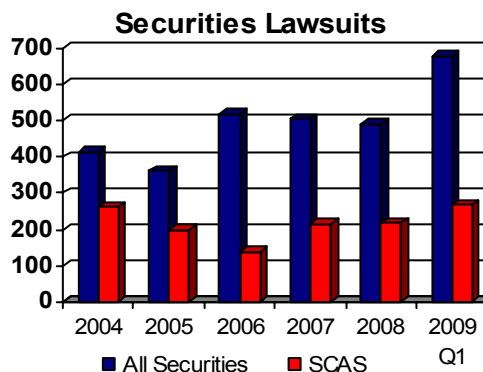


# Securities Litigation Surges in 2009

## An Advisen Quarterly Report – Q1 2009

**Essence:** With 169 securities lawsuits filed in the first quarter, 2009 is trending higher than 2008. Filings were up for securities class action, breach of fiduciary duties suits and cases filed in courts outside of the United States. For suits alleging securities fraud, filings were flat in the first quarter, but large settlements and awards occurred, underscoring the significance of these cases. Suits filed against financial firms dominated the scene, with Madoff-related suits leading the way.

Securities cases tracked in Advisen’s Master Significant Case and Action Database (MSCAd) in Q1 2009 reached 169 filings, up from 125 in Q4 2008 and 134 a year earlier in Q1 2008. On an annualized basis, securities suits filed in Q1 2009 were at 676 cases, representing an increase of 38% from 490 cases filed in 2008. Securities class action suits (SCAS) led the pack with 67 cases filed in Q1 2009, up from 53 cases the quarter before and 56 cases a year earlier. This translates to an annualized Q1 2009 figure of 268 cases filed, which would surpass the relatively litigious year of 2004 with 263 suits and 23% higher than the 218 suits filed in 2008. Madoff-related cases were responsible for 30% of all securities cases in the first quarter, and the sub-prime/credit crisis directly resulted in 26% of securities cases. The Q1 2009 figures include 27 cases filed in courts outside of the US. Five of these cases involved US companies.



Note: 2009 Q1 is annualized.

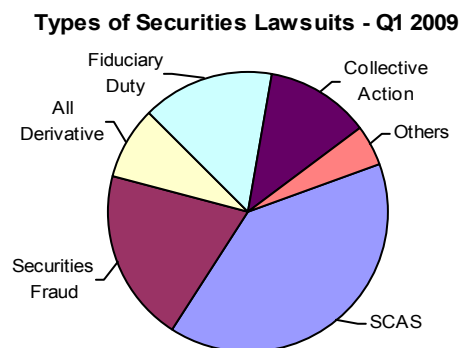
Annualizing the first quarter numbers is useful for comparing 2009 with prior years. However, 2009 might end up a year with a heavy front-end load of lawsuits as a flurry of Madoff-related cases has rolled in since the Wall Street legend was arrested in December 2008.

**Master Significant Case and Action Database (MSCAd):**<sup>1</sup> Advisen tracks significant lawsuits filed against companies and their directors and officers in MSCAd. MSCAd is the most complete and accurate database of such lawsuits, consisting of more than 30,000 events and over \$900 billion in aggregate losses. Securities cases in MSCAd represent more than 5,800 events and over \$70 billion in aggregate losses. Advisen’s MSCAd covers a full range of securities cases, categorized by type, such as SCAS, securities fraud, breach of fiduciary duties, and derivative shareholder actions, among other cases. Lists of suits and filing details are available at Advisen’s online store, Advisen Corner, at [http://corner.advisen.com/reports\\_topical\\_securities\\_quarter1\\_purchase\\_cases.html](http://corner.advisen.com/reports_topical_securities_quarter1_purchase_cases.html) and available at no extra charge to Advisen members through their [advisen.com](http://advisen.com) logins. For more information please call +1.212.897.4800 or e-mail [corner@advisen.com](mailto:corner@advisen.com).

<sup>1</sup> On Advisen.com, MSCAd cases can be found under the “Losses & Exposures” tab, then click on “MSCAd”.

## Case breakdown

Of the 169 securities cases filed in Q1 2009, the 67 SCAS cases formed the largest category. After SCAS cases, securities fraud accounted for 34 suits filed, up from 19 in Q4 2008, but down from 54 in Q3 2008. On an annualized basis, securities fraud cases filed in Q1 2009 represented 136 cases, flat with 2008 but down from 175 in 2007. Securities fraud cases largely are the result of regulatory actions such as lawsuits or proceedings by the US Securities and Exchange Commission (SEC). Other types of cases filed in Q1 2009 were: breach of fiduciary duties (26), collective actions in non-US courts (20), derivative shareholder actions and other derivative cases (14), and others (8).



SCAS cases have comprised the majority of securities lawsuits in most prior years. Continuing a trend that began in 2008, they now represent less than 40% of securities cases tracked in MSCAd. The increase in number of cases filed in courts outside the US, against both US and non-US companies, is noted in the high number of collective action cases. Collective actions are lawsuits outside the US that are similar to class-action lawsuits in the US, but often with much more stringent filing requirements, as well as limits on the types of plaintiffs allowed to file.

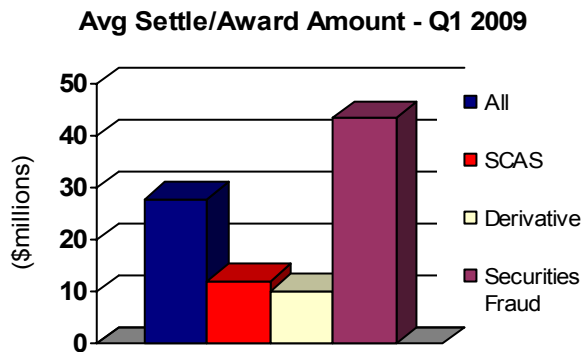
The major jurisdictions of securities suit filings during Q1 2009 include:

- 50 suits in US District Court, Southern District of New York (as well as two in the Eastern District, totaling 52 cases mostly encompassing New York City);
- 27 suits in courts outside of the US;
- 15 suits in state courts;
- 11 suits in US District Court, Northern and Central Districts of California;
- Six suits in US District Court, Southern District of Texas; and
- Five suits in US District Court, in New Jersey.

## Settlements/Awards

In Q1 2009, 76 cases were settled/awarded, meaning that either a judgment came down awarding damages or a settlement was reached. Of the 76 suits, one case was in a non-US court and 13 were cases with non-US companies as defendants. The average settled/awarded amount for the quarter was \$27.9 million, down significantly from \$60.6 million in Q4 2008. Q4, however, was a quarter strongly influenced by two large SCAS settlements, one for \$925.5 million against Unitedhealth Group and the other for \$303 million against GMAC. The Q1 2009 results were mostly in line with overall 2008, which had an average settled/awarded amount of \$25.5 million. The average amount fluctuates a bit from year to year, with 2007 at \$33.9 million, \$46.6 million in 2006, \$24.5 million in 2005, and \$40 million in 2004.

By type of suit, SCAS cases settled/awarded had an average amount of \$12.1 million, derivative shareholder actions and other derivative cases were \$10.2 million, and securities fraud had the highest average of \$43.4 million. Typically, securities fraud cases average a settled/awarded amount under \$5 million such as 2008 at \$4.7 million. Securities fraud cases, however, represented the largest five events (consisting of 16 company cases), totaling \$951.8 million among them, and including one case awarding \$406.5 million to STMicroelectronics from Credit Suisse in an auction-rate securities case.



## Trends

**SCAS leads, but other types gaining in importance.** The number of SCAS suits filed increased substantially to 67 in Q1 2009, from 53 in Q4 2008. This represents an annualized level of 268 suits, up from the flat years in 2007 and 2008, which were at 214 and 218, respectively. Despite this increase, total securities suits increased in Q1 2009, resulting in SCAS cases dropping to below 40% of securities cases filed. In an effort to distinguish themselves in the competitive securities litigation marketplace, plaintiffs' attorneys increasingly have been filing securities lawsuits alleging common law torts, contract law violations, and breach of fiduciary duties. This often results in two advantageous outcomes for plaintiffs and their attorneys: (1) it may avoid having the suit consolidated with others in a large class action suit by alleging unique claims; and (2) the suit could be tried in state court, as opposed to federal, allowing plaintiffs' attorneys to seek out states with more plaintiff-favorable laws and lower pleading standards.

Complaints that allege breach of fiduciary duties reached 26 cases in Q1 2009, an annualized rate of 104 cases. In 2008, 47 of such cases were filed, but 29 were in the fourth quarter, indicating that this trend started in Q4 2008 and continued into 2009. These suits are often tried in state courts, with eight of the 26 cases in the first quarter filed in state courts.

Securities fraud has become a growing case type since 2006. In Q1 2009, 34 securities fraud suits were filed - an annualized rate of 136 cases, matching 2008. In 2007, securities suits were filed at an even higher level, at 175 filed, which was significantly higher than the 102 cases filed in 2006. More importantly, all of the major settled/awarded cases in Q1 2009 were securities fraud cases, amounting to a total of almost \$1 billion in awards and settlements from five events. (See the Critical Cases section for details.) However, securities fraud settlements often contain fines and penalties not typically covered under directors & officers (D&O) policies, although defense costs are often covered.

**SCAS in state courts?** A tactic explored by plaintiffs' attorneys in 2008 was filing securities-related class action suits in state courts. The advantages of state class action claims over federal include forum-shopping for a more sympathetic state court, as well as avoiding the higher pleading standards for class-action status in federal courts. These suits take advantage of a non-removal provision in Section 22 of the Securities Act of 1933 that permits cases alleging violations of the '33 Act to be tried in state courts. However, the Class Action Fairness Act of 2005 (CAFA), requiring larger multi-state class actions to be removed to federal courts, is considered a potential impediment to this movement.

In July 2008, the U.S. Ninth Circuit Court ruled that no securities claims alleging violation of the '33 Act could be removed to federal courts in what was seen as a precedent-setting case, *Luther v. Countrywide*, a sub-prime mortgage-related suit originally filed in California Superior Court for Los Angeles County. Claiming that the provisions in the '33 Act trump CAFA, the court relied on a canon of statutory construction, which states that the specific should control the general. This case opened the floodgates to securities-related cases filed in state courts.

However, in January 2009, the Seventh Circuit Court in *Katz v. Gerardi* reached exactly the opposite conclusion: the provisions of CAFA trump Section 22 of the '33 Act. The court noted that the '33 Act's non-removal provision is incompatible with CAFA's jurisdiction and removal provisions. But the court claimed that it was unnecessary to consult canons of statutory construction, dismissing such canons as mere "doubt resolvers." The court points out that CAFA specifically addresses its applicability to securities cases, as it specifically lists exceptions to removal of securities cases. How this issue plays out in other federal circuits and appeals courts is yet to be seen.

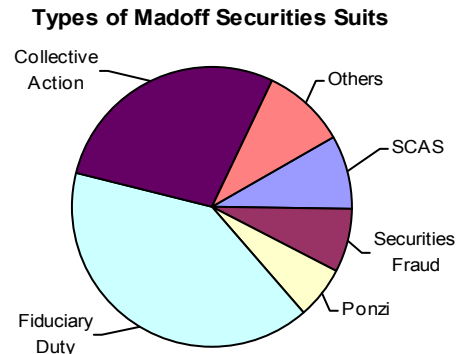
**E&O and fiduciary liability policies could take a hit.** Although securities cases have traditionally triggered coverage under D&O policies, recent securities cases may also trigger coverage under errors & omissions (E&O) and fiduciary liability policies. In a trend that started in 2008 and continued into Q1 2009, the bulk of cases have dealt with sub-prime/credit crisis issues and with Madoff and other Ponzi scheme issues. These suits, dealing with professional judgment and fiduciary duties may be excluded under D&O policies and covered under E&O policies. Fiduciary liability suits alleging violations of the Employee Retirement Income Security Act of 1974 (ERISA), the claim in many Ponzi scheme cases, may trigger fiduciary liability policy coverage.

In some cases, the same underlying cause of loss will trigger losses under D&O, E&O and fiduciary liability policies, resulting in aggregations across lines of business. Some allegations found in a securities suit that triggers E&O coverage may resurface in shareholder derivative suits, which can trigger coverage under Side A of a D&O policy. A recent trend for some Side A DIC D&O policies is wording that clearly covers ERISA liability, sparking D&O policy liability for ERISA suits.

**Financial firms dominate.** Financial services firms were by far more likely to have a securities lawsuit filed against them in Q1 2009 than firms from any other sector. Out of the 169 securities suits filed in the first quarter, 108 of them named financial services firms, or 64% of all securities suits filed. This number is substantially up from the already high level of half the suits filed in 2008. If insurance companies are included, then the number of suits filed against financial services firms rises to 117 suits or 69%.

The reason for the preponderance of suits filed against financial services firms is due to four types of related cases, in total resulting in 111 suits filed in Q1 2009: Madoff Ponzi scheme (50); sub-prime/credit crisis (44); specialist improper trading (11); and Stanford Ponzi scheme (6). The subprime/credit crisis and Madoff need no introductions. The specialist improper trading cases refer to a claim that Goldman Sachs, ETrade, and Bodel, among others, inserted option trades for their own accounts before and between customer trades. (See the Critical Cases section for details.) R. Allen Stanford, a Texas billionaire who ran his activities from offshore locales of the Caribbean, has been charged with an alleged \$8-billion fraud of operating a Ponzi-scheme similar to Madoff's. A flood of other alleged pyramid schemes have been unveiled by an uptick in investor redemptions in the current recessionary economy.

Madoff-related cases filed since the fraud was disclosed on December 11, 2008 consisted of 153 lawsuits in total through the end of Q1 2009, with 112 filed in Q1 2009. Securities-only filings totaled 82 suits since December 11, with 50 in Q1 2009. The 82 securities suits consisted of: breach of fiduciary duties (33), collective actions (23); SCAS (7); securities fraud (6), Ponzi scheme (5), and others (8).



Lawsuits filed in response to the sub-prime/credit crisis hail back as far as 2005, but started growing in number beginning in February 2007. The number of suits filed related to this issue through the end of Q1 2009 was 823. Of this total, 289 were securities suits. In Q1 2009, 44 securities suits were filed related to the sub-prime/credit crisis issue, which is at an annualized rate of 176 cases. This level of filing was in line with 171 filings in 2008, and substantially higher than the 72 filed in 2007. The 289 all-time securities suits filed related to this issue consisted of: SCAS (177); derivative suits (49); securities fraud (35); breach of fiduciary duties (15); and others (13).

It is likely that the wave of subprime-related suits, and in particular suits filed against financial services companies, will crest in 2009. As bankruptcies rise through the economy, hitting all sectors, and securities suits are filed as a consequence, suits filed will become more dispersed and broadly affecting all sectors.

**International exposure.** The number of suits filed against non-US companies in US courts is on the rise, and so is the number of suits filed against both US and non-US companies in courts outside the US. Of the 169 securities cases filed in Q1 2009, 47 were filed against non-US companies, and 22 were in courts outside the US. A total of 27 suits were filed outside of the US court system, including five against US companies.

Sub-prime-credit crisis related suits are more global than most types of suits. Of the 289 all-time securities suits related to this issue, 45 were filed against non-US companies, and eight of the total suits were filed in courts outside of the US. Of the 44 filed in Q1 2009, 10 were filed against non-US companies, indicating an increase in the percentage filed against non-US companies in the latest quarter.

The true global lawsuit phenomenon is Madoff. Of the 153 all-time Madoff-related lawsuits, for all types of lawsuits, 74 were filed against non-US companies, and 42 were filed in courts outside of the US. Of the 82 all-time Madoff-related securities cases, 31 were filed against non-US companies, and 26 were filed outside of the US. For Q1 2009, of the 50 securities Madoff-related cases, 28 were filed against non-US companies, and 23 filed outside of the US. This translates to the majority of Madoff-related securities suits filed in Q1 2009 being against non-US companies, and almost half were filed in courts outside of the US.

## Critical cases

Five events consisting of 16 lawsuits made up most of the settled/awarded amounts for Q1 2009, totaling \$951.8 million. Advisen defines each company named as a defendant in any event as a separate lawsuit, accounting for the 16 lawsuits. All were securities fraud cases, and all but one was a result of a regulatory action.

Lists of suits and filing details are available at Advisen's online store, Advisen Corner, at [http://corner.advisen.com/reports\\_topical\\_securities\\_quarter1\\_purchase\\_cases.html](http://corner.advisen.com/reports_topical_securities_quarter1_purchase_cases.html) and available at no extra charge to Advisen subscription members through their [advisen.com](http://advisen.com) logins. For more information please call +1.212.897.4800 or e-mail [corner@advisen.com](mailto:corner@advisen.com).

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