

Upping the Ante: Securities Class Actions are Suddenly Going to Trial

By Michael Tu

In the last decade, all but a handful of the federal securities class actions that were not dismissed were settled, usually because of their substantial potential exposure. From the enactment of the Private Securities Litigation Reform Act of 1995, which raised the pleading requirements for securities fraud actions, through the first half of 2004, there were only two known class actions involving post-Reform Act claims that concluded in a trial verdict. When trials involving pre-Reform Act claims are counted, that number increases to just five.



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However, the past 18 months have seen a significant acceleration in the pace of these cases going to trial and verdict; during this short time two securities class actions have been tried to a verdict and at least four have settled mid-trial.

This recent increase coincides with significant changes in the settlement landscape within the past two years. Those changes have played a significant role in changing the economics of securities settlements and the increased willingness of both plaintiffs and defendants to go to trial.

The dramatic increase in total settlement values over the past few years continued in 2005, with settlements in two cases alone totaling more than twice the value of all settlements in 2004. (JPMorgan Chase, Citigroup and Canadian Imperial Bank of Commerce agreeing to settle claims against them arising from Enron for \$2.2 billion, \$2 billion and \$2.4 billion, respectively, and Time Warner agreeing to settle actions arising from its merger with AOL for \$2.4 billion.) Total settlements in 2004 were only \$5.5 billion, which was more than double the total for 2003.

The economics of settling a securities class action have thus fundamentally changed from just several years ago, and that is affecting the traditional risk and bene-

fit analysis of going to trial for both plaintiffs and defendants in many cases. As average settlement values rapidly appreciate, plaintiffs are demanding ever-higher amounts to settle cases, encouraged by the increasing number of large settlements (more than \$100 million) within the past two years.

Moreover, although the results from the trials that have gone to verdict have been largely mixed, there have been two large jury verdicts from recent trials (*Real Estate Associates* and *ICN/Viratek*, described below) that provide further encouragement to plaintiffs that believe they have a good case for trial. This changed landscape appears to be creating an environment that is encouraging more litigants to go to trial. The federal courts have seen at least six securities class actions go to trial within the past 18 months, with two going all the way to verdict within months of each of other. The first of these, in February 2005, was against the chairman of Clarent Corp. and its auditor Ernst & Young, arising from Clarent's overstatement of revenues and restatement of earnings. (*In re Clarent Corporation Securities Litigation*, 01-CV-3361). The jury returned a mixed verdict, finding that the chairman knowingly participated in an accounting violation, but finding no liability against Ernst & Young.

Two months later, a securities class action was tried in the Central District of California (*Miller v. Thane International*, SACV 03-1031). In that case, shareholders in a company acquired in a stock-for-stock transaction alleged material misrepresentations in the merger prospectus and proxy statement. Following a bench trial in April 2005, the court returned a defense verdict on all claims.

The remaining four cases that have gone to trial within the past 18 months have settled mid-trial for significant sums. After three weeks of trial in October 2004 in the District of New Jersey, AT&T Corp. settled a securities class action in connection with its initial public offering of AT&T Wireless for \$100 million. PricewaterhouseCoopers and several officers of Safety-Kleen Corp. settled an action in

the District of South Carolina in April 2005 (in connection with Safety-Kleen's bond offerings prior to its bankruptcy in June 2000) for a combined \$84 million after seven weeks of trial. That same month in the Southern District of New York, Arthur Andersen settled claims arising from its role as WorldCom's auditor for \$65 million after four weeks of trial. In July 2005, a securities class action in the Southern District of New York, *In re Globalstar Securities Litigation*, was settled mid-trial for \$20 million.

This recent surge in trials during the past 18 months is significant because only a handful of cases had been tried to verdict in the decade before. Of those, two were post-Reform Act cases tried to differing results. The first was in 1999 in the Eastern District of New York against BDO Seidman for its audits of Health Management Corp. (*In re Health Management Securities Litigation*, 96-CV-889). That trial resulted in a defense verdict for BDO Seidman.

By contrast, in the *Real Estate Associates* trial in 2002, plaintiffs achieved a significant victory in the Central District of California (*In re Real Estate Associates Limited Partnership Litigation*, CV 98-7035). After a five-week trial involving allegations of misstated proxy solicitations concerning the sale of interests held by certain publicly limited partnerships, the jury returned a verdict for plaintiffs in the amount of \$185,095,112 (\$92,550,056 in compensatory damages; \$92,545,056 in punitive damages).

Three known pre-Reform Act cases have also been tried to verdict within the last decade. In the *ICN/Viratek* case (*In Re ICN/Viratek Securities Litigation*, 87 Civ. 4296 (1996)), the 1996 trial resulted in a partial jury verdict, after which the case settled for \$14.5 million. In the 1998 trial of the Biogen case, (*Lazar v. James*, 94-CV-12177 (1998)), the jury in the District of Massachusetts returned a verdict for defendants.

Finally, the chairman and CEO of Everex Systems Inc. went to trial twice in a securities fraud class action in the Northern District of California. (*Howard v. Hui*, 92-CV-3742). In 1998, the first trial resulted in a directed verdict for defendant at the close of plaintiffs' case. After the Ninth Circuit remanded the case for a new trial, a second jury in 2002 returned a defense verdict.

The varying results from these trial verdicts gives both plaintiffs and defendants reason to believe that they can, under the right circumstances, take their cases to trial and win. With the increasingly aggressive settlement postures now being taken by plaintiffs in many cases decreasing the defendants' relative risk of going to trial, defendants are less likely to settle when they believe they have a defensible case.

About the Author:

Michael Tu (mtu@orrick.com) is a partner at Orrick specializing in defending companies, directors, officers, underwriters and accountants in securities class action litigation, derivative actions and regulatory investigations. He was one of the lead trial counsel that obtained a defense verdict in the Miller v. Thane International securities class action trial.

About Orrick:

Orrick has over 50 lawyers who defend issuers, underwriters, accountants and individual officers and directors in securities class actions and government investigations, and last year was the only firm to have partners in Los Angeles, Palo Alto and San Francisco ranked in the top 30 securities litigators in California. Orrick's securities litigators have obtained complete defense verdicts in three of the six known federal securities class actions that have been tried to a verdict within the last decade.



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