCPA violations.

Editor: What strategies do you recommend for a corporation potentially facing increased regulatory enforcement and securities litigation?

Etzold: We encourage companies to be vigilant – to stay abreast of new regulations that might affect their industry, compliance responsibilities, and/or accounting practices.

Based on the trends noted in 2008 and the expectation that the number of securities cases filed will continue to increase, companies should ensure an effective litigation strategy which includes a formalized plan regarding e-discovery and crisis management. Companies should continue to actively update and assess their enterprise risk management and evaluate the initiatives implemented as part of SOX and ensure they have a sustainable and effective program in place to mitigate risks associated with potential claims.

Editor: How may our readers access the full report?

Etzold: The 2008 Securities Litigation Study can be accessed by visiting www.10b5.com.