At the crossroads, waiting for a sign
2012 Securities litigation study

April 2013

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Observations from the editors

Each year, PwC's *Securities Litigation Study* evaluates the private securities class action suits filed in the previous calendar year. In completing this, our seventeenth annual evaluation, it became clear that 2012 marked a significant departure: For the first time in the history of our reports, we were faced with a year that lacked any kind of sweeping, game-changing SEC rule or mandate, market-driven event, or industry practice gone wrong. Rather, 2012 was a year that implied no clear direction as to where regulators or shareholders may focus in the future—at the crossroads, waiting for a sign.

The first six months of 2012 saw securities litigation activity levels consistent with 2011, trending on an annualized basis to exceed the average number of cases over the past 16 years. The volume of cases then slowed in the latter half of the year, a period that saw increased global economic uncertainty and heightened tension, with efforts to avert the US fiscal cliff stalled as Washington lawmakers awaited the outcome of the impending presidential election. Despite this unsettled atmosphere, plaintiff activity was unexpectedly calm, perhaps a sign that shareholders were content with recent business decisions and results. In total, the number of cases filed in the last six months of 2012 declined by 21%, as compared to the number of cases filed during the year's first six months.

In analyzing accounting-related cases, various internal control violations continued to be the primary allegation by shareholders. While the Sarbanes-Oxley Act of 2002 (SOX) appears to have effectively mitigated the risk of significant or pervasive financial statement issues (including major frauds), the Securities and Exchange Commission (SEC) charged over 60 companies with various internal control violations.[1] When considering the relevant period of the alleged improper actions, less than 20% of the companies charged referenced a material weakness in their 10-K. This suggests that perhaps companies should focus on other emerging areas on regulators' radars, such as the Foreign Corrupt Practices Act (FCPA), and design their internal controls to address the requirements set forth in those statutes, even if not directly related to recurring financial reporting.

US lawmakers' influences on business may remain unchanged in 2013, given the re-election of President Obama and the continued partisan divide in Congress, with Republicans retaining a majority in the House and Democrats retaining control of the Senate. But changes in regulatory influences and enforcement focus may be on the way at both the SEC and the Department of Justice (DOJ), both of which have seen a number of important departures and resignations. At the SEC, these include Chairman Mary Schapiro; Robert Khuzami, director of the Division of Enforcement; Robert Cook, director of the Trading and Markets Division; and Mark Cahn, the agency's General Counsel. The DOJ, meanwhile, saw the departure of Assistant Attorney General Lanny Breuer in March. At this writing, it is not yet clear what changes and impacts the incoming replacements for these prominent positions might make, and their longer-term focus is necessarily even harder to predict.

1 The number of cases excludes matters in which the allegations preceded 2002, even if the deficient period extended into the years following SOX's passage.

Completing this study would not be possible without the dedicated members of our Forensics practice, who, throughout the year, diligently review case filings, compile and analyze statistics, and identify emerging trends and implications. We would especially like to thank our co-authors, Faizal Karim, Laura Skrief, and Shin Honma, for their thoughtful examination of 2012's central themes. We're also extremely grateful for the tremendous work of Luke Heffernan, Lauren Cable, Anthony Gallo, and the rest of the research team, which worked tirelessly to bring this study to life.

For this year's study, we have added a new twist by including links to thought leader discussions covering mergers and acquisitions (M&A) litigation, life science litigation and compliance risks, and cyber-crime risks and responses. For sharing their insights and experiences on these timely issues, we would like to thank Alan Charles Raul (Partner, Sidley Austin) and our PwC Partners and colleagues Kevin Kreb, Brian Vickrey, Chris Albani, Anup Kharode, and Shane Sims.

In closing, as we reflect on the 2012 study results, future securities litigation may not be foretold by the trends reflected in the cases filed, but rather in considering the possible direction of the new regime of regulators, and the future paths companies may take.

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2012: Less crisis, more crossroads

2012 overview

Overall, federal securities class action filings in 2012 decreased by about 10% from 2011. There were 172 cases in 2012, compared to 191 cases in 2011. The 172 cases fell 5% below the annual average number (181) of cases filed since the enactment of the Private Securities Litigation Reform Act of 1995 (PSLRA) and 3% below the annual average (177) of cases filed since the enactment of SOX.

Figure 1: Number of US federal securities class action lawsuits filed per year, 2008–2012

While the 10% decline from 2011 may appear to be insignificant, a closer examination reveals that 2012 started very differently than it ended. The first half of 2012 saw 96 cases, or an average of 48 cases per quarter, consistent with the quarterly average of 48 cases during 2011. Furthermore, 34 of 96 cases filed during the first half of 2012 were accounting related (35%), again consistent with the 39% of cases that included accounting allegations during 2011. In stark contrast, the second half of 2012 declined to a total of 76 cases, of which only 22% included accounting allegations.

Absence of a market-driven event

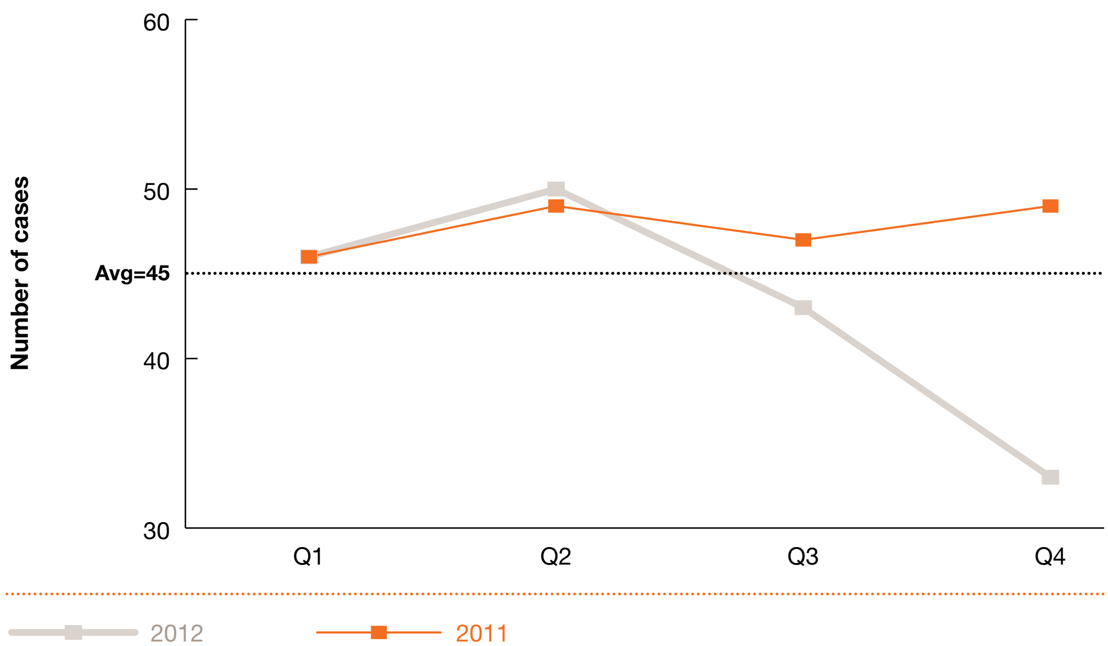
History has shown that case volume can be heavily dependent on an emerging trend or crisis-type market event that catches traction with the plaintiffs' bar and leads to a new wave of filings. Recent trends have included M&A cases in federal courts in 2010, 2011, and 2012; cases in 2011 against foreign companies, primarily the 2008 and 2009 China-based companies that entered US markets via reverse takeovers (RTOs); the 2008 and 2009 financial crisis; and the 2006 stock option cases.

Filings related to the financial crisis, China-based companies, and even M&A transactions (although to a lesser extent) saw significant downturns during 2012. Illustrating the drop, only three financial-crisis-related cases were filed in 2012 after a total of 178 such cases were filed from 2008 to 2011. Despite the expectation that M&A cases will continue with some level of activity, it will take another market-driven event to truly fill the void left by these waning market events and trends.

Storm impact: Political, financial, and weather

While the first three quarters of 2012 saw an average of 46 cases, filings decreased dramatically in the fourth quarter, to 33 cases—the lowest level since the 30 cases filed in the second quarter of 2009. In the United States, the last quarter was affected by two pivotal events: the impending presidential election and the political uncertainty inherent in the run-up, and a looming "fiscal cliff" of automatic tax hikes and government spending cuts, which was narrowly averted on New Year's Eve, allaying financial markets' concerns.[2] Perhaps it's a coincidence, but based on the timing of cases filed, especially in the Second Circuit [3], Superstorm Sandy also may have played a role by interrupting transportation, shutting down power, and blocking access to the Internet and phone service in the Northeast, thereby disrupting law firms, courts, and financial markets.

Figure 2: Number of US federal securities class action lawsuits by quarter, 2011–2012



On average, approximately 3.4 cases per week were filed from January 2012 until the week ending October 26, when Superstorm Sandy made landfall in New Jersey and New York. From October 29 through the end of 2012, that average dropped to 2.4 cases per week. Only two cases were filed during the week of October 29, neither of which was in the Second Circuit. Similarly, only one case was filed during the week of the presidential election. It took until the week after Thanksgiving before the number of cases filed (4) exceeded the weekly average

2 Maureen Farrell, "Stocks Start 2013 with Broad Gains," *CNN Money* (January 2, 2013), http://money.cnn.com/2013/01/02/investing/stocks-markets/index.html.

3 The Second Circuit includes Connecticut, New York, and Vermont.

of 3.4. In the Second Circuit, it was not until November 12 that the first post-Sandy case was filed, in the United States District Court (USDC) of Connecticut. No further cases were filed in any USDC in either New York or New Jersey until November 20, almost three weeks after the Superstorm hit the Tri-State Area. While these events were exclusive to the second half of 2012, their effect on securities litigation may not foreshadow the path forward in 2013.

SEC & DOJ enforcement

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Enforcement remains strong

The SEC Division of Enforcement brought 734 enforcement actions in 2012—the second highest number of actions filed in a single year, following the 735 filed in 2011. According to the SEC *Fiscal Year 2012 Agency Financial Report*, the commission continued to focus on cases connected to the financial crisis, insider trading, and fair trading within the securities market.[4]

The number of litigation cases that had some kind of SEC involvement has averaged approximately 13% of total cases over the past three years. This amounted to 22 cases in 2012 (13% of total cases), 26 cases in 2011 (14% of cases), and 23 cases in 2010 (13% of cases). Eight of the 23 cases with SEC involvement in 2012 had accounting-related allegations (such as the accounting treatment of vendor rebates associated with volume discounts), FCPA-related books and records and internal controls allegations, and improper accounting treatment of inventory and other balance sheet accounts. Cases with non-accounting allegations included insider trading and M&A-related allegations, among others.

With the recent tax-related legislative changes, compensation specialists have implied a potential shift to more deferred compensation arrangements, including stock-based compensation. If employees are motivated to retain company stock for longer periods of time, there is the chance that incentive to boost stock price might build, potentially by inappropriate means. This might lead to an increased emphasis by the SEC Enforcement Division on cases related to the quality of financial reporting by registrants.

A period of transition: Procedural challenges?

Some procedural aspects of the SEC's enforcement practices have been challenged, potentially affecting future activity. The most public challenge came when Judge Jed Rakoff of the Southern District of New York rejected a proposed settlement the SEC had reached with Citigroup. Judge Rakoff's rejection of the settlement was in part due to the inclusion of "neither admit nor deny" language in the agreement.[5] The decision is currently in front of an appeals panel of the Second Circuit, awaiting oral arguments.

4 SEC, Fiscal Year 2012 Agency Financial Report (November 15, 2012), www.sec.gov/about/secpar/secafr2012.pdf.

5 SEC v. Citigroup Global Mkts., Inc., at 4, No. 11. Civ. 7387 (JSR), Order (S.D.N.Y. Nov. 28, 2011)

The Supreme Court is currently considering a case with perhaps equally far-reaching consequences. In *Gabelli et al v. SEC,*[6] the Supreme Court has been asked to rule on when the five-year statute of limitations begins. The SEC has taken the position that the five-year period commences from the date that the SEC can reasonably be able to detect the fraud. Attorneys for the plaintiff argue that the clock starts ticking from the date that the alleged wrongful act occurred. At oral arguments held in January 2013, the Supreme Court appeared to sharply challenge the SEC's position on the matter, so its ruling, expected by the end of June 2013, is highly anticipated. A decision affirming that the five-year statute of limitations commences when the wrongful act occurs could have a significant impact on SEC enforcement priorities, leading the commission to bring charges more quickly or conduct more stringent investigations.

Court rulings: Are plaintiffs dejected?

Another potential factor for a decrease in cases, and perhaps one that may be more wide-reaching or impactful in the long term, is the effect of recent Supreme Court decisions. Recent court rulings that have favored the defense bar likely make it more difficult to bring successful cases. How the court rules on the *Comcast Corporation v. Caroline Behrend* case in its current docket may further this belief.

In 2010, the Supreme Court issued its ruling in *Morrison v. National Australia Bank*,[7] restricting the territorial reach of the Securities Exchange Act by prohibiting so-called F-cubed cases—those involving a foreign issuer and a foreign company with shares traded on a foreign exchange. This ruling affected both pre-existing and subsequent cases, with courts taking a very broad view of where Morrison applies, rejecting plaintiffs' attempts to limit its reach or impact.

The following year, in *Janus Capital Group v. First Derivative Traders*,[8] the Supreme Court ruled that a case could not proceed against investment advisors who, on behalf of the fund, prepare statements that the plaintiffs alleged were false and misleading. Though the decision pertains to investment advisors, its logic applies to bankers, lawyers, accountants, and others who help prepare disclosure documents. This significantly reduces the number of parties against whom plaintiffs can bring cases, contributing to a potential reduction in cases.

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6 Gabelli et al v. SEC, U.S. Supreme Court, No. 11-1274

7 Supreme Court of the United States Ruling, *Morrison et al. v. National Australia Bank Ltd. et al.*, decided June 24, 2010. The Supreme Court's decision in the *Morrison* case limited the jurisdiction of US courts to hear cases brought by foreign investors against foreign companies for shares purchased on a foreign exchange. Many speculated that the ruling would significantly curtail the number of cases brought against foreign issuers.

8 Janus Capital Group, Inc. v. First Derivative Traders, 131 S. Ct. at 2302 (2011)

Looking ahead, the aforementioned *Comcast Corporation v. Caroline Behrend* case in the court's current docket may have a significant impact on securities class actions. In this case, the Court is being asked whether "a district court may certify a class action without resolving whether the plaintiff class has introduced admissible evidence, including expert testimony, to show that the case is susceptible to awarding damages on a class-wide basis."[9] Requiring greater discovery and the scrutiny of expert testimony prior to class certification can have a significant bearing on the cases brought and how they proceed. However, on February 27, 2013, in *Amgen Inc. v. Connecticut Retirement Plans & Trust Funds*,[10] the Supreme Court upheld that plaintiffs do not need to prove materiality as a prerequisite to class certification.

Despite the potential that such cases might make it more challenging for the plaintiffs' bar to bring cases, some rulings seem to favor their cause. In 2011, the Supreme Court ruled in *Matrixx v. Siracusano*[11] that failure to have reported the potential side effects of a nasal spray product, on the grounds that the findings were not statistically significant, was not the only basis on which to determine if disclosure was necessary. This ruling may have encouraged the plaintiffs' bar to pursue efficacy cases; only one case was filed in 2011, compared to 13 cases in 2012.

With the pendulum perhaps swinging in favor of defendants or to the detriment of the investor, attorneys may have turned their attention to other avenues. The SEC Enforcement Division's Office of the Whistleblower is now fully operational. Officers within that unit have stated publically that they have seen an increase in the number of claims and greater quality of the information whistleblowers are reporting, due in no small part to the role that legal advisors have played in preparing submissions. With one bounty having been paid to date, it may be too early to fully assess how fruitful this avenue may be for plaintiff attorneys. But, should the number and amount of payments made under the program increase, more plaintiff attorneys may realign their resources to this area. This avenue is inherently attractive for plaintiffs, as it may require less work on the part of the law firm, is easy to file, and requires neither discovery nor a jury. At the same time, plaintiffs can obtain the benefit of the company's own investigation.

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9 *Comcast Corporation, et al. v. Caroline Behrend*, et. al., No. 11-864, US Sup; See April 2012.

10 Amgen Inc. v. Connecticut Retirement Plans and Trust Funds, No. 11-1085 (Feb. 27, 2013)

11 Matrixx Initiatives, Inc. v. Siracusano, 563 U.S. __, slip op. No. 09-1156 (Mar. 22, 2011)

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36 M&A-related cases were filed in 2012.

2012 was the third year in a row in which M&A-related cases accounted for more than 20% of total cases filed.

M&A-related litigation continues

Due to the large sums of capital exchanging hands, M&A transactions have always brought with them an inherent risk of litigation. However, it wasn't until 2010 that M&A transactions caught the interest of the plaintiffs' bar in federal courts, turning that inherent risk into a reality. For 2012, M&A-related filings maintained their prominence: While only 36 M&A-related cases were filed in 2012 (as compared to 48 in 2011 and 41 in 2010), those 36 cases represented 21% of the total cases filed for the year, making 2012 the third year in a row in which M&A-related cases accounted for more than 20% of total cases filed. The overall level of M&A deal activity remains below the levels seen prior to the financial crisis. PwC's *Year-End US M&A Outlook* for 2012 reported that the total number of deals in 2012 was approximately 7,600—well below the high of approximately 12,000 deals in 2007. While transaction activity post-financial crisis continues to trail the activity seen pre-financial crisis, M&A-related litigation remains significantly higher as a percentage of the total number of deals. Litigation arising from M&A transactions once again represented the single highest category of filings, indicating that plaintiff attorneys continued to focus on these cases as "easy targets." In addition, M&A-related filings were stable throughout 2012, with 18 of the 36 filings coming in the first half of the year and 18 coming in the second.

M&A-related cases usually are filed prior to the close of transactions. With regard to suits brought pre-close, shareholders of the acquired entity typically allege a breach of fiduciary duty when the board of directors accepts an offer that undervalues the entity. Such cases are most frequently filed soon after the announcement of the transaction; they tend to reach resolution (i.e., dismissal, settlement) within a relatively short period of time, and the transaction proceeds to closing.

Of the 36 M&A-related filings in 2012, 31 occurred prior to the closing of the transaction and were filed within an average of 32 days of the announcement of the proposed deal. There was only one instance in 2012 where the suit brought by the shareholders of the entity to be acquired appeared to be a contributing factor in a transaction's termination. This case was brought by the shareholders of Illumina, Inc.[12] as a result of an announced acquisition by Roche Holding AG. The Illumina shareholders alleged that the company's board of directors had breached its fiduciary duty by refusing to engage in negotiations or substantive dialogue with Roche, causing the shareholders to fail to get the best price for Illumina. The case was filed 41 days after the announcement of the acquisition and reached resolution 148 days after the filing. The remaining 30 transactions closed within an average of 73 days from announcement of the acquisition. In comparison, the 44 cases filed pre-close during 2011 took an average of 52 days to file from the date of the announcement, an average of 20 days more than in 2012. Forty-two of the 44 transactions from 2011 have closed, averaging 120 days from announcement of the transaction to closing, an average of 47 days more than in 2012.

12 Michael Derfler et al v. Illumina, Inc., No. 12 Civ. 564, S.D. Calif.

PwC's *Year-End US M&A Outlook* for 2012 stated that the fundamentals are in place for a healthy M&A market in the United States in 2013. With the potential for the number of deals to increase, so too might the volume of M&A-related litigation.

Cases against foreign issuers tumble

Cases against foreign issuers (FIs) decreased dramatically in 2012 compared to 2011, with only 32 cases filed in 2012 (19% of total cases) versus 61 filings (32% of total cases) the previous year. Cases against China-based companies[13] decreased 60%, from 37 in 2011 to 15 in 2012. Twice as many cases were filed in the first half of the year (10 cases) than in the latter half (5 cases). This is fairly consistent with filings from 2011, in which 23 cases were filed in the first half of 2011 and 14 cases were filed in the second half of the year. Also consistent with the previous year, filings against China-based companies were primarily brought in the Second Circuit and included accounting-related allegations, specifically inadequate internal controls, estimates, and overstatement of assets.

Figure 3: Percentage of US federal securities class action lawsuits filed against foreign and domestic companies per year, 2008–2012

Cases against non-China-based FIs also decreased in 2012. This decline was less dramatic but still noteworthy, and may indicate that the 2010 *Morrison* decision may be taking effect. There were 17 cases in 2012 against FIs based predominately in Canada and Europe, down 29% from the 24 cases in 2011. There was a clear trend in terms of the timing of such filings, with 13 cases brought in the first half of 2012 and the remaining four in the second half of 2012.

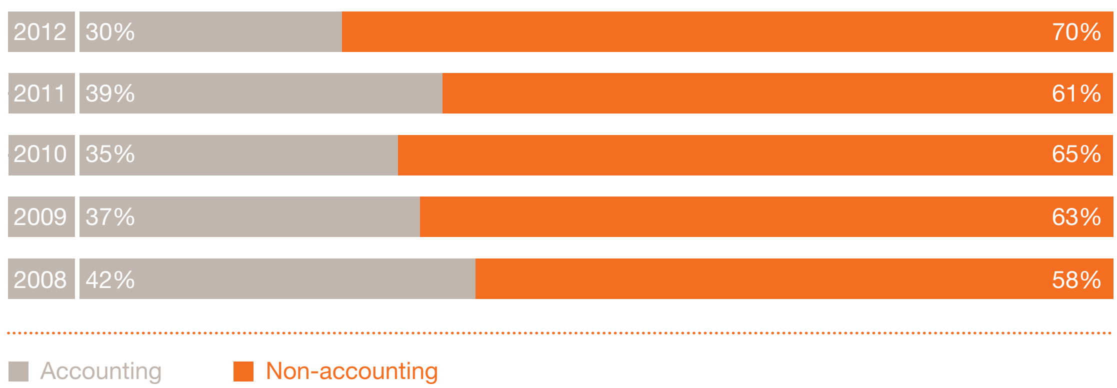
13 The term "China-based companies" includes entities headquartered in mainland China and Hong Kong.

Also noteworthy with respect to filings against FIs is the differentiation in the nature of allegations. Whereas allegations against China-based companies have typically focused on accounting issues, the opposite can be said for other FIs. Of 17 cases, 12 cited non-accounting-related allegations, such as failure to obtain permission from the government to expand a production facility; failure to fix, transparently and in good faith, Libor rates at levels that accurately reflected the inherent and actual risk in the marketplace; and failure to disclose that a drug was ineffective in treating cancer.

Accounting cases diminish, most significantly against foreign issuers

The number of cases that alleged accounting fraud decreased from 74 in 2011 to 51 in 2012, a 31% decline. A closer analysis shows that the decline reflects a dwindling number of cases against FIs. The number of cases against US domestic companies in 2012 is comparable to that of 2011.

Figure 4: Percentage of accounting and non-accounting US federal securities class action lawsuits filed per year, 2008–2012†



† Cases filed between 2008 and 2011 may have been updated with accounting allegations if the amended complaints alleged accounting violations not previously recognized. Numbers for 2012 cases reflect initial case complaints.

It was likely that the volume of China-related cases would decrease, given the finite number of such companies. At the same time, predictions that a similar trend would evolve with regard to other emerging-market companies entering the US market via RTOs have yet to play out. The instances of cases against China-based entities continued in 2012, totaling 15, with 12 alleging accounting fraud. The Public Company Accounting Oversight Board (PCAOB) identified 159 China-based companies entering US markets via RTO transactions between January 2007 and March 2010.[14] In addition, 2012 saw an emerging trend in which China-based companies attempted to de-list as publically traded entities in the United States to avoid US regulatory requirements, the scrutiny of shareholders, and the potential for litigation. However, such efforts to go private may ultimately lead to additional litigation in the event that current shareholders are dissatisfied with management's handling of the transaction or the consideration received.

While some cases remained focused on RTO companies, the accounting practices of other China-based companies also continued to come under scrutiny. Some common themes surfaced from an analysis of such cases: a lack of internal controls and general corporate governance; unreported or misrecorded related-party transactions; accounting for bank and loan transactions; and the consolidation or reporting of subsidiaries, business arrangements, and variable interest entities.

Factoring out the impact of cases pertaining to China-based companies, 2012 saw a decrease in the number of accounting cases against FIs, down from ten in 2011 to only five in 2012. Of these five accounting cases, two were brought against Swiss companies and three against Canadian entities. Several factors might be influencing this decrease: the continued focus on China-based companies; the logistical and legal difficulties experienced by plaintiffs in pursuing such cases, lessening their appetite to go international; or the *Morrison* ruling, which while perhaps not a direct correlation, may be a factor.

The remaining 34 accounting cases were against US domestic companies, compared to 35 cases brought in 2011. In 2011, nine accounting-related cases were brought against companies in the manufacturing sector; in 2012, only one similar case was brought. The decrease in these cases was offset by increases in cases against companies operating in the health, transportation, and business services sectors. The health, energy and financial services sectors saw the highest number of accounting-related cases. Financial services cases brought in 2012 include those that have elements consistent with cases seen during the financial crisis. However, other filings contained more traditional allegations: valuation and reporting of liabilities to policy holders and their beneficiaries, revenue recognition, and disclosures related to fund valuation and performance.

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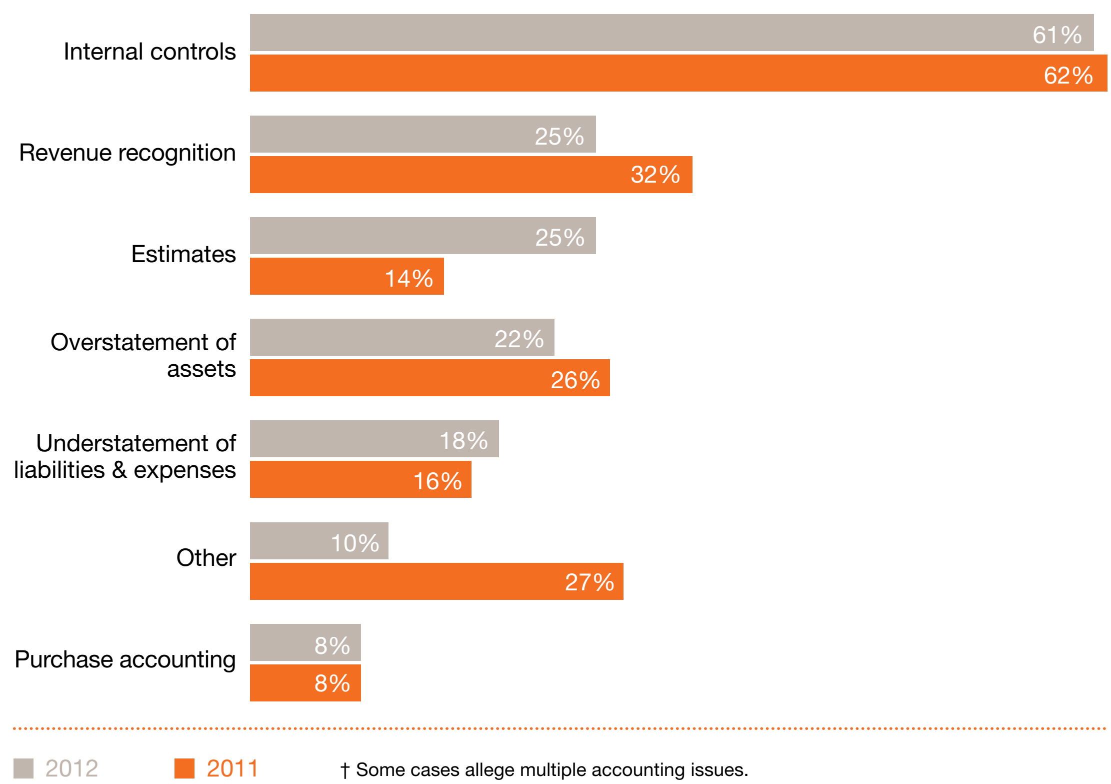
14 PCAOB Research Note # 2011-P1. "Activity Summary and Audit Implications for Reverse Mergers Involving Companies from the China Region: January 1, 2007 through March 31, 2010" dated March 14, 2011.

Figure 5: Percentage of accounting cases citing specific issues, 2011–2012†



† Some cases allege multiple accounting issues.

Three cases were brought against companies in the health industry, after reports emerged that the DOJ or the US Department of Health & Human Services had initiated investigations into potential Medicare fraud. Plaintiffs alleged that such companies had improperly recognized revenue and failed to implement adequate internal controls over billing practices.

Although the number of accounting-related cases has decreased, legal practitioners in securities litigation cases have commented on an emerging trend of disclosure-related cases evolving into accounting-related matters. Disclosure-related cases often center on comparing past statements with subsequent performance, or the delay in reporting a material event or emerging impact to the business. During the case, plaintiffs may point to the accounting treatment of an event, or the timing of accounting for the event, and use this as a means of introducing a subsequent allegation of accounting fraud. If a plaintiff can allege accounting fraud, the potential settlements have proven to be significantly higher.

Health industry sees more cases

The health industry[15] topped the charts as the industry with the highest number of filings for 2012 (38 filings), accounting for approximately 22% of total cases filed. This is the highest proportion since the enactment of the PSLRA (except for 2003 with 23%). The average proportion of filing activity against the health industry during the past five years has been approximately 17% of total filings.

Scan this for quick access link to a health industry video

A re-emerging trend in 2012 was the return of pharmaceutical-efficacy and product-efficacy cases, with 13 filings during 2012. This compares to just one in 2011, and more closely reflects levels seen in 2010 and prior. Of the 13 cases with allegations related to pharmaceutical-efficacy or product-efficacy, approximately 70% related to products (e.g., drugs, devices) in trial phase or seeking approval for a new use, while approximately 30% related to products already on the market. The return of such cases could potentially be a reaction to the favorable ruling for plaintiffs in the *Matrixx* efficacy case in 2011.

The remaining 25 filings against companies in the health industry concerned M&A-related allegations (10 filings) or business-related allegations (15 filings), such as Medicare billing schemes, violations of data protection laws, and poor projection of future sales/financial prospects.

Figure 6: Percentage of US federal securities class action lawsuits by industry, 2008–2012†

Industry	2008 %	2009 %	2010 %	2011 %	2012 %
Health: pharmaceuticals, medical devices, and health services	11	17	22	14	22
High-technology: computer services, electronics, and telecommunications	13	12	14	23	15
Energy‡	5	3	10	11	12
Financial services	47	41	22	12	9
Retail	1	3	2	4	6
Manufacturing	6	7	3	8	5
Business services	1	3	3	3	3
Other	15	13	24	25	27

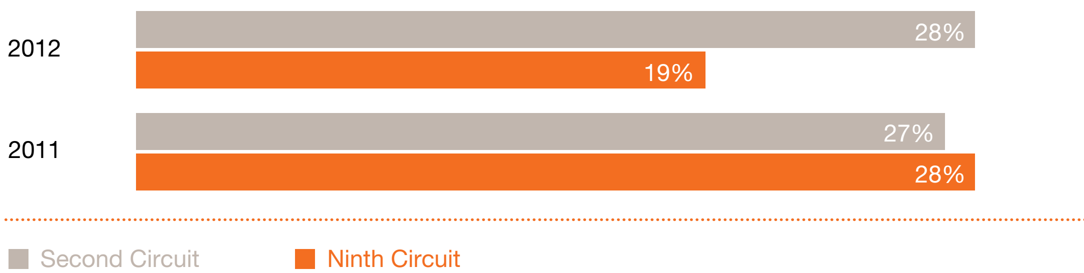
† Percentages have been rounded to whole numbers. Totals may not sum exactly due to rounding.
‡ "Energy" includes energy, utilities and oil and gas.

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

Second and Ninth Circuits continue to dominate, but to a lesser extent

The Second and Ninth Circuits[16] saw the most filings among the circuits, with 48 and 32 cases, respectively. However, the 80 combined cases accounted for a relatively low 47% of all cases, the first time in the past five years there were more cases filed outside of the Second and Ninth Circuits than within.

Figure 7: Percentage of US federal securities class action lawsuits filed in Second and Ninth Circuits, 2011–2012



The decline noted above is attributable to the Ninth Circuit, in which the number of cases fell from 54 in 2011 to 32 in 2012. This was brought on by the reduction in cases brought against China-based companies. In 2011, 16 such cases were brought before the Ninth Circuit, compared to only five during 2012. As reported in last year's study, the Ninth Circuit in 2011 also witnessed a large number of cases brought against high-tech companies. In 2012, fewer cases were filed against companies in the computer services (decrease of 39%) and telecommunications (decrease of 60%) sectors. These sectors saw a decline in cases involving allegations related to M&A transactions, disclosures, and accounting issues.

The Second Circuit again prevailed as the primary location for cases brought against FIs. Twenty-two of the 32 cases brought in 2012 against FIs were filed in the Second Circuit, with issuers headquartered in eight countries. While the Ninth Circuit had five of the remaining cases, it lacked geographic diversity, with all cases brought against China-based companies.

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

Overall number of settlements and total value of settlements decrease[17]

After a 26% decline in the number of settled federal securities class action cases from 2010 to 2011, cases settled in 2012 decreased by 7%. A total of 68 settlements were reached in 2012, compared to 73 settlements in 2011. The 68 settlements in 2012 also falls well below the average of 91 cases settled during the four-year period from 2008 through 2011. In 2012, there were eight zero-dollar or undisclosed settlements—the highest amount in the last five years. In two cases settled in 2012 with no cash settlement, the plaintiffs secured agreements to provide additional or revised disclosures in documents filed with the SEC.

Along with the decrease in the number of settlements in 2012, the total value of settlements also posted a dramatic 32% decline to $2.3 billion, compared to $3.4 billion in 2011. The total value of settlements in 2012 represented the lowest amount since 2002. With the exception of 2011, which saw an increase in total settlement value to $3.4 billion, total annual settlement amounts have been on a downward trend since 2005. In 2012 and 2011, financial crisis-related cases were the most common type of filings to be settled, representing approximately 28% of the total number of settlements, with 18 settlements in 2012 and 22 settlements in 2011. The top three settlements of 2012 were all financial crisis-related, totaling over $1.1 billion and representing approximately 48% of the total value of settled cases for the year: CitiGroup ($590 million), Bear Sterns ($295 million), and Beacon Associates and J.P. Jeanneret Associates, Inc.[18] ($220 million).

Figure 8: Settlements: all cases, 2008–2012†

Year settled	2008	2009	2010	2011	2012
Number of settled cases	95	95	99	73	68
Less: zero-dollar ($0) & undisclosed settlements	5	2	1	4	8
Net settlements‡	90	93	98	69	60
Total settlement value (in thousands $)	**4,639,100**	**3,160,300**	**2,944,300**	**3,434,000**	**2,304,600**
Average settlement value (in thousands $)	51,500	34,000	30,000	49,800	38,400
Median settlement value (in thousands $)	8,500	9,500	10,800	8,900	9,100
Number of outliers	–	–	–	–	1
Settlement value of outliers (in thousand $)	–	–	–	–	2,425,000
Total settlement value including outliers (in thousands $)	**4,639,100**	**3,160,300**	**2,944,300**	**3,434,000**	**4,729,600**

† 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.

17 During 2012 there was one settlement of $2.425 billion, that due to its size has been treated as an 'outlier' for the purpose of the discussion.

18 The Stipulation for Settlement for the Beacon Associates and J.P. Jeanneret Associates, Inc. cases settles multiple private federal and state cases.

The average settlement value (excluding zero-dollar or undisclosed settlements) decreased from $50 million in 2011 to $38 million in 2012. This decrease was attributable to a decline in the total value of settlements of $100 million or more. In 2012, there were five settlements of $100 million or more, totaling $1.5 billion, which is approximately 65% of the total value of settlements in 2012. In 2011, nine such settlements totaled $2.4 billion, or approximately 71% of the value of settlements in that year. Furthermore, 2012 had only one settlement that exceeded $500 million (Citigroup), compared to two such settlements in 2011 (Wachovia/Wells Fargo and Lehman Brothers). The Citigroup settlement of $590 million in 2012 resolved claims that shareholders incurred significant losses after the bank failed to take timely write-downs on collateralized debt obligations.

Figure 9: Settlements: accounting cases, 2008–2012†

Year settled	2008	2009	2010	2011	2012
Number of settled cases	68	58	50	33	35
Less: zero-dollar ($0) & undisclosed settlements	3	–	1	–	4
Net settlements‡	65	58	49	33	31
Total settlement value (in thousands $)	**4,289,100**	**2,333,300**	**2,223,900**	**2,412,600**	**980,800**
Average settlement value (in thousands $)	66,000	40,200	45,400	73,100	31,600
Median settlement value (in thousands $)	7,900	10,500	16,000	13,000	5,500

† 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.

For the first time in five years, the number of accounting-related settlements increased in 2012, but the total value of accounting-related settlements decreased. Thirty-five of 68 settlements in 2012 were accounting-related, compared to 33 accounting-related settlements in 2011, representing a 6% increase from 2011 to 2012. Despite the modest increase in the number of accounting-related settlements, the total value of settlements reached in accounting-related cases during 2012 fell 58%, from $2.4 billion in 2011 to $1.0 billion in 2012. The total value of accounting-related settlements of $1.0 billion in 2012 is the lowest total since 1998. Consistent with the decrease in the total value of accounting-related settlements, the average accounting-related settlement value decreased 56%, from $73 million in 2011 to $32 million in 2012.

Figure 10: Settlements: non-accounting cases, 2008–2012†

Year settled	2008	2009	2010	2011	2012
Number of settled cases	27	37	49	40	33
Less: zero-dollar ($0) & undisclosed settlements	2	2	–	4	4
Net settlements‡	25	35	49	36	29
Total settlement value‡ (in thousands $)	**350,000**	**827,000**	**720,400**	**1,021,400**	**1,323,900**
Average settlement value (in thousands $)	14,000	23,600	14,700	28,400	45,700
Median settlement value (in thousands $)	8,000	6,500	8,300	6,600	19,000
Number of outliers	–	–	–	–	1
Settlement value of outliers (in thousand $)	–	–	–	–	2,425,000
Total settlement value including outliers (in thousands $)	**350,000**	**827,000**	**720,400**	**1,021,400**	**3,748,900**

† 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 number of non-accounting-related settlements decreased in 2012. Thirty-three of 68 settlements in 2012 were non-accounting-related, compared to 40 non-accounting-related settlements in 2011, and the total settlement value of non-accounting-related settlements rose from $1.0 billion in 2011 to $1.3 billion in 2012. The average settlement value increased from $28 million in 2011 to $46 million in 2012. The increase in the average non-accounting-related settlement value is largely related to the dollar value of the top four non-accounting-related settlements in 2012 ($879 million, compared to $630 million in 2011). Four of the five settlements of $100 million or more in 2012 were non-accounting-related settlements: Bear Stearns ($295 million), Beacon Associates and J.P. Jeanneret Associates, Inc. ($220 million), Motorola ($200 million), and Pharmacia Corporation ($164 million). Bear Stearns and Beacon Associates and J.P. Jeanneret Associates, Inc. stem from the financial crisis; Motorola was a stock touting case; and the Pharmacia Corporation case was related to pharmaceutical efficacy.

What this means for your business

With the future of litigation trends still murky, companies must cast a wide net for monitoring, assessing, and mitigating risks

If there is one thing that 2012 has shown, it is that in the context of securities litigation, you never know what to expect. While the year started much the same as 2011, it closed very differently. Rather than the usual events within financial markets, law offices, and courtrooms influencing the number of securities litigation filings, events outside of those arenas appeared to influence the year's drop in filings, leaving us to wonder in what direction things will go from here. While the answer to this question is unknown, what is certain is the ability of the plaintiffs' bar to continue to identify and go after the "next big thing." Regardless of what that big thing may be, companies would be ill-advised to just stay the course; rather, they should continually monitor their business and investment activities, assess the potential risks associated with such activities, and devise strategies to mitigate those risks.

While no one knows what the future will bring, recent events and legislative activity in Washington may provide us with a few insights.

The Jumpstart Our Business Startups Act of 2012 (the JOBS Act), for instance, includes regulatory exemptions and reductions designed to make it easier for companies that qualify as "emerging growth companies" (EGCs)[19] to access capital markets. Some of those provisions include a requirement for fewer years of audited financial statements, exemptions from certain accounting standards and shareholder disclosure requirements (e.g., executive compensation), an exemption from the SOX Section 404 (b) requirement to obtain an independent auditor's opinion on internal controls over financial reporting, and an extended transition period for compliance to new Generally Accepted Accounting Principles (GAAP). These reduced requirements may limit transparency to potential investors and expose EGCs to potential litigation risk if shareholders perceive the issues to be of a large enough magnitude.

Through the first nine months of the JOBS Act, research has shown that most EGCs have chosen not to take advantage of reduced financial statement information requirements or to defer the time to comply with GAAP. However, the majority of EGCs have disclosed their intent to delay providing the auditor attestation report on internal controls. As such, companies that make use of the JOBS Act to access capital markets may be more likely to receive attention from the plaintiffs' bar.

How EGCs balance the benefits of easier access to capital markets with this potential increased risk of litigation will to a large degree influence how willing investors will be to invest in such companies, given the reduced protections they'll be afforded. As a proactive measure, some EGCs have actually disclosed in public filings that the JOBS Act may be a risk factor of which potential investors should be aware. The relaxation of SOX measures governing implementation, testing, and reporting on internal controls—instituted in response to some of the largest corporate accounting scandals in US history—might pave the way for a new round of accounting-related cases that could result in both regulatory investigations and securities litigation.

19 An EGC is defined as an issuer whose initial public offering was completed after December 8, 2011, and whose total annual gross revenues totaled less than $1 billion during its most recently completed fiscal year.

The 2012 presidential election put to rest uncertainties regarding who will be in the White House for the next four years, but it is still unclear how President Obama will work with the divided Congress to address lingering issues such as the economy and the looming debt ceiling. The potential for changes to the corporate tax code as a means to address the aforementioned issues may lead to uncertainty. This in turn could lead the plaintiffs' bar to find some sort of cause of action to allege violation of federal securities laws.

President Obama's re-election may also signal continued focus on financial regulation, despite turnover in pivotal positions on his economic team, such as Treasury Secretary, SEC Chairman, and Federal Reserve Chairman, as well as departures by enforcement chiefs at the DOJ and SEC. Some within the securities bar are already speculating that the nomination of Mary Jo White, a former prosecutor, as the next SEC Chairman might suggest continued aggressive enforcement for Wall Street. It will be interesting to see how her potential reign as the country's top financial regulator will impact other industries and areas of enforcement, particularly in light of the Dodd-Frank Act's new disclosure requirements (such as those regarding conflict minerals and resource extraction payments). In addition, the November 2012 release of the SEC and DOJ's long-awaited *A Resource Guide to the Foreign Corrupt Practices Act* might influence how the new SEC and DOJ enforcement leadership approach FCPA enforcement.

Questions still remain, too, about the SEC's new whistleblower program, created under the Dodd-Frank Act. The SEC's annual report for its fiscal year ended November 30, 2012, stated that over 3,000 whistleblower reports had been received during fiscal year 2012. However, it's unclear how prevalent the use of whistleblower information will be in enforcement actions and whether the plaintiffs' bar will try to cash in on the SEC's bounty program, either by assisting would-be whistleblowers with their submissions or through class action litigation against a registrant subsequent to an SEC enforcement action.

Recent comments and actions from the SEC appear to indicate that it will increase its attention on corporate executives trading in their own securities through the use of 10b5-1 plans, which allow executives to execute trades in accordance with pre-set plans. Corporations are not required to disclose 10b5-1 plans to regulators, much less to shareholders of their own corporations. In recent enforcement actions, the SEC has alleged that, although trades executed by executives were in accordance with pre-set trading plans, decisions to execute such trades were made on the basis of having non-public information, which enabled those executives to reap profits or avoid losses prior to that information being released to the public. If the SEC brings additional enforcement actions in 2013, depending on the subject matter, history would show that we may see an increase in "piggyback" securities litigation cases being filed by the plaintiffs' bar.

With so many items on regulators' agendas, 2013 looks to be a year that could go in many different directions. Only time will tell what direction those will be.

Additional figures

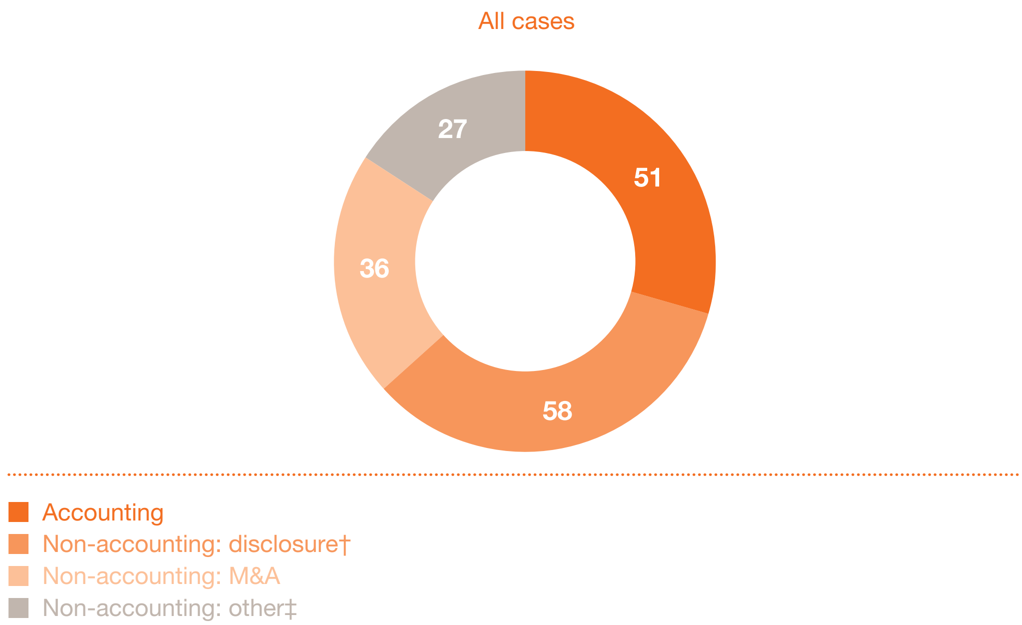


Figure 11: Number of US federal securities class action lawsuits by allegation type, 2012

† Non-accounting: disclosure includes adverse factors, declining market, IPO, touting, and false/misleading statements.
‡ Non-accounting: other includes improper activity/investigation, insider trading, pharmaceutical-efficacy, Ponzi scheme, product-efficacy, and other.

Additional figures *continued*

Figure 12: Percentage of US federal securities class action lawsuits filed by circuit, 2008–2012†

Circuit	2008 %	2009 %	2010 %	2011 %	2012 %
District of Columbia	–	–	1	1	–
First	7	3	4	4	5
Second	44	37	24	27	28
Third	6	6	8	9	10
Fourth	4	2	3	5	5
Fifth	2	6	5	6	6
Sixth	4	3	6	5	5
Seventh	4	5	7	4	6
Eighth	4	1	5	4	5
Ninth	13	25	30	28	19
Tenth	2	4	1	4	5
Eleventh	8	8	5	5	6

† Percentages have been rounded to whole numbers. Totals may not sum exactly due to rounding.

Figure 13: Number of Fortune 500 companies with US federal securities class action lawsuits filed against them, 2008–2012†

Year filed	Top 50	Top 100	Top 500
2012	5	6	19
2011	4	8	21
2010	9	10	20
2009	8	13	30
2008	14	17	37

† Companies with multiple US federal securities class action lawsuits filed against them in a single year are counted only once.

Additional figures *continued*

Figure 14: Percentage of US federal securities class action lawsuits naming particular officers or committees, 2008–2012†

Title	2008 %	2009 %	2010 %	2011 %	2012 %
CEO	74	79	86	86	94
CFO	65	61	63	69	70
Chairman	50	46	66	59	61
President	53	62	71	57	70
Director	35	42	58	64	67
Audit committee	1	3	2	9	10
Compensation committee	1	2	1	6	8

† Titles are based on those named in the complaint.

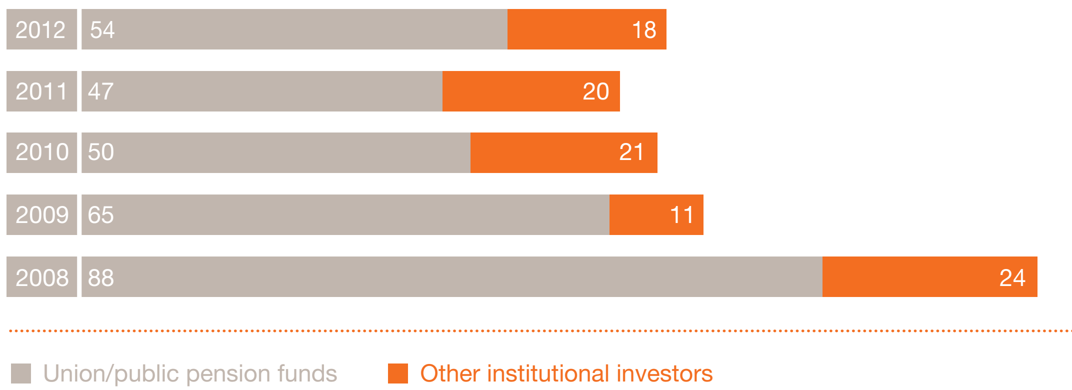
Figure 15: Percentage of settled cases by settlement value range, 2008–2012†‡

Total settlement (in millions $)	2008–2011 %	2012 %
100+	9	7
50–99.99	6	5
20–49.99	14	20
10–19.99	20	12
5–9.99	14	12
2–4.99	23	19
0–1.99	14	25

† 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 2012 outlier settlement is included in this figure.

Additional figures *continued*

Figure 16: Number of US federal securities class action lawsuits filed with institutional investors as lead plaintiff, 2008–2012†



† Final 2012 data is not available to date; the full-year projections are based upon filings through June 30, 2012.

Figure 17:
Settlement values:
by institutional investor
as lead plaintiff, 2008–2012†

	2008		2009		2010		2011		2012	
	Cases settled	Settlement (in thousands $)	Cases settled	Settlement (in thousands $)	Cases settled	Settlement (in thousands $)	Cases settled	Settlement (in thousands $)	Cases settled	Settlement (in thousands $)
Public pension	46	3,934,300	45	2,457,600	47	2,063,400	28	2,695,500	29	3,742,200
Other institutional	19	513,700	11	399,000	13	176,300	10	213,200	13	266,500
Total institutional investors	**65**	**4,448,000**	**56**	**2,856,600**	**60**	**2,239,700**	**38**	**2,908,700**	**42**	**4,008,700**
Less: zero-dollar ($0) & undisclosed settlements	2		1		1		1		2	
Less: outlier settlements	–	–	–	–	–	–	–	–	1	2,425,000
Net settlements‡	63	4,448,000	55	2,856,600	59	2,239,700	37	2,908,700	39	1,583,700
Average settlement	–	70,600	–	51,900	–	38,000	–	78,600	–	40,600

† 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).
‡ Number of cases used to calculate average settlement value.

Methodology

PwC tracks federal cases filed which allege violations of the Securities Act of 1933 and Securities Exchange Act of 1934. The focus of this study is on cases filed after the passage of the Private Securities Litigation Reform Act. The study also analyzes a variety of issues, including whether the case is accounting-related, a breakdown of accounting issues, and settlement data. Sources include case dockets, news articles, press releases, claims administrators, and SEC filings. PwC's Securities Litigation database contains shareholder class actions filed since 1996.

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 1999–2012 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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