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Observations from the editor

At the close of 2007, the PricewaterhouseCoopers Securities Litigation and Investigations Practice conducted its 12th annual evaluation of the private securities class action suits processed over the year.

And what a year it was.

Without a doubt, most notable in 2007 was the escalation of what has been termed the subprime crisis, the full implications of which have yet to be seen in the financial and legal worlds. It's worth noting that in January 2008, the American Dialect Society voted *subprime* the Word of the Year for 2007—an indication of the extent to which the subprime crisis dominated conversation across the nation.

It was also a year shaken up by several key court decisions that are expected to impact other trial decisions going forward. *Tellabs*, for example, strengthened pleading standards and arguably offered a measure of protection at the pleading stage to future defendants. Similarly, in early 2008, the *Stoneridge* decision limited the range of who could be held "primary violators" in lawsuits. While it's not entirely clear how either of these cases will fully affect trial decisions in the long-run, we will be keeping a close eye on it here at PwC as we progress further into 2008.

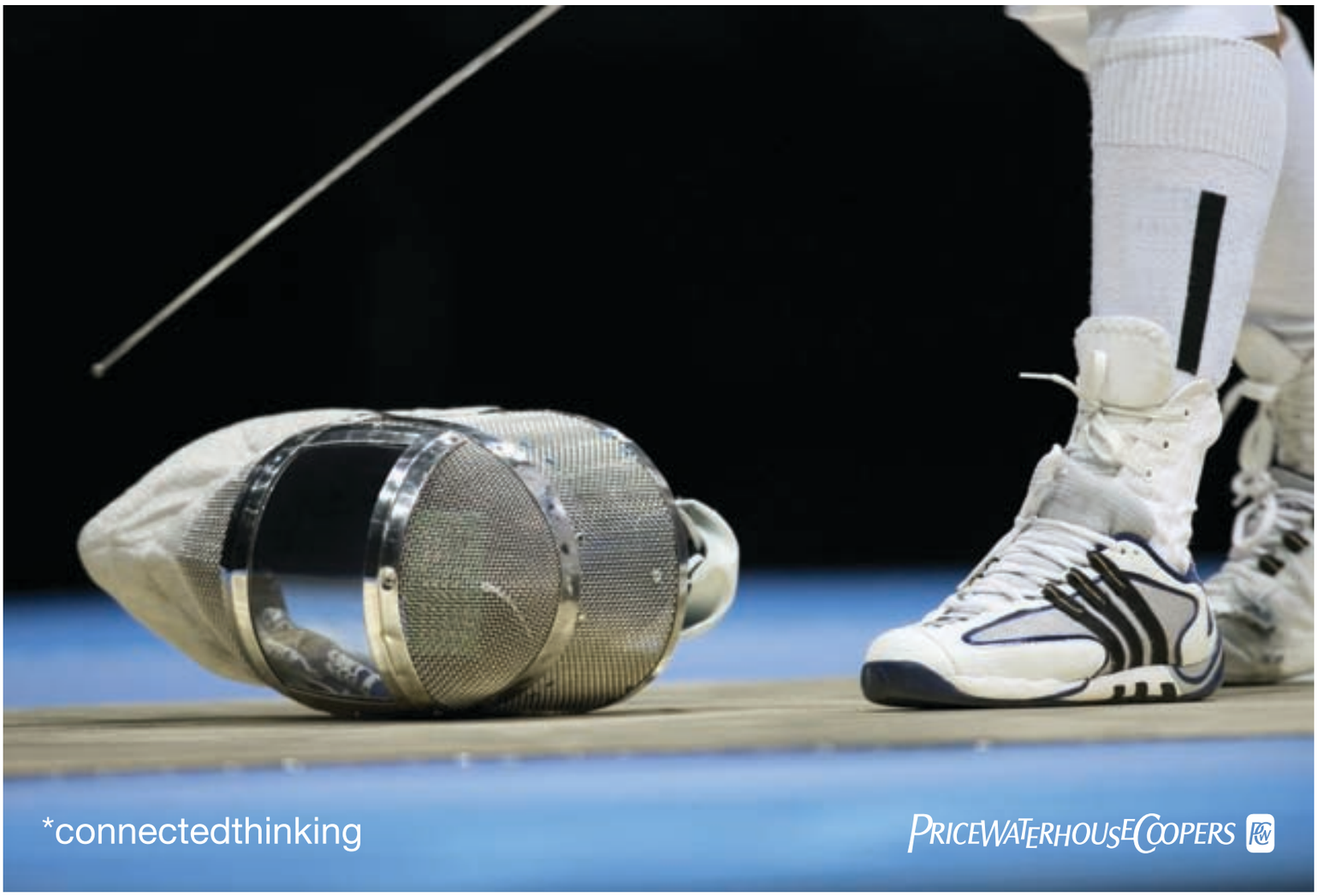
Foreign issuer activity made 2007 a year of transformation, as well. The SEC made significant changes to US reporting obligations in order to address foreign issuers' concerns about the benefits and costs of listing on US exchanges. As a result of the changes (which, among other things, made it easier for foreign private issuers (FPIs) to deregister equities), 109 FPIs deregistered in 2007. With the European Union and individual countries seemingly poised to consider collective litigation alternatives, 2008 could prove just as transformative in the foreign markets.

The year was also one in which we witnessed a marked increase in restatements, FCPA caseloads, and lawsuits against hedge funds. The latter two will likely continue to escalate well into 2008. Restatement activity, however, may decline depending on where SEC considerations lead—we will have to wait and see. Above all, 2007 was a year of change and a good deal of turmoil. How this change and instability specifically affects the outlook for 2008 remains to be seen, but one thing is for certain: it is likely to be a bumpy ride.

As we close out the 2007 study, I would like to thank all those who contributed to its creation, including my co-author, Patricia Etzold, for her expertise and examination of foreign securities litigation activity, in addition to Laura Skrief, Kevin Carter, Luke Heffernan, and all those whose assistance was vital to the production of this piece. My sincere gratitude also goes out to the editorial contributors from Allen & Overy, Gibson Dunn, and Goodwin Procter. Their perspective and insight helped illuminate some of the most important trends and issues of the year.

Grace Lamont
Partner, Leader of the Securities Litigation Practice

2007 Securities litigation study*



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The heart of the matter

The subprime crisis is born.

By far, the most significant happening in 2007 was the unfolding of what has become known as the subprime crisis. Early in the year, amid a falling housing market, increasing interest rates, and a surge in foreclosures, subprime lenders began declaring bankruptcy, announcing significant losses, and/or making themselves available for sale.

Additionally, Wall Street investment banks began to disclose losses in securities portfolios backed by subprime loans—and thus the subprime crisis was born. To date, approximately $130 billion in losses related to subprime issues have been reported by most of the major investment banks, including UBS, Goldman Sachs, and Merrill Lynch, and many subprime-related institutions have filed for bankruptcy.

Regulators and prosecutors, including the Securities and Exchange Commission (SEC), the Department of Justice (DOJ), the Federal Bureau of Investigation (FBI), and state attorneys general, are now conducting investigations in the quest to determine the "who, what, when, where, why, and how" of this debacle. In early February 2007, the plaintiffs' bar began issuing federal class action lawsuits, and the stream of private securities litigation—against the loan originators, banks, and rating agencies involved in the secondary and securitized mortgage market—continues into 2008.

The flurry of options backdating litigation and investigations seen in 2006 waned in 2007—only eight securities litigation cases were filed. The SEC also completed several enforcement activities against companies and officers associated with backdating practices. The SEC agreed upon the largest settlement of the options backdating cases to date with the CEO of UnitedHealth Group Inc., for $468 million.

During 2007, the SEC and the DOJ actively investigated violations of the Foreign Corrupt Practices Act (FCPA). Between them, these agencies opened 29 cases or investigations and brought charges against at least 16 companies and/or individuals, including Textron, Lucent Technologies, and El Paso Corporation. Alice Fisher, assistant attorney general and head of the Justice Department's Criminal Division, reported that her FCPA case load in 2007 was running at twice last year's pace, and predicted that the upward trend would continue in 2008.[1]

1 As discussed in "Payload: Taking Aim at Corporate Bribery," *The New York Times* (November 25, 2007).

An in-depth discussion

Litigation rates increase.

A bird's-eye view of 2007

In addition to the subprime crisis, the decline in options backdating cases, and the upward trend in FCPA violations, there were two significant US Supreme Court decisions: the *Tellabs* decision in the early part of 2007, and the Court's decision in the *Stoneridge* case in early 2008. The *Tellabs* decision may impact the volume of future federal securities litigation cases by strengthening pleading standards, but views differ on the extent of this impact. In the *Tellabs v. Makor Issues & Rights*[2] case, the Supreme Court held that in determining whether the pleaded facts give rise to a "strong inference" of scienter, a court must take into account "plausible opposing inferences."

At issue in the *Stoneridge* matter was whether the private right to sue for securities fraud extends to suing any third parties who assist business partners in schemes that result in those partners artificially inflating their financial statements. On January 15, 2008, the US Supreme Court issued its decision in *Stoneridge Investment Partners v. Scientific-Atlanta*.[3] Plaintiffs in the case argued that third parties who assist a company in artificially inflating its financial statements should be held as "primary violators" even though they themselves did not issue any public statements to advance the scheme. The Supreme Court decision disagreed, thereby limiting the range of lawsuits.

After a two-year decline and a sluggish start to the year, total federal class actions filed in 2007 against foreign and domestic companies increased once more, reversing the previous downturn. Not surprisingly, much of the filing activity was due to subprime-related matters, which represented 30 of the 103 filings made in the second half of 2007 and 23% of the overall 2007 filings. Despite the increase, however, the total number of filings remains below the average of 180 that has been the norm since the enactment of the Private Securities Litigation Reform Act of 1995 (PSLRA).

2 Case No. 06-484: T*ellabs, Inc. v. Makor Issues & Rights, Ltd.*
3 Case No. 06-43: *Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc., et. al.*

The number and total dollar value of settlements during 2007 were consistent with those of 2006. Total settlements were valued at $6.37 billion compared to $6.44 billion in 2006, with the largest settlement in 2007 against Tyco, for $3.2 billion. The average settlement, of $56.3 million, was also consistent with the prior year's average. However, excluding outlier settlements (defined as those greater than $2.5 billion), that average settlement value falls to $28.3 million, from $57.5 million in 2006.

The industry breakout for companies sued during 2007 was more or less in line with that of prior years, except for the financial services industry, which saw a rise in cases, primarily as a result of subprime-related filings. The technology sector remained the most sued industry for yet another year, although the percentage of cases filed against technology companies decreased slightly, from 30% to 25%.

Federal class actions directed at foreign filers almost doubled during 2007. Twenty-seven cases were filed in 2007, compared to 14 cases in 2006. More cases were filed against Chinese foreign private issuers (FPIs) than any other geographical group.

Federal cases bounce back

After two years of decline, the number of federal class action lawsuits once again increased. During 2007, 163 cases were filed, compared to 109 in 2006—an increase of nearly 50%. Much of the filing activity occurred in the second half of the year. By midyear, 60 cases in total (37%) had been filed, compared to the 163 total cases for the year. However, despite this increase, since the enactment of the PSLRA, 2007 still ranks third in number of cases, 9% below the average of 180 since 1995.

Undoubtedly, 2007 was the year of the subprime debacle. Subprime-related cases accounted for 37 of the total cases filed during the year, or 23%, and represented 29% of the total number of cases filed during the latter half of 2007. The surge in the number of subprime-related cases filed coincided with the disclosures and news of the deteriorating events occurring in the housing and mortgage-backed securities markets.

The PricewaterhouseCoopers *2006 Securities Litigation Study* noted that a likely reason for much of the decrease in the 2006 numbers was the preoccupation of the plaintiffs' bar with stock options matters filed primarily as derivative actions (110 derivative actions versus 21 federal class actions). In accordance with our previous speculation, it comes as no surprise that the number of federal filings increased in 2007, given that the stock options matters appear mostly to have dissipated.

Although the number of cases filed increased in 2007, the number did not return to pre-Sarbanes-Oxley levels. During the post-PSLRA period, 1996 through 2002, the average number of cases filed was approximately 191. Interestingly, however, the number of filings in 2007 is in keeping with the 164-case average during the post-Sarbanes-Oxley era.[4] This appears to support the view that the deterrent effects of Sarbanes-Oxley, and the increased involvement of regulators that followed its enactment, may have led to a lower number of overall cases.

Other factors that, no doubt, continued to influence the number of securities litigation filings were the high costs of settlements (which continue unabated) and the active involvement of major institutional shareholders as lead plaintiffs. Last but not least was the overall state of the economy: During hard times, the increased pressure to produce good financial results is more likely to lead to bad behavior, which in turn is likely to result in higher levels of shareholder litigation. If current speculation on the downward direction of the economy is to be believed, then private securities class actions will most likely trend upward over the next few years, above the recent average number of filings since Sarbanes-Oxley.

4 The post-Sarbanes-Oxley era is defined as 2003 to the present.

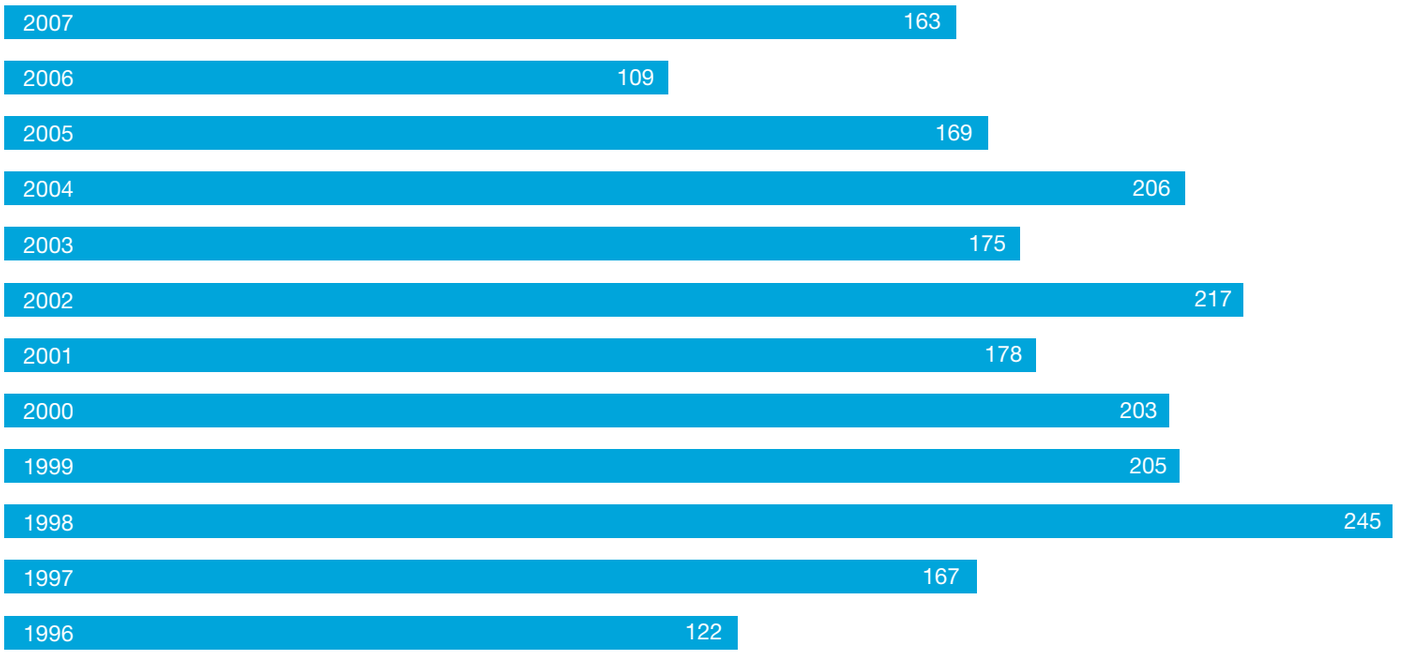
Table 1. Number of securities class action lawsuits, 1996–2007*

Year filed**	Federal cases	State-only cases	IPO laddering cases	Analyst cases	Mutual fund cases	Stock option backdating (derivative)	Total
2007	163	—	—	—	4	2	169
2006	109	—	—	—	—	110	219
2005	169	—	—	—	4	—	173
2004	206	—	—	1	20	—	227
2003	175	—	—	19	16	—	210
2002	217	—	1	46	—	—	264
2001	178	—	309	—	—	—	487
2000	203	—	—	—	—	—	203
1999	205	—	—	—	—	—	205
1998	245	13	—	—	—	—	258
1997	167	11	—	—	—	—	178
1996	122	25	—	—	—	—	147
12-yr avg	**180**						

* Filings from 1996 onward occurred after the Private Securities Litigation Reform Act of December 22, 1995; filings for 1999 through 2007 occurred after the Securities Litigation Uniform Standards Act of November 3, 1998.

** The year a case is filed is determined by the filing date of the initial complaint in state or federal court.

Table 2. Number of federal securities class action lawsuits filed per year, 1996–2007



Accounting-related cases fall

The number of accounting-related cases fell in proportion to the total number of cases filed in 2007 (50%) compared to 61% in 2006. The average since the PSLRA of 1995 was 61%. Much of the decline was due to the higher number of disclosure cases filed, including initial public offering (IPO) and product-efficacy cases, which rose significantly during 2007.[5]

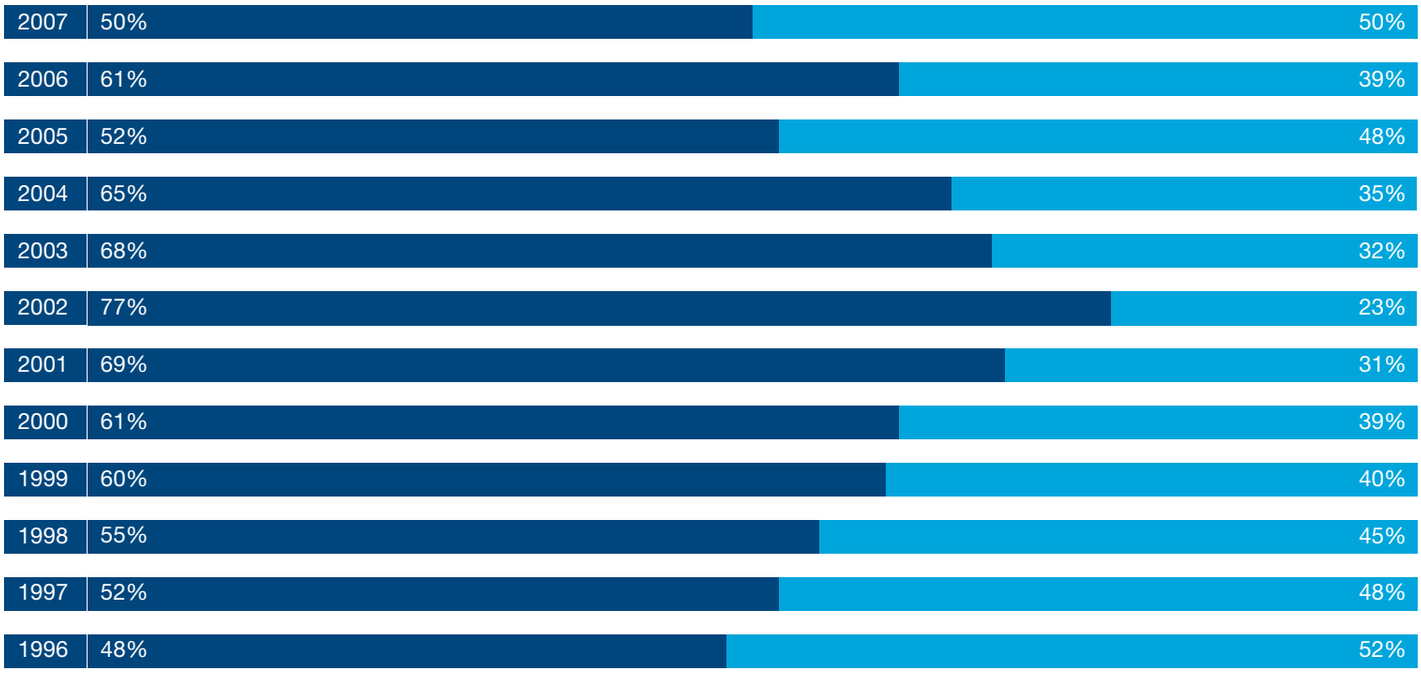
The accounting-related issues alleged in cases filed during 2007 differed from those asserted in accounting cases filed in 2006. Allegations relating to internal controls were cited most frequently in 49% of the cases filed—a level consistent with the 48% frequency cited in 2006. Not surprisingly, estimates was the next most commonly asserted category of allegation, appearing in 47% of filings, higher by 38 percentage points than in 2006.

Subprime-related allegations, such as loan loss reserves and impairment of mortgage portfolios, were the main drivers of the increase in estimates-related allegations. Understatement of expenses and liabilities fell to 23%, from a high of 59% in 2006 (a fall resulting mainly from the stock options cases filed in 2006), and overstatement of assets was asserted in 32% of filings, slightly above the 25% reported in 2006. Notably, revenue recognition declined as a category of allegation, falling to 17% in 2007, from 41% in 2006.

As the “Paying the price” section later explains, accounting-related cases have traditionally been associated with higher settlement costs. They also tend to be the most costly cases to defend.

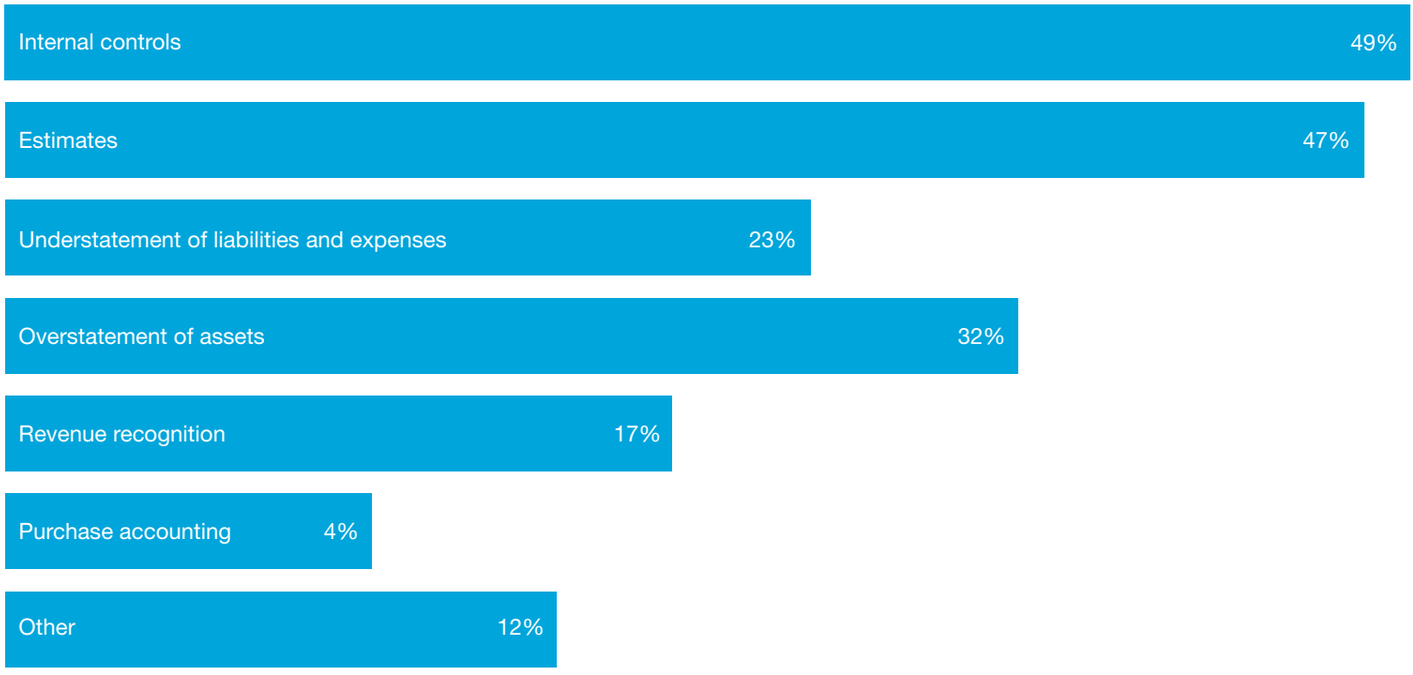
5 Typically a product-efficacy case alleges that a stock-price drop, relating to some negative news concerning a product (e.g., a drug), was due to fraud—the theory being that management intentionally withheld material facts concerning the negative information and/or intentionally made materially false and misleading disclosures concerning the efficacy or success of the product.

Table 3. Percentage of accounting and non-accounting federal securities class action lawsuits filed per year, 1996–2007*



* Cases filed between 1996 and 2006 may have been updated with accounting allegations if the amended complaints alleged accounting violations not previously recognized. Numbers for 2007 cases reflect only initial case complaints.

Table 4. Percentage of accounting cases citing specific issues, 2007*



* Some cases allege multiple accounting issues.

Restatements: a hot topic

Restatements made for a hot discussion topic in 2007 and appear set to remain so in 2008. Both the SEC and the Public Company Accounting Oversight Board (PCAOB) are examining, among other things, the reasons for and the ultimate utility of the high and rising level of restatements over the last several years.

After a dramatic increase in restatements in recent years, in October 2007 the PCAOB's Office of Research and Analysis presented a working paper, "Changes in Market Responses to Financial Statement Restatement Announcements in the Sarbanes-Oxley Era," that suggests that despite the burgeoning number of restatements in recent years, market reaction to restatements is declining.

The SEC's Advisory Committee on Improvements to Financial Reporting released a report dealing with audit process and compliance that recognized the significant increase in reported restatements and discussed the potential benefit of providing guidance on the materiality of errors.

Despite the high level of restatements reported—which some observers put at over 1,300[6]—the number of restatements associated with federal securities class actions is relatively small: In 2007, their number fell to 39, from 47 in 2006.[7] This statistic would seem, therefore, to support not only the position that market reaction to restatements is declining, but also that the market does not react to all restatements.

6 Andrew Osterland, "The SarBox: The Bill for Restatements Can Be Costly," *Financial Week* (January 14, 2008).

7 PwC continually updates previous years' statistics for new information not announced until after the publication date of previous studies.

A sector appraisal

Continuing the post-PSLRA trend, technology companies remained the industry group most frequently involved in private securities class actions. During 2007, 25% of filings involved technology companies, compared with 30% in 2006 and similar levels in previous years. Of all accounting cases, 53% of allegations made against technology companies related to internal controls, and 41% to revenue-recognition practices. This marks a shift away from allegations of understating expenses and liabilities that resulted from the high proportion of technology companies involved with the stock options scandal during 2006.

Companies caught up in the technology filings included Vodafone Group and Yahoo! Inc. Vodafone's accounting allegations included overstatement of assets and estimates. Yahoo! was accused of disclosure issues relating to operational deficiencies resulting in declining market share. Two of the three industry sub-categories experienced decreases in the proportion of cases filed against them: Filings against computer services companies fell from 11% in 2006 to 8% in 2007, and filings against electronics companies fell from 13% to 7%. Filings against the third sub-category, telecommunications, increased from 6% of total filings in 2006 to 9% in 2007, due to issues of internal controls, revenue recognition, and disclosure.

Table 5. Percentage of federal securities class action lawsuits by industry, 2005–2007*

Industry	Percentage of total cases		
	2005	2006	2007
High technology			
Computer services	16	11	8
Electronics	9	13	7
Telecommunications	4	6	9
	30	30	25
Health services	7	7	4
Pharmaceutical	14	9	13
Business services	5	5	5
Retail	4	6	4
Banking, brokerage, financial services & insurance	13	6	21
Utilities: energy, oil & gas	2	2	2
Other	27	35	26

* Totals may not add up to 100% due to rounding.

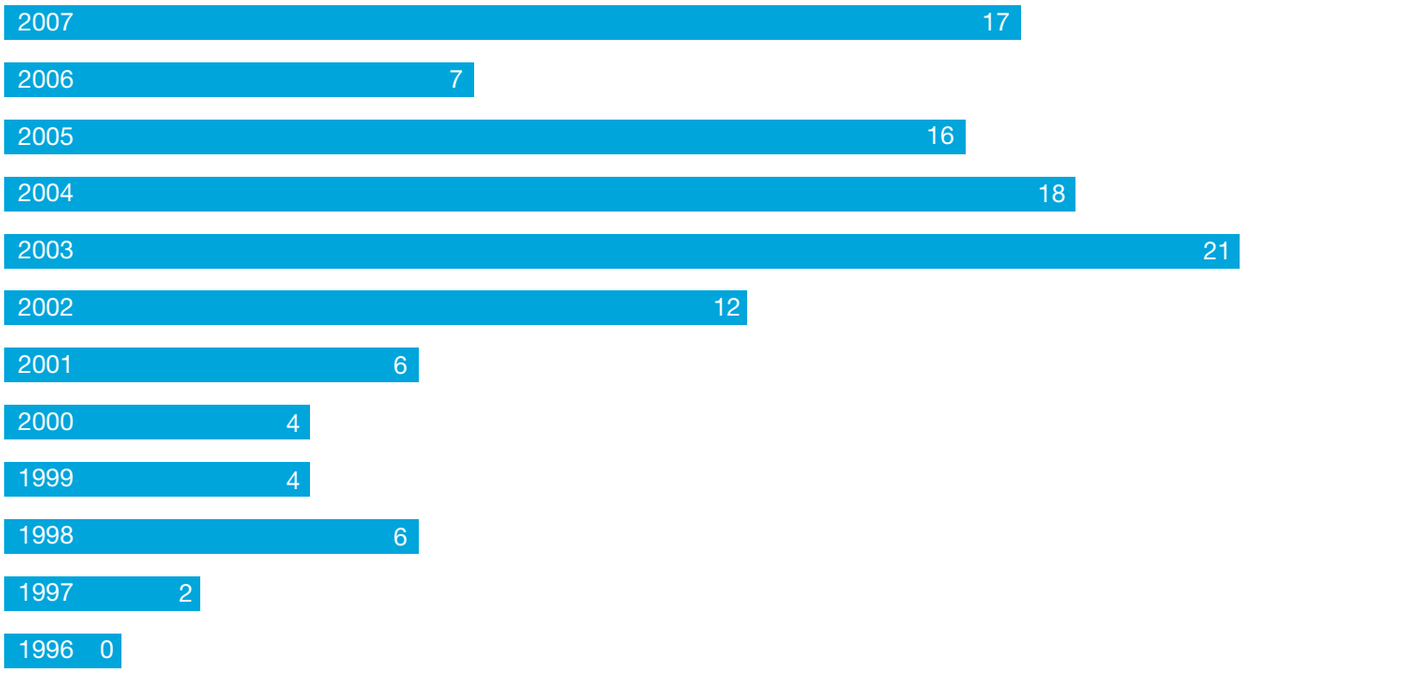
As the subprime crisis unfolded, banking and financial services came in second among industry groups caught most frequently in the sights of the plaintiffs' bar. This group was associated with 21% of the filings during 2007, up 15 percentage points from 2006. Specific issues that formed the basis of allegations included estimates and overstatement of assets; the filings involved companies such as Washington Mutual and Merrill Lynch.

The level of filings for all other industry groups remained more or less consistent with that in past years, except for the pharmaceutical industry, which once again suffered an increase in filings after the short-lived decline in filings against the industry in 2006. In 2007, 13%, or 21 private securities litigation actions, involved a pharmaceutical company, consistent with the levels of 2004 and 2005 but up from the 9% of 2006.

The increase was due principally to the number of suits filed regarding efficacy issues, which had been declining since 2003 and had finally hit bottom last year, with 7 suits filed. During 2007, the number of suits filed rose again, reaching 17, which almost rivaled the peak of 21 filings in 2003. The companies affected included GlaxoSmithKline PLC and POZEN, Inc., which were each the subject of filings in previous years.

Perhaps the plaintiffs' bar went for a second helping from defendants because they either had depleted the list of first-time candidates or were inspired by the record settlements achieved last year in relation to such matters—a case in point being Bristol-Myers Squibb, which suffered a record $185 million settlement in 2006.

Table 6. Number of US securities class action lawsuits involving pharmaceutical/health efficacy allegations, 1996–2007*



* Excludes cases alleging product efficacy.

Pointing a finger at the C-suite

Senior officers of companies continued to be named in the majority of cases during 2007, although at a less frequent rate than in prior years. The number of filings naming the CEO, CFO, and president all decreased. Each position was named fewer times than in any of the previous four years.

Likewise, audit committees and compensation committees, which in 2006 were named at a record rate due to matters related to stock options, saw the 2007 rate fall back to levels more comparable to those of 2005 and prior. Both rates fell to 4%, from 2006 levels of 14% and 11%, respectively.

Table 7. Percentage of US federal securities class action lawsuits naming particular officers or committees, 2003–2007

Title*	2003	2004	2005	2006	2007
CEO	98	96	96	96	91
CFO	88	83	81	83	79
Chairman	70	72	72	61	64
President	77	71	59	68	55
Audit committee	3	2	2	14	4
Compensation committee	1	0	1	11	4

* Titles are based on those named in the complaint.

Fortune 500 hold steady

The percentage of federal securities class action lawsuits filed against Fortune 500 companies has always remained within a range of 7% to 15%, except for 2002, when they peaked at 28%. In 2007, the number of filings remained in range, as Fortune 500 companies were named in 12% of filings, or 20 cases in total.

As a proportion of the population of the Fortune 500 companies, the 2007 filings represented 4%, compared to just over 2% in 2006. When the stock-options-related derivative filings are included (a total of 26) in the 2006 calculations, the figure is 5%, which is more consistent with percentage levels in 2007 and prior years.

Table 8. Number of federal securities class action lawsuits filed against Fortune 500 companies, 1998–2007

Year filed	Top 50	Top 100	Top 500	Total cases	%
2007	4	9	20	163	12
2006	5	5	12	109	11
2005	3	6	24	169	14
2004	7	9	27	206	13
2003	1	3	20	175	11
2002	16	25	60	217	28
2001	5	10	26	178	15
2000	4	8	24	203	12
1999	3	8	25	205	12
1998	2	4	16	245	7

Circuit breaker: Second and Ninth continue to dominate

Most of the filing activity continued to be in the Second (New York) and Ninth (California) Circuits. The Second Circuit was the most active, with 55 filings (34% of total filings), while the Ninth Circuit had 44 (27%). Filings in both circuits rose by 5% and 3%, respectively, over 2006 levels.

More of the subprime-related cases were filed in the Second and Ninth Circuits, accounting for most of the increase—11 subprime cases in the Second Circuit and 10 in the Ninth Circuit.

Table 9. Percentage of US federal securities class action lawsuits filed by circuit, 2006–2007

Circuit	2006	2007
District of Columbia	1	2
First	5	1
Second	29	34
Third	11	6
Fourth	1	2
Fifth	6	4
Sixth	3	4
Seventh	2	4
Eighth	5	2
Ninth	24	27
Tenth	3	4
Eleventh	12	10

A fall in class action cases with associated SEC and DOJ involvement

The number of filed federal securities class action cases that had some form of SEC involvement fell for the third year running during 2007. Through either a formal or informal investigation or an SEC enforcement action or settlement, the Commission was involved in at least 24 (approximately 15%) of the 163 federal securities class actions filed. The comparable numbers for 2006 were 35 cases filed (32% of the total).

DOJ activity in connection with the cases filed during 2007 was also down from 2006. In 2007, 15 cases (compared to 25 in 2006) had some form of DOJ activity, including investigations, guilty pleas, indictments, and settlements, which represented 9% and 23% of total cases filed each year, respectively.

Nine cases during 2007 had both DOJ and SEC involvement, including Beazer Homes, Countrywide Financial Corporation, and Sunrise Senior Living. Several of these cases also saw the additional involvement of the state attorneys general, including New Century Financial and The McGraw-Hill Companies (Standard & Poor's).

Table 10. Number of US federal securities class action lawsuits involving SEC investigations, 1996–2007*

Year filed	Informal investigation	Formal investigation	Action or settled	Cases closed	Total cases
2007	15	6	2	1	24
2006	10	16	5	4	35
2005	9	24	15	4	52
2004	10	21	17	18	66
2003	10	11	21	9	51
2002	12	12	67	7	98
2001	2	7	36	0	45
2000	1	4	39	0	44
1999	7	2	24	2	35
1998	5	1	29	4	39
1997	3	0	22	3	28
1996	1	0	22	4	27

* Information is based on a review of press releases, SEC releases, and news articles. Statistics from prior years have been updated based on current information.

Table 11. Number of US federal securities class action lawsuits involving DOJ criminal investigations, 1996–2007*

Year filed	DOJ investigation	Indictment	Guilty/ conviction	DOJ settlement	Total cases
2007	10	1	2	2	15
2006	17	2	4	2	25
2005	5	2	2	4	13
2004	16	2	7	6	31
2003	10	1	8	5	24
2002	12	3	25	19	59
2001	7	1	9	7	24
2000	5	4	7	12	28
1999	1	4	6	10	21
1998	5	1	7	15	28
1997	3	1	5	4	13
1996	1	1	4	3	9

* Information is based on a review of press releases and news articles. Statistics from prior years have been updated based on current information.

Table 12. Number of US federal securities class action lawsuits involving both SEC and DOJ investigations, 1996–2007*

Year filed	Accounting	Non-accounting	Total cases
2007	7	2	9
2006	20	1	21
2005	9	1	10
2004	22	3	25
2003	19	0	19
2002	49	4	53
2001	17	2	19
2000	24	2	26
1999	13	1	14
1998	17	0	17
1997	13	0	13
1996	7	1	8

* Information is based on a review of press releases, SEC releases, and news articles. Statistics from prior years have been updated based on current information.

Paying the price

During 2007, a total of 113 settlements were reached, comparable to the 112 reached in 2006. The total value of settlements did not significantly change, either—$6.37 billion in 2007, compared to $6.44 billion in 2006. The average settlement value in 2007 was $56.3 million, compared to $57.5 million in 2006. Excluding outlier settlements[8] (defined as those higher than $2.5 billion), the total settlement value dropped by approximately 51%, from $6.44 billion in 2006 to $3.17 billion in 2007. Likewise, the average settlement amount, excluding outliers, dropped by approximately 51% to $28.3 million, from the average 2006 settlement amount of $57.5 million.

The principal reasons for a drop were fewer settlements over $1 billion and the comparatively lower value in the amounts. For example, in 2006, there were three settlements over $1 billion, while in 2007 there were no settlements of this size, excluding outliers. Additionally, there were 9 settlements greater than $100 million in 2007 compared to 11 and 12 in years 2006 and 2005, respectively. Settlements equal to or greater than $10 million and less than $100 million numbered 43 during 2007, compared to 30 in 2006, and there were 61 settlements of less than $10 million but greater than zero in 2007, compared to 71 in 2006.

Fewer accounting-related settlements were made during 2007 than in 2006. In 2007, 79 settlements were made, compared to 87 in 2006. The total value of settlements in 2007 for accounting-related cases remained consistent with the total value of 2006 settlements, at approximately $6 billion. The average settlement in 2007 was approximately $75 million (although, after excluding one outlier for the Tyco settlement, the 2007 average dropped to $35 million), compared to approximately $68.6 million in 2006. Consistent with prior years, the average accounting case settlement was higher than the average non-accounting case settlement, by $22.2 million, or 173%.

8 The $3.2 billion Tyco settlement was excluded as an outlier.

The average value of the non-accounting-related settlements was $12.8 million in 2007, versus $19.2 million in 2006.

Worthy of note was the fact that 2007's highest settlement—Tyco, for $3.2 billion—was made in an accounting-related case. The next largest settlement was Cardinal Health, for $600 million. Other settlements above $100 million were as follows:

- Delphi Corp., $333.4 million
- CMS Energy Corp., $200 million
- Motorola, $190 million
- Refco, $147.6 million
- Biovail Corp., $138 million
- Doral Financial Corp., $130 million
- Mercury Interactive Corp., $117.5 million

In addition to the monetary settlements imposed on companies, there were instances in which corporate governance requirements were stipulated in overall settlement terms, including: compliance with additional independence standards; the hiring of a lead independent director; the holding of annual elections for board of director appointments; and, in a few cases, shareholder participation in board elections. For the years leading up to the Sarbanes-Oxley Act of 2002, the incidence of certain corporate governance requirements included in settlement terms increased; in 2002 the number of cases peaked at 29. However, in 2007, only 3 comparable cases were filed, and 15 cases included additional settlement provisions. This compares with 7 similar cases filed and 24 settlements in 2006. This is due perhaps to requirements of Sarbanes-Oxley that already provide for many of the corporate governance reforms requested.

Table 13. Settlements (in thousand $): all cases, 1996–2007*

Year settled	1996–2000	2001	2002	2003	2004	2005	2006	2007
Number of settled cases	248	108	108	115	115	120	112	113
Total settlement value	6,813,200	1,934,500	2,101,600	2,744,100	5,771,200	18,621,200	6,444,300	6,365,000
Total settlement value excluding outliers	3,627,200	—	—	—	3,196,200	7,926,700	—	3,165,000
Average settlement value†	14,700	17,900	19,500	23,900	28,000	67,200	57,500	28,300
Median settlement value†	5,000	5,500	6,300	5,600	6,800	9,000	6,400	7,900
Average settlement value for cases settled for $1M or more, up to $50M	9,100	10,900	9,300	9,700	9,700	10,400	9,100	10,200

* Year of settlement is determined based on the primary settlement pronouncement. Any subsequent settlement amounts are attributed to the primary announcement year. Settlement information reflects only those cases filed and settled after passage of the PSLRA (12/22/1995). Table excludes $0 settlements.

† Excludes all settlements over $2.5 billion (outliers).

Table 14. Settlements (in thousand $): accounting cases, 1996–2007*

Year settled	1996–2000	2001	2002	2003	2004	2005	2006	2007
Number of settled cases	161	70	81	81	86	89	87	79
Total settlement value	6,155,100	1,667,300	1,410,000	2,232,000	5,486,200	18,339,300	5,964,500	5,929,200
Total settlement value excluding outliers	2,969,100	—	—	—	2,911,200	7,644,800	—	2,729,200
Average settlement value†	18,600	23,800	17,400	27,600	34,200	87,900	68,600	35,000
Median settlement value†	6,500	7,400	7,500	7,000	7,300	13,300	7,000	8,400
Average settlement value for cases settled for $1M or more, up to $50M	10,600	12,600	10,500	10,800	10,400	12,200	10,000	10,200

* Year of settlement is determined based on the primary settlement pronouncement. Any subsequent settlement amounts are attributed to the primary announcement year. Settlement information reflects only those cases filed and settled after passage of the PSLRA (12/22/1995). Table excludes $0 settlements.

† Excludes all settlements over $2.5 billion (outliers).

Table 15. Settlements (in thousand $): non-accounting cases, 1996–2007*

Year settled	1996–2000	2001	2002	2003	2004	2005	2006	2007
Number of settled cases	87	38	27	34	29	31	25	34
Total settlement value	658,100	267,200	691,600	512,100	285,000	281,900	479,700	435,800
Average settlement value	7,600	7,000	25,600	15,100	9,800	9,100	19,200	12,800
Median settlement value	3,800	3,800	4,800	3,300	4,600	3,200	4,500	7,600
Average settlement value for cases settled for $1M or more, up to $50M	6,300	7,800	6,000	7,300	6,900	5,800	6,600	10,300

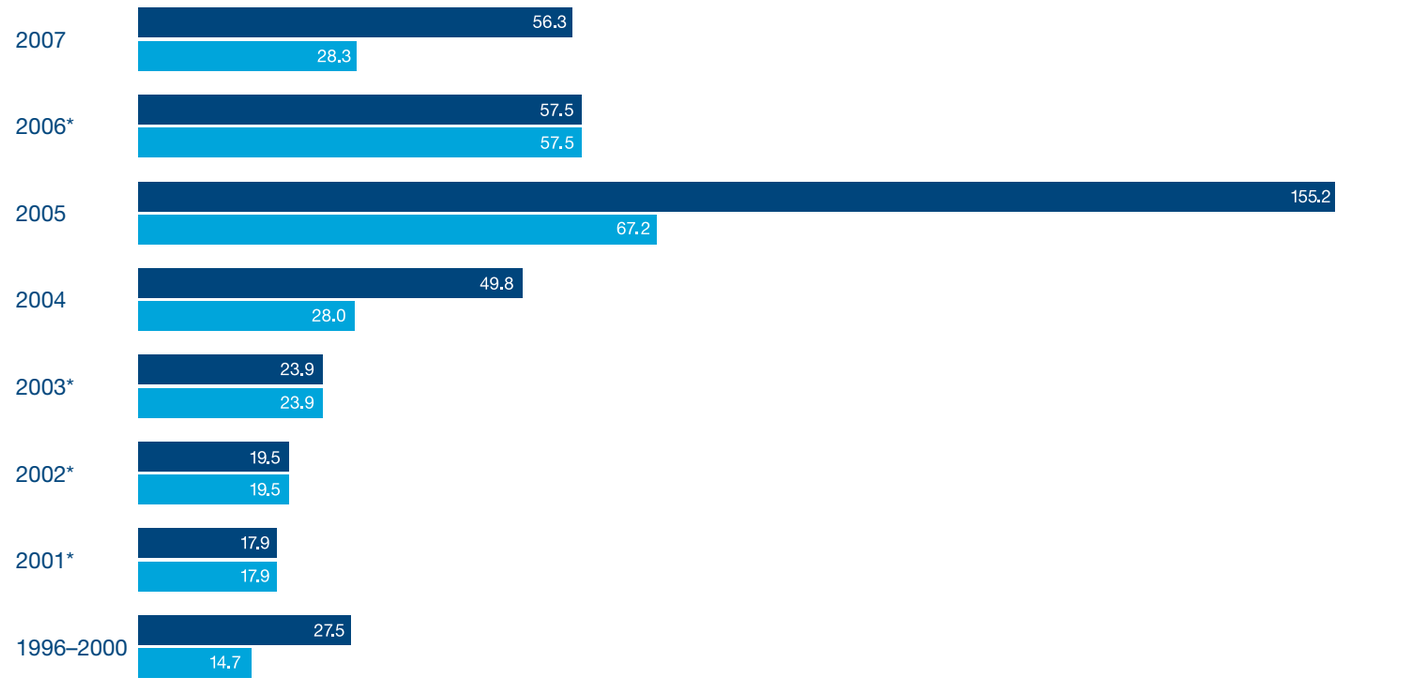
* Year of settlement is determined based on the primary settlement pronouncement. Any subsequent settlement amounts are attributed to the primary announcement year. Settlement information reflects only those cases filed and settled after passage of the PSLRA (12/22/1995). Table excludes $0 settlements.

Table 16. Percentage of settled cases by settlement value range, 1996–2007*

Total settlement (in million $)	1996–2006	2007
100+	6	8
50–99.99	5	5
20–49.99	10	10
10–19.99	16	23
5–9.99	21	17
2–4.99	24	26
0–1.99	18	12

* Settlement year is determined by the year the settlement is disclosed. Settlement information reflects only those cases filed and settled after passage of the PSLRA (12/22/1995). Percentage totals may not add up to 100% due to rounding.

Table 17. Average settlement values (in million $) for cases filed and settled post-PSLRA, by year



* There were no outliers for the years 2001, 2002, 2003, and 2006.

Including outliers Excluding outliers

Institutions: leaders of the pack

For many years now, there has been a growing phenomenon of large institutional investors serving as lead plaintiffs in private securities litigations. Cases filed increased from 8% of total cases in 1996 to a peak of 53% in 2002, the year of Sarbanes-Oxley. From 2002 through 2006, representation by large institutional investors as lead plaintiffs continued at an average level of 52% of total cases filed. In 2007, large institutional investors were named as lead plaintiffs in 48% of cases, down 9 percentage points from the 57% observed in 2006.

Pension funds, both public and union, have typically been the most active sub-categories within large institutional investors. In 2007 these included the New York State Common Retirement Fund, NECA-IBEW (National Electrical Contractors Association/International Brotherhood of Electrical Workers), and Massachusetts Public Pension Funds. In 2007, pension funds filed as the lead plaintiff in 40% of cases, the same percentage as in 2006.

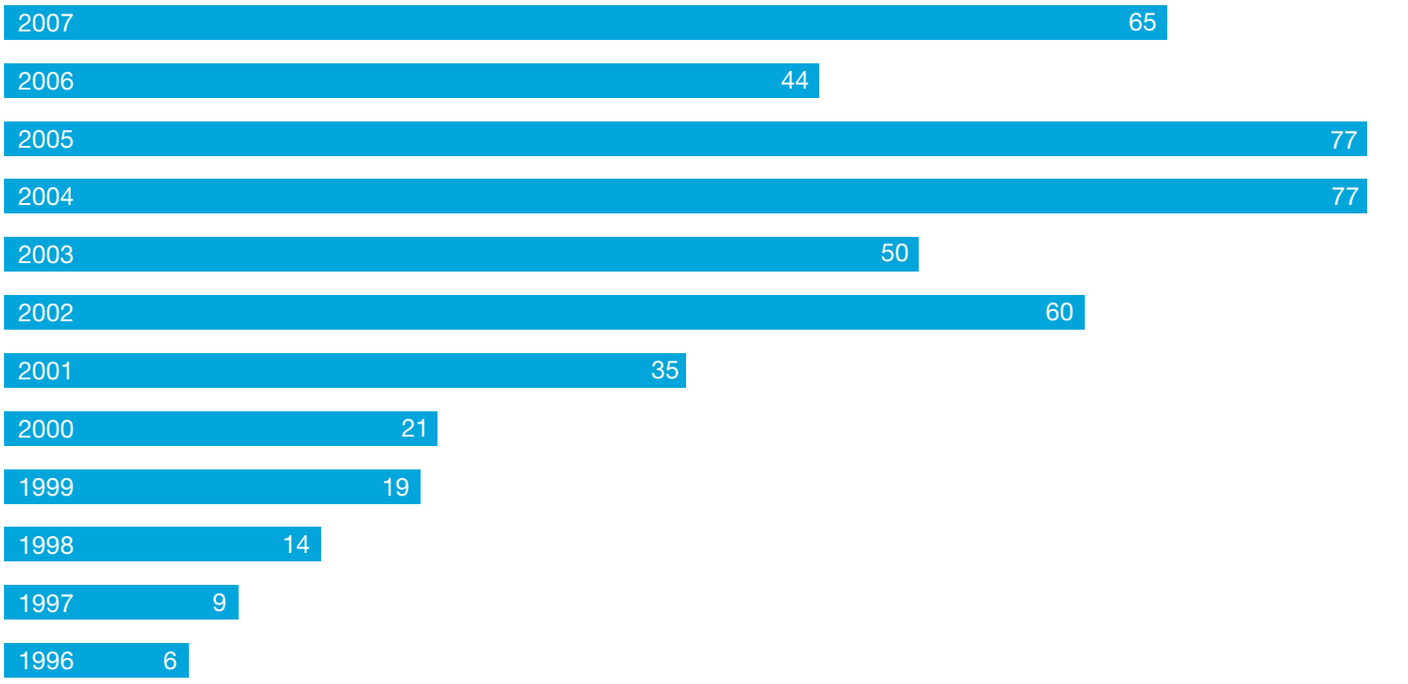
During 2007, 68 cases in which large institutional investors were named as lead plaintiff settled for $6 billion, consistent with the approximately $6 billion from 2006. These represented 60% of total cases settled during 2007 and 94% of total settlement dollars. Cases with pension funds named as lead plaintiff settled for $5.53 billion, compared to $5.26 billion in 2006. Tyco, the largest settlement of the year, had a pension fund as lead plaintiff.

Table 18. Settlement values (in thousand $): by lead plaintiff, 2002–2007*

	2002		2003		2004		2005		2006		2007	
	Cases settled	Settlement	Cases settled	Settlement	Cases settled	Settlement	Cases settled	Settlement	Cases settled	Settlement	Cases settled	Settlement
Public pension	11	682,500	18	1,825,700	27	4,695,800	40	17,454,700	41	5,257,800	49	5,531,900
Other institutional	11	124,100	22	360,600	25	438,900	21	390,400	21	832,500	19	463,600
Total institutional investors	**22**	**806,600**	**40**	**2,186,300**	**52**	**5,134,700**	**61**	**17,845,100**	**62**	**6,090,300**	**68**	**5,995,500**
Average settlement	—	36,700	—	54,700	—	100,700	—	292,500	—	99,800	—	93,700
Total cases settled	**108**	**2,101,600**	**115**	**2,744,100**	**115**	**5,771,200**	**120**	**18,621,200**	**112**	**6,444,300**	**113**	**6,365,000**

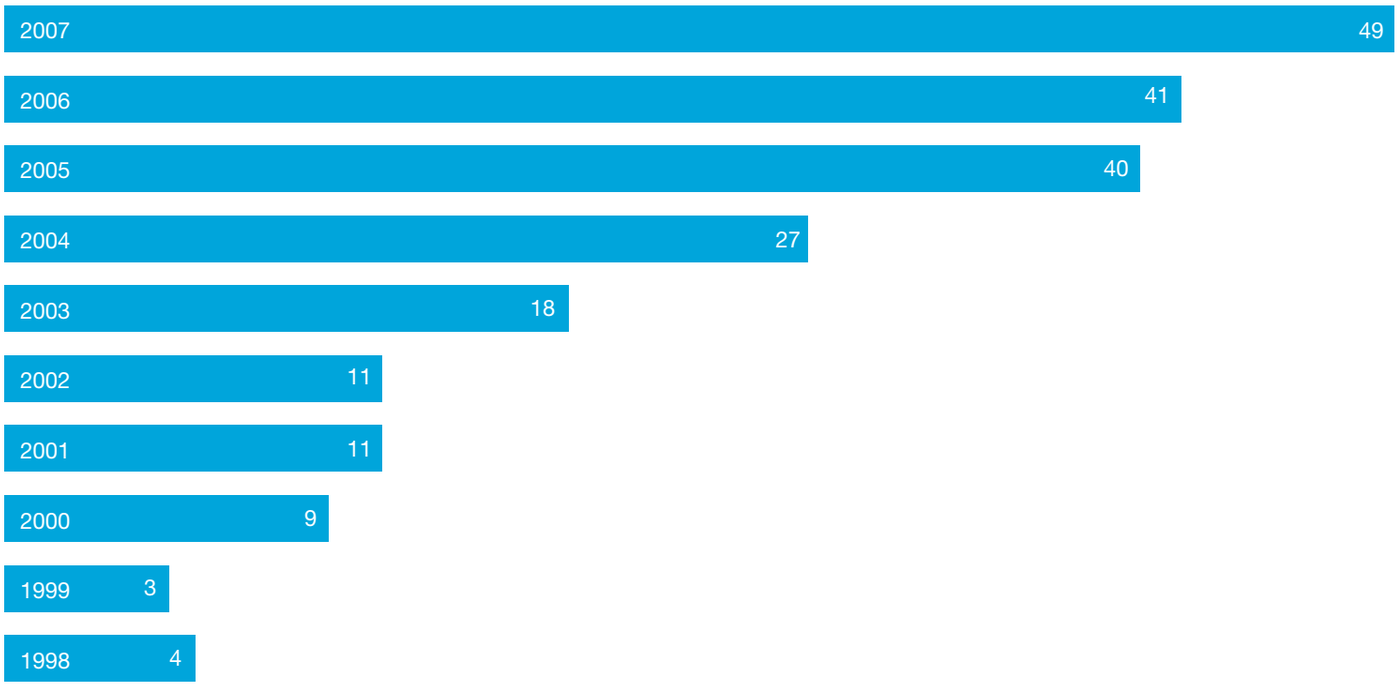
* Settlement year is determined by the year the settlement is disclosed. Settlement information reflects only those cases filed and settled after passage of the PSLRA (12/22/1995). Table excludes $0 settlements.

Table 19. Number of US federal securities class action lawsuits filed with union/public pension funds as lead plaintiff, 1996–2007*



* Final 2007 data is not available to date; the full-year projections are based upon filings through June 30, 2007.

Table 20. Number of US federal securities class action lawsuits settled with union/public pension funds as lead plaintiff, 1998–2007



The story of subprime

On January 4, 2008, the American Dialect Society (ADS) voted *subprime* the Word of the Year for 2007. According to the ADS website, the Word of the Year has to be "newly prominent or notable in the past year"—a fitting description, therefore, for a word that became commonplace throughout 2007 and is associated with the year's major controversy and resulting credit crisis.

Back in 2005, there were signs of impending problems. For example, Bear Stearns disclosed that the "SEC… intends to recommend that the Commission bring a civil enforcement action against Bear Stearns in connection with Bear Stearns' involvement in the pricing, valuation and analysis related to approximately $62.9 million worth of collateralized debt obligations…."[9] It also disclosed that the company was responding to inquiries from the New York State attorney general regarding a sale of $16 million of collateralized debt obligations to an unnamed client.

But it was not until 2006 that the true depth of the subprime crisis started to become evident. In early 2006, more issues began to surface when HSBC Finance reported that it would set aside 20% more than analysts had estimated for bad loans in 2006 because of weakening in the US mortgage business. Following HSBC, in February 2007, was New Century Financial, the second largest subprime mortgage originator in the United States, which announced that it would restate results for the first three quarters of 2006 to correct accounting errors related to loan repurchase losses.

Since then, subprime-related institutions, including New Century Financial, have gone bankrupt, major investment banks have disclosed cumulative losses of around $130 billion, and liquidity in the credit market has become a problem.

In addition, most regulators are now consumed with the issue and are actively conducting investigations into mortgage securitization activities, which include everything from originating loans to buying them, packaging them, and selling them to investors. Regulators active in this area include the FBI, SEC, DOJ, state attorneys general, the Treasury Department's Financial Crimes Enforcement Network, and the Federal Deposit Insurance Corporation (FDIC).

9 Jenny Anderson, "Bear Stearns Sets Aside $100 Million as Investigations Loom," *The New York Times* (July 12, 2005).

The FBI has initiated criminal fraud probes into 16 companies, and the SEC has established its own subprime task force and is reported to have at least 36 ongoing investigations into companies involved with mortgage securitization issues. The DOJ is working closely with the SEC to coordinate efforts to gather information and is looking into whether there was fraud in originating, packaging, or selling mortgage-related products. The DOJ is investigating Bear Stearns in connection with the collapse of two internal hedge funds, and UBS in connection with the issue of whether the company had knowledge that should have led it to lower valuations of certain mortgage bonds.

Not to be excluded from all this, plaintiffs filed 37 subprime-related federal securities litigation cases during 2007, 9 of which were directed at Fortune 500 companies. The majority of activity from the plaintiffs' bar occurred in the second half of the year, with 30 of the 37 total cases filed during that time frame. In the third and fourth quarters of 2007, 16 and 14 cases were filed, respectively, with much of the activity (21 cases) occurring in the Second (11 cases, or 30%) and Ninth Circuits (10 cases, or 27%).

Most of the cases filed—30 out of the 37—contained accounting-related allegations, of which 26 (87%) were related to inadequate estimates—specifically, the understatement/underreporting of loan loss reserves and the failure to record impairment on mortgage portfolios. Other accounting allegations related to internal controls and overstatement of assets. Specific allegations include the material overstatement of assets associated with home loans held in portfolios or held for sale. Named defendants ranged from loan originators to rating agencies. Approximately 51%, 8%, and 5% of the subprime cases were against loan originators, investment banks, and rating agencies, respectively.

Table 21. Number of subprime-related federal securities class action lawsuits, by quarter, for 2007

2007 trends: the year of living dangerously

By Jonathan Dickey, partner at Gibson Dunn & Crutcher

In 2007, litigation rates increased dramatically across a wide swath of corporate America. Recent headlines have focused on the subprime "meltdown" and the attendant class and derivative litigation that quickly followed. As previously discussed, subprime litigation was a major story in 2007, and the level of subprime-related litigation is likely to broaden and deepen in 2008 as more cases related to the "credit crunch" are filed against a range of companies and against firms involved in the subprime marketplace, including originators, syndicators, insurers, and ratings agencies.

Subprime litigation was not the only 2007 story, however, and as discussed below, both private litigants and regulators are focusing on several other major areas.

Subprime—Round 1

As the 2007 data demonstrate, the second half of 2007 showed a significant upsurge in case filings in the subprime arena. The cases included both direct and derivative claims, and were brought both as putative class actions and by individual aggrieved investors or other market participants. While the Southern District of New York has become the epicenter of these cases, it is by no means the exclusive forum. As was true of certain past scandals, both federal and state regulators are actively investigating these matters as well.

One can expect 2008 to be "Round 2" in this multistate, multi-defendant fight. Regulatory proceedings are likely to expand, led by the SEC and various state attorneys general. The year 2007 ended with several attorneys general serving subpoenas to a number of market participants and looking hard at possible state law violations. More investigative proceedings are expected in the year to come.

In a number of the subprime cases filed in 2007, it is clear that plaintiffs will have challenges at the pleading stage, particularly on scienter and loss causation. Case law generally has been favorable to defendants on loss causation defenses. Large portions of the alleged damages in some of the subprime cases therefore may be excluded on loss causation grounds.

PSLRA pleading standards

The Supreme Court's 2007 decision in *Tellabs, Inc. v. Makor Issues & Rights, Ltd.,* 127 S. Ct. 2499 (2007) is likely to affect not only subprime-related cases, but also cases in all other areas. In *Tellabs*, the Court held that trial courts must consider all plausible inferences of scienter, and that cases may proceed only if the inference of scienter is "cogent and at least as compelling as any opposing inference." Already, trial courts are dismissing cases under this standard. Yet, several

other courts have read *Tellabs* to essentially hold that the "tie goes to plaintiffs," and have found scienter adequately pleaded. In 2008, we should see a more discernable trend in the case law as to whether *Tellabs* will, indeed, shift the balance of power at the pleading stage to defendants.

"Scheme liability"

On January 15, 2008, the US Supreme Court decided one of the most hotly contested issues in private securities litigation in decades—namely, whether companies and individuals can be sued for primary liability under Section 10(b) of the Securities Exchange Act of 1934 because they participated in a "scheme to defraud," even if they did not make any misleading statements to the market and even if they had no duty to disclose. The case, *Stoneridge Investment Partners, LLC v. Scientific-Atlanta,* 128 S. Ct. 761 (2008), has pitted the plaintiffs' bar against Wall Street, accounting firms, lawyers, and other "secondary actors." In *Stoneridge,* plaintiffs sued two equipment vendors who sold products and services to Charter Communications, which was the issuer of securities. Plaintiffs claimed that the equipment vendors had helped Charter "cook the books" by entering into "wash" transactions that were alleged to have falsely inflated Charter's revenues. While the Court affirmed the court of appeals ruling dismissing the case, it found that the conduct of the equipment vendors might be a "deceptive act" even though the vendors had no duty to Charter's shareholders and were not involved in making any statements to investors.

Already, the plaintiffs' bar is seeking to capitalize on the Supreme Court's observations about the "deceptive act" requirement and to argue that *Stoneridge* still allows claims to be asserted against secondary actors in some cases. Recent public remarks from plaintiffs' lawyers suggest two possible arguments may be advanced. First, plaintiffs argue, a claim can be asserted if the defendant operated in the "realm of financing business," as opposed to the "realm of ordinary business operations" that the majority opinion described. Second, plaintiffs may contend that a claim can be brought if the transaction or event was disclosed to the public—e.g., a third party's involvement in a material contract or an underwriting firm's involvement in the issuer's public or private financing. Trial court decisions will be closely watched in 2008.

Litigation involving foreign purchasers

In 2007, a number of court decisions addressed the issue of whether foreign purchasers can sue under US federal securities laws in US courts, or otherwise participate as class members in such cases. In *In re Royal Dutch/Shell Transport Sec. Litig.*, 2007 US Dist. LEXIS 84434 (D.N.J. Nov. 13, 2007), for example, the Court said no, concluding that there was an insufficient connection between the United States and the foreign purchasers' claims, and dismissed on this basis. Other decisions, however, have found that foreign investors not only can sue but also can be appointed lead plaintiffs. Thus, in *Borochoff v. Glaxosmithkline PLC,* 246 F.R.D. 201, 205 (S.D.N.Y. 2007), the court appointed a UK-based party as lead plaintiff. Similar logic was applied by the court in *In re Vivendi Universal, S.A. Sec. Litig.,* 242 F.R.D. 76, 109 (S.D.N.Y. 2007), in which it certified French, English, and Dutch purchasers as class members. Another recent case permitted foreign purchasers of securities purchased on a US exchange to sue, but barred those who had purchased on a foreign exchange (In re Rhodia S.A. Sec. Litig., 2007 WL 2826651, at *12, S.D.N.Y. [September 26, 2007]). The basic conclusion one can draw from this line of cases is that foreign investors are beginning to play a more prominent role in US securities litigation, reflecting the more global reach of US issuers and the sometimes strong involvement of foreign issuers in the US securities markets.

Options backdating litigation

In 2007, options backdating cases played a prominent role in the securities litigation arena, and a number of key rulings were made in class and derivative suits across the country. Most of these cases have been brought as derivative suits, and therefore are not included in the metrics of class action filings nationally. The courts have been split on whether these derivative suits should proceed past the pleading stage, with a majority of court decisions so far finding that plaintiffs have failed to plead "demand futility." In a distinct minority of cases, however, the cases

have survived pleading challenges. Similarly, several class action cases have survived pleading challenges, including suits against directors and officers of Brocade Communications.

Also in 2007, former officers of Brocade Communications were convicted in separate criminal trials relating to options backdating. And the SEC brought several enforcement actions against officers and directors over options backdating, including the former general counsels of Apple Computer, McAfee, Mercury Interactive, KLA-Tencor, Monster Worldwide, and Comverse Technology.

The first major civil settlements of stock options backdating cases were announced toward the end of 2007, including two settlements in excess of $100 million (UnitedHealth and Mercury Interactive). Besides the dollar amounts involved, some of these recent settlements are noteworthy for the fact that they also included various corporate governance reforms in the settlement terms. We can expect many more backdating settlements in 2008.

Hedge funds

Finally, in 2007, hedge funds began receiving new regulatory scrutiny, as the SEC announced that it was focusing renewed attention on potential securities law violations by hedge funds and launched a “sweep” late last year, pursuant to which it requested a long list of documents and information from a number of hedge funds. The SEC brought several insider trading cases against hedge fund representatives last year, and 2008 may witness an increase in these kinds of cases.

Hedge funds: under a microscope and on the stand

More than a year has passed since the District of Columbia Court of Appeals, in the *Goldstein* decision, overturned the SEC's rule requiring hedge fund managers to register with the Commission and adhere to other record-keeping and compliance requirements. It has also been over a year since the SEC's chairman, Christopher Cox, declared that investigations into hedge funds and private equity funds were on the increase.

Since September 2007, the SEC is reported to have conducted more than 30 investigations in the Northeast alone, and actions have been brought against more than 100 hedge fund managers in the last 5 years. The SEC has issued enforcement actions against more than 100 investment advisors within the past 8 years, with some significant settlement amounts being reached. Among these was a hedge fund scheme wherein 14 defendants were charged with netting more than $15 million from illegal trades and reliance on stolen information from UBS Securities LLC and Morgan Stanley.

The majority of SEC investigations focused on the sharing of insider information among hedge funds and banks, brokers, and other public companies. Other areas of scrutiny include compliance and the use of non-public information to make investment decisions. During 2007, the SEC created a hedge fund working group within the Division of Enforcement to lead efforts with other federal enforcement agencies to combat hedge fund insider trading.

In late October 2007, the DOJ reported 60 civil actions and 33 criminal indictments against commodity pools and hedge funds. Among the indictments and convictions were those related to Bayou Capital Management and Mission LC, in which the DOJ also recovered $106 million for distribution to victims and $20 million in restitution, respectively.

During 2007, hedge funds received further attention, from investors as well as regulators, as a result of the funds' involvement in the subprime debacle and the recent demise of several significant hedge funds. During 2007, two Bear Stearns hedge funds, for example, lost $1.6 billion through investments linked to the subprime mortgage market, and investors filed suit against the collapsed Amaranth Advisors LLC—the largest hedge fund collapse to date. The DOJ is currently conducting a criminal investigation into Bear Stearns.

As the subprime fallout continues into 2008, this will be one area to watch. Not only could litigation against hedge funds by investors increase, but large institutional investors such as pension funds—which have added hedge funds to their portfolios over recent years and which are increasingly active in shareholder lawsuits—may also begin to focus with similar activism on hedge funds in order to recover losses associated with the subprime crisis.

The SEC and DOJ forge ahead

According to the SEC's *2007 Performance and Accountability Report*, during 2007 the Commission initiated 776 investigations, 262 civil actions, and 394 administrative proceedings covering a wide range of issues, including financial fraud, abusive backdating of stock options, insider trading, violations by broker-dealers, and fraud related to mutual funds. The SEC ordered a total of approximately $1.6 billion in disgorgement and penalties against securities violators. The SEC also continued to increase cross-border cooperation in connection with enforcement actions during 2007. Both requests to and from foreign regulators increased over 2006 levels.

SEC litigation releases issued during 2007 increased for the first year since 2002. The Commission issued 51 litigation releases relating to new accounting cases, compared to 30 in the previous year. Notably, 13 were issued in connection with FCPA-related matters, against, for example, Chevron, Inc., Ingersoll Rand Company Ltd., El Paso Corporation, and Lucent Technologies. The charges were related to kickback payments to foreign officials in countries including China, Egypt, Indonesia, and Iraq.

Throughout 2007 the SEC continued its efforts in the area of stock options backdating and brought to completion several enforcement activities against both companies and officers associated with backdating practices. It settled with Mercury Interactive for $28 million, and in the largest settlement to be assessed against an individual in a stock-options-related matter, the former CEO of UnitedHealth Group settled for $468 million. Other matters involving financial fraud that were settled with the SEC during the year included actions against ConAgra Foods, Inc., and Cardinal Health—which settled for $45 million and $35 million, respectively. Both matters related to alleged improper and fraudulent accounting practices, including earnings management practices and overstatement of revenue.

Increased SEC activity in relation to alleged violations of the FCPA during 2007 resulted in Baker Hughes settling with the SEC for $10 million (disgorgement) and $23 million (prejudgment interest). The company was charged with paying $20.8 million in bribes to government officials in Kazakhstan. Also, Statoil ASA agreed to pay $10.5 million in disgorgement of profits in relation to charges that the company had paid more than $5.2 million in bribes to an Iranian government official. Other noteworthy settlements with the SEC during 2007 were as follows:

- Chevron, $30 million
- Veritas, $30 million
- Evergreen Investment Management Company, $32.5 million
- Fred Alger Management, Inc., and Fred Alger and Company, Inc., $40 million
- Freddie Mac, $50 million

Overall, settlement amounts reached with the SEC during 2007 were lower than in 2006. Missing were the mega-settlements of over $100 million that were observed in prior years.

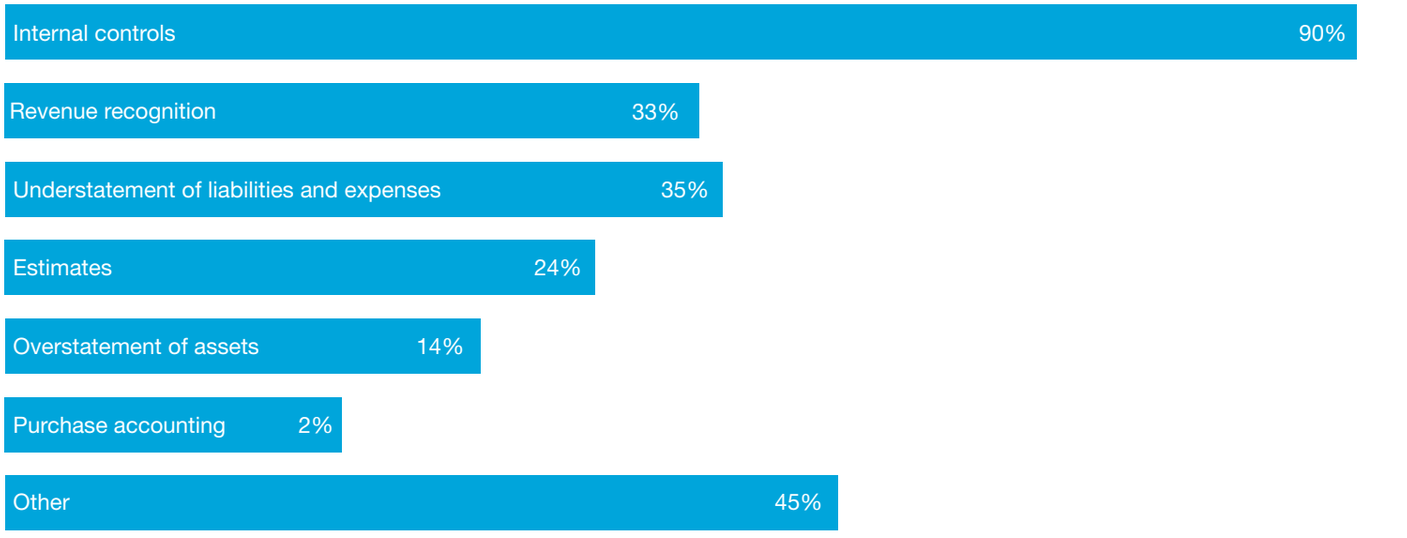
DOJ settlements during 2007 included some hefty amounts. Bristol-Myers Squibb agreed to pay more than $515 million to resolve allegations of illegal drug marketing and pricing. British Petroleum likewise paid approximately $373 million in fines and restitution for environmental violations stemming from a fatal explosion at a Texas refinery in March 2005 and leaks of crude oil from pipelines in Alaska, and fraud for conspiring to corner the market and manipulate the price of propane.

Companies involved in Department of Justice FCPA-related prosecutions in 2007 settled for a total of $72.7 million. These included York International (a Johnson Controls company), Paradigm BV, Textron, Lucent Technologies, Chevron, Ingersoll Rand, Baker Hughes, and Vetco International. Baker Hughes pleaded guilty and agreed to pay a criminal fine of $11 million, serve a three-year term of organizational probation, and adopt a comprehensive anti-bribery compliance program. Ingersoll Rand admitted to paying kickbacks to the Iraqi ministries and agreed to a $2.5 million penalty.

Table 22. Number of SEC litigation releases related to new accounting cases, 1996–2007

Year	Number of releases
2007	51
2006	32
2005	43
2004	42
2003	52
2002	61
2001	32
2000	36
1999	29
1998	31
1997	40
1996	34

Table 23. Percentage of SEC litigation releases with specific accounting issues, 2007*



* Some cases allege multiple accounting issues.

The FCPA goes global

By David Pitofsky, partner at Goodwin Procter LLP

The Foreign Corrupt Practices Act of 1977 (the FCPA) grew into a new phase of maturity in 2007, which is appropriate, since last year it also celebrated its 30th anniversary. The Department of Justice (DOJ), which estimated the number of open FCPA investigations and prosecutions at 60, also announced the creation of a five-member FBI task force assembled to investigate only possible FCPA violations.

These record-breaking numbers are no longer surprising. For years, the FCPA has been a growing focus of investigations and prosecutions inside the United States. But in 2007, the FCPA's application to cases *outside* the United States shifted into a markedly higher gear.

The case that grabbed the most headlines involved Siemens AG, the giant German electronics and electrical engineering firm. Until the passage of the German International Bribery Act in 1999 (by which Germany implemented the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions), corrupt payments to foreign officials by German entities were not just legal but *tax deductible*. Siemens plainly had difficulty adjusting to the new anti-corruption regime. By September 2007, reports had Siemens' bribe total at a staggering $2.3 billion, which had been paid to cabinet ministers and dozens of other officials in Russia, Nigeria, and Libya to win telecommunications contracts.

In October 2007, Siemens agreed to pay a €201 million ($284 million) fine to settle the investigation by the Munich Office of Public Prosecution. But this resolution—with a fine amount that dwarfed the highest FCPA-related fine in history—was not the end of Siemens' trouble. Instead, the DOJ and the Securities and Exchange Commission (SEC) both have open FCPA investigations of Siemens. Notwithstanding its German pedigree, Siemens tapped US lawyers from Debevoise & Plimpton to conduct its internal investigation—further evidence that international entities are now (properly) concerned about the FCPA, even more than the anti-bribery legislation in their home countries.

In November 2007, *The New York Times* ran a major piece on the DOJ's investigation of BAE Systems, a British manufacturer of fighter jets and other military hardware. The *Times* reported that BAE had made billions of dollars in secret payments to members of the Saudi royal family over a period of 20 years to facilitate an $80 billion supply contract. The payments reportedly included

female escorts and luxury travel, including paying for the honeymoon of the daughter of Prince Bandar bin Sultan, the former Saudi ambassador to the United States. The matter was initially investigated by the Serious Fraud Office (SFO) in Great Britain. However, the SFO's investigation was halted on the order of Prime Minister Tony Blair, apparently after Prince Bandar threatened to cut off the flow of intelligence information regarding possible terrorism suspects unless the investigation was terminated. (The British High Court is considering whether or not to order the SFO to reopen its investigation.) The DOJ began investigating BAE after it learned that the company had used American banks to make some of the questionable payments.

Although these cases—which are by no means isolated or anomalous—have become commonplace, one might ask how the DOJ and SEC assert jurisdiction over non-US entities making payments to foreign officials in foreign countries. The answer appears to be twofold.

First, in 1998, the FCPA was amended to assert territorial jurisdiction over foreign companies and nationals. A foreign company (or person) is now subject to the FCPA if it causes, directly or indirectly, an act in furtherance of a corrupt payment to take place within the United States (e.g., BAE's use of a US bank to make corrupt payments abroad).

Second, the FCPA's core jurisdiction covers all "issuers," defined to encompass corporations that have issued securities registered in the United States or who are required to file periodic reports with the SEC. The DOJ has taken the position that foreign corporations whose stock is traded on a US exchange through American depository receipts also fall within the statute's definition of "issuer." This interpretation might be a stretch, but like many other aspects of the FCPA, it may not be subject to judicial review, because companies are loath to endure the costs and uncertainties of litigating FCPA issues.

With the DOJ's increased commitment of resources, the FCPA will surely continue to have a major impact in 2008 and beyond. Corporate counsels—both inside and outside the United States—continue to seek education and advice regarding FCPA compliance, and this demand is met by countless articles and seminars. However, while the FCPA may present a few challenging issues, it is in fact a very straightforward statute.

The FCPA advice industry is a bit like the popular diet industry, where 250-page books are written to communicate the basic message "Eat less, exercise more." With the FCPA, the message boils down to "Don't pay bribes to foreign officials, and don't look the other way while agents do it for you."

In 2008 and beyond, as the FCPA continues to become more muscular and its impact worldwide continues to grow, some attention should be given to its innate frailties. First, the statute should obviously have its greatest application in major world markets with a history of and reputation for corrupt business practices. Three of the most dominant emerging economies are China, India, and Russia—three countries who ignominiously held the bottom three spots on Transparency International's 2006 Bribe Payers Index. The FCPA may appear to have the momentum of an irresistible force, but these countries may yet prove to be immovable objects.

Second, the statute has always had certain drafting deficiencies. For example, it permits certain categories of "promotional payments," which are expenses incurred for the non-corrupt purpose of promoting goods and services, not the corrupt purpose of obtaining or maintaining business or an unfair commercial advantage. But if payments are not made for a corrupt purpose, they are not prohibited by the FCPA, so the "promotional payments" exception is at best redundant and at worst an invitation to stray into a dangerous gray area.

Third, companies worldwide are growing increasingly concerned about the business impact of FCPA, in tandem with the Sarbanes-Oxley Act. These concerns are causing a flight of business from US exchanges, with London being the primary beneficiary. How far will US politicians and regulators be willing to take the causes of transparency and accountability when such causes start to eat into US financial interests in a down-turning economy?

But these are questions for the future. For now, the FCPA has the world on a very tight string.

What a difference a year makes

Foreign issuer activity heats up in 2007

In 2006, the industry saw a year of comparative calm. Markets were stable, indexes were hitting new highs, and capital-rich private equity firms continued to dominate in the mergers and acquisitions arena, taking public companies private. From the standpoint of foreign filers, it was also calm. Securities class actions filed against foreign issuers[10] decreased by 26% over those filed in 2005. The number of cases filed in 2006 (only 14) was the lowest since 1999.

On the domestic front, backdating of options was the big issue in 2006. However, only two foreign filers—MSystems Ltd.[11] and Marvell Technology Group Ltd.—were implicated.

Foreign issuers, however, continued to question whether the benefits of trading on the US exchange outweighed the costs of accessing the largest capital market in the world. The minimum initial listing fee for foreign issuers is notably higher on the NYSE than on the Hong Kong, London, Toronto, or Shanghai exchange. Foreign private issuers (FPIs) considered the costs high when taking into account the additional burden of converting financial statements to generally accepted accounting principles (GAAP), and the exchange-listing fees. And of course, FPIs continue to risk confrontation with the SEC Enforcement Division, Department of Justice, and/or the US trial bar (where settlement amounts continue to rise).

In an effort to stay competitive with other capital markets and to encourage and retain registrants, the SEC made significant changes to US reporting obligations to address these concerns. In March 2007 the SEC amended the rules governing when an FPI may terminate the registration of a class of equity securities under section 12(g) of the Securities Exchange Act of 1934.

10 For purposes of the study, we define a foreign company as one that is either headquartered or incorporated outside of the United States and US territories (e.g., Puerto Rico, the US Virgin Islands).

11 MSystems Ltd. is a derivative action case.

The revised rule allows a company to deregister if its average daily trading volume of securities in the United States in the previous 12 months did not exceed 5% of its total global average trading volume.

Based on 15F forms filed with the SEC, more than 100 companies deregistered in 2007. An analysis of deregistrations indicates that 109 FPIs deregistered equity. Such FPIs were headquartered in Europe, the Middle East, and Africa (68%); North America (13%); Asia Pacific (16%); and South America (4%). Deregistered FPIs included Akzo Nobel NV, British Energy Group PLC, Fiat S.p.A., Sodexho Alliance SA, and Benetton Group S.p.A.

Of the 109 foreign equity deregistrants, 66 (or 61%) cited cost as a key reason for deregistration. These included companies such as National Australia Bank, SkyePharma PLC, and Royal Ahold. Gentry Resources Ltd., which deregistered in November 2007, announced in its press release that the "burdens and costs outweigh any benefits derived from the Company's foreign issuer status with the SEC…." The South Korean company Hanarotelecom echoed this sentiment, stating that "the costs and expenses associated with maintaining a dual listing significantly outweigh the benefits of continuing listing and registration."[12]

Despite these figures, the number of foreign IPOs climbed to 55 in 2007, surpassing the record of 34 IPOs set in 2006 (an increase of about 62%). China accounted for 55% of the 2007 foreign IPOs. Perhaps this trend can be attributed to what SEC commissioner Roel C. Campos cited as the reason foreign companies list in the United States: "The cost of capital is low and [the companies] want to show investors that they meet the highest standards in the world. Indeed, studies consistently show that shares cross-listed in the US will sell at a premium of 15 to 30% greater than the shares in home markets."[13]

12 "hanarotelecom incorporated Intends to Delist Its American Depositary Receipts from the Nasdaq Global Select Market and to Deregister and Terminate Its U.S. Reporting Obligations Under the U.S. Securities Exchange Act of 1934" (June 8, 2007).

13 Stated in his remarks at the International Corporate Governance Network Annual Conference, Cape Town, South Africa (July 6, 2007).

To further address FPI concerns, in December 2007 the SEC published a final rule accepting financial statements from foreign private issuers, prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB), without reconciliation to US GAAP. This new rule is applicable to annual financial statements for financial years ending after November 15, 2007, and to interim periods within those years contained in filings made after the effective date of the rule. The elimination of the reconciliation requirement between US GAAP and IFRS as promulgated by the IASB is a short-term goal for the SEC—and the long-term goal is a single, high-quality, globally accepted set of accounting principles. The SEC is discussing the idea of whether US domestic issuers should be allowed to use IFRS.

The climate wasn't changing only at the SEC in 2007. Global credit markets were also in turmoil, negatively impacting investor confidence. The price of oil reached record highs, interest rates rose across the globe, and the global credit crunch began. Arguably, expanding global markets, a variety of higher-risk products available to investors, and an overall lack of global coordination and regulation compounded global credit issues and left few markets unscathed.

Banks across the globe in 2007 suffered cumulative write-downs of over $130 billion. Foreign banks reporting subprime-related write-downs include HSBC (Europe's largest bank), $7.5 billion; UBS, $14.4 billion; Crédit Agricole, $3.6 billion; Deutsche Bank, $3.2 billion; CIBC, $3 billion; and the Royal Bank of Scotland, $2.5 billion. One of China's largest banks, the Bank of China, is expected to incur related write-downs as well.

Actions against foreign private issuers spike

The number of federal securities class actions filed in 2007 against foreign private issuers increased by 93%, to 27 cases, compared to 14 cases filed in 2006, falling short of the 2004 record year of 30 cases. Twenty of the cases (or 74%) were filed in the Second Circuit, while six (or 22%) were filed in the Ninth Circuit.

Companies in emerging markets appear to have attracted both investor money and the attention of plaintiff attorneys. Ten cases (or 37%) were filed against companies headquartered in China, surpassing for the first time in the last six years the number of cases filed against companies incorporated or headquartered in Bermuda or Canada. It is worth noting that during the five-year period of 2002 through 2006, only six cases were filed against companies in China.

Six (or 22%) of the cases filed in 2007 alleged IPO fraud, with five filed against Chinese companies. This represents a significant increase in the number of IPO fraud cases filed in the last five years, with two cases in 2006 (14%) and one in 2005 (5%). The increase appears to be reflective of the record number of foreign IPOs in the United States for 2007.

Five (50%) of the cases filed against companies headquartered in Europe related to pharmaceutical efficacy allegations, which included cases against GlaxoSmithKline PLC, Novartis, and Sanofi-Aventis. Six pharmaceutical efficacy cases were filed against foreign filers during the period of 2002 through 2006, four of which were against companies based in Europe.

Table 24. Number of federal securities class action lawsuits filed against foreign companies per year, 2000–2007

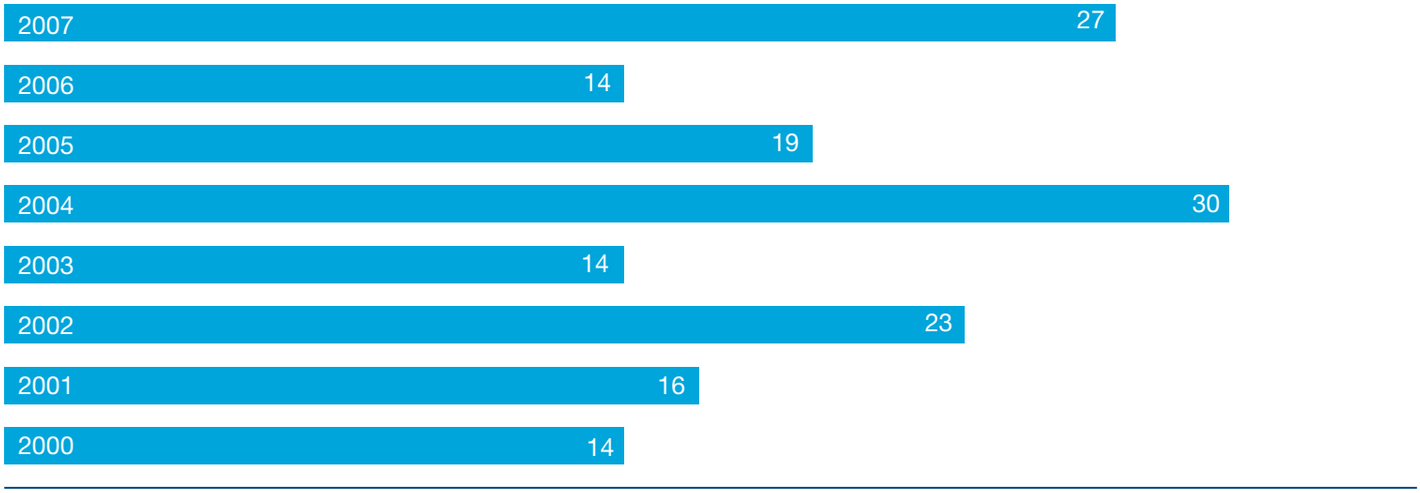
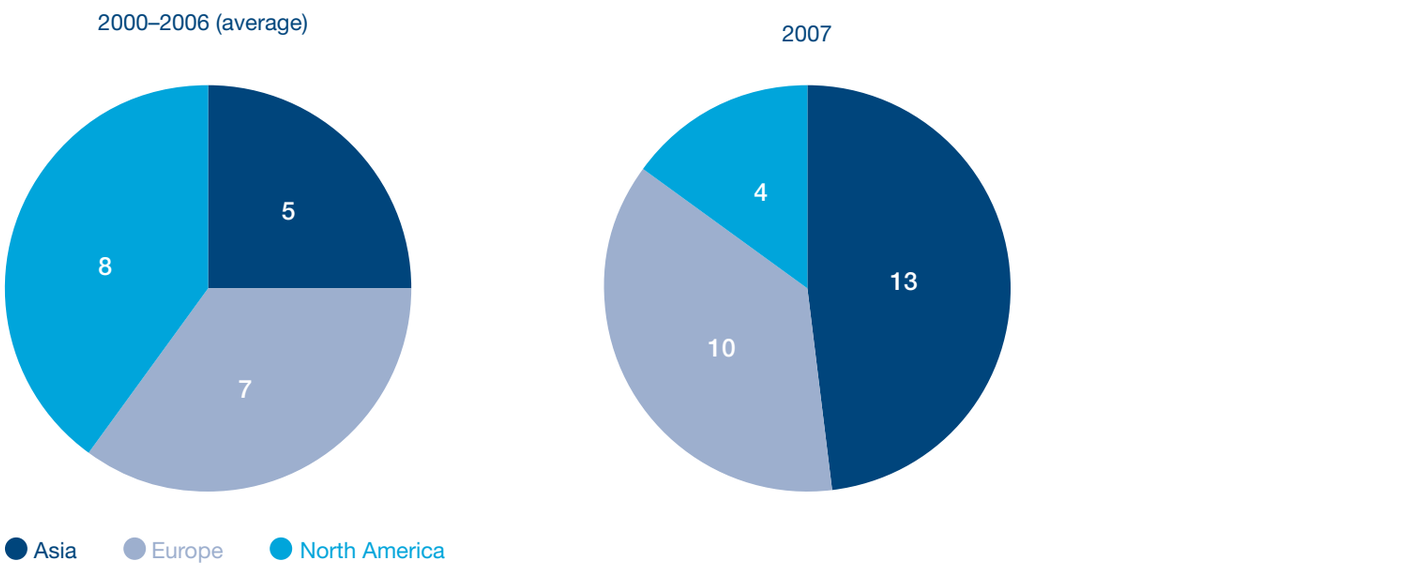


Figure 1. Number of federal securities class action lawsuits filed against foreign companies by region, 2000–2007



In 2007, the number of SEC enforcement actions against foreign companies remained consistent at three, and were leveled against the following companies and/or their former employees:

Centerpulse Ltd.	L.R. 20336	October 17, 2007
Nortel Networks Corp.	L.R. 20036	March 12, 2007
SmartForce PLC	L.R. 20202	July 19, 2007

All three of the foreign registrants and/or employees were charged with improper or inadequate internal controls. Additionally, Centerpulse Ltd. (FY2002) and Nortel Networks Corp. (FY2000, FY2001, FY2002, FY2003) were charged with improper behavior in the area of reserves. Nortel Networks Corp. and SmartForce PLC (FY1999, FY2000, FY2001, FY2002) were charged with improper revenue recognition.

In 2007 the number of FCPA investigations increased to 11. Foreign companies undergoing FCPA-related investigations initiated by the SEC or indictments by the DOJ in 2007 included BAE Systems, Magyar Telekom, NITEL, Paradigm BV, Siemens AG, Total SA, Noble Corp., Intervet International (a subsidiary of Akzo Nobel), Smith & Nephew PLC, and Willbros Group, Inc.[14] Allegations of FCPA violations were related to a number of global regions, including:

Africa	6
Asia	5
European Union	13
Middle East	7

Foreign regulators also weighed in from around the globe. The UK's Financial Services Authority imposed fines totaling £16.9 million ($30.9 million) in 2005, £13.3 million ($23.9 million) in 2006, and £5.3 million ($10.6 million) in 2007. In October 2007,[15] German courts fined Siemens AG €201 million ($284 million),[16] ending only one of the investigations the company is facing into alleged bribery practices.[17] The China Securities Regulatory Commission (CSRC) is limited to levying fines up to 400,000 yuan ($50,000), and has conducted close to 200 investigations per year since 2006. Those fined during 2007 included Datang Telecom Technology and executives of Zhejiang Hangxiao Steel Structure.[18] In November 2007, South Korea's president, Roh Moo-hyun, agreed to legislation to kick-start an investigation into alleged bribery and accounting irregularities in the country's largest conglomerate, the Samsung Group.[19]

14 Two FCPA cases were filed against Willbros Group, the first in September 2006, against Jim Bob Brown, a former employee of Willbros International. The case involved a $1.8 million bribe related to $283.4 million in potential business revenue. The second case involved an investigation, begun in July 2007, against James K. Tillery, former president of Willbros International, and centered on a $6 million bribe in Nigeria related to $387.5 million in potential business revenue.

15 Financial Services Authority, at www.fsa.gov.uk.

16 US-dollar amounts are determined according to the interbank exchange rates listed on www.OandA.com (The Currency Site) on the dates of the FSA transactions.

17 "Siemens to Pay Fine and Taxes in Germany," Associated Press (October 5, 2007), at www.nytimes.com/2007/10/05/business/worldbusiness/05siemens.html?_r=1&partner=rssnyt&emc=rss&oref=sloginon.

18 Zhou Jiangong, "China Stock Market Seen as Insiders' Playground," *Asia Times* (August 30, 2007), at www.atimes.com/atimes/China_Business/IH30Cb01.html.

19 Evan Ramstad, "Samsung's Image Faces New Bruise: South Korea Plans Government Inquiry of Bribe Allegations," *The Wall Street Journal Asia* (November 28, 2007).

European companies could be in for a bumpy ride

Foreign collective actions may become more widely accepted in 2008 as the European Union (EU) and individual countries seriously consider collective litigation alternatives. On March 13, 2007, the EU released its Consumer Policy Strategy, stating that the EU will "consider action on collective redress mechanisms for consumers both for infringements of consumer protection rules and for breaches of EU anti-trust rules."[20]

The EU Commissioner for Consumer Protection, Meglena Kuneva, denies that US-style class action litigation will ever come to the EU under her watch. However, the EU is researching ways to make group actions easier. Kuneva is considering the possibility that when a group of people from across the 27-member bloc all have the same complaint against a company, each person could be represented by his nation's consumer-protection body. She explains: "Options exist, which range from a market-led approach to the establishment of an EU consumer collective redress scheme or out-of-court redress scheme."[21] It may not be called a class action, but the EU will certainly be developing a method of redress to protect consumers and allow them to seek damages from companies.

20 EU Consumer Policy Strategy 2007–2013.
21 "EU Consumer Chief Rules Out US-Style Class Action Cases," Reuters (November 11, 2007), at http://qa.cnbc.com/id/21738968.

In December 2007, Italy enacted a new collective action law. The law amends Italy's Consumers' Code by introducing a new article, 140 bis, which, beginning on July 1, 2008, gives certain associations capacity to sue collectively, in the context of "standard contract arrangements" (provided for in the Italian Civil Code), for tort liability, unfair trade practices, and anti-competitive behavior (antitrust violations). The law doesn't specify the availability of collective procedure to redress security class action claims.[22] Under this law, a collective action (*azione collettiva risarcitoria*) may be initiated to claim damages caused to consumers (including investors) by an unlawful act committed relative to a contractual relationship. Standing to sue does not belong to individuals but to associations of consumers, users, professionals, and other groups, who can bring an action in the interest of all the consumers or users who have been damaged by the same act.

Spain and the Netherlands also permit collective actions to be brought by associations on behalf of injured parties. Although these initiatives may primarily be consumer-focused, this may be the opening that plaintiff attorneys have been hoping for.

22 Mass Tort Litigation Blog, "Italy's New Class Action Law" (January 11, 2008), at http://lawprofessors.typepad.com/mass_tort_litigation/class_actions/index.html.

Foreign settlements climb

Fifteen cases filed against foreign private issuers were settled in 2007, representing matters initially filed between the years 2002 and 2005.

Settlement values continued to climb, averaging $253.3 million in 2007, a 70% increase compared to 2006. Even when outlier settlements[23] are excluded (Tyco International in 2007 and Nortel Networks in 2006), average settlements remain high: $26.6 million in 2007 compared to the 2006 average of $11.7 million, an increase of 128%. Eight settlements, or 53% of the settled matters, involved public pension or union pension funds named as the lead plaintiff.

Not reflected in the statistics in the preceding paragraph is the foreign settlement against Royal Dutch/Shell PLC (Shell). On April 11, 2007, the first-ever European class action settlement of securities fraud claims related to allegations of improperly recorded oil and gas reserves was made against Shell. The settlement, estimated at $450 million, ranks as one of the largest between European shareholders and a Europe-based company. The settlement covered non-US purchasers of Shell stock, including institutional investors in countries such as the Netherlands, the United Kingdom, Germany, and Sweden.

US class actions continued to include foreign investor plaintiffs. In March 2007, the UK's National Association of Pension Funds Ltd. (NAPF), whose member schemes hold £800 billion ($1.598 trillion),[24] accounting for approximately one fifth of investments in the UK stock market,[25] issued a paper outlining the potential benefits of investors taking part in securities class actions. NAPF stated that UK pension funds are becoming more active in joining US class actions, and posed the question of whether trustees had a fiduciary duty to join such suits. Although no UK trustee had been sued for not joining a securities class action, the paper pointed out that "it seems self-evident that trustees have a duty to protect the assets in their scheme and that they should therefore at the very least not neglect opportunities to recoup losses, where the cost and effort are commensurate with the expected return." [26]

23 For purposes of foreign company settlements analysis, outliers are defined as all settlements over $1 billion.
24 Exchange rate: $1.99731: £1, as of December 31, 2007.
25 National Association of Pension Funds Ltd., at www.napf.co.uk/index.cfm.
26 "NAPF, Securities Litigation: Questions for Trustees."

Table 25. Top settlements over $100 million by foreign companies, 2000–2007*

Company	Country	Year settled**	Amount
Tyco International	Bermuda	2007	$3,200,000,000
Nortel Networks†	Canada	2006	$2,217,041,000
Royal Ahold NV‡	Netherlands	2005	$1,100,000,000
Global Crossing Ltd.	Bermuda	2004	$444,000,000
DaimlerChrysler AG	Germany	2003	$300,000,000
Lernout & Hauspie Speech Products NV♦	Belgium	2004	$180,520,000
Biovail	Canada	2007	$138,000,000
Deutsche Telekom AG	Germany	2005	$120,000,000

* Includes only US settlements.

** Year of settlement is determined based on the primary settlement pronouncement. Any subsequent settlement amounts are attributed to the primary announcement year. Settlement information reflects only cases filed and settled after passage of the PSLRA (December 22, 1995).

† Nortel settled both the 2001 case and the 2004 case in 2006.

‡ Partial settlement.

♦ Lernout & Hauspie Speech Products NV includes multiple partial settlements.

Foreign accounting cases decline

The percentage of accounting-related cases filed against foreign companies decreased in 2007 when compared to 2006 (30% versus 79%), the lowest percentage since 2000.

Four of the cases, representing 50% of the total, were filed against Asia-based companies, a 100% increase over the 2006 percentage. North America saw a 67% decrease in cases filed, from six cases in 2006 to just two in 2007. Cases against European companies also decreased by 33% (i.e., by one case) when compared to the three cases filed in 2006.

Thirteen percent of the accounting-related cases alleged improprieties in revenue recognition. This is a significant decrease in the percentage of revenue recognition cases when compared to those filed in 2006 and to the five-year average for 2001 through 2005—i.e., 45% and 55%, respectively.

Fifty percent of the accounting-related cases alleged overstatement of assets such as inventory and debt securities.

Table 26. Percentage of accounting and non-accounting federal securities class action lawsuits filed against foreign companies per year, 2000–2007*

* Cases filed between 2000 and 2006 may have been updated with accounting allegations if the amended complaints alleged accounting violations not previously recognized. The number for 2007 reflects only initial complaints.

Global class actions

By Michael Feldberg, litigation partner and co–managing partner of the New York office of Allen & Overy LLP, and Lanier Saperstein, senior litigation associate of the New York office of Allen & Overy LLP

Class actions in the United States are mirroring the increasingly globalized nature of the securities markets. Virtually any class action now will include a global class of investors. However, class actions involving foreign issuers present a particularly unique set of challenges because of their class composition. Such classes tend to consist primarily of "f-cubed" plaintiffs—foreign plaintiffs who purchased foreign securities on foreign exchanges. US courts and litigants are grappling with whether the US securities laws reach the claims of f-cubed plaintiffs, whether classes comprised largely of such plaintiffs should be certified, and how litigants can effectively settle actions involving predominantly f-cubed plaintiffs.

There have been a number of recent actions against foreign issuers, including Parmalat, Royal Dutch/Shell, and Vivendi, which have raised all of the above issues. While the number of class action filings against foreign companies has decreased since reaching an all-time high in 2004, it would be premature to relegate such suits to the dustbin of history.

Most significantly, there are economic incentives to commence suit in the United States, including against foreign issuers. Settlement values continue to remain high. In 2006 alone, 13 foreign issuers settled class actions for a total of $2.4 billion.

Two of the ten largest class action settlements ever involved foreign issuers, namely Nortel ($2.2 billion) and Royal Ahold ($1.1 billion). Given the potential recoveries, US plaintiffs' firms are organizing in Europe in an effort to attract foreign investors to commence class actions in the United States and possibly elsewhere. Finally, most countries do not have collective action mechanisms, which means that the United States, at least for now, is the main forum for such suits.

Extraterritorial application

A threshold issue is whether US courts have subject-matter jurisdiction over the claims of f-cubed plaintiffs. The antifraud provisions of the US securities laws are silent regarding their extraterritorial application.

US courts typically employ the "conduct" test to determine whether they have jurisdiction over the claims of f-cubed plaintiffs.[27] Under the "conduct" test, a plaintiff must establish that substantial acts in furtherance of the fraud were committed by the defendant in the United States. That standard is satisfied if (i) the defendant's conduct in the United States was more than merely preparatory to the fraud, and (ii) the particular acts or culpable failures to act within the United States directly caused losses to foreign investors abroad.

27 The other jurisdictional test—the "effects" test—is generally inapplicable to the claims of f-cubed plaintiffs because it examines the effects on US (not foreign) investors and securities markets.

In cases involving almost exclusively foreign conduct, courts routinely hold that the US securities laws do not apply to the claims of f-cubed plaintiffs. The case law is less consistent where plaintiffs allege a mix of foreign and domestic conduct.

However, two recent decisions suggest that courts may be moving toward a more consistent and restrictive approach. In *Royal Dutch/Shell*, the court declined to exercise jurisdiction over the claims of non-US purchasers.[28] Plaintiffs alleged that the company had improperly reported its proven oil and gas reserves. They introduced evidence that the company had engaged in investor-relations activities in the United States and had certain US-based affiliates perform technical and accounting activities relating to its oil and gas reserves. Nonetheless, the court found that those US-based activities were merely preparatory and nonessential to the alleged fraud perpetrated on non-US purchasers.

Similarly, in *Parmalat*, the court refused to exercise jurisdiction over the claims of foreign purchasers.[29] Notably, a bank defendant had been the placement agent soliciting funds in the United States in connection with the bank's transaction with Parmalat Brazil. The court found that the bank's solicitation did not support the extraterritorial application of the securities laws because it did not complete the allegedly fraudulent transaction and did not directly cause the alleged losses of the foreign plaintiffs.

While it is too early to tell if a definite trend is emerging, it appears that US courts are taking heed of the Supreme Court's efforts to restrict the extraterritorial reach of US laws.[30] In 2004, the Supreme Court revived the doctrine of prescriptive comity. In 2007, it adopted the "presumption that US law governs domestically but does not rule the world."[31] No court has explicitly applied the doctrine to dismiss securities claims of foreign investors, but it is likely that courts are implicitly acknowledging the Supreme Court's direction.

Class certification

Even if a US court finds that it has subject-matter jurisdiction over foreign claims, that does not mean it will necessarily certify a worldwide class.

The *Vivendi* court, for example, found that it had subject-matter jurisdiction over the claims of the foreign members of the putative class.[32] However, when the plaintiffs subsequently moved to certify the class, the court held that the German and Austrian investors could not be part of the class.[33] The court reasoned that "it was more likely than not" that German and Austrian courts would not give effect to judgments or settlements in US class actions. Because the court believed that

28 *In re Royal Dutch/Shell Transp. Sec. Litig.*, 522 F. Supp. 2d 712, 717 (D.N.J. 2007).
29 *In re Parmalat Sec. Litig.*, 497 F. Supp. 2d 526, 531–532 (S.D.N.Y. 2007).
30 *F. Hoffman–La Roche, Ltd. v. Empagran S.A.*, 542 US 155 (2004).
31 *Microsoft Corp. v. AT&T Corp.*, 127 S. Ct. 1746, 1758 (2007).
32 *In re Vivendi Universal, S.A., Sec. Litig.*, No. 02 Civ. 5571, 2004 WL 2375830 (S.D.N.Y. Oct. 22, 2004).
33 *In re Vivendi Universal, S.A., Sec. Litig.*, 242 F.R.D. 76 (S.D.N.Y. 2007).

Austrian and German nationals could therefore bring lawsuits against the defendants alleging the same wrongdoing underlying the allegations in the US action, it found that the "class action is not necessarily superior," which is one of the requirements for certification. The court did certify a class with French, English, and Dutch members.

Notably, the *Vivendi* court found that the Second Circuit's nonrecognition test—that it be a "near certainty" that a foreign court not recognize a US judgment—was not "particularly useful." The court preferred to evaluate the risk of nonrecognition "along a continuum." The relaxation of the standard, if adopted by other courts, may result in more decisions limiting the size of global classes at the class-certification stage.

Developments abroad

Another important development is the emergence of collective action procedures outside the United States.

In April 2007, in what is being touted as the first-ever European class settlement of securities fraud claims, a group of European institutional investors agreed to resolve all claims against Royal Dutch/Shell. The settlement, reported to have a value of $450 million, covers all non-US purchasers of the company's securities on European exchanges between April 1999 and March 2004. The parties have submitted the settlement for Dutch court approval pursuant to a relatively new statute.

Two particularly notable aspects of the settlement

The settlement did not resolve the competing US class action. Indeed, it was contingent on the US court holding that it did not have jurisdiction over the claims of non-US purchasers. (The US court ultimately dismissed the claims of the non-US investors, as noted above.) While the court found that the non-US plaintiffs had not satisfied the "conduct" test, it also found it "significant" that the non-US purchasers could participate in the Dutch settlement.

The Dutch settlement indicates that foreign collective action mechanisms may facilitate settlements by providing multiple avenues for resolution. The settlement was negotiated between the company and the plaintiffs who had opted out of the US action. Lead plaintiffs in the US action were not involved in the negotiations. Indeed, they filed a motion to enjoin the parties from seeking approval of the Dutch settlement, complaining it had been entered into without their "knowledge or consent." They ultimately withdrew their application.

What this means for your business

There may be trouble ahead.

Viewed against the backdrop of the subprime crisis, 2007 was a tumultuous year for the global economy, and its impact has certainly been evident in the type and number of securities litigations filed against the financial services industry. The sector took a hard blow, experiencing a rise in the number of class action and private securities suits filed against it. With the SEC, DOJ, FBI, and state attorneys general currently conducting investigations into the various causes and effects of the situation, backlash of this kind is certainly far from over.

The financial services industry, though, was not alone in grabbing headlines in 2007. Although it experienced a slight decrease in the number of cases filed against it, the technology sector remained the most sued industry, with the majority of allegations centering on internal controls and revenue recognition. On the foreign front, foreign private issuer activity heated up, with the number of federal securities class actions filed in 2007 increasing by 93%.

The fate of 2008 will depend largely on how a number of trends and issues that emerged in 2007 evolve. At the forefront of these, of course, is the subprime fiasco, which we expect will have ramifications well into 2008. The unknowns that we expect to reveal themselves in 2008 include:

- how successful the subprime-related lawsuits will be;
- how active institutional shareholders will be in pursuing the defendants in these cases (the hedge funds in particular); and
- if settlement amounts will reach lofty heights driven by these cases.

Methodology

The PricewaterhouseCoopers (PwC) Securities Litigation database contains shareholder class actions filed since 1994. The focus of this study is on all cases filed after passage of the Private Securities Litigation Reform Act. PwC tracks all cases filed and more than 50 data points related to each case, including court, circuit, company location, SIC code, class period, stock exchanges, GAAP allegations, earnings restatements, SEC investigations, DOJ investigations, and lead plaintiff type.

PwC also analyzes a variety of issues, including whether the case is accounting-related, a breakdown of accounting issues, and settlement data.

Sources: case dockets, news articles, press releases, claims administrators, SEC filings.

All tables and charts, except when noted, exclude "IPO laddering," "analyst," and "mutual fund" cases.

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