The D & O Diary

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Cornerstone Releases Study of 2009 Securities Lawsuit Settlements

On March 24, 2010, Cornerstone Research released its annual study of securities class action lawsuit settlements. The most recent study, which is entitled "Securities Class Action Settlements: 2009 Review and Analysis" and is written by Ellen M. Ryan and Laura E. Simmons, can be found here. Cornerstone's March 24, 2010 press release concerning the study can be found here.

The study reflects a number of interesting observations about median and average securities class action lawsuit settlements that were approved during 2009. The study also includes a useful analysis of the factors that affect settlement size, and concludes with some commentary about likely future settlement trends.

First, the median 2009 settlement of $8.0 million is unchanged from 2008, although slightly up from the $7.4 median of all settlements during the years 1996 through 2008.

Second, the 2009 average settlement amount of $37.2 million is up from the 2009 average of $28.4 million. The 2009 average of $37.2 million is well below the $55.4 million average of all settlements during the period 1996 through 2009. However, if the largest four settlements during the period 1996 through 2008 are removed from the analysis, the average 2009 settlement of $37.2 million is slightly higher than the adjusted $34.4 million average for the 1996 to 2008 period.

(This analysis of average settlements excludes the settlements associated with the IPO Laddering cases, which given the number of cases resolved in that settlement has the effect of distorting the average settlement values.)

Third, the distribution of 2009 settlements also is comparable to prior years. Almost 60% of all settlements during the period 1996 through 2009 are below $10 million, and more than 80 percent settled for less than $25 million. Settlements in excess of $100 million remain relatively infrequent, occurring in approximately 7 percent of all cases.

Fourth, according to the study, the largest single most important factor is the amount of so-called plaintiffs' style damages (that is, "damages" calculated using the methodology most often urged by securities class action plaintiffs). However, settlements as a percentage of plaintiffs' style damages generally decrease as damages increase, and this observation is particularly valid for very large cases.

Fifth, the Cornerstone also assesses settlement values relative to what it calls Disclosure Dollar Loss, which compares the defendants company's stock prices on the days before and the days after the corrective disclosure. The study reports that settlements as a percentage of the disclosure dollar loss generally decline as the loss increases.

The study also identified a number of other factors that affect overall settlement size:

1. *GAAP Violations:* Approximately 65% of 2009 settlements involved cases included alleged violations of GAAP. These cases "continued to be resolved for larger settlements that for cases not involving accounting allegations.

2. *Auditor Defendants:* Cases in which auditors are defendants settle for a relatively higher percentage of estimated plaintiffs' style damages even when compared to the broader set of all cases in which improper accounting allegations were made. Since the cases filed in 2009 involve an increased number of auditor defendants even while the overall number of filings declined compared to the prior year, the presence of auditor defendants could become an increasingly significant factor in future settlements.

3. *Financial Restatements:* Approximately 45 percent of 2009 settlements involved financial restatements, which contrasts with reports of declining numbers of financial restatements. However, given the general lag between filing and settlement, the 2009 settlements generally

involve cases filed during the 2004 to 2006 period, which was when the most significant numbers of restatements occurred.

4. *’33 Act Allegations:* After controlling for the presence of underwriter defendants and controlling for other factors, the inclusion of ’33 Act claims does not result in a statistically significant increase in settlement amounts.

5. *Institutional Investors Plaintiffs:* Cases involving institutional investors as lead plaintiffs are associated with significantly higher settlements. The higher settlements are associated with cases involving public pension plans as lead plaintiffs as opposed to union funds or other institutional investors. These larger settlements may be due to the fact that the sophisticated investors get involved in the stronger cases and the larger cases. However, even when controlling for case size and other factors the presence of a public pension plan as lead plaintiff is still associated with a statistically significant increase in settlement size.

6. *Companion Derivative Suits:* Securities class action lawsuits associated with companion derivative cases are associated with statistically significant higher settlement amounts.

7. *SEC Enforcement Actions:* Cases that involve SEC actions are associated with significantly higher settlements, as well as higher settlements as a percentage of estimated "plaintiffs’ style" damages.

The study concludes with the observation that the economic environment during 2009 "did not have a distinguishable effect either on the number of settled cases or on the total value of securities case settlements approved during the year.’

The study also notes that as a general matter the securities class action lawsuits associated with credit crisis largely have not yet settled. Looking ahead, the study’s authors "anticipate that as these cases are resolved, settlements are likely to increase both in number and in value."

Discussion

As has been the case in prior years, Cornerstone's analysis of the 2009 settlements is interesting and full of useful information. There are a number of important considerations to keep in mind in assessing the information in the study.

The first is that the Cornerstone analysis is limited exclusively to aggregate amounts paid in settlement of securities class action lawsuits. It does not reflect, or even provide any indication of, settlement amounts that were or were not paid for out of D&O insurance.

Second, the settlement values do not reflect costs incurred in connection with the defending the securities class action lawsuits, or any related proceedings (for example, derivative suits or SEC enforcement proceedings). In considering the Cornerstone data for purposes of assessing D&O limits adequacy, appropriate adjustment would have to made for associated defense expense. Given the incredible escalation of defense expenses in recent years, the adjustment required to accommodate likely defense expense is substantial.

Third, the data set upon which the Cornerstone analysis is based is limited exclusively to class action settlements. In recent years, however, there has been the increased incidence of claimants opting out of the class settlement and reaching their own separate settlements. This phenomenon potentially increases the aggregate dollar costs required to resolve all related securities litigation, which is an additional factor that needs to be taken into account in connection with the overall question of D&O limits adequacy.

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