April 1, 2011

Observations from the editor

Welcome to PwC's 15th annual *Securities Litigation Study*, which summarizes the major trends of 2010—a year that, both literally and figuratively, put a cap on the sloppy financial landscape of the last decade, with its mega-frauds, corruption, and near financial collapse.

Reverberations continued to be felt from the 2007–2008 financial crisis, with financial services companies holding the top spot as targets of private securities class action filings for the third consecutive year. However, the trend of decreasing financial-crisis-related filings we noted in 2009 was even more pronounced in 2010, with filings against financial services firms falling from 48 percent of total cases in 2008 to 41 percent in 2009 to 22 percent in 2010. Accounting-related cases also continued to decline in 2010, reaching an all-time low since passage of the Private Securities Litigation Reform Act of 1995 (PSLRA). Actions against Fortune 500 companies fell as well, in line with the decline in financial-crisis-related cases.

These steep declines were offset by filings against other industries on a variety of issues, leading to an overall jump in the total number of cases filed for the year, from 155 in 2009 to 174 in 2010, an increase of 12 percent. Actions against the health industry jumped from 17 percent in 2009 to 21 percent in 2010, putting the industry in the number-two spot for percentage of total filings. Actions against foreign private issuers also jumped by 35 percent, with nearly half of those cases filed against Chinese companies. Cases related to mergers and acquisitions (M&A) were one of the principal drivers of filing activity in the second half of 2010, along with cases alleging deceptive or questionable sales and marketing practices by for-profit educational companies.

Filings by the Securities and Exchange Commission (SEC) and the Department of Justice (DOJ) rose only slightly in 2010, but their overall activities increased significantly. The SEC obtained increased penalties and disgorgements and upped its number of reported enforcement cases, as well as the number of investigations it opened and closed. It also completed the restructuring of its enforcement division and continued internal reforms aimed at improving its efforts to identify and pursue fraud. Most importantly, the year also saw passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank), which significantly expanded the SEC's authority, reach, and enforcement capabilities.

The close of 2010 likely marks the start of a new era, as rules associated with Dodd-Frank (and the UK's tough new anti-bribery law) begin to take effect. Enforcement activities are likely to increase, and SEC oversight will expand to include market participants not previously subject to registration and regulation. Provisions of Dodd-Frank also increase the SEC's and DOJ's extraterritorial jurisdiction in actions alleging violations of US antifraud provisions. The Act's new whistleblower program could also produce a surge in allegations of securities violations, and its promise of financial incentives for actionable information could complicate companies' own internal compliance efforts. All in all, the financial regulatory landscape is vastly different in 2011 from what it was just one year ago, and companies will have to devote significant resources to understanding and adapting to its new topography.

In closing, I would like to thank the members of our Forensics practice who participated in creating this report, especially my co-author, Neil Keenan, for his thoughtful examination of global litigation activity. I am also tremendously grateful to Laura Skrief, Luke Heffernan, Lauren Cable, Kevin Carter, and the rest of the research team, who tirelessly scrutinized the 2010 filings and provided invaluable analysis to this study.

Lastly, I'd like to extend thanks to the law firms Gibson Dunn & Crutcher LLP, Latham & Watkins LLP, and Skadden, Arps, Slate, Meagher & Flom LLP. Their discerning editorial contributions illuminate some of the most important securities litigation developments of 2010.

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Looking beyond a decade of fraud, corruption, and turmoil
2010 Securities litigation study

April 2011

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The heart of the matter

After a decade of turmoil, the financial world faces a new era of regulation, oversight, and whistleblower justice.

Mega-frauds and corruption, supersized settlements, and sweeping financial reforms are just some of the memorable news events to emerge from the first decade of the 21st century. The plaintiffs' bar took securities litigation global and then, at the end of the decade, saw its reach seemingly curtailed.

The decade's early years saw revelations of the biggest accounting frauds ever recorded, in the form of Enron, WorldCom, and Tyco. The combination of these frauds' financial magnitude and the dramatics surrounding the cases, including perp walks and long jail sentences, placed financial fraud firmly in the public eye. The US government's response was financial regulatory reform, in particular the Sarbanes-Oxley Act of 2002 (SOX), along with powerful new sentencing guidelines aimed at preventing financial fraud. Since then, levels of securities litigation class actions have been on a relatively steady decline. On the face of it, SOX and the deterrent effects of the associated criminal sentences appear to have provided the impetus for this decline, but a more cautious explanation might find cause in additional factors, including macroeconomic conditions, legal clarifications, and legal decisions.

During the latter part of the decade, the 2007–2008 financial crisis precipitated, among other things, global economic disasters, major bank collapses, and comprehensive reviews of risk and regulatory safeguards by many leading governments. The US government responded with the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank), which extended the authority of the Securities and Exchange Commission (SEC) and provided it with additional enforcement tools to pursue securities law violations. Several of Dodd-Frank's provisions, including its proposed whistleblower program, arguably herald a transfer of power to the SEC at the expense of the plaintiffs' bar. Other provisions—such as the SEC's authority to pursue both aiding and abetting violations and foreign companies that violate US securities laws—effectively position the commission as the sole enforcer. At the same time, the plaintiffs' bar has been all but removed from such pursuits following the recent Supreme Court rulings in *Morrison v. National Australia Bank* and *Stoneridge Investment Partners v. Scientific-Atlanta*.

As much as the securities litigation landscape changed during the century's first decade, the second decade has the potential to yield yet more transformations. The anticipated effects of Dodd-Frank, and particularly the whistleblower program, could lead to a reinvigorated volume of reported securities violations and associated class actions. Other exogenous factors, such as the possibility of WikiLeaks targeting specific industries and the advances in global communication and networking access, may have far larger implications.

An in-depth discussion

As filings against financial firms ebb, other industries feel the heat.

2010 overview

The decade closed after a year in which federal class action filing activity rose, and the focus of the plaintiffs' bar shifted from an overwhelming focus on the financial services industry to a medley of issues across a variety of industries. Filings against financial services companies still dominated, but to a lesser extent than during the previous three years.

After a slow start to the year, and a shift from the financial industry to other potential areas of opportunity, filing activity gained momentum in the latter half of 2010. The total number of filings for 2010 increased by 12 percent from 2009, despite a continuing decline in the number of financial-crisis-related filings.

Rivaling the financial industry's top spot, the health industry[1] was the second most commonly sued industry, followed by the high-technology industry.[2] The utilities industry, specifically oil and gas, experienced the highest percentage increase of filings for any one industry during 2010 due to an increased number of cases related to mergers and acquisitions (M&A) and the Gulf oil spill.

Accounting-related cases, which involved issues of overstatement of revenues, understatement of expenses and liabilities, and overstatement of assets, continued to decline in 2010, reaching an all-time low since passage of the Private Securities Litigation Reform Act of 1995 (PSLRA).

Notably, the percentage of cases naming directors and officers increased during 2010; however, the number and percentage of actions against Fortune 500 companies fell, due to the decline in financial-crisis-related cases.

Total settlement value in 2010 fell to the lowest level since 2003. The average value of settlements also decreased in 2010 compared to 2009. Accounting-related settlement values continued to exceed non-accounting-related settlement values, and were approximately 319 percent higher on average.

Overall, SEC and Department of Justice (DOJ) activities increased in 2010. At the SEC, the number of penalties and disgorgements increased, as did the number of reported enforcement cases and, likewise, the number of investigations opened and closed throughout 2010. Similarly, the DOJ, specifically the Criminal Division's Fraud Section, imposed unprecedented fines and significant jail sentences for individual violators in four major areas: foreign corrupt practices; health care fraud; corporate, securities, and commodities fraud; and financial institutions and government fraud.

1 The health industry includes pharmaceuticals, medical devices, and health services.

2 High-technology includes computer services, electronics, and telecommunications.

The year 2010 was a landmark for foreign private issuers (FIs). In the *Morrison v. National Australia Bank* case, the US Supreme Court ruled that US courts do not have jurisdiction over "F-cubed" matters, those in which foreign shareholders purchased stock of a foreign company, on a foreign exchange, and then filed a securities lawsuit in the US courts. Despite the *Morrison* ruling (see "Is this the end of F-cubed?," page 40), actions against FIs in 2010 increased by 35 percent from 2009. Of the 27 cases filed against FIs in 2010, 12 cases (44 percent) were filed against Chinese companies.

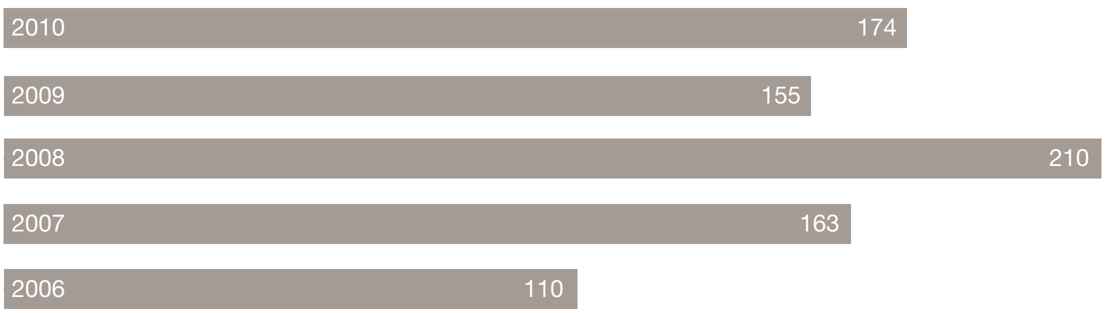
Filings higher in 2010

The total number of federal securities class action filings rose 12 percent in 2010 compared to the previous year, reversing 2009's downturn in both number and percent (26 percent) compared to 2008. In total, 174 filings were recorded in 2010 compared to 155 in 2009. Despite 2010's decline in the number and percentage of financial-crisis-related cases, overall filings reached the second highest level in the last five years. Certain groups of filings with specific common characteristics—such as those filed against educational companies, M&A-related cases filed across all industries, and health industry cases—all impacted this year's filings. Cases filed against FIs, in particular Chinese FIs, also contributed to the increase.

Figure 1. Number of US federal securities class action lawsuits, 2006–2010

Year filed	Federal cases	Mutual fund cases	State-only/stock options backdating (derivative) cases	Total cases
2010	174	–	–	174
2009	155	–	–	155
2008	210	–	–	210
2007	163	4	2	169
2006	110	–	110	220
Average since PSLRA	**180**			

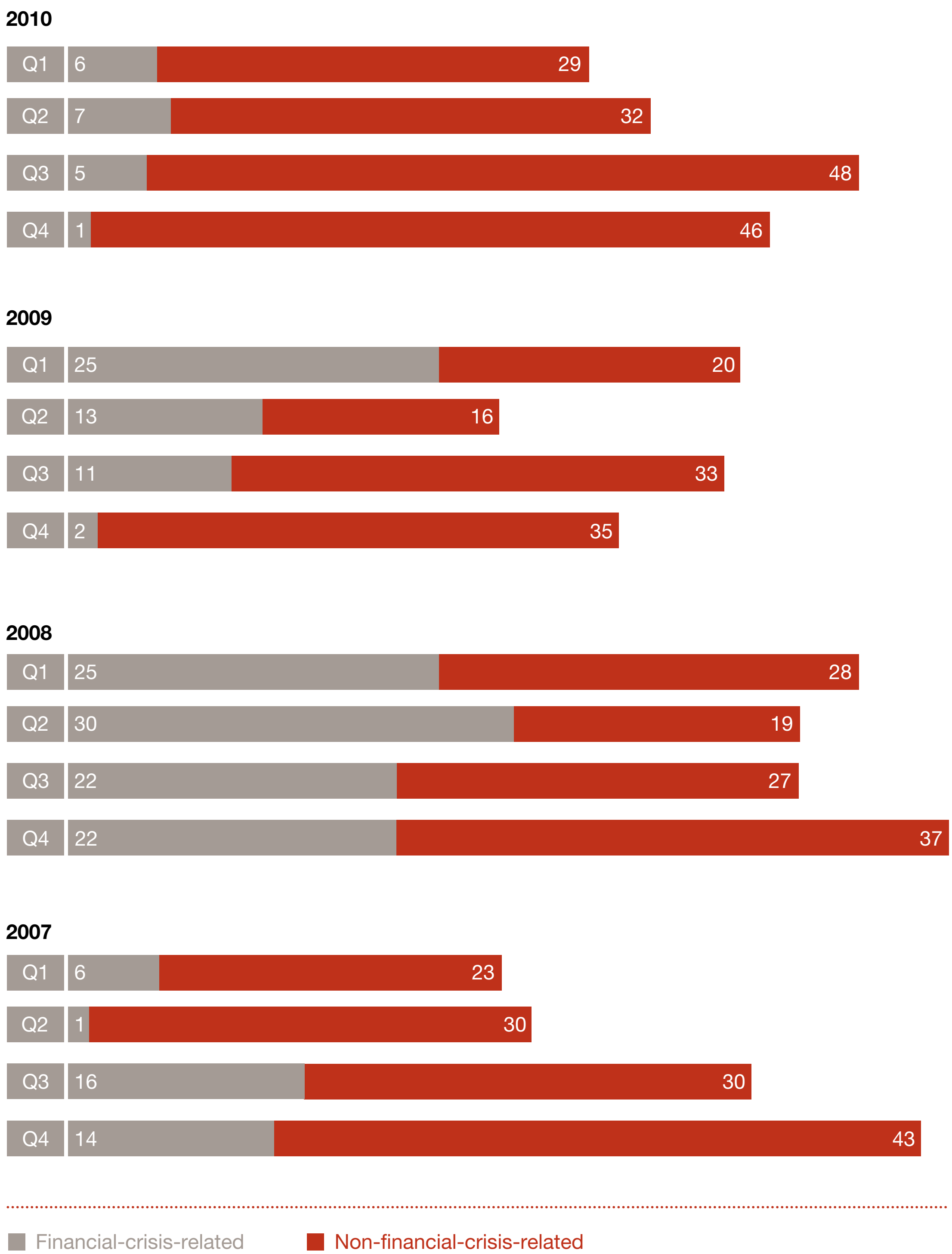
Figure 2. Number of US federal securities class action lawsuits filed per year, 2006–2010



Relative to the annual average number of filings (180) since the enactment of the PSLRA in 1995 and the annual average number of filings (176) since the enactment of SOX in 2002, the number of filings recorded in 2010 (174) is still lower by 3 percent and 1 percent, respectively.

More filings were recorded in each of the last two quarters of 2010 than in the first two quarters. The first and second quarters saw 35 and 39 cases filed, respectively, while 53 cases were recorded in the third quarter and 47 were recorded in the fourth. Most noticeable in the analysis of filings by quarter during 2010 was the increasing domination of non-financial-crisis-related cases and the decline in financial-crisis-related cases.

Figure 3. Number of US federal securities class action lawsuits by quarter, 2007–2010



Financial-crisis-related cases began to decline after the first quarter of 2009. Before that, during 2008 and including the first quarter of 2009, the number of financial-crisis-related cases filed each quarter was relatively consistent. The first significant signs of decline appeared in 2009 when the number of filings dropped by almost 50 percent, from 25 in the first quarter to 13 in the second quarter. By the fourth quarter of 2009, the number of financial-crisis-related filings totaled only two. Throughout 2010, the number of similar cases filed in each quarter remained in single digits: six in the first quarter, seven in the second, five in the third, and just one in the fourth.

The steady increase in non-financial-crisis-related cases began with the 29 cases filed in the first quarter of 2010, a number that rose to 32 cases in the second quarter, hit a high of 48 cases in the third quarter, and held relatively steady at 46 cases in the year's last quarter. One of the principal drivers of the increases in 2010's latter half was the M&A-related cases, which represented 24 percent of total cases compared to only 4 percent in 2009. The associated allegations typically centered on violations of fiduciary duties and the company's articles of incorporation, resulting from unfair and inequitable actions. Seventeen (or 41 percent) of these cases had already been dismissed.

The group of cases filed against educational establishments also contributed to the increase in non-financial-crisis-related cases filed in the last two quarters of 2010. The majority of these cases related to a report issued by the US Government Accountability Office (GAO) in August 2010, which concluded that certain for-profit educational companies had "engaged in deceptive and otherwise questionable sales and marketing practices."[3] A total of seven cases were filed in August and September 2010 and an additional six cases were filed in the year's final quarter.

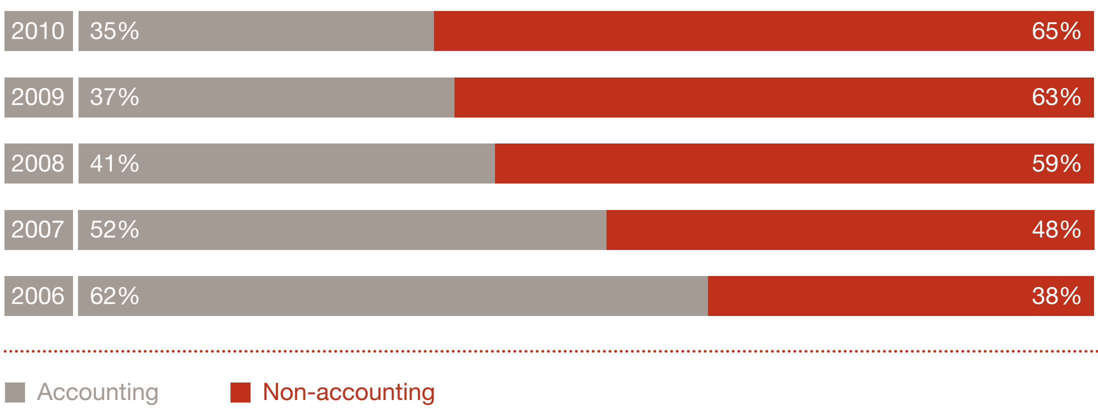
Non-financial-crisis-related accounting cases also increased from 38 in 2009 to 49 in 2010, representing a 29 percent jump.

3 http://www.gao.gov/new.items/d10948t.pdf.

Percentage of accounting-related cases falls further

In recent years, accounting-related cases[4] as a percentage of overall filings have fallen steadily. Except for one year—2006, the year of the stock option backdating matters—the decline has been consistent since 2002. Notably, each of the last three years has seen the number of cases plummet to a new low since the passage of the PSLRA in 1995.

Figure 4. Percentage of accounting and non-accounting US federal securities class action lawsuits filed per year, 2006–2010†



† Cases filed between 2006 and 2009 may have been updated with accounting allegations if the amended complaints alleged accounting violations not previously recognized. Numbers for 2010 cases reflect initial case complaints.

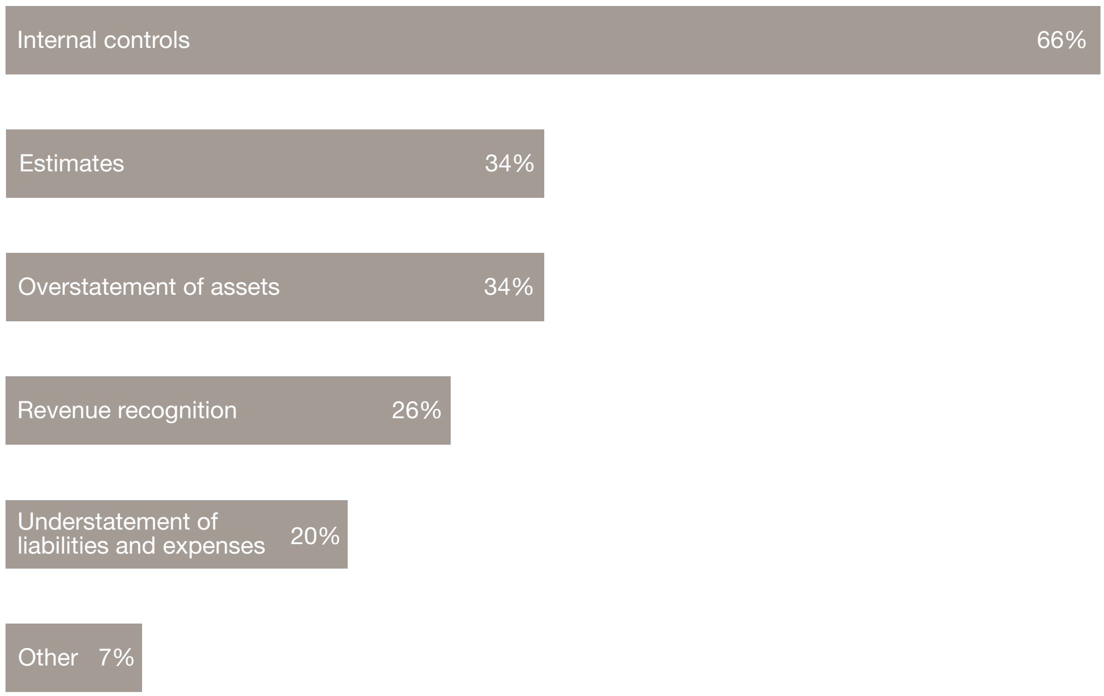
Accounting-related cases as a percentage of total cases fell from 37 percent in 2009 to 35 percent in 2010, representing the lowest level in 15 years. The percentage of accounting-related cases relative to total filings measured each year has been less than 50 percent for only 4 of the last 15 years analyzed. Other than the three most recent years (2008, 2009, and 2010), 1996 was the only other year when accounting-related cases represented less than 50 percent of total filings in any individual year.

4 Accounting-related cases are those that contain an accounting allegation such as an overstatement of assets or revenues or an understatement of liabilities or expenses.

Since the enactment of the PSLRA, accounting-related cases as a percentage of the year's total filings rose steadily until 2002, when the percentage peaked at 77 percent. This coincided with the accounting mega-frauds (Enron, Worldcom) and the introduction of SOX. Thereafter, the decline took hold. On average, accounting-related cases from 1996 until 2002 represented 61 percent of total filings annually. By contrast, accounting-related cases from 2003 through 2010 represented an average of 51 percent of total annual filings, with the last three years being below 50 percent.

There are likely multiple forces behind the decline in accounting-related cases since 2002. One probable driver is the effectiveness of SOX in combating accounting fraud. The Act's introduction in 2002 coincided with the start of the decline. Another likely cause is the influence of macroeconomic factors in predetermining the nature of cases filed. Furthermore, the decline in accounting-related cases is also dependant on the specific focus on certain issues. For example, the focus on stock option cases caused accounting-related cases to increase in 2006, whereas the M&A-related cases in 2010 contributed to that year's decline in accounting-related filings. The M&A-related cases, which are non-accounting in nature, jumped from 4 percent in 2009 to 24 percent in 2010, thus contributing to the sustained decline in the percentage of accounting-related cases. Of the total 113 non-accounting-related cases, 41 were M&A-related, representing the largest single group of non-accounting cases.

Figure 5. Percentage of accounting cases citing specific issues, 2010†



† Some cases allege multiple accounting issues.

Accounting allegations fall within the following five main categories: (1) overstatement of assets, (2) estimates, (3) internal controls, (4) understatement of expenses and liabilities, and (5) revenue recognition. In 2010, the dispersion of allegations across these categories changed significantly from 2009.

The most notable change was in cases alleging accounting estimates issues, which decreased by 23 percent, from 57 percent in 2009 to 34 percent in 2010. In recent years, this type of allegation was frequently cited in financial-crisis-related filings. Specifically, over the last five years, allegations concerning estimates rose from 9 percent in 2006 to 47 percent in 2007 to 52 percent in 2008 to 57 percent in 2009. As the decline in financial-crisis-related cases occurred in 2010, so too did the decline in accounting-estimates-related allegations. Examples of estimates-related allegations include: “the company improperly accounted for its loan loss reserves and provision” and “defendants misrepresented the extent of the company’s impaired assets by failing to establish adequate reserves.”

The category of internal control allegations also changed significantly in 2010, increasing from 43 percent in 2009 to 66 percent in 2010. A typical example of an internal control allegation is that “the company’s internal and disclosure controls were materially deficient.” Internal control allegations only began appearing as a common allegation after 2002, when SOX required companies to establish and maintain an adequate system of controls and mandated that the company’s auditors report on these controls. Since then, the allegations have become common.

Other less significant category changes in 2010 included a 2 percent decrease in allegations stating an overstatement of assets (from 36 percent in 2009 to 34 percent in 2010) and a 5 percent increase in allegations related to revenue recognition (from 21 percent to 26 percent). The decline in allegations involving the overstatement of assets will likely continue, in step with the decline in financial-crisis-related cases, which had been the primary impetus for this category during recent years.

Despite the fall in the number and the percentage of accounting-related cases relative to total filings, the 2010 average settlement amount associated with accounting cases continued to exceed the average amount agreed upon in non-accounting cases (see “The changing face of settlements,” page 22).

Financial services filings remain dominant, but less so

For the third consecutive year, more private securities class action filings were recorded against companies in the financial services industry than against any other industry group. That said, the percentage of total filings recorded against financial services companies (22 percent) was down significantly from prior years.

When the financial crisis began to gain momentum in 2007, filings against financial services companies increased exponentially. In 2007, filings against the industry increased to 21 percent from 5 percent the previous year. The percentage of the filings peaked in 2008 at 48 percent before declining to 41 percent in 2009 and falling to 22 percent in 2010. The 19 percent year-over-year decrease in filings against this industry group was the largest change observed over all industry groups, and brought financial services back from its outlier position to a more comparable position relative to other industry groups.[5] Nearly half of the cases filed against financial services companies were accounting-related and the majority contained allegations around estimates and overstatement of assets.

Health industry cases increased from 17 percent in 2009 to 21 percent in 2010, representing the second highest percentage of total industry filings for the year.[6] Filings in this industry targeted pharmaceutical, medical device, and health services companies.

5 The percentage of filings against the financial services industry group in 2008 and 2009 represented the highest percentage of filings against a single industry since enactment of the PSLRA.

6 The 21 percent of cases filed against companies in the health industry is the second highest against the industry since enactment of the PSLRA.

Figure 6. Percentage of US federal securities class action lawsuits by industry, 2006–2010†

Industry	2006	2007	2008	2009	2010
High-technology					
Computer services	12	8	3	6	7
Electronics	13	7	6	1	3
Telecommunications	6	9	4	5	4
	31	25	13	12	14
Health: pharmaceuticals, medical devices, and health services	16	17	11	17	21
Business services	5	5	1	3	3
Retail	6	4	1	3	2
Financial services	5	21	48	41	22
Utilities: energy, oil, and gas	2	2	5	3	10
Other	35	26	21	21	27

† Totals may not sum exactly due to rounding.

Filings against pharmaceutical companies specifically have tended to rise and fall from year to year, but from 2009 to 2010 the percentages remained consistent, representing 10 percent of filings in each year. The nature of the filings was also consistent with prior years: Most of the associated allegations related to disclosure issues, including pharmaceutical efficacy and declining market share matters where plaintiffs alleged that the defendants failed to disclose material adverse facts about the company's true financial condition, business, and prospects. Filings alleging pharmaceutical and health efficacy issues in 2010 were relatively consistent with the number of 2009 filings. In total, 11 such cases were filed in 2010, compared to 8 in 2009.

Figure 7. Number of US federal securities class action lawsuits involving pharmaceutical/health efficacy allegations, 2006–2010†

† Excludes cases alleging product efficacy.

Federal filings against health services and medical device companies increased 2 percent and 1 percent, respectively. For companies within health services, filings rose from 3 percent in 2009 to 5 percent in 2010, and filings against medical device companies rose from 5 percent to 6 percent over the same period. Allegations against companies in these industries varied widely, and included accounting issues (including lack of proper internal controls and revenue recognition issues), violations of fiduciary duties relating to various mergers and acquisitions, and disclosures about an offering.

The high-technology industry saw the third largest percentage of 2010 filings. Following passage of the PSLRA, high-tech companies held the top spot for lawsuits every year until the effects of the financial crisis fully took hold in 2008 and financial services companies began bearing the brunt of federal securities litigation (which they continued to do, albeit to a lesser extent, in 2009 and 2010). Relatively consistent with 2008 (13 percent) and 2009 (12 percent), 2010 saw 14 percent of filings naming high-technology companies as defendants. The majority of the filings were either M&A-related cases or cases alleging disclosure issues (specifically relating to initial and secondary offerings, price-fixing, or a decline in market share).

The utilities industry (energy, oil, and gas) experienced an increase of 7 percent in filings, the largest increase recorded for any individual industry group during 2010. Total filings against the industry rose from 3 percent in 2009 to 10 percent in 2010. Eight out of the 17 utilities cases filed were M&A-related cases alleging violations of fiduciary duties. In addition, the Gulf oil spill resulted in four cases.

No reprieve for directors and officers

The majority of 2010 federal filings continued to name directors and officers. Notably, almost all of the categories of directors and officers named increased from 2009. This reverses the consistent decline that began in 2002 and continued through 2009, with the exception of the spike in 2006 when many filings centered on stock option cases.

The most significant category increases in 2010 related to the positions of chairman and director. Cases naming a company's chairman as a defendant increased from 47 percent in 2009 to 66 percent in 2010, and cases naming a director increased by 15 percent, from 43 percent in 2009 to 58 percent in 2010.

Noteworthy is the downward trend related to the position of chief financial officer (CFO), which seems correlated to the drop in accounting-related filings. The percentage of cases that named CFOs as defendants dropped from 84 percent in 2006 to 63 percent in 2010. Over the same period, accounting-related filings also dropped from 62 percent to 35 percent.

Figure 8. Percentage of US federal securities class action lawsuits naming particular officers or committees, 2006–2010†

Title	2006	2007	2008	2009	2010
CEO	96	90	83	81	86
CFO	84	79	72	62	63
Chairman	62	66	57	47	66
President	69	56	59	62	71
Director	45	51	38	43	58
Audit committee	15	5	1	3	2
Compensation committee	12	4	1	2	1

† Titles are based on those named in the complaint.

A decrease in filings against Fortune 500 companies

The percentage of filings directed at Fortune 500 companies dropped by 6 percent compared to 2009, reflecting the concurrent fall in financial-crisis-related filings. In 2010, 14 percent of filings were directed at Fortune 500 companies, compared to 20 percent of filings in 2009. The percentage of 2010 filings approximated pre-financial-crisis levels. Filings against Fortune 500 companies peaked in 2008 at 24 percent of total filings, coinciding with the highest number of financial-crisis-related filings recorded in any year. Other than 2008 and 2009, 2002 was the only other year that saw filings against Fortune 500 companies in the 20-plus percent range. Filings during all other years since 1996 were below 15 percent.

Figure 9. Number of Fortune 500 companies with US federal securities class action lawsuits filed against them, 2006–2010

	Fortune 500 companies†				
Year filed	Top 50	Top 100	Top 500	Total filings	%‡
2010	9	10	20	174	14
2009	8	13	30	155	20
2008	14	17	37	210	24
2007	4	9	20	163	12
2006	5	5	12	110	11

† Companies with multiple US federal securities class action lawsuits filed against them in a single year are only counted once.
‡ Percentage includes all filings, including multiple US federal securities class action lawsuits filed against the same company.

Circuits: A shift in filings from east coast to west coast

The majority of filings continued to occur in the Second and Ninth Circuits. However, in 2010, the single largest number of filings was recorded in the Ninth Circuit,[7] ending the dominance of the east coast and specifically the Second Circuit, which between 2005 and 2009 saw more filings annually than any other. Prior to 2005, the Ninth Circuit dominated for all but two years.

From 2002 to 2007, the Ninth Circuit and Second Circuit recorded roughly similar numbers of filings; however, the gap widened significantly in 2008 and 2009 due to the slew of financial-crisis-related filings in the Second Circuit. In 2008 and 2009, 45 percent and 37 percent of filings were in the Second Circuit, respectively, compared to 13 percent and 25 percent in the Ninth Circuit. In 2010, 30 percent of filings were in the Ninth Circuit compared to 24 percent in the Second Circuit.

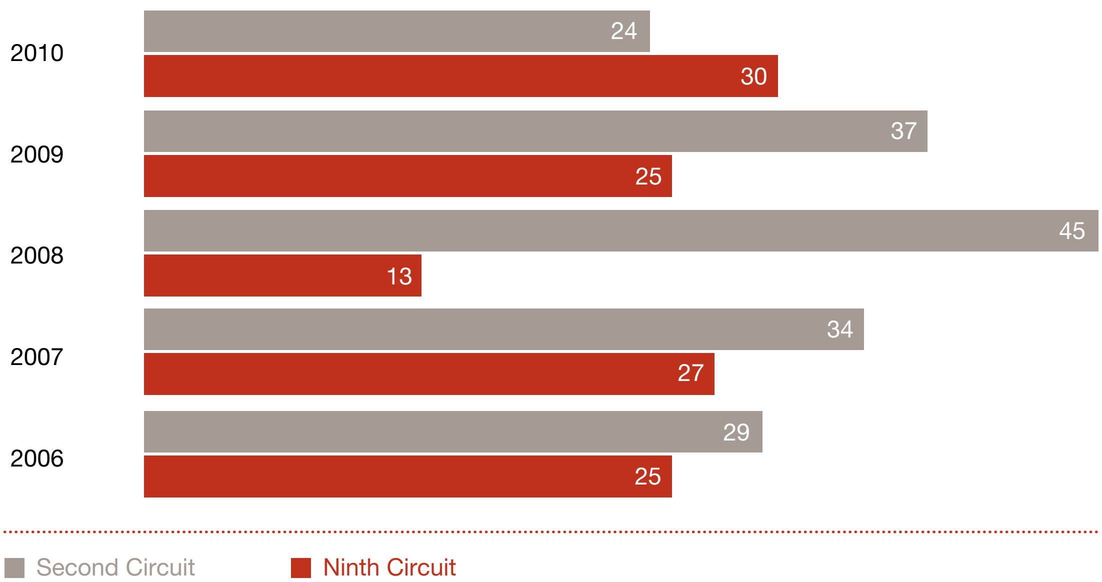
Figure 10. Percentage of US federal securities class action lawsuits filed by circuit, 2006–2010†

Circuit	2006	2007	2008	2009	2010
District of Columbia	1	2	1	–	1
First	5	1	7	3	4
Second	29	34	45	37	24
Third	11	6	7	6	10
Fourth	1	2	3	2	1
Fifth	5	4	2	6	5
Sixth	3	4	4	3	6
Seventh	2	4	4	5	7
Eighth	5	2	4	1	5
Ninth	25	27	13	25	30
Tenth	3	4	2	3	1
Eleventh	12	10	8	8	5

† Percentages have been rounded to whole numbers.

7 The Ninth Circuit includes California, Nevada, Arizona, Idaho, Montana, Oregon, Washington, Hawaii, Alaska, Guam, and the Northern Mariana Islands.

Figure 11. Percentage of US federal securities class action lawsuits filed in Second and Ninth Circuits, 2006–2010



The filings in the Second Circuit were mainly concentrated within the financial services, high-technology, and utilities industries. The Ninth Circuit covers those same industries, but in 2010 also heard cases involving the health, real estate, manufacturing, and education industries.

All other individual circuits saw activity volume more or less consistent with prior years.

The changing face of settlements

The overall number of settlements increased in 2010, while the total value of settlements fell.

The number of settlements increased slightly in 2010 to 99 settlements, compared to 96 in 2009—an increase of 3 percent. The average number of settlements since the PSLRA has been 89. Although the number of settlements increased, the total value of settlements decreased by 9 percent to $2.9 billion, compared to $3.2 billion in 2009. This continues a trend that began with the financial crisis in 2007: Between 2007 and 2009, a 32 percent decrease was observed each year.

Figure 12. Settlements (in thousands $): all cases, 2006–2010†

Year settled	2006	2007	2008	2009	2010
Number of settled cases	118	123	95	96	99
Zero-dollar ($0)/ undisclosed settlements	4	2	5	3	3
Number of outliers	–	1	–	–	–
Net settlements‡	114	120	90	93	96
Total settlement value	6,867,500	6,810,500	4,639,100	3,160,300	2,892,800
Total settlement value excluding outliers‡	6,867,500	3,531,500	4,639,100	3,160,300	2,892,800
Average settlement value	60,200	29,400	51,500	34,000	30,100
Median settlement value	6,400	8,000	8,000	7,500	10,100
Average settlement value for cases settled for $1M or more, up to $50M	9,500	9,800	11,200	10,700	12,900

† 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).

‡ Cases and amounts used to calculate average and median settlement values.

The total value of settlements in 2010 represented the lowest amount since 2003. Total settlement amounts have been falling since 2005, due perhaps to a combination of the higher dismissal rates associated with the large financial-crisis-related cases and the overall effects of the 2007 Tellabs decision, which strengthened pleading standards. Consistent with the fall in total settlement value, the average settlement during 2010 decreased by 11 percent, from $34.0 million to $30.1 million. However, the average settlement value for cases settled for more than $1 million and less than $50 million increased by 21 percent, from $10.7 million in 2009 to $12.9 million in 2010.

Figure 13. Percentage of settled cases by settlement value range, 2006–2010†

Total settlement (in millions $)	2006–2009 %	2010 %
100+	9	6
50–99.99	5	6
20–49.99	11	18
10–19.99	19	22
5–9.99	18	8
2–4.99	24	23
0–1.99	11	8

† 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). Percentages have been rounded to whole numbers.

The top ten settlements in 2010 amounted to $1.8 billion and represented 64 percent of the total value of settlements. This compares to the top ten settlements of 2009, which represented 71 percent of total settlements for the year. Six settlements in 2010 were above $100 million and represented 53 percent of the total:

- Countrywide Financial Corporation .... $624.0 million
- Charles Schwab .... $235.0 million
- WellCare .... $194.0 million
- Maxim Integrated Products .... $173.0 million
- Juniper Networks .... $169.5 million
- New Century Financial Corporation .... $124.8 million

The six settlements over $100 million in 2010 compares to nine such settlements in 2009 and seven in 2008. Notably, as shown in Figure 13 (see page 23), the dispersion of settlements over the value ranges analyzed were relatively consistent with those measured for the period from 2006 to 2009 except in two categories: Settlements in the $20 million to $49.99 million range for the 2006–2009 period were 11 percent compared to 18 percent in 2010, and settlements in the $5 million to $9.99 million range for the 2006–2009 period were 18 percent compared to 8 percent in 2010.

The number and total value of accounting-related settlements fell in 2010. The total of 51 accounting-related settlements in 2010 represented 52 percent of total settlements. In 2009, 58 accounting-related settlements represented 60 percent of total settlements.

The total value of accounting-related settlements in 2010 was $2.2 billion, down by 4 percent from $2.3 billion in 2009. The year's $45.9 million average accounting-related settlement value, however, represented an increase of 14 percent from 2009's $40.2 million, and was 20 percent higher than the $38.4 million average accounting-related settlement value since the PSLRA. All six of the 2010 settlements over $100 million, listed on page 24, were accounting-related filings. Allegations against the companies varied, but included a lack of adequate internal controls, underestimated loan loss provisions, and improperly recognized and reported revenue and expenses.

Figure 14. Settlements (in thousands $): accounting cases, 2006–2010†

Year settled	2006	2007	2008	2009	2010
Number of settled cases	90	83	68	58	51
Zero-dollar ($0)/ undisclosed settlements	3	1	3	–	3
Number of outliers	–	1	–	–	–
Net settlements‡	87	81	65	58	48
Total settlement value	6,379,800	6,169,900	4,289,100	2,333,300	2,201,400
Total settlement value excluding outliers‡	6,379,800	2,890,900	4,289,100	2,333,300	2,201,400
Average settlement value	73,300	35,700	66,000	40,200	45,900
Median settlement value	7,000	8,000	7,900	10,500	13,000
Average settlement value for cases settled for $1M or more, up to $50M	10,500	9,600	10,600	11,400	15,100

† 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).

‡ Cases and amounts used to calculate average and median settlement values.

Accounting-related settlements in 2010 continued to exceed non-accounting-related settlements, both in number and total settlement value. The average accounting-related settlement value of $45.9 million was 319 percent greater than the average non-accounting-related settlement value. In 2009, the difference between the two kinds of settlements was 170 percent.

Although the number of non-accounting-related settlements increased in 2010, the total value of settlements decreased. A total of 48 settlements were recorded in 2010, compared to 38 in 2009. In 2009, non-accounting-related settlements represented 40 percent of the total number of settlements. The 48 settlements in 2010 represented 48 percent of the total number of settlements, an increase of 8 percent over 2009.

The value of non-accounting settlements fell from $827 million in 2009 to $691 million in 2010. The average settlement value fell from $23.6 million in 2009 to $14.4 million in 2010. Whereas three of the ten largest settlements recorded in 2009 were non-accounting settlements, and all were higher than $100 million, the three non-accounting settlements among 2010's top ten were all below $100 million. The three settlements were Bank of America (Nations Funds Mutual Funds) for $89.7 million, MFS Funds for $75.0 million, and Alliance Capital Management (AllianceBernstein Family of Mutual Funds) for $74.6 million.[8] All three of these cases claimed a breach of fiduciary duties by the officers and directors and claimed violations in late trading by allowing certain investors to purchase mutual fund shares after 4:00 p.m. at that day's price (as opposed to the next day's price), which is a violation of SEC rules.

8 The $74.6 million settlement fund is comprised of $30 million from Alliance Settling Defendants; $6.5 million from Banc of America Securities; $1.2 million from Bear Stearns Defendants; $35.8 million from the Security Brokerage Defendants; and $1 million from the Canary Defendants, as defined in the proposed settlement.

Figure 15. Settlements (in thousands $): non–accounting cases, 2006–2010†

Year settled	2006	2007	2008	2009	2010
Number of settled cases	28	40	27	38	48
Zero-dollar ($0)/ undisclosed settlements	1	1	2	3	–
Net settlements‡	27	39	25	35	48
Total settlement value‡	487,700	640,600	350,000	827,000	691,400
Average settlement value	18,000	16,400	14,000	23,600	14,400
Median settlement value	4,200	7,900	8,000	4,800	6,900
Average settlement value for cases settled for $1M or more, up to $50M	6,600	10,200	12,400	9,700	11,000

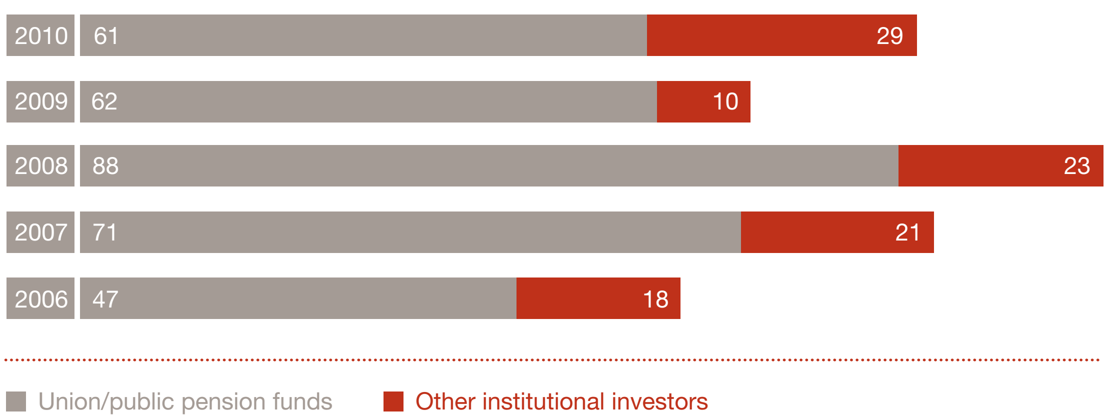
† Year of settlement is determined based on the primary settlement pronouncement. Any subsequent settlement amounts are attributed to the primary announcement year. Settlement information reflects only those cases filed and settled after passage of the PSLRA (12/22/1995).

‡ Cases and amounts used to calculate average and median settlement values.

The reign of institutional investors

Institutional investors continued to dominate as the lead plaintiff in cases filed. In 2010, 52 percent of filings (or 90 cases) had an institutional investor assigned as lead plaintiff, up from 46 percent (or 72 cases) in 2009. As in years past, pension funds constituted the majority of the institutional investors in 2010, representing 68 percent of filings (61 cases) with institutional investors as lead plaintiff.

Figure 16. Number of US federal securities class action lawsuits filed with institutional investors as lead plaintiff, 2006–2010†



† Final 2010 data is not available to date; the full-year projections are based upon filings through June 30, 2010.

The number of institutional investor settlements increased by 5 percent in 2010. Sixty settlements and 61 percent of total settlements had involvement from an institutional investor, compared to 57 settlements and 59 percent of total settlements in 2009. The total settlement value associated with these cases decreased by 24 percent, to $2.2 billion in 2010 from $2.9 billion in 2009. In relation to overall settlement values for the year, institutional investor settlements represented 77 percent, compared to 90 percent in 2009. Eight of the year's ten largest settlements (including the year's largest) involved an institutional investor as lead plaintiff.

The most active institutional investors in federal class settlements continued to be union and public pension funds. In 2010, their involvement was recorded in 47 percent of settlements, consistent with the 48 percent recorded in 2009. Settlement dollars associated with cases with pension fund involvement represented 71 percent of total settlement value in 2010 compared to 78 percent in 2009, a decrease of 7 percent. In the 2006–2009 period, the dollar value of settlements with institutional investors other than pension funds as lead plaintiff hovered between 9 percent and 13 percent of the overall settlement value in each year. This group's representation fell to 6 percent in 2010, a decrease of 7 percent from 2009's 13 percent level.

Figure 17. Settlement values (in thousands $): by institutional investor as lead plaintiff, 2006–2010†

	2006		2007		2008		2009		2010	
	Cases settled	Settlement	Cases settled	Settlement	Cases settled	Settlement	Cases settled	Settlement	Cases settled	Settlement
Public pension	43	5,620,600	49	5,689,200	46	3,934,300	46	2,457,600	47	2,040,900
Other institutional	22	851,700	19	623,500	19	513,700	11	399,000	13	176,300
Total institutional investors	**65**	**6,472,300**	**68**	**6,312,700**	**65**	**4,448,000**	**57**	**2,856,600**	**60**	**2,217,200**
Zero-dollar ($0)/ undisclosed settlements	2	–	–	–	2	–	2	–	2	–
Net settlements‡	63	–	68	–	63	–	55	–	58	–
Average settlement	–	102,700	–	92,800	–	70,600	–	52,000	–	38,200
Total cases settled§	**114**	**6,867,500**	**120**	**6,810,500**	**90**	**4,639,100**	**93**	**3,160,300**	**96**	**2,892,800**

† 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). Totals may not sum exactly due to rounding.
‡ Number of cases used to calculate average settlement value.
§ Excludes zero-dollar settlements and settlements in which an amount has not been determined.

Securities litigation: Behind the numbers

By Jay B. Kasner, Partner, and Scott D. Musoff, Partner, Skadden, Arps, Slate, Meagher & Flom LLP

When many predicted a decline in securities class action filings for 2010, Skadden, Arps, Slate, Meagher & Flom suggested that, although financial-crisis-related filings would be down, overall filings would be at a level similar to 2008 and 2009. The 2010 numbers have proven that to be the case, with 174 cases filed in 2010, up from 155 in 2009. As expected, the number of 2010 financial-crisis-related filings continued to decline as those from 2008 worked their way through the courts. As a result, the Second Circuit's recent dominance in the total number of filings leveled off. There was also a declining trend of restatement and accounting-based cases. The decline in financial-crisis-related and accounting-related filings was offset by the more traditional "stock-drop" actions, especially in the health industry and against Asia-based companies listed in the United States. There was also a decrease in the time between the decline in stock price and the filing of a complaint, perhaps suggesting that the resources of plaintiffs' securities firms were less constrained in 2010 in light of the decline in financial-crisis-related litigation.

It is likely that the trend of plaintiffs' securities firms capitalizing on negative news headlines will continue in 2011. Historically, traditional stock-drop cases have been brought primarily on the heels of a company announcing disappointing financial results. In 2010, however, we witnessed a series of significant securities class actions filed against companies in the wake of unexpected non-financial crises, such as the Gulf oil spill, the SEC complaint filed against Goldman Sachs, the mortgage industry's foreclosure paperwork and processing issues, and Toyota's recall issues. It is important to keep this trend in mind when responding to a corporate crisis or announcing unexpected negative news.

Decisions on motions to dismiss in financial-crisis-related litigation

- The dismissal of class actions related to the financial crisis and subprime securities was somewhat mixed. For example, courts dismissed complaints against CIBC, Fremont General, and Société Générale, while denying motions to dismiss in cases against E*Trade and AIG.
- The safe harbor for forward-looking statements embodied in the PSLRA of 1995 should continue to play an important role in securities litigation, particularly in light of a recent ruling by the Second Circuit involving American Express. The ruling clarified that statements in the MD&A portion of an SEC filing are eligible for safe harbor coverage and reaffirmed that the safe harbor applies to forward-looking statements, even in the absence of cautionary language, if the plaintiff fails to demonstrate that the statements were made with actual knowledge of falsity.
- It's likely that a number of settlements will be reached in cases where motions are denied in 2011, which may increase the median size of securities class action settlements compared to previous years.

- For those cases that do not settle, loss causation will be a primary defense, as plaintiffs will be required to prove that the losses resulted from the disclosure of allegedly false and misleading information and not from the overall financial crisis.

Mortgage-backed securities and put-back litigation

- Mortgage-related and put-back litigation generated much discussion in the latter half of 2010 and will continue to do so in 2011.
- Generally, investors in mortgage-backed securities cases have pursued two avenues: misrepresentation claims and contractual claims. Each has its own hurdles and obstacles that will continue to play out in 2011.
  1. Misrepresentation claims often are based on Sections 11 and 12 of the Securities Act of 1933. Some plaintiffs also have asserted state statutory and common law claims. In a series of 2010 rulings, courts limited, for the most part, the proposed class representative's standing to those specific offerings in which he or she actually purchased securities, thereby greatly narrowing the cases. In 2011, class certification will be a major battlefield in mortgage-backed securities litigation, as well as "negative causation"—a defense that the losses suffered were a result of something other than the alleged false and misleading statements in the offering documents, such as general economic conditions or the nationwide decline in housing prices.
  2. Contractual "put-back" claims face a different set of obstacles. Some holders of mortgage-backed securities have claimed that loans backing the securities violate contractual representations and warranties made at the time of the offerings, and that the party that made the representations and warranties should be required to repurchase the loans. For the most part, the underlying documents require at least 25 percent of the certificate holders to act together in order to enforce such contractual rights. It also can be an extremely time-consuming and expensive process on both sides, as many of the documents require a loan-by-loan analysis.

The Supreme Court addresses the extraterritoriality of US securities laws

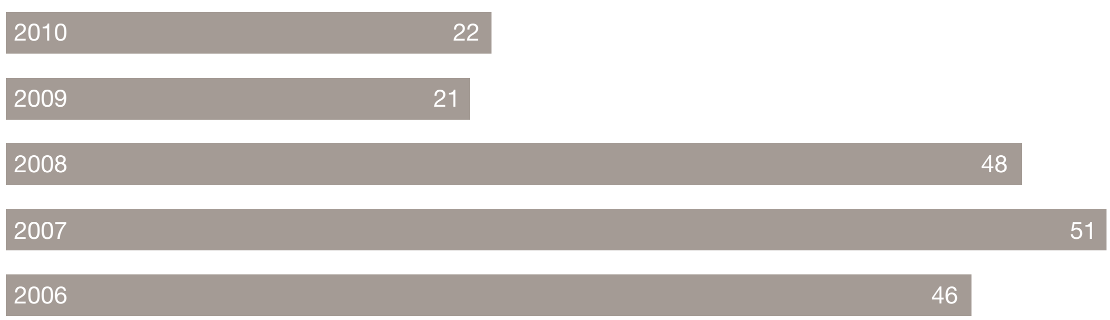
- The Supreme Court issued its decision in *Morrison v. National Australia Bank*, rejecting the Second Circuit's long-standing "conducts and effects" test and establishing a transaction-based test focusing on the location of the purchase or sale of the securities.
- The transaction test established by the Supreme Court held that Section 10(b) of the Securities Exchange Act of 1934 covers "[o]nly transactions in securities listed on domestic exchanges, and domestic transactions in other securities."
- While the buzz last year was focused on the phrase "F-cubed" (whether Section 10(b) applies to US cases brought against foreign companies by foreign investors in shares traded on foreign exchanges), the transaction test has limited the application of Section 10(b) even to so-called F-squared cases. All of the lower courts that have addressed the issue have held that *Morrison* applies even to US investors that purchase or sell shares traded on foreign exchanges.
- Although exchange-traded securities appear to be subject to a bright-line test, continued litigation is expected over what are considered "domestic transactions in other securities"—including derivatives, over-the-counter American depositary receipts (ADRs), and other non-exchange-traded securities.
- Some have predicted that foreign companies will retreat from the US capital markets in light of *Morrison;* however, *Morrison* affords foreign companies the opportunity to tap the US capital markets while limiting their exposure to US securities litigation to the proportion of securities traded in the United States.

SEC and DOJ enforcement update

In 2010, the number of filings with SEC or DOJ involvement remained relatively consistent with 2009.

Twenty-two cases in 2010 had some type of SEC involvement, which is a 5 percent increase from the 21 cases in 2009. However, relative to total filings, these cases remained consistent at approximately 13 percent each year.

Figure 18. Number of US federal securities class action lawsuits with SEC involvement, 2006–2010†



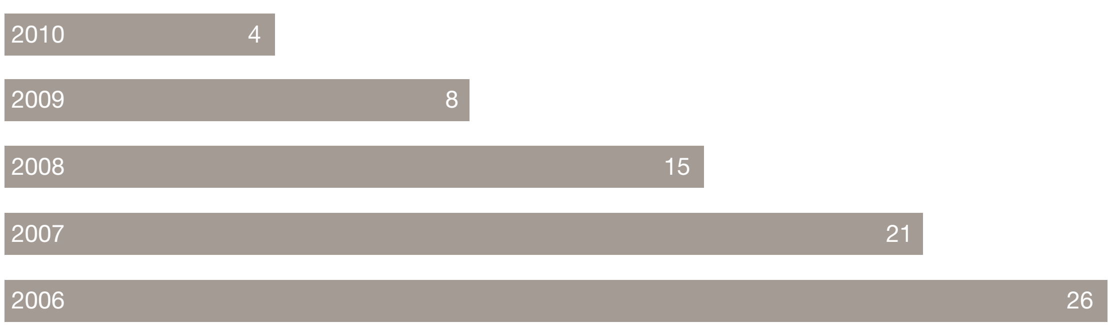
† Information is based on a review of press releases, SEC releases, and news articles. Statistics from prior years have been updated based on current information.

The percentage of cases with DOJ involvement remained consistent at 7 percent of filings, increasing from 11 filings in 2009 to 12 in 2010. Notably, the number of filings with both SEC and DOJ involvement fell, from eight cases in 2009 to four cases in 2010—a decrease of 50 percent.

Figure 19. Number of US federal securities class action lawsuits with DOJ involvement, 2006–2010†

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

Figure 20. Number of US federal securities class action lawsuits with both SEC and DOJ involvement, 2006–2010†



† 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.

For the SEC, 2010 was a noteworthy year. The agency completed the restructuring of its enforcement division and continued internal reforms aimed at increasing the efficiency and effectiveness of its efforts to identify and pursue fraud. Most significant of all, however, was President Obama signing the Dodd-Frank Act into law on July 21, 2010. The new legislation expanded the SEC's enforcement powers and extended its oversight to market participants not previously subject to SEC registration and regulation. As stated right in its full title, the Act's objectives are to "promote the financial stability of the United States by improving accountability and transparency in the financial system, to end 'too big to fail', to protect the American taxpayer by ending bailouts, to protect consumers from abusive financial services practices, and for other purposes."[9]

The internal reform and restructuring efforts aimed at reinvigorating the SEC's enforcement program included the creation of five specialized units to concentrate on high-priority areas of enforcement, and the establishment of an Office of Market Intelligence to serve as a central office for handling tips, complaints, and referrals.

Dodd-Frank, considered to be the most significant piece of financial reform legislation since the 1930s, bestowed new regulatory authority upon the SEC and provided additional enforcement powers. Among other things, the law provided the SEC with the authority to seek monetary penalties in administrative proceedings, pursue foreign companies in relation to transactions that occurred outside the United States, and pursue aiding-and-abetting claims against "any person that knowingly or recklessly has aided, abetted, counseled, commanded, induced, or procured"[10] a securities violation (amending earlier language that imposed liability only for "knowing" violations).

Dodd-Frank also expanded the SEC's clawback powers as provided by Section 304 of SOX by extending the scope of its applicability to include any current or former executive of the restating company rather than just chief executive officers (CEOs) and CFOs, as was the previous scope under Section 304. Clawback provisions under Dodd-Frank allow the SEC to recover executive compensation from senior executives following restatements necessitated by "material noncompliance . . . with any financial reporting requirement under the securities laws,"[11] not just for "misconduct" as stated in SOX Section 304. But the most widely discussed enhancement to the SEC's new arsenal of powers has been the authority granted to pay bounties to individuals (whistleblowers) who provide the SEC with original information that leads to successful SEC enforcement actions. In November 2010, the SEC issued proposed rules to implement the Dodd-Frank whistleblower provisions. Currently, one of the major concerns associated with the proposed whistleblower rules is whether they will undermine corporate compliance systems by encouraging employees to disregard the company's internal reporting system and report potentially unlawful activity directly to the SEC.

9 Dodd-Frank Wall Street Reform and Consumer Protection Act (January 5, 2010).

10 Dodd-Frank (§ 929N).

11 Dodd-Frank (§ 954).

Enforcement performance

According to the SEC's *FY2010 Performance and Accountability Report*,[12] the Division of Enforcement's efforts during 2010 produced "excellent results." The following is a summary of the reported 2010 results and additional comparative statistics from previous years.

- In aggregate, the Division of Enforcement obtained $2.8 billion in penalties and disgorgement, an increase of 17 percent over the $2.4 billion obtained in 2009.
- In all, the SEC brought 681 enforcement cases for the year. This compares to 664 in 2009—an increase of 3 percent.
- The commission opened 952 investigations in 2010 compared to 944 in 2009—an increase of 1 percent. The growth in the number of investigations opened during 2010 slowed to 1 percent from the 6 percent achieved in 2009.
- The commission closed 975 investigations in 2010 compared to 716 in 2009—an increase of 36 percent. (It's worth noting that the 716 investigations closed in 2009 represented a decrease of 47 percent over 2008 levels.)

The SEC continued to report heightened levels of cross-border cooperation in connection with enforcement actions during 2010. It reportedly made more than 605 requests for assistance to foreign regulators during 2010, compared to the 774 requests in 2009 and 594 in 2008. The SEC also continued to increase cooperation with other US regulators, including the DOJ and other member agencies of the Financial Fraud Enforcement Task Force.

Major SEC enforcement cases and settlements

During 2010, the range of cases described by the SEC as "key enforcement cases" spanned the range of financial crisis, pay-to-play arrangements, insider trading, offering frauds, Ponzi schemes, financial fraud, and infringements of the Foreign Corrupt Practices Act (FCPA).

The SEC reached several notable settlements during 2010. Five settlements were in excess of $100 million and included two financial-crisis-related cases, two FCPA matters (Eni/Snamprogetti Netherlands B.V. and Alcatel-Lucent), and one financial accounting and disclosures investigation case (Dell). Settlement amounts were as follows:[13]

- Goldman Sachs .... $550.0 million
- State Street .... $313.3 million
- Alcatel-Lucent .... $137.4 million[14]
- Eni/Snamprogetti .... $125.0 million[15]
- Dell.................................... $111.2 million

12 http://www.sec.gov/about/secpar/secpar2010.pdf.

13 Settlements are listed with the corresponding company; however, the SEC may have settled with the company and/or with current or former executives.

14 Alcatel-Lucent also settled with the DOJ and agreed to pay $92 million to resolve an FCPA investigation.

15 Snamprogetti and Technip also settled with the DOJ, and each will pay a criminal penalty of $240 million to resolve charges relating to FCPA violations.

A further eight settlements over $20 million were reached, as follows:

- Technip S.A. . . . .$98.0 million[16]
- Daimler AG . . . . $91.4 million[17]
- Citigroup . . . . $75.2 million
- ABB . . . . $39.0 million
- Banc of America Securities . . . . $36.0 million[18]
- Pequot Capital Management . . . . $28.0 million[19]
- General Electric . . . . $23.5 million
- Pride International . . . . $23.5 million

The SEC issued a total of 41 new accounting litigation releases[20] in 2010 compared to 45 in 2009. Nineteen cases (or 46 percent) were FCPA-related matters, up 33 percent from 2009. Eight of the FCPA-related litigation releases were issued against foreign companies (for further comment, see "SEC litigation releases against FIs," page 51). The remaining 22 non-FCPA-related releases covered a wide range of allegations, including anti-trust, market manipulation, accounting fraud, and options backdating.

Figure 21. Number of SEC litigation releases related to new accounting cases, 2006–2010†

Year	Number of releases
2010	41
2009	45
2008	40
2007	53
2006	32

† New accounting cases are defined as the first litigation release naming a particular company or related individual. Subsequent releases that contain the same allegations are not counted.

16 *Ibid.*

17 Daimler AG also settled with the DOJ and agreed to pay $93.6 million to resolve an FCPA investigation.

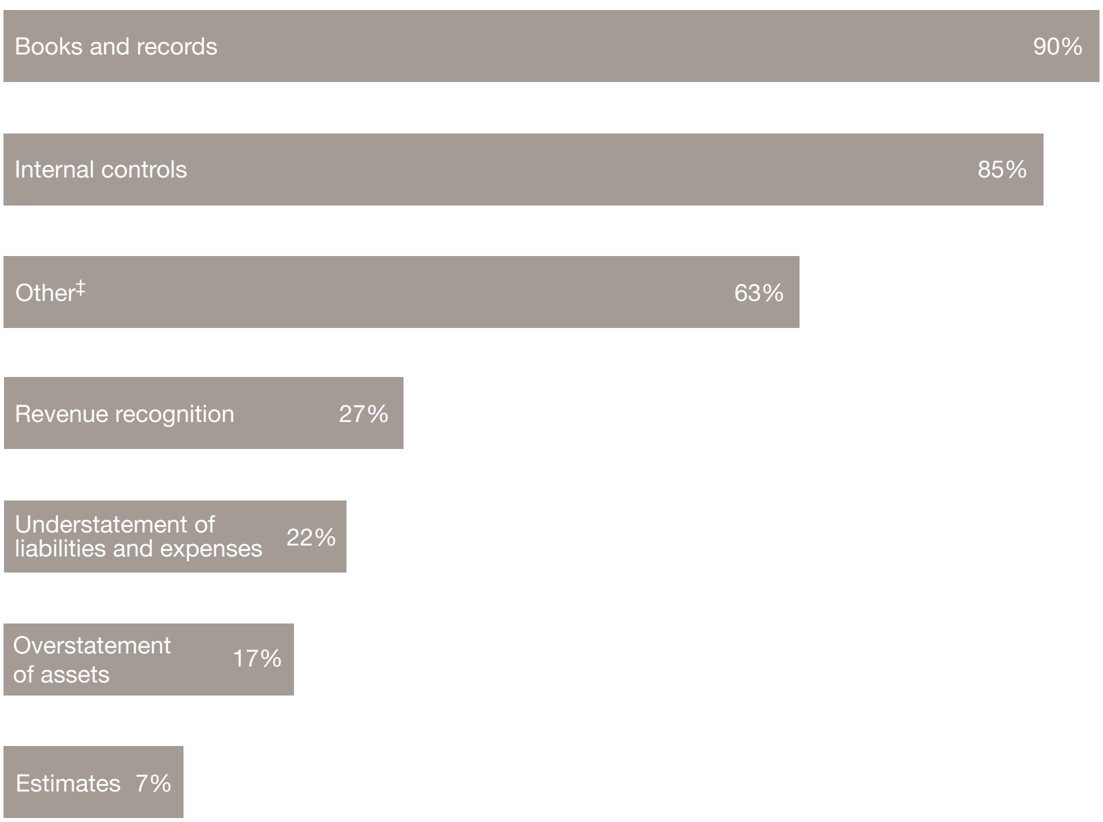
18 ABB also settled with the DOJ and agreed to pay $19 million in criminal penalties.

19 Banc of America Securities also agreed to pay $101 million to other federal and state authorities.

20 The SEC issued 438 litigation releases in 2010. A new accounting litigation release refers to the first accounting-related litigation release, based on unique allegations listed, involving a company and/or its officers.

Consistent with 2009, internal control and books-and-records violations were cited most often, at 85 percent and 90 percent, respectively. The number of FCPA cases (19) that centered around these two violations contributed to the high percentages. Cases with revenue recognition allegations dropped from 47 percent in 2009 to 27 percent in 2010, and cases citing understatement of liabilities and expenses dropped from 36 percent in 2009 to 22 percent in 2010. Estimates and overstatement of assets also decreased, but to a lesser degree.

Figure 22. Percentage of SEC litigation releases related to new accounting cases citing specific accounting issues, 2010[†]



† Some cases allege multiple accounting issues.
‡ The category "Other" includes accounting-related allegations not included in the categories listed. Cases alleging violations of the FCPA are included in this category.

The Supreme Court closes the border to Section 10(b) plaintiffs, and Congress opens it for the government

By Michele Rose, Partner, William Baker, Partner, and Laura Mancini, Associate, Latham & Watkins LLP

Over the past decade, private class action litigation targeting foreign issuers had been gaining steam.[21] That trend has likely reversed direction due to last summer's US Supreme Court holding that the anti-fraud provisions of the Securities Exchange Act of 1934 do not apply to claims brought against certain foreign issuers.

On June 24, 2010, the US Supreme Court rejected years of federal jurisprudence on the extraterritorial application of Section 10(b) of the Securities Exchange Act. In *Morrison v. National Australia Bank*, 130 S.Ct. 2869 (2010), the court held that a claim brought by foreign investors against a foreign company based on shares bought on a foreign exchange—a so-called "F-cubed" case—may not be litigated in United States courts under Section 10(b). The court explained that Section 10(b) is silent on its scope beyond US borders and observed that its language "contains nothing to suggest [that the statute] applies abroad."

The court explained that "the focus of the Exchange Act is not upon the place where the deception originated, but upon purchases and sales of securities in the United States." As such, the court held that Section 10(b) punishes only deceptive conduct in connection with the purchase or sale of any security in the United States or any security registered on a national securities exchange. The court reasoned that it is only those transactions that Section 10(b) seeks to regulate, and it is only the parties or prospective parties to those transactions that the statute seeks to protect.

Congressional response to *Morrison*

The Supreme Court reasoned in *Morrison* that "[w]hen a statute gives no clear indication of an extraterritorial application, it has none." Congress acted quickly in the wake of *Morrison* to clarify the extraterritorial reach of US securities laws. Less than a month after the court ruled in *Morrison*, President Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act.[22] Dodd-Frank contains two provisions, Sections 929P(b) and 929Y, that concern the territorial scope of the federal securities laws.

Section 929P(b) amends federal securities laws by expressly providing for extraterritorial jurisdiction over certain actions brought by the SEC or the DOJ.[23] Section 929P(b) confers US jurisdiction in actions alleging violations of the antifraud provisions of the Securities Act of 1933, the Securities Exchange Act of 1934, and the Investment Advisers Act involving (1) conduct within the US that constitutes significant steps in furtherance of the violation, even if the securities transaction occurs outside the US and involves only foreign investors; or (2) conduct occurring outside the US that has a foreseeable, substantial effect within the US. Since the passage of Dodd-Frank, the SEC's Division of Enforcement has argued that, in civil enforcement actions brought by the SEC, "Congress effectively overruled *Morrison* by codifying the Second Circuit's long-standing conduct and effects test."[24]

As noted, the amendments contained in Section 929P(b) apply only in actions brought by the SEC and the DOJ. While Dodd-Frank did not restore the private actions barred by *Morrison,* Section 929Y of the Act directs the SEC to study whether the anti-fraud provisions should be given extraterritorial effect in private actions and to report its recommendations to Congress in eighteen months (i.e., by January 2012). In the meantime, courts have been left to their own discretion to interpret and apply *Morrison* to private actions.

The interpretation and application of *Morrison* by the courts

Since June 2010, dozens of district and appellate courts have cited the Supreme Court's opinion in *Morrison*. These courts have not been reluctant to dismiss lawsuits brought in the US against foreign issuers,[25] and have not been reluctant to apply the holding beyond the facts presented in *Morrison*.[26] Notably, in a July 27, 2010, opinion, Southern District of New York Judge Victor Marrero took *Morrison* a step further, holding that the Exchange Act's anti-fraud provisions did not apply to "F-squared" claims—claims by Americans who bought their shares of foreign companies on foreign exchanges.[27] In a very colorful opinion, Judge Marrero reasoned that "a corollary" of *Morrison* is that the Exchange Act's provisions "would not apply to transactions involving (1) the purchase or sale, wherever it occurs, of securities listed only on a foreign exchange, or (2) a purchase or sale of securities, foreign or domestic, which occurs outside the United States."

In *In re Société Générale Securities Litigation,* Judge Richard M. Berman *sua sponte* decided that *Morrison* precludes security holders who purchased ADRs (traded over-the-counter) in the US from seeking damages under the Securities Exchange Act of 1934, even though defendants had not sought to dismiss those particular claims.[28] Judge Berman held that not even domestic purchasers of ADRs can assert claims under the Exchange Act because the purchase of an ADR is a fundamentally foreign transaction. And in a January 11, 2011, opinion, Judge Deborah Batts extended, for what appears to be the first time, the *Morrison* holding to claims under the Securities Act of 1933.[29] Judge Batts stated that,"[u]nder *Morrison,* the Securities Act, like the Exchange Act, does not have extraterritorial reach."

Plaintiffs' response to *Morrison*

At least two US securities law firms (Grant & Eisenhofer P.A. and Barroway Topaz Kessler Meltzer & Check, LLP) recently announced that they'd filed an action in Utrecht Civil Court on behalf of a specifically formed foundation, Stichting Investor Claims Against Fortis, representing investors in the US, Europe, the Middle East, and Australia. The lawsuit is filed against Ageas NV/BV (formerly Fortis) and its directors, officers, and offering underwriters for allegedly defrauding investors through a 2007 rights issue to acquire ABN Amro, and comes after the dismissal of the securities class action complaint filed in the Southern District of New York. Since *Morrison* limited plaintiffs' ability to bring private actions against foreign issuers under federal securities laws, plaintiffs may increasingly turn to other jurisdictions, as they did here, to seek remedy for fraudulent activity.

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21 "Foreign issuers (FIs) had their fair share of the securities litigation and regulatory limelight over the past ten years, averaging approximately 20 cases per year. During this period, FIs also paid out some of the highest USD class action settlements." PricewaterhouseCoopers, *2009 Securities Litigation Study* (April 1, 2010), p. 34.

22 Public Law No. 111-203, §§ 929P, 929Y, 124 Stat. 1376 (July 21, 2010).

23 Section 929P(b) amended Section 22 of the Securities Act of 1933, Section 27 of the Securities Exchange Act of 1934, and Section 214 of the Investment Advisers Act.

24 SEC's Memorandum of Law in Opposition to Defendant Tourre's Motion to Dismiss the Amended Complaint, *SEC v. Tourre,* No. 10 Civ. 3229 (BSJ)(MHD) (S.D.N.Y. Dec. 21, 2010),10 n.1.

25 See, e.g., *Plumbers' Union Local No. 12 Pension Fund v. Swiss Reinsurance Co.,* No. 08 Civ. 1958 (JGK), U.S. Dist. LEXIS 105730 (S.D.N.Y. Oct. 4, 2010), granting defendants' motion to dismiss because "a purchase order in the United States for a security that is sold on a foreign exchange is insufficient to subject the purchase to the coverage of Section 10(b) of the Exchange Act."

26 See, e.g., *Elliot Associates v. Porsche Automobil Holding SE,* No. 10 Civ. 0532 (HB), 2010 U.S. Dist. LEXIS 138399 (S.D.N.Y. Dec. 30, 2010), dismissing claim by a US-based hedge fund based on swap agreement and referencing price of foreign issuer shares as not a "domestic transaction in other securities."

27 See *Cornwell v. Credit Suisse Group,* No. 08 Civ. 3758 (VM), 2010 U.S. Dist. LEXIS 76543 (S.D.N.Y. July 27, 2010).

28 No. 08 Civ 2495 (RMB), 2010 U.S. Dist. LEXIS 107719 (S.D.N.Y. Sept. 29, 2010).

29 *In re Royal Bank of Scotland Group PLC Securities Litigation,* No. 09 Civ. 200 (DAB) (S.D.N.Y. Jan. 11, 2011).

Is this the end of F-cubed?

In years to come, 2010 may be viewed as a milestone year in securities litigation against FIs.

In June 2010, the Supreme Court issued its decision in the *Morrison v. National Australia Bank* case, which has had immediate and potentially long-lasting implications. The case—which is considered an "F-cubed" matter because it involved foreign shareholders purchasing securities of a foreign company, on a foreign exchange, while heard in a US court—was brought to the US Supreme Court to decide whether or not US courts had jurisdiction over such matters. The Supreme Court determined that they did not, stating that Section 10(b) of the Securities Exchange Act of 1934 does not apply extraterritorially. Instead, the court ruled that Section 10(b) and SEC Rule 10b-5 apply only to transactions in securities listed on domestic exchanges in the United States and to purchases or sales of unregistered securities in the United States.

ADRs on US exchanges may not be enough

The impact of the ruling has been immediate. In July 2010, the District Court for the Southern District of New York, in rulings related to Credit Suisse, dismissed US plaintiffs who had purchased Credit Suisse shares on the Swiss stock exchange. Only those investors who had purchased ADRs listed by Credit Suisse on the New York Stock Exchange were permitted to remain in the class action. In a case against Toyota, California courts indicated that they, too, would likely permit only investors in US-traded ADRs to remain in the class, excluding investors who purchased shares traded on the Tokyo exchange.

The impact of the *Morrison* ruling is not restricted to pending or future cases. In January 2010, a jury in the Southern District of New York found that the French entertainment company Vivendi had made false statements in public statements, press releases, and SEC registration statements. Damages in the case have been estimated at as much as $9.3 billion. In post-trial motions, Vivendi argued that purchasers of ordinary shares should be excluded from the class because the shares were not traded on a US domestic exchange. Vivendi maintained that only investors in ADRs listed in the US should remain. In February 2011, Judge Richard J. Holwell of the Southern District of New York upheld Vivendi's position in a ruling that could potentially reduce the level of damages by approximately 90 percent, or $8.4 billion.

Morrison also applies to the Securities Act of 1933

In a January 2011 ruling in a case against the Royal Bank of Scotland, the District Court for the Southern District of New York issued a ruling consistent with those mentioned above—that only investors in ADRs listed in the US could remain in the class, removing investors in ordinary shares listed on the London and Amsterdam stock exchanges. Of perhaps greater significance was the ruling related to plaintiff claims under the Securities Act of 1933, arising from the share exchange that took place in connection with Royal Bank of Scotland's acquisition of ABN Amro. The motion to dismiss such claims was upheld on grounds that the complaint was "void of any allegations that the purchase of RBS ordinary shares pursuant to the Exchange Offer actually took place in the United States."[30]

The overall impact of the Supreme Court's ruling is yet to be determined, but early indications favor FI defendants. On a broader level, some have questioned whether this will impact companies' decisions regarding whether or not to list ordinary shares on US exchanges, and many speculate that it could reduce listings of international companies. The ruling may also spur plaintiffs to pursue claims in the domestic courts of the issuer. As noted in PwC's *2009 Securities Litigation Study,* many foreign jurisdictions have started to lay the foundations for class-action-type litigation. If plaintiffs seek to recover losses through international courts, it will be interesting to observe the development of class action securities litigation dockets in those foreign markets.

More commentary on the impact of the *Morrison* ruling is provided in the editorial "The Supreme Court closes the border to Section 10(b) plaintiffs, and Congress opens it for the government," page 38.

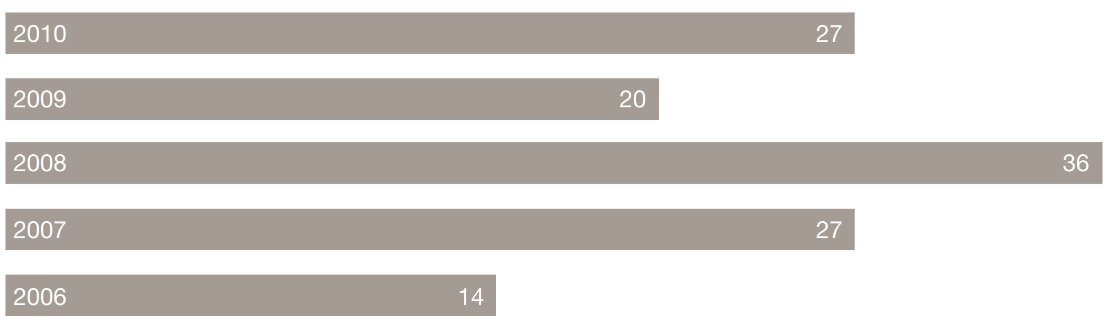
30 *In re Royal Bank of Scotland Group PLC Securities Litigation,* 09 Civ. 300 (S.D.N.Y. Jan. 11, 2011).

FI filings on the up

Perhaps surprisingly given the Supreme Court's decision in the *Morrison* case, there was a 35 percent increase in the number of cases brought against FIs during 2010. Of the 27 cases filed against FIs during the year, 16 (or 59 percent) were filed after the June 2010 Supreme Court decision. The percentage of cases filed against FIs as a percentage of total cases increased from 13 percent in 2009 to 16 percent in 2010, returning to the levels witnessed in 2007 and 2008. The average number of cases filed in a single year since the PSLRA has been 19.

The increase in the number of cases brought against FIs is perhaps even more surprising considering that none of the cases were financial-crisis-related. Given the global impact of the financial crisis, it might have seemed reasonable to assume that a proportion of cases would have been brought against foreign financial institutions. Looking at the cases filed against US-based companies in 2010, approximately 13 percent of cases were financial-crisis-related, indicating that the plaintiffs' bar continued to pursue cases against US-based companies.

Figure 23. Number of US federal securities class action lawsuits filed against foreign companies, 2006–2010



The China factor

To explain the increase in cases against FIs, it's necessary to look toward China. During 2010, an unprecedented 12 cases (44 percent) were filed against Chinese companies. In 11 of those 12 cases, the plaintiffs alleged inappropriate accounting practices. In four of those cases (China Education Alliance, RINO International Corporation, China Green Agriculture, and China-Biotics), the plaintiffs' complaints noted that revenue and profit figures reported in SEC filings were considerably different from those reported to Chinese authorities. As an example, in the case of China Education Alliance, the complaint stated that while the company reported revenue of $24.9 million in its 10-K filed with the SEC, its main operating company reported revenue of less than $1 million to Chinese authorities. In the case of RINO International Corporation, the discrepancy in reported revenue was even greater: $192.6 million in SEC filings compared to $11 million in submissions to the China State Administration for Industry and Commerce. NASDAQ delisted RINO International Corporation in November 2010, making it the second China-based company delisted in recent years[31] for providing unreliable financial statements.

Given the public availability of SEC filings, it is difficult to understand why companies would choose to file financial reports in different jurisdictions with such differing results. While discrepancies between SEC and domestic filings can sometimes be attributed to different accounting and reporting conventions, such differences would require disclosure in filings with the SEC. It will be interesting to observe how these cases proceed in the year ahead.

Other cases were brought against Chinese entities that publicly disclosed that they had (1) initiated internal investigations into alleged inappropriate accounting practices, (2) received a subpoena from the SEC related to an investigation into accounting practices, or (3) issued guidance that previously issued financial statements could no longer be relied upon and would need to be restated.

31 China Energy Savings Technology was delisted in 2006.

US regulators have also focused on accounting issues at China-based companies. In July 2010, the Public Company Accounting Oversight Board (PCAOB) issued a Practice Alert in which they provided guidance to audit firms that reaffirmed the level of reliance that should be placed on the work of audit firms outside the United States. The alert specifically referenced companies operating in China, and was critical of US-based audit firms and their reliance and willingness to sign off on audit work performed by China-based auditors on the financial statements of their clients. During 2010, the SEC also publicly announced that it had opened investigations into the accounting practices of China-based companies, especially those listed on US markets through "reverse takeover" arrangements. The SEC probe is believed to include a review of the practices of US accountants, lawyers, and bankers who have helped many Chinese companies list on US stock markets. In December 2010, the SEC charged an Orange County–based auditing firm for failing to "exercise professional skepticism and due professional care"[32] in audits of China Energy Savings Technology, a company that was ordered to pay $35 million in March 2009 for overstating revenue.

With the House Financial Services Committee reported to be planning hearings on Chinese company accounting in 2011, the events of 2010 may be an indication of what to expect in the years ahead.

FI filings in response to major events

During 2010, several lawsuits were brought against FIs involved in high-profile events, including the Gulf oil spill and motor vehicle recalls. Both BP and Transocean were the subject of several class actions whose complaints charged both companies with violations of the Securities Exchange Act of 1934 for the dissemination of false and misleading statements about deficient safety protocols and their operating and safety record. Transocean currently faces two class action lawsuits: one related to disclosures made in proxy statements issued in connection with its 2007 merger with GlobalSantaFe, the other related to statements in financial filings in 2009 and 2010.

Following Toyota's public recall of millions of motor vehicles, several class action lawsuits were filed[33] in which plaintiffs claimed that the company issued materially false and misleading statements regarding its operations and its business and financial results and outlook, by failing to disclose major design defects. The cases were consolidated in October 2010.

32 http://www.sec.gov/litigation/admin/2010/33-9166.pdf.

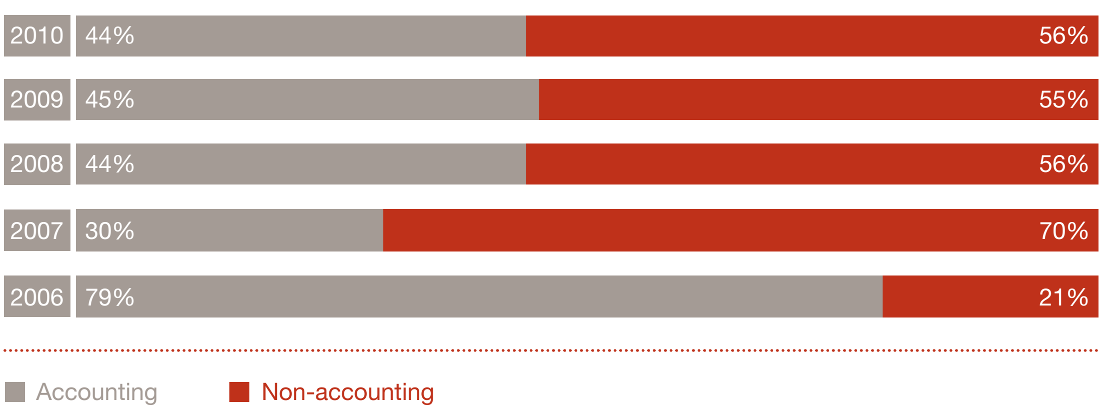
33 Per PwC's methodology, multiple filings against the same defendant with similar allegations are counted as one case.

Accounting-related allegations restricted to China

Historically, the PwC *Securities Litigation Study* has shown that, compared with the overall population, FIs have a higher percentage of cases that include allegations of accounting improprieties. At first glance, the pattern in 2010 was consistent with this trend, with 44 percent of cases brought against FIs (12 cases) citing accounting improprieties, compared to 35 percent of total cases (international and domestic).

That 44 percent figure remains relatively consistent with the past two years. However, on closer inspection (and as described above), 11 of the 12 cases were brought against China-based companies. Removing the impact of Chinese companies, the trend is markedly different from prior years, when accounting-related cases were brought against companies operating in a variety of different geographical markets. The lack of accounting-related cases brought against FIs based in countries other than China is noteworthy. It is also consistent with the overall gradual reduction in accounting-related cases, which declined from 52 percent of cases in 2007 to 35 percent in 2010.

Figure 24. Percentage of accounting and non-accounting US federal securities class action lawsuits filed against foreign companies, 2006–2010†



† Cases filed between 2006 and 2009 may have been updated with accounting allegations if the amended complaints alleged accounting violations not previously recognized. The number for 2010 reflects initial complaints.

This reduction could be the consequence of improved internal controls implemented by corporations in the wake of SOX. Another possibility is that accounting cases are, in general, more complex, take more time, and are therefore more expensive for plaintiff attorneys to manage. As described above, many of the accounting cases brought against China-based companies were grounded on simple allegations: Some were brought after revenues disclosed in SEC filings proved inconsistent with revenues disclosed to Chinese authorities; others were brought following public disclosures of restatements or SEC or internal investigations.

The rebound of M&A activity provided an opportunity for plaintiff attorneys to pursue cases that were perhaps less complex and time-consuming, and more cost-effective. As a consequence, there was a fourfold increase in M&A-related cases brought against FIs, and a sevenfold increase in similar cases overall.

Even so, it would be surprising not to see a future resurgence in accounting-related cases given that, historically, they have yielded much higher settlements than non-accounting cases.

A shift in circuit preference for FI cases

For the past ten years, the majority of cases against FIs have been filed in the Second Circuit. In 2010, while the Second Circuit still accounted for the most FI filings of any individual circuit (with 13 cases, or 48 percent), an increasing number of cases were filed in other circuits—most notably the Ninth Circuit, which had eight filings (30 percent). Six of the eight filings were accounting-related cases filed against China-based companies, with the remaining two cases related to the Toyota product efficacy matter and the disclosure allegations brought against Canada-based Freedom Investment Club. The cases against BP and Transocean were filed in the Fifth Circuit Court in Texas.

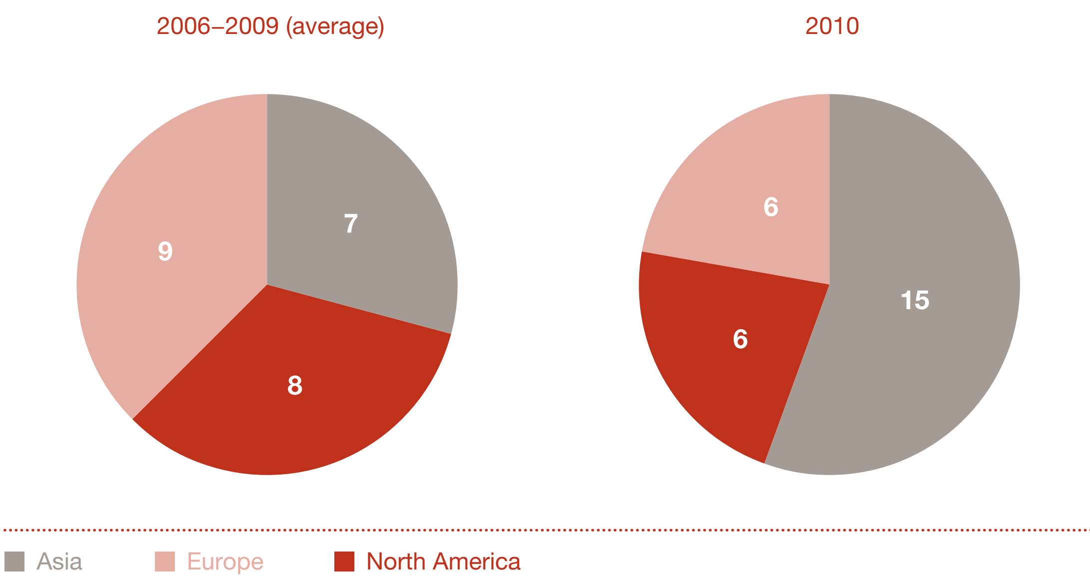
Asia increases in prominence

Fifteen of the FI cases filed, or 56 percent, were against Asian companies, which was almost three times the number filed in 2008 or 2009. Between 2006 and 2009, an average of seven cases per year were brought against Asian companies. Aside from the cases brought against China-based entities in 2010, cases were brought against companies headquartered in Japan, South Korea, and Singapore.

Only six cases were brought against European companies in 2010, a decrease of 50 percent from the levels seen in 2008 and 2009. None of the six cases cited accounting-related issues; rather, the plaintiffs alleged concerns of false or misleading disclosure in connection with M&A activity or public offerings. Two cases, against Eksportfinans and Novartis, were voluntarily dismissed by plaintiffs in 2010.

For the second straight year, no claims were filed against companies based in South America or Africa.

Figure 25. Number of US federal securities class action lawsuits filed against foreign companies, by region, 2006–2010



FI settlements are up

The 14 FI settlements during 2010 represented a 56 percent jump over the 9 FI settlements in 2009, but the total was still slightly below the average of 15 settlements filed each year since 2006. More notable, the decline in the dollar value of FI settlements was significantly less than in prior years.

Figure 26. Settlement values (in thousands $) for foreign companies: by lead plaintiff, 2006–2010†

	2006		2007		2008		2009		2010	
	Cases settled	Settlement	Cases settled	Settlement	Cases settled	Settlement	Cases settled	Settlement	Cases settled	Settlement
Public pension	6	2,241,400	8	3,481,800	9	347,600	3	76,000	4	53,900
Other institutional	3	21,300	2	121,800	6	81,400	2	235,800	1	1,300
Private investors	7	117,900	4	20,500	4	10,300	3	26,300	7	65,700
No lead plaintiff‡	–	–	1	30,000	–	–	1	4,000	–	–
Total cases settled	**16**	**2,380,600**	**15**	**3,654,100**	**19**	**439,300**	**9**	**342,100**	**12**	**120,900**

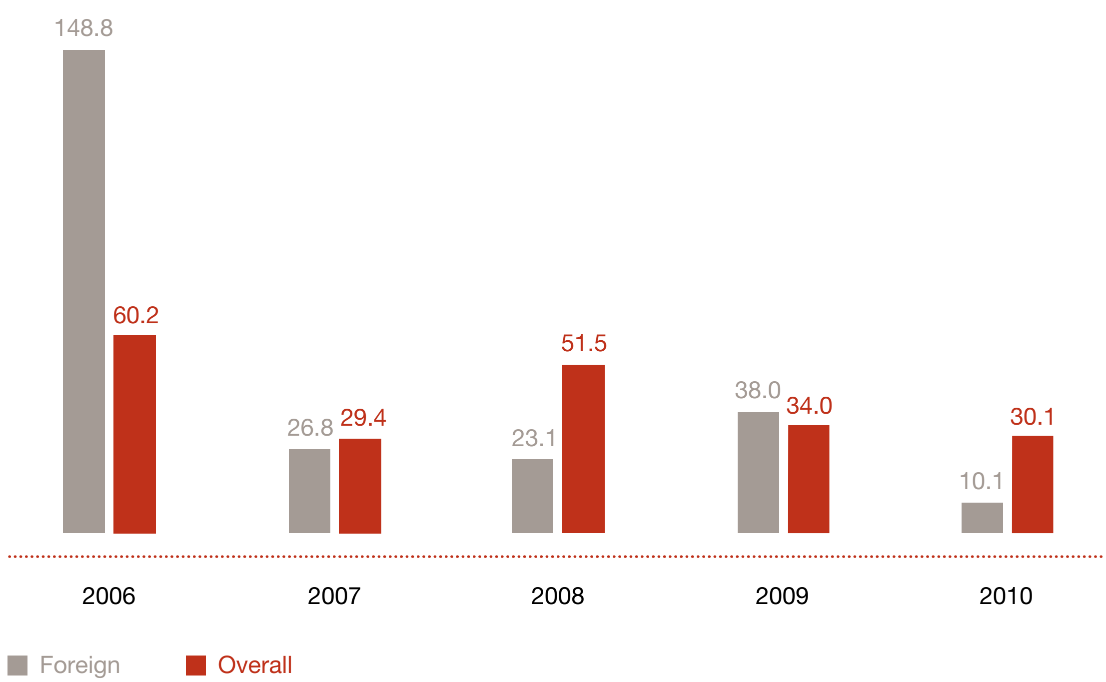
† Year of settlement is determined based on the primary settlement pronouncement. Any subsequent settlement amounts are attributed to the primary announcement year. Settlement information reflects only those cases filed and settled after passage of the PSLRA (12/22/1995). Excludes zero-dollar settlements and settlements in which an amount has not been determined. Totals may not sum exactly due to rounding.

‡ Two cases were settled without lead plaintiff involvement: Converium Holding (2007) and Lernout & Hauspie (2009).

The $120.9 million in total settlements paid[34] was considerably less than the average annual total since 2006 of $1.7 billion. The average of prior years was impacted significantly by the outlier settlement[35] paid by Tyco in 2007 ($3.3 billion). Removing that outlier settlement, the average was still $884 million, highlighting the decline in settlements reached in 2010. In two of the past five years, average settlements paid by FIs (excluding outliers) exceeded the average of all settlements reached. In 2010, the average FI settlement ($10.1 million) was approximately three times lower than the overall average of $30.1 million. Also, for the first time since 2006, there were more settlements where the lead plaintiff was a private investor rather than a pension fund.

With the exception of two cases—a $24.4 million settlement reached with Flag Telecom Holdings for a case filed in 2002 and a $12.8 million settlement reached with Deutsche Bank for a case filed in 2004—all other settlements related to cases filed in 2007 or 2008. Ten of the 14 cases settled were accounting-related.

Figure 27. Average settlement values (in millions $), foreign vs. overall, 2006–2010†



† Excludes zero-dollar settlements, settlements in which an amount has not been determined, and outlier settlements.

34 There were two settlements where the settlement amount is undisclosed: Australia and New Zealand Banking Group (ANZ) and Gildan Activewear Inc. For the purpose of the averages above, these have been removed from the calculation.

35 An outlier settlement is defined as over $2.5 billion.

Figure 28. Top settlement values over $100 million by foreign companies, 2006–2010†

Company	Country	Year settled‡	Amount
Tyco International	Bermuda	2007	$3,279,000,000
Nortel Networks§	Canada	2006	$2,217,040,606
Banco Santander	Spain	2009	$235,000,000
Biovail Corporation	Canada	2007	$138,000,000
Royal Dutch/Shell Transport	Netherlands	2008	$130,000,000
Parmalat Finanziaria SpA‖	Italy	2007	$101,800,000

† 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 (12/22/1995).
§ Nortel settled both the 2001 case and the 2004 case in 2006.
‖ Parmalat Finanziaria SpA settled for $50 million, $36.8 million, and $15 million in 2007, 2008, and 2009, respectively.

SEC litigation releases against FIs

In 2010, the SEC issued nine litigation releases against FIs, compared with two issued in 2009. All but one of the nine related to breaches of the FCPA. In addition to being subject to enforcement actions taken by the SEC for alleged violation of the FCPA's books-and-records and internal control provisions, all but one of the companies were also subject to criminal fines levied by the DOJ. Aside from the financial penalties (outlined below), the companies may also have been subject to deferred or non-prosecution agreements with the DOJ, and/or consented with the SEC to an injunction prohibiting future FCPA violations.

It is not surprising that enforcement actions against companies (including FIs) under the FCPA increased in 2010, given the high dollar settlements reached with companies, the public announcements by the SEC that the area remains one of its key priorities, and the creation of a dedicated FCPA unit within the SEC. During 2010, in total, SEC settlements with FIs were larger than settlements resulting from class actions.

Four of the litigation releases against FIs resulted from the investigation of inappropriate payments by energy companies through their freight forwarding agent, Panalpina. The total disgorgement, prejudgment interest, and fines paid to the SEC by Panalpina, Transocean, GlobalSantaFe, and Noble Corporation amounted to approximately $30 million, excluding fines paid to the DOJ.

Although significant, the payments by companies to resolve enforcement actions associated with the Panalpina investigation paled compared to amounts paid by energy companies in connection with the Bonny Island, Nigeria, joint venture consortium. The members of the consortium were alleged to have paid bribes to Nigerian officials to secure a $6 billion contract to construct liquefied natural gas facilities. To date, the total fines levied by the SEC and DOJ against consortium members have reached close to $1.3 billion. FIs contributed $703 million of this amount: Eni and its Dutch subsidiary, Snamprogetti, paid $365 million, and Technip paid $338 million in disgorgement, interest, and penalties.

Other FCPA-related litigation releases involving FIs included ABB, which paid $39.3 million in penalties, disgorgement, and prejudgment interest to the SEC and $19 million to settle criminal charges with the DOJ; and Alcatel-Lucent, which paid $45.4 million to the SEC and $92 million to the DOJ. Daimler also paid $91.4 million to the SEC and $93.6 million to the DOJ.

The one non-FCPA litigation release against an FI involved alleged market manipulation by East Delta Resources Corporation and three individuals.

Onward and upward: FCPA and anti-bribery enforcement in 2010

By Debra Wong Yang, Partner, and Michael Farhang, Partner, Gibson Dunn & Crutcher LLP

Last year marked a number of significant developments for US and international anti-bribery enforcement. First, the pace and number of enforcement actions brought by the DOJ and the SEC under the FCPA accelerated significantly over 2009. Second, US lawmakers implemented new incentives in securities legislation and elsewhere for continued aggressive policing. Third, other foreign governments also made strides in the anti-corruption area. The United Kingdom passed rigorous anti-bribery legislation with potential application to US issuers and other companies that do business in the UK. In addition, the Organisation for Economic Co-operation and Development (OECD) and the UK government issued guidance regarding the appropriate components of an anti-corruption compliance program, providing some clarity on the elements necessary to enable corporations to prevent and detect bribery issues in their foreign operations. These developments have encouraged an increased focus by US and foreign multinational companies on expanding ways to safeguard against bribery in their far-flung business operations.

Heightened US FCPA enforcement

The number of FCPA enforcement actions against corporations and individuals has been rising steadily in recent years, and increased dramatically in 2010—by approximately 85 percent. As compared to 26 DOJ actions and 14 SEC actions brought in 2009, in 2010 the DOJ brought 48 actions and the SEC brought 26 actions.[36] US regulators also increased their enforcement capabilities in 2010, with the DOJ requesting funding to add new attorneys in 2011 dedicated to FCPA matters, and the SEC creating a new unit in San Francisco to handle FCPA cases. The year saw a number of sizable FCPA-related settlements with companies, including Technip ($338 million), Snamprogetti ($365 million), Daimler ($185 million), Alcatel-Lucent ($137.4 million), Panalpina ($81.9 million), ABB ($58.3 million), and Pride International ($56.2 million).[37]

Congressional action involving FCPA enforcement

Legislators in the US increased pressure on corporate and individual wrongdoers with new legislation and public statements supporting aggressive enforcement. In 2010, Congress strengthened the federal securities laws with the Dodd-Frank Wall Street Reform and Consumer Protection Act, which implemented a new legal framework of incentives and protections for whistleblowers who voluntarily provide information about securities violations, including violations of the FCPA. Dodd-Frank provides for whistleblowers to receive a monetary reward of between 10 percent and 30 percent of any monetary sanction greater than $1 million imposed in a subsequent SEC enforcement action or related government enforcement action, and also provides expanded protection for whistleblowers.[38] Proposed SEC rules also open up the possibility that employees in the legal and compliance functions could become eligible for a whistleblower bounty in the event that companies fail to disclose internally reported FCPA violations in a timely manner or in good faith.[39]

Congress also held hearings in 2010 to consider the current state of FCPA enforcement. On November 30, 2010, the Senate Judiciary Subcommittee on Crime and Drugs heard testimony from a DOJ representative, an academic, and two private practitioners on the history of FCPA enforcement and proposals for modifications to the current enforcement regime. During the hearing, Senator Arlen Specter (D-PA) emphasized his belief that “criminal conduct is individual” and that prosecution and jail time for culpable individual defendants will have the greatest deterrent impact on future violations.[40] Although the Senate panel heard testimony regarding a proposal for a corporate amnesty program, the DOJ shows no signs yet of moving to change its enforcement practices accordingly.

The United Kingdom's Bribery Act of 2010

In 2010, the United Kingdom passed legislation that promises to substantially increase its prosecutions of bribery crimes. The Bribery Act of 2010, replacing prior statutory and common law offenses, penalizes both commercial bribery and bribery of foreign public officials. It also creates an additional offense for the "failure to prevent" bribery by a commercial organization.[41] Like the FCPA, the UK Bribery Act has extraterritorial reach over overseas bribery activities, requiring only that "any act or omission which forms part of the offence" take place in the UK or that the defendant have a "close connection" (e.g., citizenship, incorporation, etc.) with the UK.[42] For the corporate crime of failing to prevent bribery, however, the jurisdictional reach is broader, permitting prosecution of any company that carries on any part of its business in the UK, regardless of whether the activity took place entirely outside the UK.[43] Unlike the FCPA, the Bribery Act does not have an exception for facilitating payments or a defense for reasonable and bona fide business expenditures, although it does have a local law defense.

Although the Bribery Act, which was originally set to go into effect in April 2011 (the implementation has since been delayed), will affect US issuers who carry on part of their businesses in the UK, it contains another important defense that the FCPA does not: A company may defend against a "failure to prevent" charge by showing that it had in place "adequate procedures" to prevent bribery.[44] Just what will constitute adequate procedures is not yet entirely clear. The Act directs the UK Secretary of State to publish guidance about what adequate procedures may be required under this section. In draft guidance issued in September 2010, the UK Ministry of Justice enumerated six categories that companies should focus on for an effective anti-bribery compliance program: (1) risk assessments; (2) top-level commitment; (3) due diligence on third parties; (4) clear, practical, and accessible policies and procedures; (5) effective implementation; and (6) monitoring and review.[45] Further clarifying guidance is expected early in 2011.

OECD guidance for anti-corruption compliance programs

The year saw other international efforts to establish best practices for effective anti-corruption compliance. In November 2009, a working group of the OECD, which at the time represented the 30 member nations and eight other countries, issued a "Recommendation of the Council for Further Combating Bribery of Foreign Public Officials in International Business Transactions." The recommendation encouraged member countries to "develop and adopt adequate internal controls, ethics and compliance programmes" and other measures to prevent and detect foreign bribery.[46] In March 2010, the working group released its "Good Practice Guidance on Internal Controls, Ethics, and Compliance." The guidance set forth a number of best practices for ensuring an effective anti-corruption ethics and compliance program, including, *inter alia,* clear policies, monitoring, coverage of gifts, hospitality, travel, entertainment, contributions, sponsorships, facilitation payments, third-party diligence measures, internal controls, training, discipline, confidential reporting, and periodic compliance reviews.[47] The DOJ's then-chief for the Fraud Section (which handles FCPA enforcement), Mark Mendelsohn, was quoted at the time as saying that the OECD guidelines would have the "endorsement of the US government."[48]

Conclusion

In short, 2010 marked a strong uptick in enforcement activity by the DOJ and SEC, as well as increased attention by US and foreign lawmakers to the need for heightened anti-bribery enforcement. FCPA enforcement shows no signs of abating, and the activities of governments in the UK and elsewhere show that the rest of the world is beginning to catch up. With increased enforcement has also come further guidance on how to design effective compliance programs for companies seeking to avoid trouble in this area. While 2011 is still in its early stages, recent trends suggest that the two-pronged approach of toughened enforcement and legislation is likely to continue for the near term.

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36 Gibson Dunn & Crutcher LLP (GDC), "2010 Year-End FCPA Update" (January 3, 2011); http://www.gibsondunn.com/publications/pages/2010Year-EndFCPAUpdate.aspx.

37 *Ibid.*

38 The whistleblower provisions are codified in Section 21F of the Securities Exchange Act of 1934 (15 U.S.C. § 78a, *et seq.*).

39 SEC press release, "SEC Proposes New Whistleblower Program Under Dodd-Frank Act" (November 3, 2010); http://www.sec.gov/news/press/2010/2010-213.htm.

40 Transcript, "Senate Judiciary Subcommittee on Crime and Drugs Holds Hearing on Enforcement of the Foreign Corrupt Practices Act" (PL 95-213), CQ Financial Transcripts (November 30, 2010).

41 Bribery Act 2010 (Chapter 23, §§ 1-2, 6-7).

42 Bribery Act (§ 12).

43 Bribery Act (§ 7).

44 Bribery Act (§ 7(2)).

45 GDC client alert, "UK Bribery Act 'Adequate Procedure' Draft Guidance" (September 22, 2010).

46 Harvard Law School Forum on Corporate Governance and Financial Regulation, "OECD Provides Guidance for Anti-Bribery Compliance Programs" (May 23, 2010); http://blogs.law.harvard.edu/corpgov/2010/05/23/oecd-provides-guidance-for-anti-bribery-compliance-programs/.

47 OECD Working Group on Bribery in International Business Transactions, "Recommendation of the Council for Further Combating Bribery of Foreign Public Officials in International Business Transactions" (February 2010), Annex II.

48 David Hechler, "'Roided Up Enforcement: DOJ Unit That Prosecutes FCPA to Bulk Up 'Substantially,'" *Corporate Counsel* (February 25, 2010); http://www.law.com/jsp/cc/PubArticleCC.jsp?id=1202444478279&Roided_Up_Enforcement_DOJ_Unit_That_Prosecutes_FCPA_to_Bulk_Up_Substantially.

What this means for your business

With government oversight ramping up, companies' compliance efforts must keep one step ahead—or more.

There were a number of landmark events in 2010 that pose potentially large implications for companies as they look to 2011 and beyond.

Dodd-Frank, shaped with an overriding goal of promoting financial stability throughout the economy, has noticeably expanded the SEC's enforcement powers and extended its oversight of the corporate landscape. Within the SEC's expanded repertoire, one of the more contentious areas is the new whistleblower program, which enables the SEC to pay awards to eligible whistleblowers who voluntarily provide it with original information about violations of federal securities laws that, in turn, lead to successful enforcement actions.

This has several potentially significant ramifications. Some corporate governance experts argue that internal compliance systems may be compromised if individuals are incentivized to report potentially unlawful activity directly to the SEC via the whistleblower program rather than through a company's internal compliance mechanisms. This could prove problematic on a number of levels. By circumventing compliance systems, the program may rob companies of the opportunity to investigate potential matters internally before the SEC begins its investigations, thereby limiting companies' initial responses and reactions, which at a minimum will likely prolong SEC investigations. Moreover, companies will not have the benefit of being able to research and dispose of unfounded tips and complaints before incurring unnecessary legal and investigation-related costs.

Furthermore, with clear financial incentives on offer, the SEC whistleblower program could result in a notable uptick in reports, tips, and complaints, and presumably a correlated uptick in internal investigations, which in turn will lead to considerably increased compliance and legal costs for companies.

Beyond the whistleblower program, the SEC's expanded clawback powers under Dodd-Frank will also give companies pause as they contemplate the way forward. Dodd-Frank has extended the applicability of SOX Section 304 to include any current or former executive of a restating company rather than just the CEO and CFO. Perhaps more significantly, the clawback provisions allow the SEC to recover executive compensation from senior executives following any restatement, regardless of whether misconduct was involved.

Corruption and bribery will continue to be ongoing priorities for companies around the globe. Last year marked a strong uptick in enforcement activity by US regulators, and this trend will likely not abate on the heels of Dodd-Frank. Moreover, the United Kingdom passed rigorous anti-bribery legislation that has potential application to US issuers and other companies that do business in the UK. The OECD also provided guidance to corporations on appropriate anti-corruption compliance efforts—specifically, what companies need to do to help prevent and detect bribery issues in their foreign operations. This will likely motivate US and foreign multinational companies to further explore and expand effective ways to safeguard against bribery in all regions within their global networks.

To handle the ever-changing securities litigation environment, companies must be diligent about reviewing and bolstering their approach to compliance to ensure timely and early identification of potential disclosure and financial matters, both domestically and in foreign subsidiaries. Risk, compliance, and internal audit groups must establish and augment a coordinated and systematic approach to ensure the proper checks and balances are in place.

Finally, at this point, it would be a mistake for foreign companies listed on US exchanges to consider the *Morrison* decision as a license to relax. The SEC continues to have authority to pursue securities violations of foreign companies. With its newly expanded scope and responsibilities stemming from Dodd-Frank, its 2010 public announcements that foreign company activity remains a key priority, and the creation of a dedicated FCPA unit within the organization, the SEC will surely continue to scrutinize the activities of FIs in 2011 and beyond.

Methodology

The 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, and SEC filings.

Filings from 1996 onward occurred after the PSLRA of December 22, 1995; filings for 1999–2010 occurred after the Securities Litigation Uniform Standards Act of November 3, 1998.

The year a case was filed is determined by the filing date of the initial complaint in state or federal court. Multiple filings against the same defendant with similar allegations are counted as one case.

Company names used to reference cases throughout this study are determined according to one of the following: (1) the first named defendant; (2) the company of the affected security or securities; and/or (3) the management company of the security or securities.

All figures, except when noted, exclude “IPO laddering,” “analyst,” and “mutual fund” cases pertaining to the 2003/2004 “market timing” and “revenue sharing” cases.

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