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Observations from the editor

In PricewaterhouseCoopers' 13th annual evaluation of private securities class action lawsuits, one thing is glaringly obvious: While 2008 was an extraordinary year for litigators, it also demonstrated how extremely vulnerable giant financial institutions and entire economies are to fissures in the financial system.

In the seemingly free-falling economic environment of the latter part of the year, we witnessed unprecedented events: Major failing institutions, systemic breakdowns in the financial system, and record government bailouts throughout the globe. All of this set the stage for notable litigation activity and trends.

US regulatory authorities focused on the players within various areas of the financial markets: mortgage companies, investment banks, broker-dealers, and insurance companies. The SEC secured some of the largest settlements in its history from firms charged with misleading investors. At the close of the SEC's fiscal year, 50 investigations relating to the financial crisis were ongoing. The SEC and DOJ secured record settlements for FCPA violations. Both regulatory bodies pledged to continue pursuing FCPA violations going forward.

Fuelled by the financial crisis, federal securities class actions increased for a second year, and, not surprisingly, the financial services industry group was the most frequently sued, replacing high-technology companies for the first time since the passage of the PSLRA. Public and union pension funds continued to be the most active lead plaintiff in institutional investor filings, and a number of filings alleging Ponzi schemes emerged in the latter part of the year.

We also observed certain downward trends: The number of accounting-related cases as a percentage of total filings declined, and, likewise, the number of settlements recorded declined to the lowest number in any year this decade. Similar declines in settlement values, however, did not follow.

On the foreign securities litigation activity front, federal securities class actions filed against foreign private issuers (FPIs) jumped to an all-time high since the passage of the PSLRA. The number of FPI accounting-related cases doubled to 16 cases in 2008, while the average settlement value of FPI cases overall decreased. The number of foreign companies registered with the SEC continued to slide downward for a third year.

While the ramifications for 2009 and beyond remain to be seen, one thing is certain: The worldwide economic crisis will transform the financial industry and shape future regulation and enforcement.

As editor of the 2008 Study, I am appreciative to a handful of exceptional team members in the PricewaterhouseCoopers Securities Litigation and Investigations Practice, particularly my co-author, Patricia Etzold, for her scrutiny of global litigation activity. I extend additional thanks to Laura Skrief, Luke Heffernan, and Kevin Carter, who all provided meticulous analysis of the 2008 filings and invaluable contributions to the project at large.

Lastly, we are tremendously grateful for the editorial contributions from the law firms Hunton & Williams LLP and Sullivan & Cromwell LLP, in addition to Tricia Howse from the SFO, for the UK perspective on international regulatory cooperation.

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2008 Securities litigation study*



*connectedthinking


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The heart of the matter

In a remarkable year of floundering institutions, government interventions, and teetering economies, the financial industry is facing unprecedented challenges.

For most, the Latin phrase “annus horribilis” best sums up 2008. It will be remembered as the year in which the subprime crisis of 2007 evolved into a financial crisis with reverberating effects on financial markets and economies throughout the world. It was a year that brought events such as the demise of prominent financial institutions, the near collapse of whole economies, and financial interventions by various governments around the world in critical bids to revive lending and shore up their financial and insurance industries.

In the US, the crisis worsened in September 2008, leading to plummeting stock markets, losses of trillions of investor dollars, and the failure of major institutions such as Lehman Brothers. The US government, in an effort to stave off further disaster, approved the passage of the Emergency Economic Stabilization Act of 2008, which committed \$700 billion to repurchase toxic assets and recapitalize certain financial institutions. Indeed, the overall federal resources committed in 2008 to support the financial markets, housing, and financial institutions has been estimated to exceed \$6.4 trillion.¹

To add fuel to the fire, another disturbing discovery emerged in December: the Bernard Madoff scandal, which is now regarded as the largest Ponzi scheme in history. Financial losses associated with Madoff were suffered by investors worldwide, and loss estimates were set in excess of \$50 billion.

To date, many countries around the world, including the US and Britain, have officially declared their economies to be in recession. The crisis is widely recognized as driving a transformation of the financial industry and necessitating a reengineering of future regulation.

Regulatory authorities responded by focusing attention on the players within various areas of the financial markets: mortgage companies, investment banks, broker-dealers, and insurance companies. The plaintiffs’ bar was also vocal in response, with the number of federal securities class actions increasing for a second year. Activity against companies listed on US markets mirrored this trend, with federal securities class actions filed against foreign private issuers (FPIs) jumping to an all-time high since the passage of 1995’s Private Securities Litigation Reform Act (PSLRA).

1 SEC Chairman Christopher Cox, “Address to Joint Meeting of the Exchequer Club and Women in Housing and Finance.” Presented at the Mayflower Hotel, Washington, DC (December 4, 2008); <http://www.sec.gov/news/speech/2008/spch120408cc.htm>.

An in-depth discussion

The worldwide economic crisis is transforming the financial industry and shaping future regulation.

2008 in brief: Financial services steps into the spotlight

It was a year of tumultuous change for the financial industry, and one that is likely to usher in a future of new regulation, oversight, and enforcement.

In 2008, both the Securities and Exchange Commission (SEC) and the Department of Justice (DOJ) focused attention on financial markets. The SEC secured some of the largest settlements in its history from firms charged with misleading investors about the liquidity risks associated with auction rate securities (ARS) that they underwrote, marketed, and sold: UBS Securities LLC and UBS Financial Services and Citigroup Global Markets settled for \$30 billion, and, reportedly, the SEC is close to reaching final settlements with Bank of America, Merrill Lynch, RBC Capital Markets, and Wachovia. The settlements are expected to total more than \$50 billion. At the close of the SEC's fiscal year, 50 investigations involving lenders, investment banks, credit rating agencies, insurers, and broker-dealers were ongoing.

Despite the current crisis, however, the number of new accounting-related SEC litigation releases during 2008 declined. And specifically, new accounting-related SEC litigation releases issued in connection with the Foreign Corrupt Practices Act (FCPA) also dropped.

However, it was during 2008 that both the SEC and DOJ secured a record settlement with Siemens for \$350 and \$450 million, respectively, in connection with FCPA violations. Both regulatory bodies pledged to continue their commitment to pursuing FCPA violations going forward.

Not surprisingly, the number of federal securities class actions from the plaintiffs' bar rose for the second year, with 29 percent more filed in 2008 than in 2007. As discussed in more detail on page 6, a total of 210 cases were filed in 2008 compared with 163 in 2007. The majority of filings during 2008 were related to the financial crisis, with investment banks most often named as the defendants. In fact, for the first time since the PSLRA, in 2008 the plaintiffs' bar filed more federal securities class actions against the financial services industry group (banking, brokerage, financial services, and insurance) than against any other industry.

The total value of settlements in federal securities class actions amounted to \$3.6 billion in 2008—a decrease of 45 percent from 2007, but that's due primarily to Tyco's \$3.2 billion settlement in 2007. Excluding the Tyco settlement, the total settlement value actually increased by approximately 9 percent over 2007, from \$3.3 billion in 2007 to \$3.6 billion in 2008. The highest nine settlements were exclusively accounting-related settlements.

Within the past year, there was also an increase in the number of class actions filed against foreign companies listed on US stock exchanges. In 2008 there were 36 in total, compared to 27 in 2007—an increase of 33 percent. As was the case with 2008 filings overall, almost half the matters were related to the financial crisis and involved companies including Credit Suisse, Royal Bank of Canada, and Société Générale. The majority of foreign companies affected were Canadian companies. In contrast to 2007, the highest federal securities class action settlement was not made by a foreign filer.

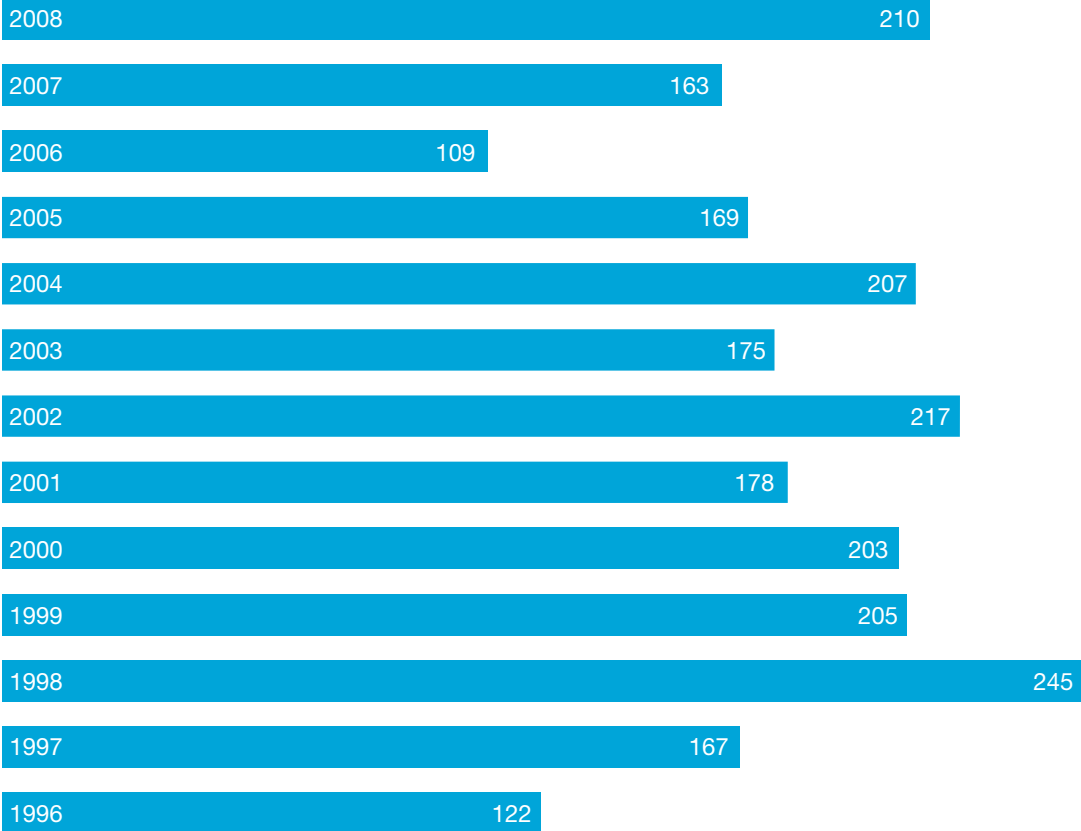
Federal cases continue to climb

The number of federal securities class action filings continued to increase during 2008. Fuelled by the financial crisis, federal filings increased to 210 from 163 case filings in 2007. This represented a 29 percent increase over 2007, an increase of approximately 15 percent over the average number of filings (182) since the enactment of the PSLRA in 1995, and an approximate increase of 22 percent over the average filings (172) since the enactment of the Sarbanes-Oxley Act (SOX) in 2002. Unlike 2007, when much of the filing activity occurred in the last two quarters of the year, overall filing activity during 2008 was steady throughout the year. About 50 cases were filed each quarter, with only a minor uptick to 59 cases in the fourth quarter.

Figure 1. Number of US federal securities class action lawsuits, 1996–2008

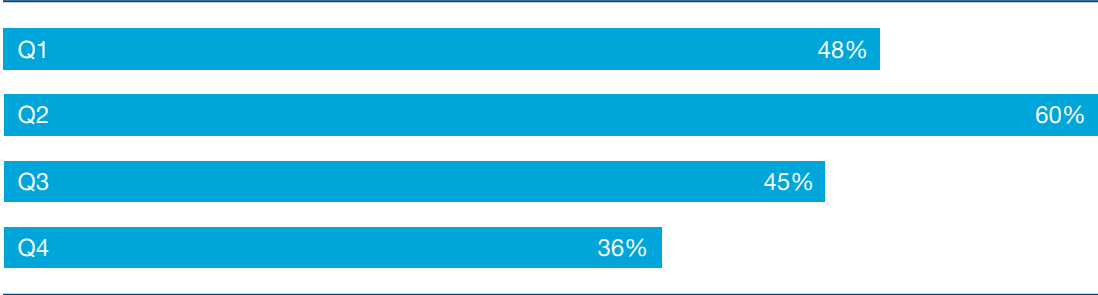
Year filed	Federal cases	Laddering cases	Analyst cases	Mutual fund cases	State-only/ stock options backdating (derivative) cases	Total cases
2008	210	–	–	–	–	210
2007	163	–	–	4	2	169
2006	109	–	–	–	110	219
2005	169	–	–	4	–	173
2004	207	–	1	20	–	228
2003	175	–	19	16	–	210
2002	217	1	46	–	–	264
2001	178	309	–	–	–	487
2000	203	–	–	–	–	203
1999	205	–	–	–	–	205
1998	245	–	–	–	13	258
1997	167	–	–	–	11	178
1996	122	–	–	–	25	147
13–yr avg	182					

Figure 2. Number of US federal securities class action lawsuits filed per year, 1996–2008



Filings related to the financial crisis dominated throughout 2008 and represented the largest group of similar filings. A total of 98 such cases were filed, representing 47 percent of total filings. Most occurred in the first two quarters of the year, when 25 and 30 filings were recorded, respectively. The last two quarters of 2008 witnessed a drop in the number of such cases filed—to 22 and 21 cases, respectively. Cases involving auction rate securities (ARS) accounted for approximately a third of the 55 cases filed in the first half of the year and represented a fifth (21 cases) of the financial-crisis-related cases filed during 2008. Filings related to the financial crisis represented 48, 60, 45, and 36 percent of total filings in each quarter of 2008, respectively.

Figure 3. Percentage of US federal securities class action lawsuits related to the financial crisis, Q1–Q4 2008

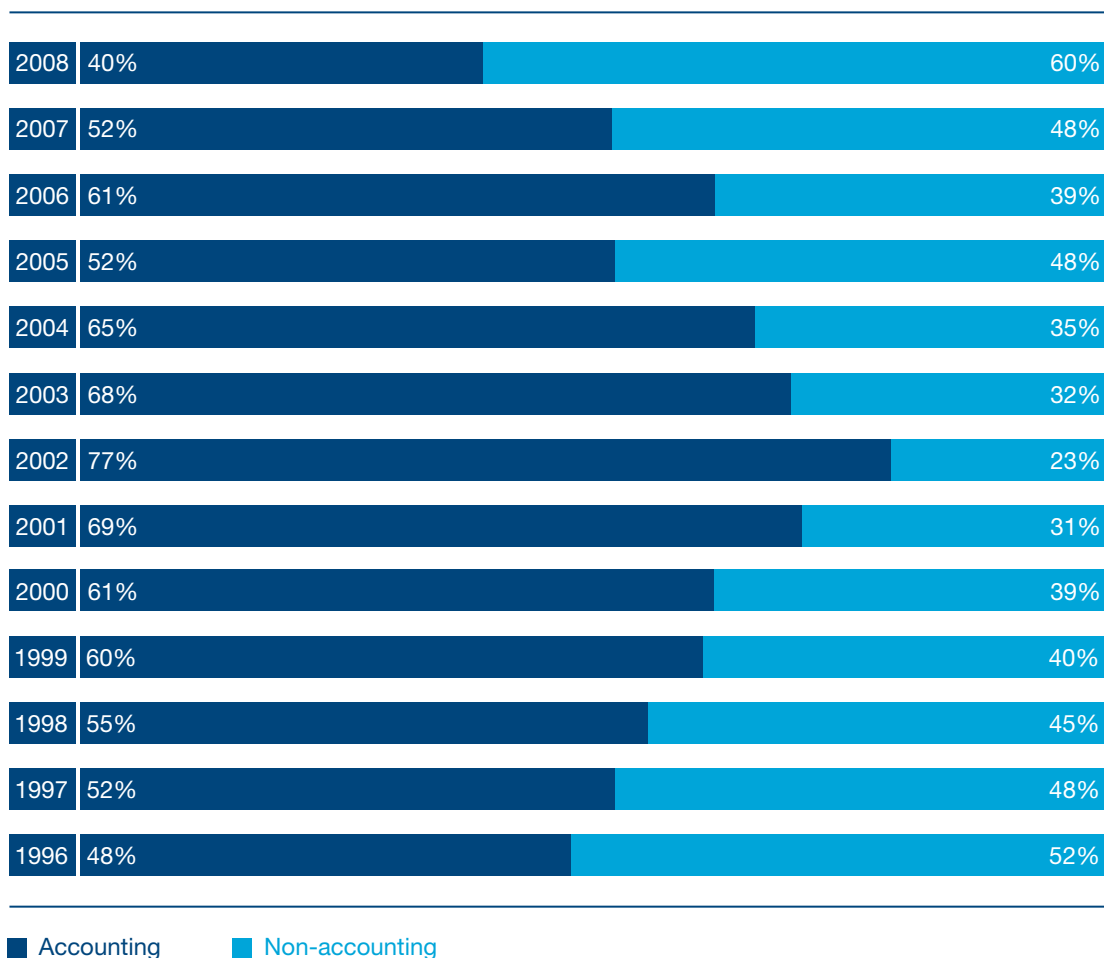


During the third and fourth quarters of 2008, disclosure-related cases and those with accounting allegations unrelated to the financial crisis replaced the predominance of financial-crisis-related cases.

Accounting-related cases hit all-time low

The number of accounting-related cases as a percentage of total filings continued to decline for yet another year, falling from 52 percent in 2007 to 40 percent in 2008—the lowest since passage of the PSLRA. The average since the PSLRA was 59 percent. Prior to the 2008 report, 1996 was the only other year in which accounting-related cases represented less than 50 percent of total filings. Disclosure-related cases filed in connection with the financial crisis and initial public offerings (IPOs) dominated during 2008, representing 55 percent of the 126 non-accounting-related cases filed.

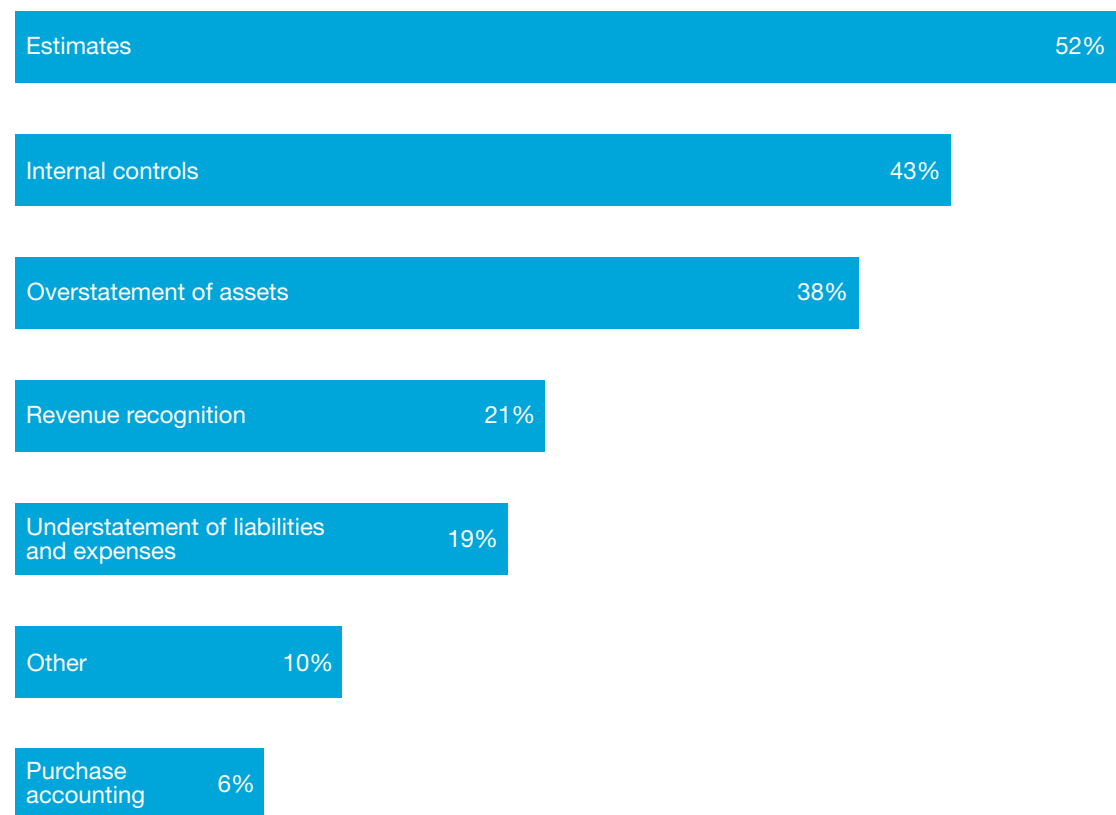
Figure 4. Percentage of accounting and non-accounting US federal securities class action lawsuits filed per year, 1996–2008†



† Cases filed between 1996 and 2007 may have been updated with accounting allegations if the amended complaints alleged accounting violations not previously recognized. Numbers for 2008 cases reflect initial case complaints.

Of the accounting issues alleged in accounting-related cases filed during 2008, estimate-related allegations were the most commonly cited, representing 52 percent of all accounting-related filings. In 2007, inadequate estimates were alleged in 47 percent of such filings. As in 2007, filings related to the financial crisis accounted for most estimate-related cases. Specific allegations in 2008 included the failure to timely record an impairment and the misuse of mark-to-market accounting. Cases with estimate-related allegations included Ambac Financial, Farmer Mac, and Lehman Brothers.

Figure 5. Percentage of accounting cases citing specific issues, 2008[†]



[†] Some cases allege multiple accounting issues.

Allegations pertaining to internal controls were the second most common accounting-related issue. It had been the most cited category in 2007 (representing 49 percent of all accounting-related filings), but dropped to 43 percent in 2008. Within the internal controls category, allegations included lack of controls surrounding off-balance-sheet entities, lack of controls to ensure that reserves for asset-backed securities were adequate, and lack of risk management and mitigation controls. Such allegations were filed against 12 banking/brokerage companies, including Citigroup, Merrill Lynch, and MoneyGram International.

The third most common category of accounting allegations (cited in 38 percent of cases) was overstatement of assets. This category of allegations was also principally driven by financial-crisis-related filings, but to a slightly lesser extent than in 2007. Specific allegations included overvaluing positions in commercial and subprime mortgages (and in securities tied to these mortgages), artificially inflating asset values, and failing to properly account for highly leveraged loans. More than 50 percent of the filings that alleged overstatement of assets were against companies operating in the banking/brokerage sector, such as Charles Schwab, CompuCredit, Downey Financial, and PMI Group.

In 2007, 23 percent of accounting-related filings alleged understatement of liabilities and expenses compared to 19 percent in 2008. Allegations related to revenue recognition occurred in 21 percent of accounting-related filings made in 2008, up from 17 percent in 2007.

Of course, despite the fall in the number of accounting-related cases during 2008, it is noteworthy that the liability attached to accounting-related settlements during 2008 increased.

Filings target financial services industry group

High-tech is no longer the top target. For the first year since the PSLRA, high-technology companies—including computer services, electronics, and telecommunications companies—ceased to be the industry group most frequently targeted by federal securities class actions. In 2008, the financial services industry group was the most frequently sued.

The increase in filings against the financial services industry group began in 2007 with the dawning of the financial crisis, and by year-end 2007, 21 percent of all filings involved financial services companies (compared to 6 percent in 2006). In 2008, as the financial crisis deepened, so too did the number of filings against financial services companies: By year-end, they represented a record 48 percent of all 2008 filings—the largest percentage of filings recorded against one specific industry group since the PSLRA. Loan originators such as IndyMac, National City, and Thornburg Mortgage—as well as investment banks such as Citigroup, Merrill Lynch, and Morgan Stanley—bore the brunt of filings in the financial services industry group.

The high-technology group was a distant second, with federal securities class actions against this sector actually falling—from 40 (or 25 percent of all filings) in 2007 to 27 (or 13 percent) in 2008. The cases were mostly accounting-related and involved companies such as AuthenTec, Cadence Design, and NextWave Wireless. Specific issues alleged included understatement of expenses due to improper options backdating, and overstatement of assets relating to the valuation of inventory. Two of the three subsets of the high-technology group—computer services and telecommunications—experienced the biggest percentage drop in the number of filings from 2007 to 2008. Filings against computer services companies fell from 8 percent in 2007 to 3 percent of all 2008 filings, and those against telecommunications companies fell from 9 percent in 2007 to 4 percent in 2008.

Figure 6. Percentage of US federal securities class action lawsuits by industry, 2006–2008†

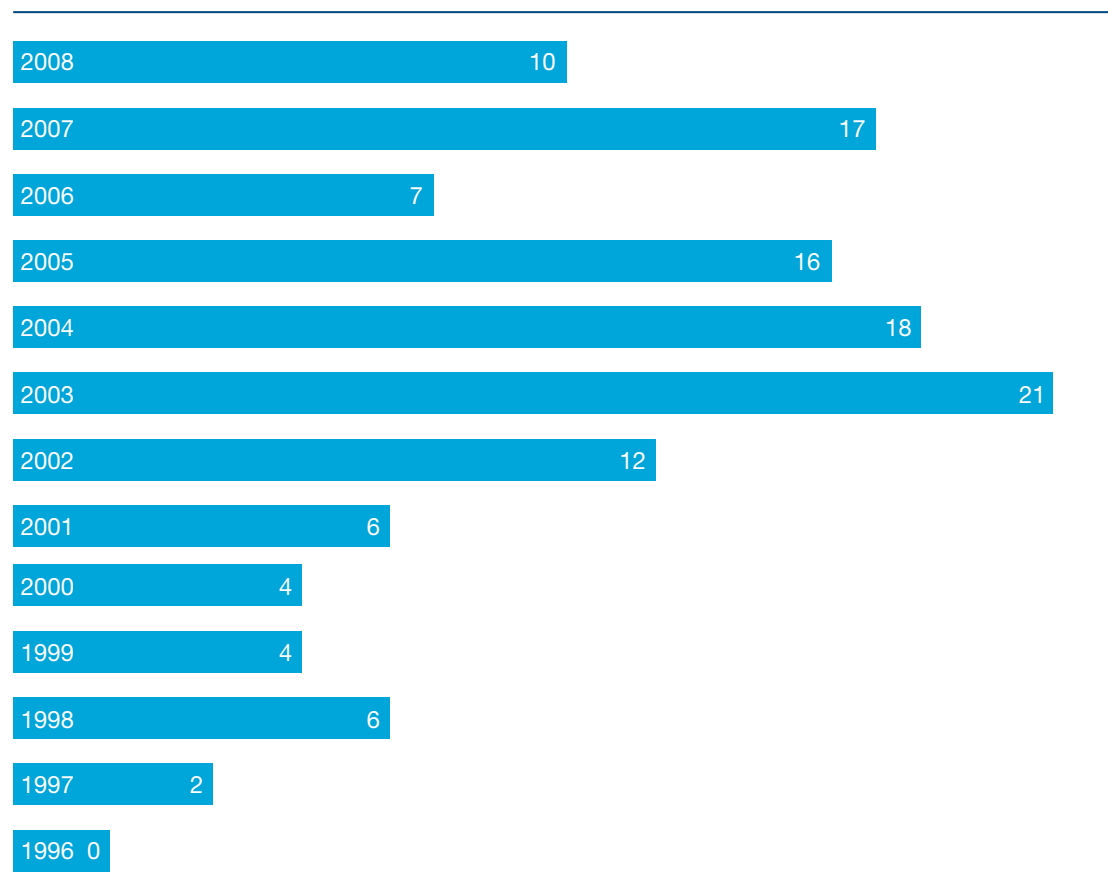
Industry	Percentage of total cases		
	2006	2007	2008
High-technology			
Computer services	11	8	3
Electronics	13	7	6
Telecommunications	<u>6</u>	<u>9</u>	<u>4</u>
	30	25	13
Health services	7	4	1
Pharmaceutical	9	13	10
Business services	5	5	1
Retail	6	4	1
Financial services	6	21	48
Utilities: energy, oil, and gas	2	2	5
Other	35	26	21

† Totals may not add up to 100% due to rounding.

The number of filings against pharmaceutical companies remained consistent with the number filed in 2007. Twenty-one cases were filed in each of the past two years, representing 10 percent and 13 percent of total cases filed during 2008 and 2007, respectively. Filings during 2008 included ten pharmaceutical efficacy cases against companies including Biovail, Medtronic, and Merck. Overall, the number of pharmaceutical efficacy cases fell by 7 (or 41 percent) compared to the filings in 2007. This drop may be due to circumstances of the past few years. For example, a record settlement of \$185 million was awarded against Bristol-Myers Squibb during 2006, which may have encouraged the plaintiffs' bar to file further suits in 2007. Notably, five companies sued in 2008 (including Merck, Schering-Plough, and Vertex Pharmaceuticals) were also sued in past years.

Except for the financial services and energy, oil, and gas groups, filings against all observed industry groups fell slightly as a percentage of total filings in 2008. Filings against energy, oil, and gas companies increased 3 percent (6 cases) during 2008. These included cases filed against Cano Petroleum, Constellation Energy Group, and EnerNOC.

Figure 7. Number of US federal securities class action lawsuits involving pharmaceutical/health efficacy allegations, 1996–2008[†]



[†] Excludes cases alleging product efficacy.

Directors and officers remain in line of fire

The majority of filings during 2008 continued to name senior officers of companies as defendants. However, similar to 2007, 2008 saw a slight decrease in the number of chief executive officers and chief financial officers named as defendants. Even so, as Figure 8 shows, most filings still named the chief executive officer (83 percent of all filings) and chief financial officer (72 percent of all filings) as defendants.

Figure 8. Percentage of US federal securities class action lawsuits naming particular officers or committees, 2004–2008[†]

Title	2004	2005	2006	2007	2008
CEO	96	96	96	90	83
CFO	83	81	83	79	72
Chairman	72	72	61	66	57
President	71	59	68	56	59
Audit committee	2	2	14	5	1
Compensation committee	0	1	11	4	1

[†] Titles are based on those named in the complaint.

Actions against Fortune 500 increase

The percentage of federal securities class action lawsuits filed against Fortune 500 companies during 2008 increased by 6 percent from 2007, and was the second highest filed since the PSLRA (though still 10 percent below the 28 percent peak of such filings recorded in 2002). During 2008, 18 percent of filings involved a Fortune 500 company, compared to 12 percent in 2007. The average number of annual filings against Fortune 500 companies since the PSLRA has been 13 percent.

Financial companies caught up in the financial debacle of 2008 represented the majority (almost 65 percent) of Fortune 500 companies sued. Of those cases, most filings were recorded in the first half of 2008 and approximately 43 percent were filed against investment banks in connection with ARS cases. Filings against Fortune 500 companies that contained financial-crisis-related allegations included JPMorgan Chase, Merrill Lynch, and Wachovia.

Figure 9. Number of Fortune 500 companies with US federal securities class action lawsuits filed against them, 1998–2008[†]

Year filed	Top 50	Top 100	Top 500	Total cases	%
2008	14	17	37	210	18
2007	4	9	20	163	12
2006	5	5	12	109	11
2005	3	6	24	169	14
2004	7	9	27	207	13
2003	1	3	20	175	11
2002	16	25	60	217	28
2001	5	10	26	178	15
2000	4	8	24	203	12
1999	3	8	25	205	12
1998	2	4	16	245	7

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

The Second and Ninth Circuits dominate

Filing activity was more frequent in the Second Circuit (New York) and Ninth Circuit (California) than ever before. Second Circuit filings accounted for most filings, jumping 10 percentage points—from 34 percent of total filings in 2007 to 44 percent in 2008. This increase was driven by financial-crisis-related filings, which were predominantly filed in New York. The Ninth Circuit accounted for 13 percent of filings—a drop from 27 percent in 2007. The Eleventh Circuit (Alabama, Florida, and Georgia) and First Circuit (Maine, Massachusetts, New Hampshire, and Rhode Island) represented 8 percent and 7 percent of total filings, respectively. A minor point to note is the sevenfold increase in filings in the First Circuit, from 1 percent of total filings in 2007. In 2008, a total of 15 cases were filed in the First Circuit, including actions against EnerNOC, GT Solar, Perini, and Vertex Pharmaceuticals.

Figure 10. Percentage of US federal securities class action lawsuits filed by circuit, 2007–2008[†]

Circuit	2007	2008
District of Columbia	2	1
First	1	7
Second	34	44
Third	6	7
Fourth	2	3
Fifth	4	2
Sixth	4	4
Seventh	4	5
Eighth	2	4
Ninth	27	13
Tenth	4	2
Eleventh	10	8

[†] Totals may not add up to 100% due to rounding.

Total settlements fall

The number of settlements recorded during 2008 declined to the lowest number recorded in any year this decade. A total of 95 settlements were made in 2008, 7 of which were for amounts still to be determined, and 88 whose dollar values were established. This compares to a total of 121 settlements made in 2007, 117 of which were associated with actual dollar settlement amounts. The average number of monetary settlements over the 7 years prior to 2008 was 114. The number of settlements in 2008 therefore declined by 25 percent from those reached in 2007 and by 23 percent from the prior 7-year average.

Likewise, the total value of settlements fell to \$3.6 billion in 2008, from \$6.5 billion in 2007. In part, the decrease reflects the absence of outlier settlements (i.e., settlements of value exceeding \$2.5 billion) in 2008. In 2007, there was one outlier settlement: Tyco for \$3.2 billion. Excluding this outlier, the total value of settlements in 2007 was \$3.3 billion, compared to \$3.6 billion in 2008—an increase of 9 percent. The average settlement value in 2008 was \$41 million,² 45 percent higher than 2007's average settlement amount of \$28.3 million.³ The increase in average settlement value in 2008 is principally due to an increase in settlements over \$500 million. In 2008, there were two such settlements—Xerox (\$750 million) and UnitedHealth Group (\$925 million)—whereas in 2007 there was only one: Cardinal Health (\$600 million).⁴

2 Excludes zero-dollar settlements and settlements in which an amount has not been determined.

3 Excludes zero-dollar settlements, settlements in which an amount has not been determined, and outlier cases (e.g., Tyco) that exceed \$2.5 billion.

4 Excludes Tyco as an outlier case.

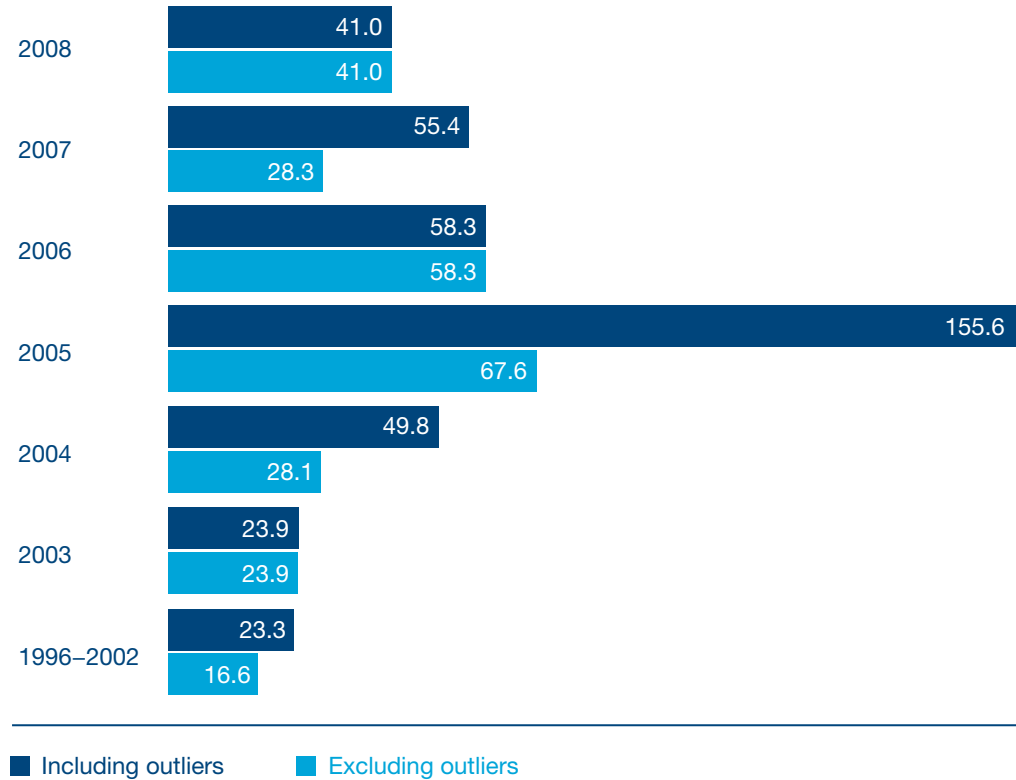
Figure 11. Settlements (in thousands \$): all cases, 1996–2008†

Year settled	1996–2002	2003	2004	2005	2006	2007	2008
Number of settled cases	469	118	119	120	114	121	95
Zero-dollar (\$0)/undisclosed settlements	5	3	4	–	2	4	7
Number of outliers	<u>1</u>	<u>–</u>	<u>1</u>	<u>2</u>	<u>–</u>	<u>1</u>	<u>–</u>
Net settlements‡	463	115	114	118	112	116	88
Total settlement value	10,830,300	2,748,100	5,781,700	18,666,200	6,528,800	6,483,800	3,608,100
Total settlement value excluding outliers‡	7,665,300	2,748,100	3,206,700	7,971,700	6,528,800	3,283,800	3,608,100
Average settlement value	16,600	23,900	28,100	67,600	58,300	28,300	41,000
Median settlement value	5,500	5,600	6,800	9,000	6,900	8,000	8,000
Average settlement value for cases settled for \$1M or more, up to \$50M	9,600	9,700	9,800	10,400	9,200	9,600	11,200

† 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).

‡ Amount used to calculate average and median settlement values.

Figure 12. Average settlement values (in millions \$) for cases filed and settled post-PSLRA, by year†



† 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). There were no outliers for the years 1996-1998, 2000-2003, 2006, and 2008. Excludes zero-dollar settlements and settlements in which an amount has not been determined.

In 2008, 6 settlements (7 percent of the year's total) were for amounts in excess of \$100 million, compared to 9 and 11 similar settlements (representing 8 and 10 percent of each year's total, respectively) in 2007 and 2006. Settlements greater than or equal to \$10 million and less than \$100 million numbered 36 (41 percent) in 2008, compared to 44 (38 percent) in 2007 and 31 (28 percent) in 2006. There were 46 (52 percent) monetary settlements for less than \$10 million in 2008 compared to 64 (55 percent) in 2007 and 70 (63 percent) in 2006.

Figure 13. Percentage of settled cases by settlement value range, 1996–2008[†]

Total settlement (in millions \$)	1996–2007	2008
100+	6	7
50–99.99	5	7
20–49.99	10	14
10–19.99	17	20
5–9.99	21	18
2–4.99	24	26
0–1.99	18	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). Totals may not add up to 100% due to rounding. Excludes settlements in which an amount has not been determined.

The number of accounting-related cases settled during 2008 also fell for the second consecutive year. A total of 68 settlements were reached during 2008, compared to 82 during 2007 and 88 during 2006. Excluding those accounting-related cases where the value of settlement has yet to be disclosed, there were 63 settlements reached during 2008 compared to 80 in 2007 and 87 in 2006. The fall represents a 21 percent decrease compared to 2007 and a 28 percent decrease compared to 2006.

Despite the fall in the number of accounting-related settlements, the total and average values of settlements reached in accounting-related cases during 2008 increased, and overall, accounting-related settlements accounted for 90 percent of total settlement dollars. The total of accounting-related settlements was \$3.3 billion compared to \$3.6 billion for all settlements during 2008. The largest nine settlements were accounting-related cases. Compared to the value of settlements reached in accounting-related cases during 2007,⁵ the value of accounting-related settlements increased 18 percent from \$2.8 billion. The average accounting-related settlement also increased 48 percent, from \$34.9 million⁶ in 2007 to \$51.7⁷ million in 2008.

Both the number and value of non-accounting-related settlements fell during 2008. Excluding those cases where the value of settlement has yet to be disclosed, a total of 25 non-accounting-related settlements were made in 2008 (accounting for \$350 million of settlement value), compared to 37 settlements in 2007 (accounting for \$525.6 million of settlement value).

5 Excludes Tyco as an outlier case.

6 Excludes zero-dollar settlements, settlements in which an amount has not been determined, and outlier cases (e.g., Tyco) that exceed \$2.5 billion.

7 Excludes zero-dollar settlements and settlements in which an amount has not been determined.

Historically, accounting-related settlements have dwarfed non-accounting settlements, and settlements reached during 2008 continued that trend. The average accounting-related settlement during 2008 was 269 percent higher than the average non-accounting-related settlement.

The largest settlement of 2008 was UnitedHealth Group, Inc. for \$925 million, followed by Xerox for \$750 million and General Motors for \$303 million. Other settlements for amounts over \$100 million included:

- Brocade Communication Systems: \$160 million
- Coca-Cola Company: \$137.5 million
- Royal Dutch Shell: \$130 million

PricewaterhouseCoopers' studies from prior years reported on settlement terms other than monetary settlements reached in private securities class action matters. During the years leading up to SOX, the number of instances where various corporate governance requirements were included in overall settlement terms increased, reaching a peak of 29 cases in 2002. Such requirements included: compliance with additional independence standards, the addition of a lead independent director, annual elections for board of director appointments, and shareholder participation in board elections. However, in 2007 there was a significant fall-off in the number of cases with additional non-monetary corporate governance settlements, to only three cases. In 2008, the trend reversed and increased to at least 16 such cases.

Figure 14. Settlements (in thousands \$): accounting cases, 1996–2008[†]

Year settled	1996–2002	2003	2004	2005	2006	2007	2008
Number of settled cases	314	83	89	89	88	82	68
Zero-dollar (\$0)/undisclosed settlements	2	2	3	–	1	2	5
Number of outliers	<u>1</u>	<u>–</u>	<u>1</u>	<u>2</u>	<u>–</u>	<u>1</u>	<u>–</u>
Net settlements [‡]	311	81	85	87	87	79	63
Total settlement value	9,213,400	2,236,000	5,496,700	18,384,300	6,049,000	5,958,200	3,258,100
Total settlement value excluding outliers [‡]	6,048,400	2,236,000	2,921,700	7,689,800	6,049,000	2,758,200	3,258,100
Average settlement value	19,400	27,600	34,400	88,400	69,500	34,900	51,700
Median settlement value	7,000	7,000	7,300	13,300	7,000	8,100	8,000
Average settlement value for cases settled for \$1M or more, up to \$50M	11,000	10,800	10,600	12,200	10,000	9,300	10,700

[†] 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).

[‡] Amount used to calculate average and median settlement values.

Figure 15. Settlements (in thousands \$): non-accounting cases, 1996–2008[†]

Year settled	1996–2002	2003	2004	2005	2006	2007	2008
Number of settled cases	155	35	30	31	26	39	27
Zero-dollar (\$0)/undisclosed settlements	<u>3</u>	<u>1</u>	<u>1</u>	<u>–</u>	<u>1</u>	<u>2</u>	<u>2</u>
Net settlements [‡]	152	34	29	31	25	37	25
Total settlement value [‡]	1,616,900	512,100	285,000	281,900	479,700	525,600	350,000
Average settlement value	10,600	15,100	9,800	9,100	19,200	14,200	14,000
Median settlement value	3,900	3,300	4,600	3,200	4,500	7,700	8,000
Average settlement value for cases settled for \$1M or more, up to \$50M	6,600	7,300	6,900	5,800	6,600	10,100	12,400

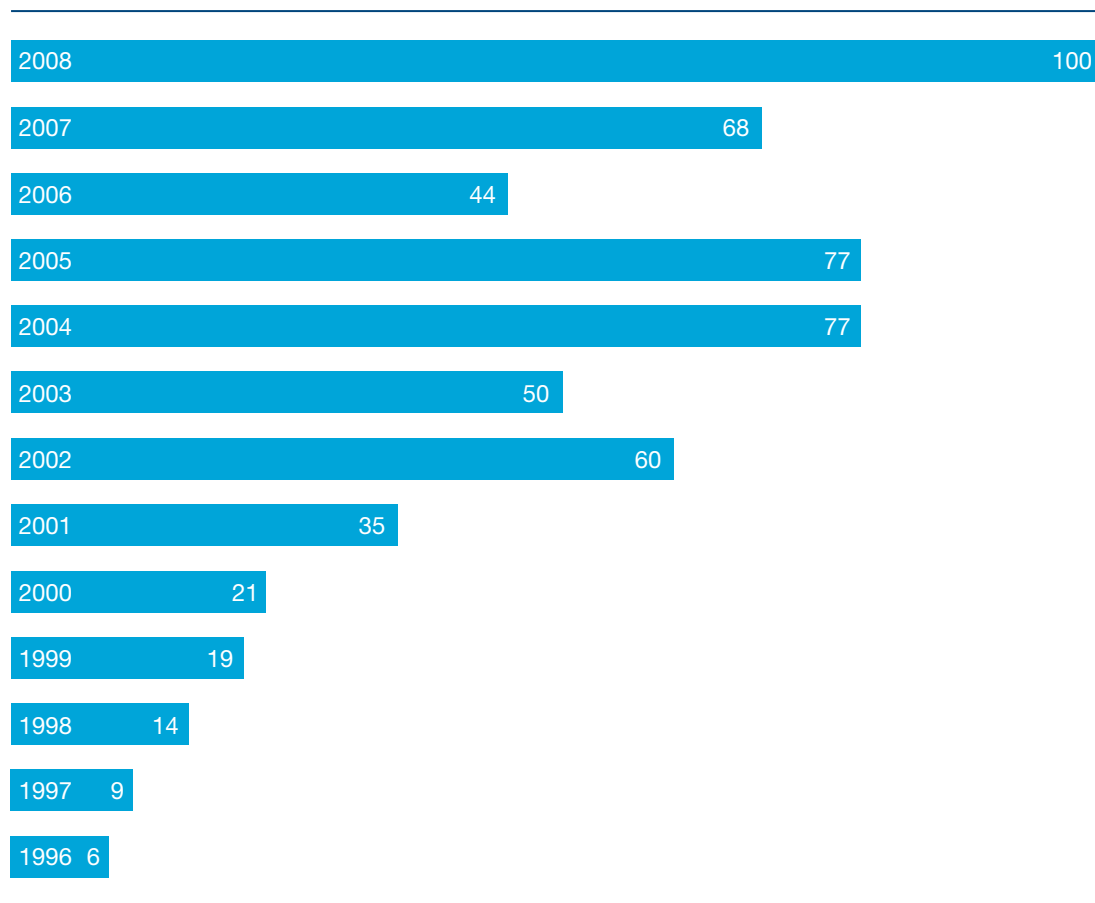
[†] Year of settlement is determined based on the primary settlement pronouncement. Any subsequent settlement amounts are attributed to the primary announcement year. Settlement information reflects only those cases filed and settled after passage of the PSLRA (12/22/1995).

[‡] Amount used to calculate average and median settlement values.

Institutions tighten the reins

Public and union pension funds continued to be the most active subcategory of the institutional investors named as lead plaintiff in 2008 filings. Pension funds appeared as lead plaintiff in 48 percent of all cases filed during 2008, compared to 42 percent in 2007. Funds included Teachers Retirement System of Oklahoma, Electrical Workers Local 357 Pension Fund, and City of Fort Myers Police Officers' Retirement System.

Figure 16. Number of US federal securities class action lawsuits filed with union/public pension funds as lead plaintiff, 1996–2008†



† Final 2008 data is not available to date; the full-year projections are based upon filings through June 30, 2008.

Despite the fall in the number of settlements reached during 2008, the number of settlements involving large institutional investors as lead plaintiff increased significantly as a percentage of total settled cases since 2007. Seventy-three percent of the 88 cases settled during 2008 had some form of large institutional investor named as lead plaintiff, compared with 57 percent in 2007. A total of 64 such cases (representing \$3.4 billion in settlement value, or 95 percent of the total settlement value) were recorded in 2008, compared with 67 recorded cases in 2007 (with a settlement value of 94 percent of total settlement dollars). Public and union pension funds, the largest subcategory of large institutional investors, accounted for \$2.9 billion, or 81 percent, of total settlements during 2008. As in past years, the largest settlements in 2008 all had a large institutional investor as a lead plaintiff, including all six of the settlements over \$100 million. (See Figures 17 and 18.)

Figure 17. Number of US federal securities class action lawsuits settled with union/public pension funds as lead plaintiff, 1998–2008

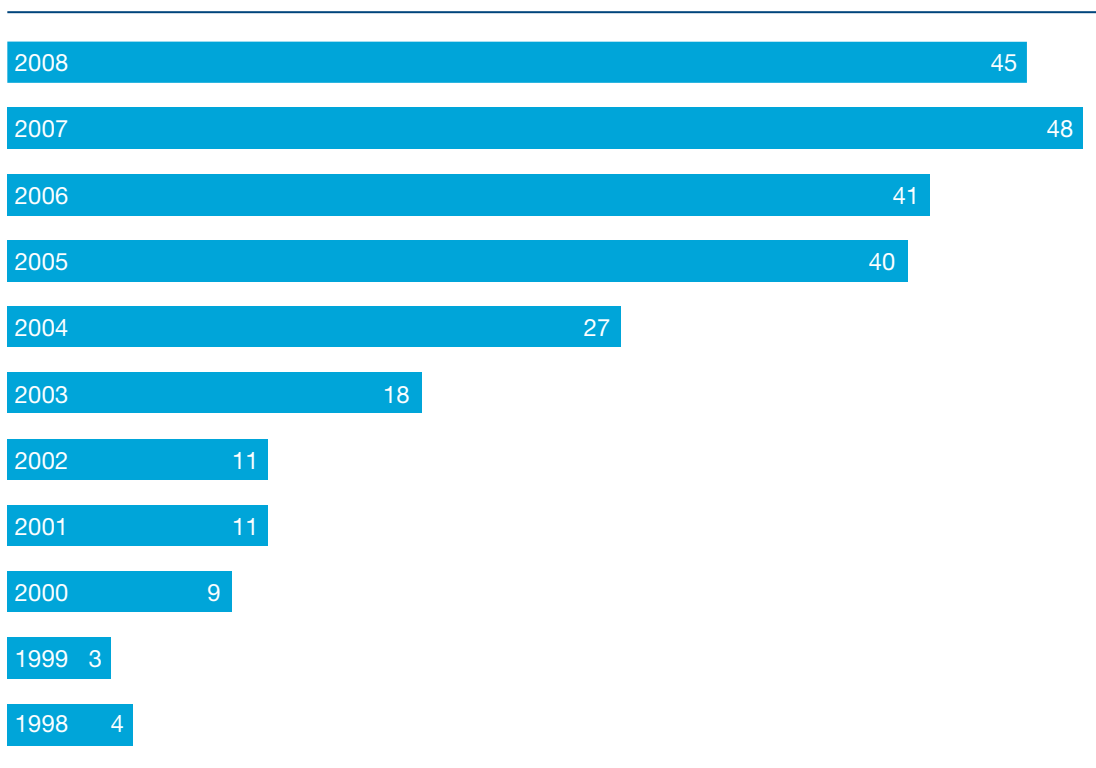


Figure 18. Settlement values (in thousands \$): by lead plaintiff, 2003–2008[†]

	2003		2004		2005		2006		2007		2008	
	Cases settled	Settlement	Cases settled	Settlement	Cases settled	Settlement	Cases settled	Settlement	Cases settled	Settlement	Cases settled	Settlement
Public pension	18	1,829,700	27	4,706,300	40	17,499,700	41	5,337,800	48	5,602,700	45	2,904,800
Other institutional	22	360,600	25	438,900	21	390,400	21	837,000	19	506,000	19	508,700
Total institutional investors	40	2,190,300	52	5,145,200	61	17,890,100	62	6,174,800	67	6,108,700	64	3,413,500
Zero-dollar (\$0)/undisclosed settlements	0	–	1	–	0	–	1	–	4	–	4	–
Net settlements [‡]	40	–	51	–	61	–	61	–	63	–	60	–
Average settlement	–	54,800	–	100,900	–	293,300	–	101,200	–	97,000	–	56,900
Total cases settled	115	2,748,100	115	5,800	120	18,666,200	112	6,528,800	117	6,483,800	88	3,608,100

[†] 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).

[‡] Amount used to calculate average settlement value.

Global financial crisis triggers US filings

The unprecedented financial events of 2008 eclipsed all other issues during the year. What started as the subprime crisis quickly turned into the credit crisis, which soon became the global financial crisis. Very few could have imagined that the subprime snowball was to evolve into the global financial avalanche that devastated financial markets around the world and continues to pound global financial markets and economies into 2009, with predictions estimating the lasting effects rolling into 2010 or beyond.

During 2008, the demise of mortgage institutions continued and prominent global financial institutions became embroiled in the worsening crisis through their exposure to mortgage-backed securities or credit derivatives used to insure them. Institutions such as AIG, HBOS, Lehman Brothers, Merrill Lynch, Morgan Stanley, and Washington Mutual fell prey to the disastrous events. Faced with looming failure, acquisitions were consummated, including JPMorgan Chase's purchase of Bear Stearns and Bank of America's purchase of Merrill Lynch. Consolidation of the financial industry began, and with it, the transformation of the banking industry. Many prominent American, Asian, and European banks continued to fail amidst plummeting stock markets, and governments around the world were forced to intervene to stem the worsening and developing crisis, providing multi-billion-dollar bailouts and capital injections for certain financial institutions.

In response to the financial crisis, various regulators and enforcement agencies entered the fray, including the SEC, DOJ, Federal Bureau of Investigation (FBI), Financial Industry Regulatory Authority (FINRA), Federal Deposit Insurance Corporation (FDIC), and the offices of various state attorneys general. All of these organizations were already involved to some extent in conducting investigations into loan originations and mortgage securitizations at the end of 2007. In 2008 the investigations continued and new initiatives were pursued. The SEC, for example, initiated investigations into ARS and reached settlements in principle amounting to more than \$50 billion. By the end of 2008, the SEC had approximately 50 pending subprime-related investigations and was investigating potential fraud and manipulation of securities through abusive short selling and intentional spreading of false information. Reportedly, the FBI launched at least 26 investigations related to the financial crisis.

As the financial crisis deepened, the filing of federal class action matters followed. At the end of 2007 there were a total of 37 financial-crisis-related cases recorded, 30 of which were filed in the last two quarters of that year. In 2008, an additional 98 cases were filed in total, with 55 cases filed in the first half of the year and 43 cases filed in the second half. Seventeen of the 55 federal cases filed in the first half of 2008 related to ARS, with a further four filed in the latter half of the year. Cases related to the financial crisis were filed against financial institutions and insurance companies, including Fannie Mae, Fifth Third Bank, MBIA, Merrill Lynch, and National City. The majority (62 percent) of cases were filed in the Second Circuit, unlike in 2007 when the filings were almost equally split between the Second and Ninth Circuits.⁸

Figure 19. Number of financial-crisis-related US federal securities class action lawsuits, Q1–Q4, 2008



⁸ SEC Chairman Christopher Cox, “Address to Joint Meeting of the Exchequer Club and Women in Housing and Finance.” Presented at the Mayflower Hotel, Washington, DC (December 4, 2008); <http://www.sec.gov/news/speech/2008/spch120408cc.htm>.

During 2008, the profile of the defendants named in the majority of these financial-crisis-related cases changed from loan originators in 2007 to entities involved in loan securitization—reflecting, for the most part, the increasing exposure of investment banks to the financial crisis during 2008. Fifty-seven cases (or 58 percent of total filings related to the financial crisis) were directed at these entities during 2008, compared to three cases representing 8 percent of total financial-crisis-related filings recorded in 2007.

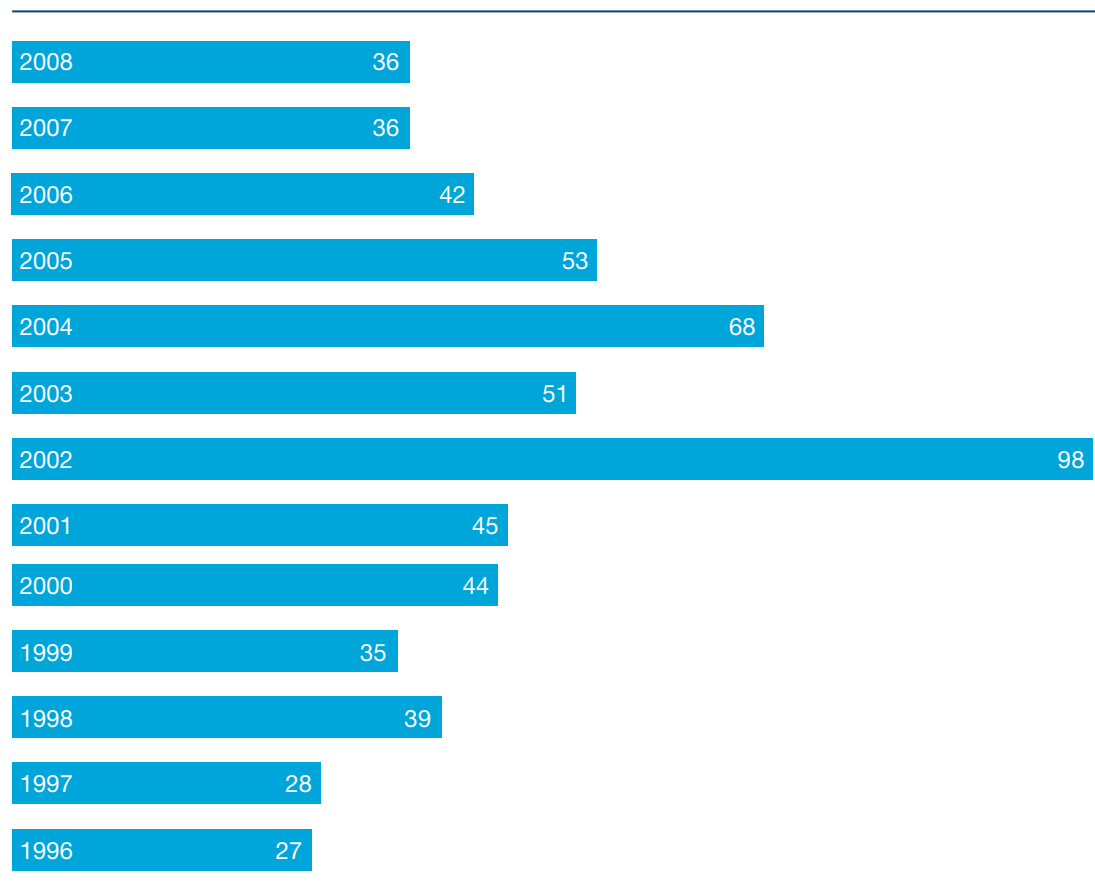
ARS was a substantial driver and accounted for almost 35 percent of the 57 cases filed against entities involved in loan securitization. Insurance companies emerged as another group of defendants in 2008, representing 7 cases (or 7 percent) of the total financial-crisis-related filings. The number of cases filed against loan originators in 2008 remained steady compared to 2007 (22 versus 19). However, as a percentage of the respective total financial-crisis-related filings, cases filed against loan originators represented just 22 percent in 2008 as compared to 51 percent in 2007.

The nature of the allegations found in these financial-crisis-related cases ranged from claims of inadequate reserves and overstatement of assets to inadequate disclosures. Sixty percent of cases filed during 2008 were non-accounting-related cases alleging inadequate disclosures, as compared to only 19 percent in 2007. Therefore, 40 percent of cases were accounting-related cases during 2008, compared to 81 percent in 2007. Eighty-seven percent of the accounting-related cases contained estimate-related allegations.

The SEC and DOJ remain active

In 2008, 36 filings had some form of SEC involvement,⁹ exactly the same number as in 2007. In percentage terms, however, this represented a 5 percent decrease, falling from 22 percent of total filings in 2007 to 17 percent in 2008. The cases included CellCyte, MBIA, MoneyGram International, and Thornburg Mortgage.

Figure 20. Number of US federal securities class action lawsuits with SEC involvement, 1996–2008[†]

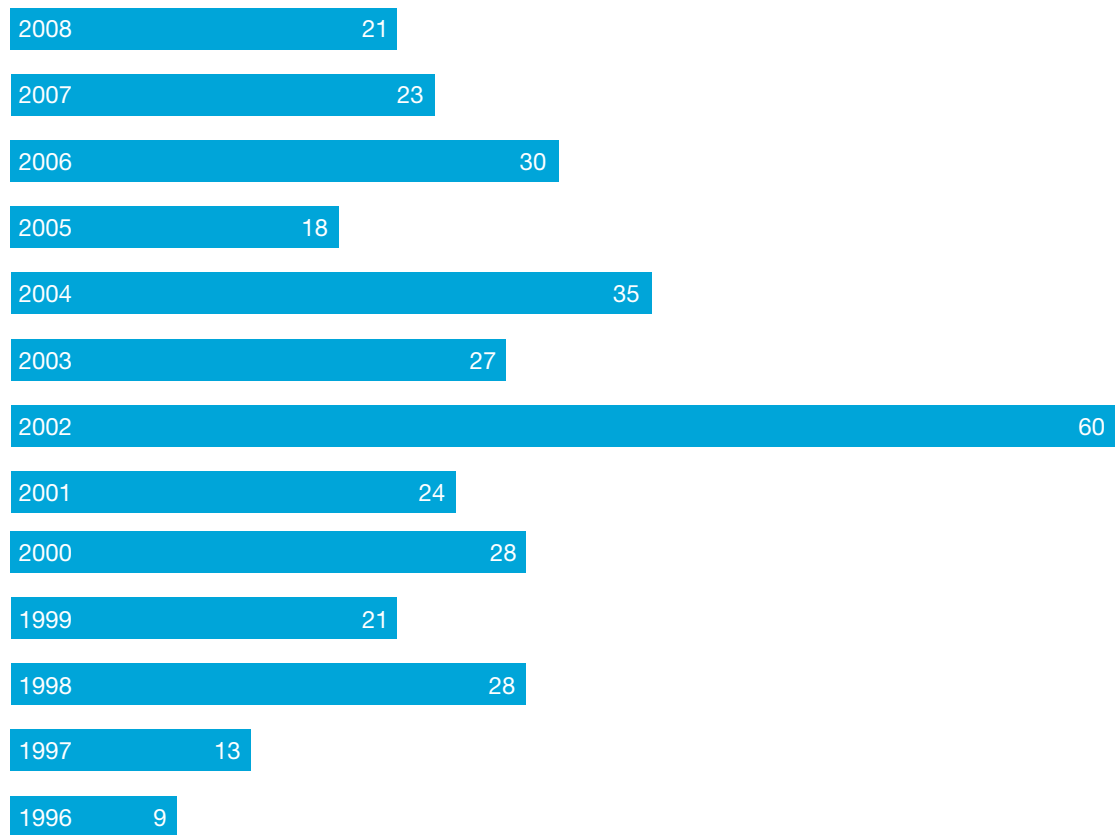


[†] Information is based on a review of press releases, SEC releases, and news articles. Statistics from prior years have been updated based on current information.

⁹ SEC involvement includes instances of formal or informal SEC investigations, SEC actions, and judgments.

The number of cases filed during 2008 that had some form of DOJ involvement¹⁰ fell to 21 from 23 in 2007, and represented 10 percent of total filings in 2008 compared to 14 percent in 2007. The cases included Atricure, Horizon Lines, Reddy Ice, and SemGroup Energy Partners.

Figure 21. Number of US federal securities class action lawsuits with DOJ involvement, 1996–2008[†]



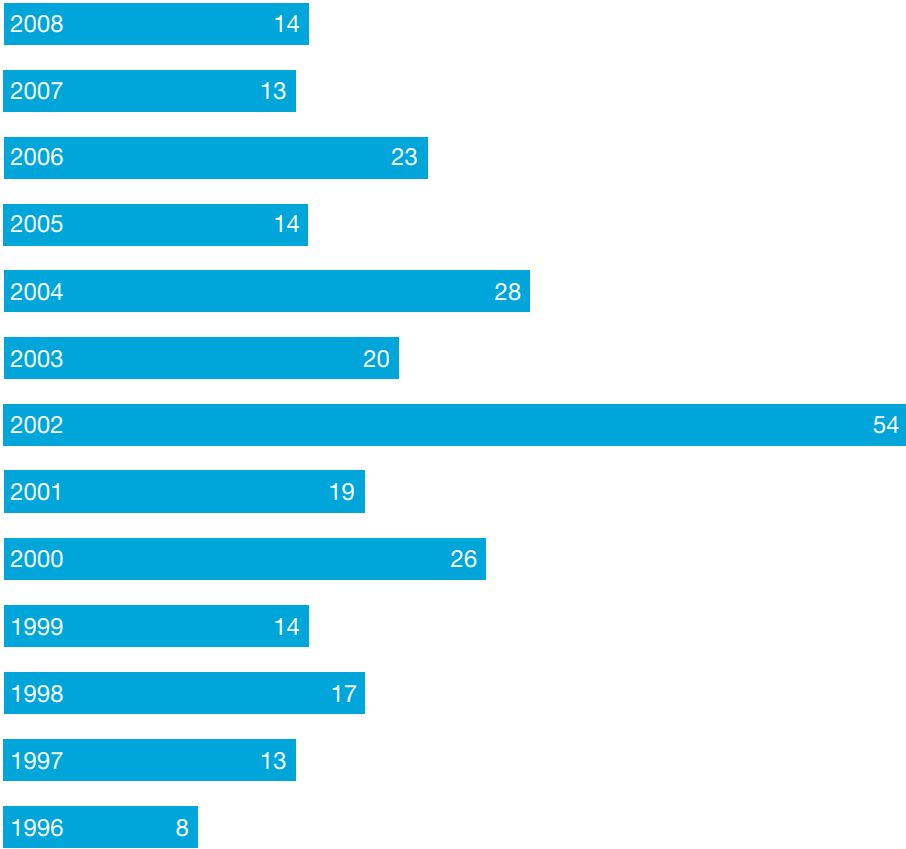
[†] Information is based on a review of press releases and news articles. Statistics from prior years have been updated based on current information.

¹⁰ DOJ involvement includes instances of DOJ investigations, indictments, and settlements.

Filings that had both SEC and DOJ involvement in 2008 represented 7 percent of total filings compared to 8 percent in 2007. In numerical terms, these represented 14 cases of the total 210 cases filed during 2008, as compared to 13 of the 163 cases filed in 2007.

Additionally, several cases—such as Citigroup, JPMorgan Chase, Morgan Stanley, and UBS—also had the involvement of the New York attorney general.

Figure 22. Number of US federal securities class action lawsuits with both SEC and DOJ involvement, 1996–2008†



† 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.

2008 SEC enforcement actions and DOJ prosecutions

The SEC's *2008 Performance and Accountability Report*¹¹ lists the highlights of its 2008 efforts, including:

- The Enforcement Division's subprime working group's¹² investigations into possible fraud, market manipulation, and breaches of fiduciary duty, including investigations of various parties involved in the securitization of mortgage-backed securities and collateralized debt obligations.
- The Enforcement Division's subprime working group's investigations related to market manipulation of financial institutions, which focused on broker-dealers and institutional investors and led to the largest settlements in the SEC's history. Over \$50 billion was recovered on behalf of investors in ARS from Bank of America, Citigroup, Merrill Lynch, RBC Capital Markets, UBS, and Wachovia.
- Guidance on fair value accounting and specifically the study of FASB Statement No.157, which was required by the Emergency Economic Stabilization Act of 2008.
- The 671 enforcement actions and cases relating to insider trading and market manipulation, which represented an increase of more than 25 percent and 45 percent, respectively, over 2007.

The SEC also continued to increase cross-border cooperation in connection with enforcement actions during 2008, making 556 requests to foreign regulators for assistance and cooperating with 454 requests from foreign regulators for enforcement assistance.

¹¹ www.sec.gov/about/secpar/secpar2008.pdf.

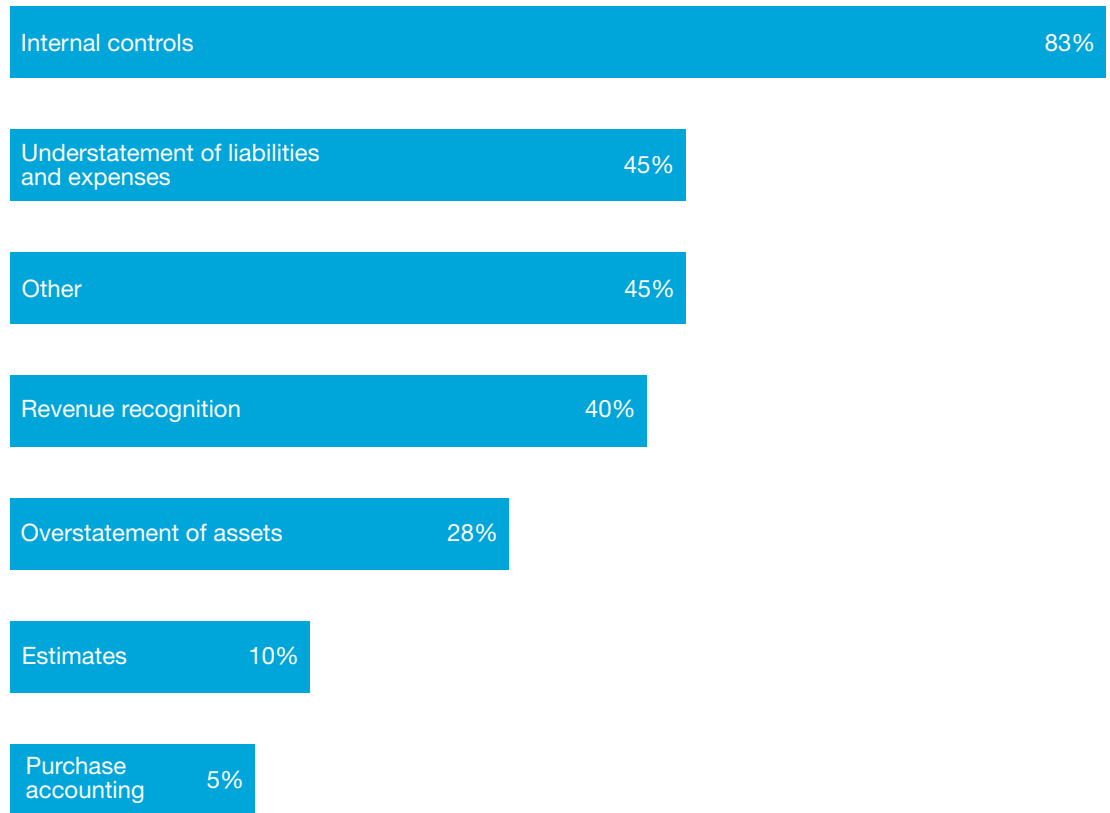
¹² www.sec.gov/news/press/2008/2008-187.htm.

During 2007 the SEC saw its first increase in new accounting-related litigation releases since 2002, but in 2008 that number once again fell. Only 40 new accounting-related litigation releases were issued in 2008, compared to 53 in 2007 and 32 in 2006. Other than internal controls failures (alleged in 83 percent of 2008 enforcement releases), the most common issue, alleged in 45 percent of cases, was understatement of expenses or liabilities, 56 percent of which related to options backdating matters. The remaining 44 percent related to various fraudulent schemes, including deferring recognition of expenses and improperly moving expenses off the company's financial statements. Revenue recognition was the next most common allegation (asserted in 40 percent of new accounting litigation releases), followed by overstatement of assets (28 percent). The number of FCPA matters fell from 14 in 2007 to 7 during 2008.

Figure 23. Number of SEC litigation releases related to new accounting cases, 1996–2008

Year	Number of releases
2008	40
2007	53
2006	32
2005	43
2004	42
2003	52
2002	61
2001	32
2000	36
1999	29
1998	31
1997	40
1996	34

Figure 24. Percentage of SEC litigation releases related to new accounting cases citing specific accounting issues, 2008†



† Some cases allege multiple accounting issues.

The largest settlements in the history of the SEC were reached during 2008, both in relation to all settlements and to FCPA settlements specifically. The largest settlements of all were reached in connection with ARS. The SEC charged that firms misled investors about the liquidity risks associated with ARS that they underwrote, marketed, and sold. Settlements totaling \$29.7 billion were made with Citigroup and UBS. At this study's date of publication, the commission had not reached final settlement with Bank of America, Merrill Lynch, RBC Capital Markets, and Wachovia; however, total settlements related to ARS cases are expected to reach \$50 billion.

Notwithstanding 2008's decrease in new accounting litigation releases involving FCPA violations, the SEC reached a record settlement in connection with the Siemens FCPA matter. Siemens agreed to pay \$350 million to resolve charges that it engaged in worldwide bribery. Additionally, Siemens agreed to a settlement with the DOJ amounting to \$450 million, and to a third settlement with German regulators for \$854 million.¹³ In connection with FCPA violations, the SEC and DOJ also reached respective settlements with Willbros Group for \$10.3 million and \$22 million, Fiat for \$10.8 million and \$7 million, and Volvo for \$12.6 million and \$7 million.

Other notable settlements over \$10 million that were agreed with the SEC were:

- Ritchie Capital Management, et al.: \$40 million
- W.P. Carey & Co., et al.: \$30 million
- Zurich Financial Services: \$26 million
- Dow Jones, et al.: \$24 million
- United Rentals: \$14 million
- Broadcom: \$12 million
- AmSouth: \$11.4 million
- Marvell Technology Group: \$10.5 million

¹³ Siemens will pay a fine of approximately \$569 million to the Office of the Munich Prosecutor. Siemens previously paid a fine of approximately \$285 million to the Munich Prosecutor in October 2007.

In addition to the record SEC settlements, the DOJ reached some substantial settlements of its own. During 2008, several major international airlines agreed to pay the second highest fine ever levied in a criminal antitrust prosecution: In total, Air France, Cathay Pacific Airways, KLM Royal Dutch Airlines, Martinair Holland, and SAS Cargo agreed to pay \$504 million in criminal fines for participating in a multi-year conspiracy to fix air cargo rates. Other airlines, including Qantas Airways and Japan Airlines, settled similar matters for \$61 million and \$110 million, respectively.

Substantial settlements were agreed with the DOJ related to alleged fraudulent price reporting and kickbacks, and off-label marketing by various pharmaceutical and biopharmaceutical companies. In particular, Merck, Bayer HealthCare, and Cephalon settled for \$650 million, \$97.5 million, and \$425 million, respectively.

Ponzi schemes steal front page news

Ponzi schemes rose to prominence as 2008 came to a close, principally due to the December uncovering of the Madoff Ponzi scheme. That scheme is now regarded as possibly the largest Ponzi scheme in history, with associated losses estimated at greater than \$50 billion, but it was not the only such scheme exposed in 2008. Others included those perpetrated by Petters Group Worldwide (\$3.5 billion), Wextrust Capital (\$255 million), and VesCor Capital (\$180 million).

In 2008, there were six federal securities class action filings alleging Ponzi schemes. These included actions against Bernard L. Madoff Investment Securities, Tremont Group Holdings, and Creative Capital Consortium. Various regulators and authorities including the SEC, DOJ, FBI, FINRA, Commodity Futures Trading Commission (CFTC), and Securities Investor Protection Corporation (SIPC) also set their sights on Ponzi schemes.

According to the SEC, there were 70 Ponzi cases in 2007 and 2008, averaging three per month. The SEC vowed to continue focusing on the perpetrators in 2009. The CFTC saw the number of reported leads to Ponzi schemes more than double in the past year, resulting in the prosecution of 15 Ponzi schemes. Additionally, the CFTC established a new Enforcement Task Force in part to prosecute Ponzi cases in which investors were told their money was invested in foreign currencies.

In an effort to combat financial fraud, legislation was recently introduced by the US Senate Banking Committee that would provide \$110 million to hire 500 additional FBI agents, 50 additional US government prosecutors, and 100 more SEC enforcement officials.

International regulatory cooperation

By Tricia Howse CBE, LLB, Barrister and Former Assistant Director SFO

It can be instructive to read predictions later, when the future has actually arrived. In the case of the UK Financial Services Authority (FSA),¹⁴ its modest April 2008 publication *International Regulatory Outlook* contained very little in its crystal ball of the horrors to come. It did perhaps presciently note that “financial services regulation in [EU] member states is rooted in national legislation and is typically directed at national objectives.” But it went on to review in some detail the Lamfalussy arrangements, five years on, and to explore (somewhat ponderously) the possibilities for modest extensions of “non legally binding collegiate guidance” in the context of EU regulatory “convergence.” Incidentally, convergence is the newly approved euphemism for harmonization in Euro-speak, just as a “no” from an Irish referendum actually means “please ask me again later.”

But I digress. The responses to the global banking and financial crisis have indeed been typically directed at national objectives. International cooperation on the macro level has been notably absent, despite the existence of the grandly named Financial Stability Forum—the main tasks of which are “to identify vulnerabilities to stability of the global financial system and to ensure these are addressed” [*sic*]. There were not many signs that either was being addressed back in April 2008.

So has international cooperation failed us? Not perhaps in its original goal of replicating the mutual legal assistance arrangements that had been developed for the criminal law—to permit one country’s regulator to ask another’s to obtain evidence for him, or to share knowledge about an international bank or market operator about which each held only half the story (e.g., the sort of cooperation that would have prevented the BCCI scandal, had we only known it). On this level, things are better than they have ever been. Within Europe and what has hitherto been known as the “developed world,” international evidence gathering, coordinated regulatory action, and the quaintly named “spontaneous disclosures”

(so desired by FATF¹⁵) are flourishing. The regulatory cooperation mechanisms provided in the Financial Services & Markets Act 2000¹⁶ are far superior to those in the old Financial Services Act, and, moreover, it is the FSA that is in charge of them, not the Treasury.

But on the wider level? Where was Liu Mingkang, Chairman of the China Banking Regulatory Commission, when the FSA and the Fed were congratulating themselves earlier this year on “the close cooperation that we engaged in with US regulators in the lead-up to the rescue/takeover offer for Bear Stearns by JPMorgan Chase”?¹⁷

By September 2008, with a magnificent degree of hindsight, Mr. Liu was gravely warning the World Economic Forum that he was “horrified” by the level of financial risk-taking in the developed world, as illustrated by 100 percent mortgages. He remarked that the degree of leverage involved was “dangerous” and “indefensible.”

What shines through very clearly is that neither the domestic regulators nor, of course, any international ones were fully aware of the details of the concerned banks’ loan books until it was far too late to do anything other than wring their hands. No amount of international cooperation or spontaneous disclosures would have fended off the crunch. Even now it seems the banks themselves have difficulty identifying the precise amount of toxic assets held.

The existence of all this ex post facto detail is of course very familiar to the criminal lawyer. We have been trying to predict crime and to have police and CCTV cameras trained on potential crime scenes for a long time. It is fair to say that law enforcement agencies are probably better at passing on intelligence to regulators than vice versa. But it would be nice to see our warnings factored into regulatory and market risk analysis. I have been

¹⁴ The Financial Services Authority is the single regulator for all financial services including banking, insurance, and securities in the United Kingdom.

¹⁵ United Nations Financial Action Task Force, begetter of the 40 Recommendations (which now number around 150).

¹⁶ UK financial regulatory legislation.

¹⁷ Hector Sants, “FSA Chief Executive’s Report, *FSA Annual Report 2007/08*, p. 11.

tramping around the UK and the world for some years now warning of the horrors (and the horrid success) of the simple, old-fashioned Ponzi scheme. Assiduous attendees of the annual Corporate Accountability conference will bear witness to the fact. I was prepared for Albania not to heed my warnings, but not for the SEC to forget the basics. Doubtless the salutary tale of Mr. Madoff's magic fund will be revealed by the US Attorney in due course, but meanwhile I can only shake my head in frustration.

So is it worth bothering to promote, facilitate, and advocate international regulatory cooperation? Does it do any good? Is it worth all the hand-wringing and law-changing that makes it possible? Again, I would separate the day-to-day mutual assistance work from the high-level meetings and crystal-ball sessions. There are probably not enough of the latter yet—and the summits and conferences that the International Organization of Securities Commissions, the Basel Group, or the Financial Stability Forum hold may well be too polite and cautious to uncover the real icebergs lurking beneath the surface of “capital adequacy.” But the joint inspections and the intelligence flowing between supervisors and those who guard the gates of the regulated communities should not be underestimated. This is routine work, but it matters.

At a course this summer in enforcement for the Egyptian Capital Markets Authority (CMA), the senior magistrate who has been appointed to supervise future CMA criminal investigations conducted a postmortem on the first insider dealing case to be brought under the new law—his own case, incidentally.¹⁸ It started with and it succeeded thanks to international cooperation.

The case involved insider dealing in the shares of the Egyptian American (EA) Bank. The SEC first spotted that the trigger for dealing had been the disposal of American Express's holdings in the bank—a

confidential operation conducted between late 2000 and May 2001. It tipped off the Cairo and Alexandria Stock Exchange (CASE), where the EA Bank was listed. CASE consulted its regulator, the CMA, which ordered an investigation. The defendant, the Egyptian Regional Manager of AmEx, had organized some share-dealing of his own through subordinates and their wives. Evidence and vital background information was obtained by the SEC and transmitted to the CMA for use in the Egyptian court. Local brokers were interviewed—several had been used as usual in insider dealing cases—and banking information was obtained via the Central Bank of Egypt.

One of the joys of international training events is the insight it gives into comparative law and procedure. In fact, both the timing and the substance of the charges were crucial factors in the outcome of the case, as they are so often in the UK and US. There was no evidence of disclosure of confidential information, but plenty of evidence of using information and realizing benefits. For this latter offense, the first defendant was sentenced to two years imprisonment and the monetary penalties necessary to remove his profits. His male aiders and abettors received sentences reflecting their degree of knowledge (a Nuremberg defense was rejected). The wives were acquitted. Egyptian criminal law (which contains modified Sharia elements) provides a defense for “compulsory involvement [in crime] imposed by a lawful husband.”

So—another everyday tale of international regulatory cooperation—the unsung stuff that gets results. It's useful but it doesn't often hit the headlines. I leave the verdict on the high-level cooperation to others.

¹⁸ Abbous & Others, Lawsuit No. 400 of 2001 (appeal published January 31, 2005).

International impact: Money makes the world go 'round

In May 2008, key financial executives and government leaders, including Treasury Secretary Henry Paulson and CEOs from Citigroup, JPMorgan Chase, and Lehman Brothers, believed the credit crisis was more than half over and that the United States was closer to the end of the problem than it was to the beginning.¹⁹ But less than five months later we would witness just how wrong they were.

Although the credit crisis was believed to be a US problem—the only perceived threat to the rest of the world was a slowing demand for foreign products by the US—it soon became evident that, like businesses, financial reporting standards, and financial markets, the credit crisis, too, was going global.

As the US considered a rescue plan to buy troubled US bank assets in October 2008, foreign leaders moved quickly to approve their own government rescue plans. Germany put forth a rescue package for banks totaling €500 billion. Britain's plan included partial nationalization of certain banks for £50 billion. The Swiss government invested \$5.3 billion in UBS for a 9 percent stake in the bank's balance sheet, and Ireland's government decided to inject €5.5 billion to rescue the country's financial system, which was on the verge of collapse.

The rescue plans were intended to inject capital and give banks enough of a cushion to remain liquid as they wrote off failed assets and took on new loans to rebuild their balance sheets. Despite government efforts, however, growing unemployment and loan defaults fostered a continued reluctance by banks to lend, and share prices around the world continued to fall to record lows.

Europe was thought to have limited exposure to the market's volatility with only 10 to 15 percent of individual investors holding stock directly, versus 25 percent in the UK and 20 to 50 percent in the US. These percentages only take into account direct stock investments by individuals, and do not include investments made by foreign governments and pensions on behalf of their employees. While the spread of the credit crisis has affected current funding to businesses and Main Street, failed global investments may have a longer-lasting impact on funds for current and future retired foreign workers.

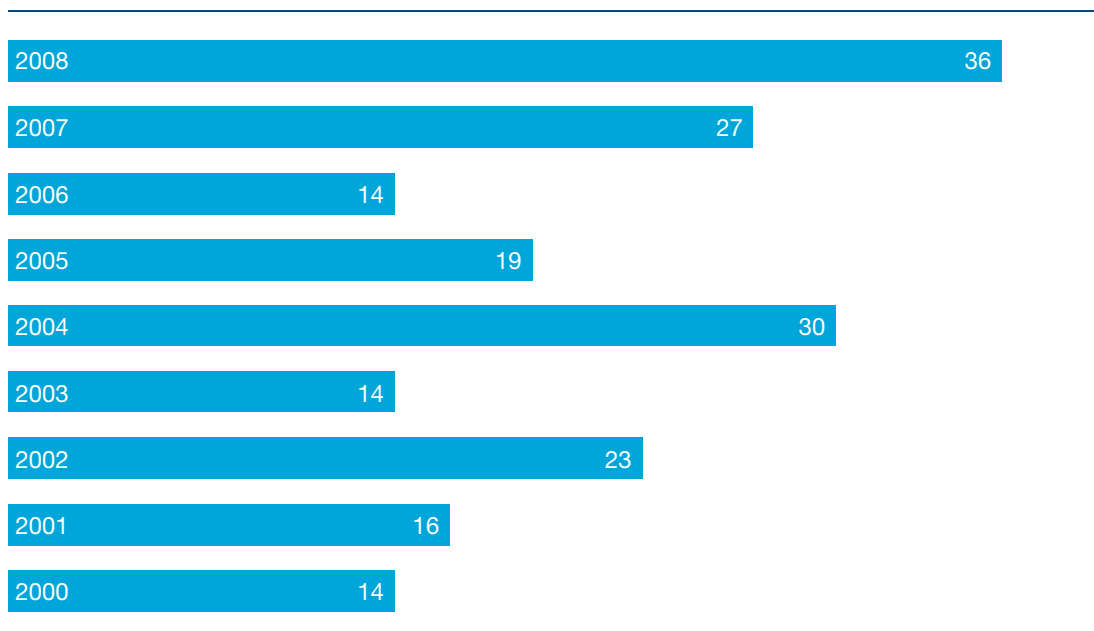
Mortgage-backed securities and collateralized debt obligations were marketed to European and Asian institutional investors. As a result, pension funds around the world have lost billions of dollars. Foreign asset managers, such as WestLB Mellon Asset Management, invested heavily in mortgage-backed securities, and Union Investment Asset Management suspended redemptions when foreign investors panicked about the subprime meltdown in the US.

¹⁹ Peter Cook and John Brinsley, "Paulson Says U.S. Credit-Market Crisis Is 'Closer to the End,'" Bloomberg.com (May 1, 2008).

Actions against foreign filers hit all-time high

Federal securities class actions filed against FPIs hit an all-time high in 2008, with 36 cases representing 17 percent of the total federal securities class actions filed. It was also the highest percentage of cases during the 13-year period since passage of the PSLRA. However, the number of companies with cases filed against them represents only 3 percent of the FPIs registered with the SEC.

Figure 25. Number of US federal securities class action lawsuits filed against foreign companies per year, 2000–2008



The previous record of 30 cases was reached in 2004, and some of these cases resulted in significant settlements, including Nortel Networks for \$2.2 billion,²⁰ Royal Dutch Shell for \$130 million, and Parmalat for \$86.8 million. Similar to 2004, deficient internal controls continued to be a recurring allegation in 2008 complaints.

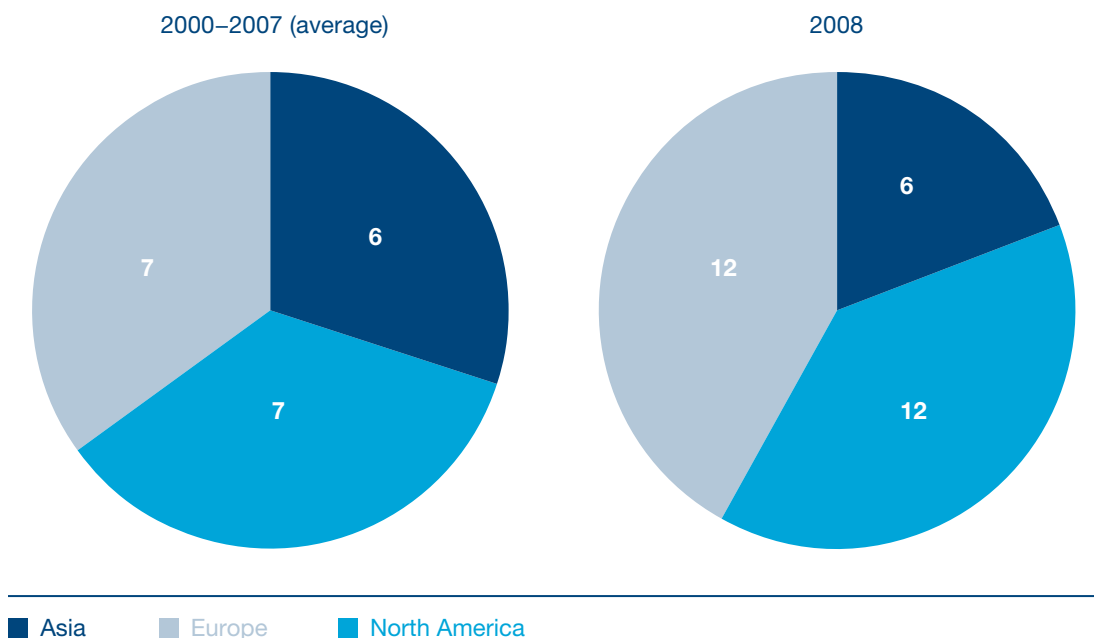
The crisis affecting 2008 is a global issue and is not specific to a certain company's shareholders, but rather has negatively impacted the share price of almost every listed entity around the world. Significant losses incurred by shareholders of companies involved in corporate and accounting scandals in 2002 triggered regulators' response with the enactment of SOX of 2002. One can only imagine what the regulators' response will be to the current crisis. As was to be expected, 15 (or 42 percent) of the federal securities class actions filed against FPIs in 2008 were against financial-services-related entities, and include financial crisis and ARS allegations. Some of the entities named in the complaints are Credit Suisse, Deutsche Bank, and Royal Bank of Canada.

An overwhelming 32 (or 89 percent) of the class actions filed against FPIs were in the Second Circuit, versus 35 percent of the cases filed against domestic filers in 2008. The First, Ninth, Tenth, and Eleventh Circuits only saw one case filed in each—against GSI Group, Camtek, Absolute Capital Management Holdings, and Aracruz Celulose, respectively.

20 Nortel Networks settled two cases in 2006, one from 2001 and one from 2004, totaling \$2.2 billion.

Fifty-six percent of cases filed were against entities in Canada, China, and Switzerland. Ten of the cases filed in 2008 (or 28 percent) were against entities in Canada and included pharmaceutical efficacy, financial crisis, ARS, and disclosure-related allegations. Five cases (or 14 percent) were against entities in China and included product efficacy, financial crisis, and disclosure allegations. Five cases (or 14 percent) were filed against entities in Switzerland and included financial crisis and ARS-related allegations. In addition to the increase in cases filed in the US against Canadian entities, the number of cases filed in Canada increased. It is unclear whether the potential exclusion of foreign plaintiffs by a US court or the lower threshold of liability was the reason cases were filed in two jurisdictions.

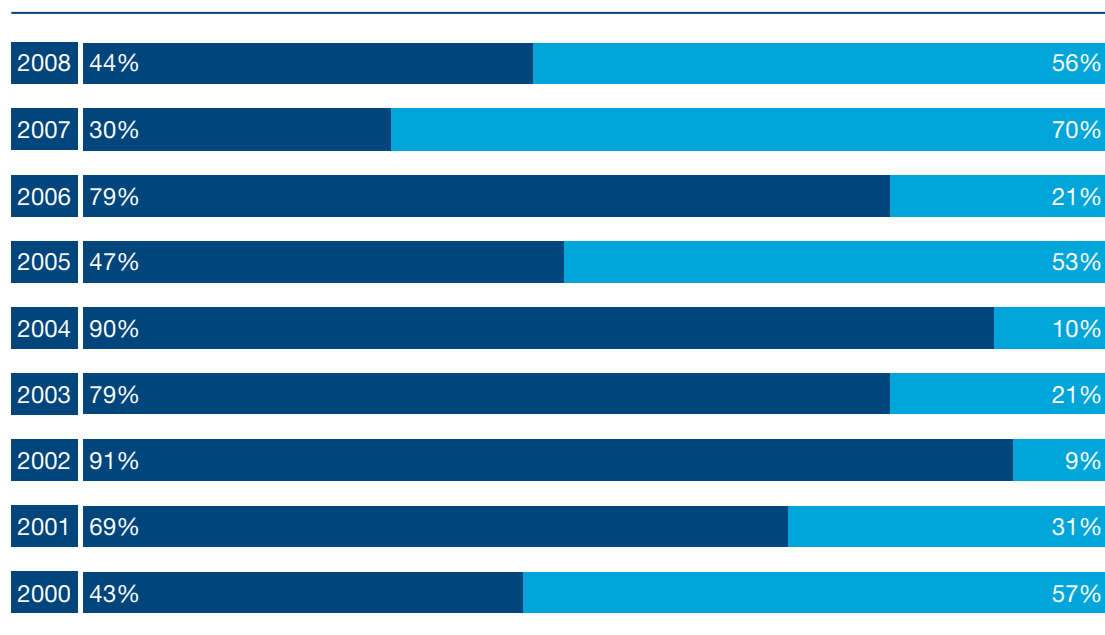
Figure 26. Number of US federal securities class action lawsuits filed against foreign companies: by region, 2000–2008



Internal controls top allegations against foreign filers

The percentage of FPI accounting-related cases increased by 14 percent in 2008 compared to accounting-related cases filed in 2007, but still did not reach the highs of 91 and 90 percent seen in 2002 and 2004, respectively. This decrease in the face of a record number of cases filed could be good news for FPIs, since accounting-related matters tend to have higher settlement values.

Figure 27. Percentage of accounting and non-accounting US federal securities class action lawsuits filed against foreign companies per year, 2000–2008[†]



■ Accounting ■ Non-accounting

[†] Cases filed between 2000 and 2007 may have been updated with accounting allegations if the amended complaints alleged accounting violations not previously recognized. The number for 2008 reflects initial complaints.

Of the 16 accounting-related cases, 10 (or 63 percent) cited allegations of internal control deficiencies, 8 (or 50 percent) cited allegations of improper estimates, and 6 (or 38 percent) cited allegations of overstated assets.²¹ Six (or 38 percent) of the accounting cases filed had financial-crisis-related allegations. Among the 5 cases filed against Canadian entities, 60 percent cited overstatement of asset allegations, 40 percent cited internal control deficiencies, 40 percent cited allegations of improper estimates, and there was one instance of improper revenue recognition. Cases filed against Chinese entities numbered 3 (or 19 percent) of the total accounting-related complaints and cited internal control deficiencies, improper revenue recognition, and overstatement of assets allegations.

Unlike in years prior to 2006, improper revenue recognition allegations are no longer the number-one allegation in complaints. This decrease may be a result of increased revenue recognition guidance provided by the SEC following the financial fraud scandals of early 2000.

The accounting areas with the highest increase in allegations are estimates—a trend reflective of the financial crisis—and internal controls. Improper estimate allegations increased to 50 percent versus an average of 32 percent during 2002–2006 and 25 percent in 2007. Internal control deficiency allegations increased to 63 percent versus an average of 32 percent during 2002–2006 and 25 percent in 2007.

21 Some cases allege multiple accounting issues.

Number of foreign settlements rises while average value declines

A record of 19 class actions filed against FPIs were settled in 2008.²² The average settlement, however, decreased to \$23.8 million.²³ This represents a 19 percent decrease when compared to the average 2007 settlement of \$29.4 million.²⁴ Unlike in the previous three years, settlements in cases filed against FPIs did not exceed \$1 billion and did not hold the top position in overall settlements for the year.

Fourteen (or 78 percent) of the cases settled were accounting-related and had an average settlement value of \$24.8 million; this is a decrease when compared to the accounting-related average value of \$59.4 million for domestic filer settlements.²⁵ Eight (or 44 percent of the cases settled with an amount) had lead plaintiffs that were pension funds, and had an average settlement of \$42.2 million.²⁶ Six (33 percent) had lead plaintiffs that were other institutional investors, and had an average settlement value of \$13.6 million. Four (22 percent) of the cases had a private investor named as lead plaintiff, and an average settlement of \$2.6 million.

The majority of 2008 settlements related to cases initially filed during the years 2001–2007 and represented companies in the high-technology, health services, pharmaceutical, financial services, business services, and energy, oil, and gas industries.

22 One of these settlements has an amount still to be determined, while 18 have established amounts.

23 Excludes zero-dollar settlements and settlements in which an amount has not been determined.

24 Excludes zero-dollar settlements, settlements in which an amount has not been determined, and outlier cases (e.g., Tyco) that exceed \$2.5 billion.

25 Excludes zero-dollar settlements and settlements in which an amount has not been determined.

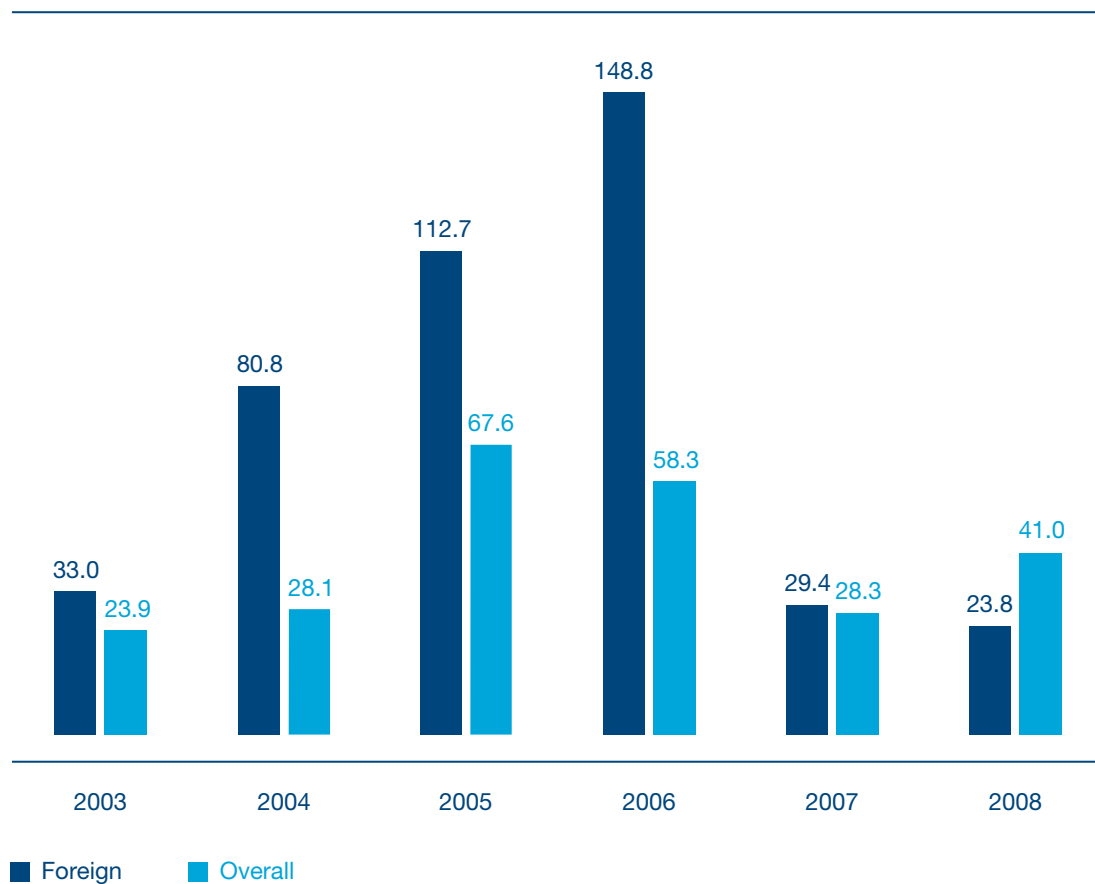
26 *Ibid.*

Figure 28. Settlement values (in thousands \$) for foreign companies: by lead plaintiff, 2003–2008†

	2003		2004		2005		2006		2007		2008	
	Cases settled	Settlement	Cases settled	Settlement	Cases settled	Settlement	Cases settled	Settlement	Cases settled	Settlement	Cases settled	Settlement
Public pension	2	307,100	4	525,000	2	1,107,000	6	2,241,400	6	3,395,300	8	337,600
Other institutional	2	19,000	3	98,500	3	37,800	3	21,300	2	106,800	6	81,400
Private investors	9	161,200	3	185,000	7	208,000	7	117,900	4	20,500	4	10,200
No lead plaintiff	2	7,300	–	–	–	–	–	–	1	30,000	–	–
Total cases settled	15	494,600	10	808,500	12	1,352,700	16	2,380,600	13	3,552,600	18	429,200

† 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.

Figure 29. Average settlement values (in millions \$): foreign vs. overall, 2003–2008†



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

Figure 30. Top settlements over \$100 million by foreign companies, 2000–2008[†]

Company	Country	Year settled [‡]	Amount
Tyco International	Bermuda	2007	\$3,200,000,000
Nortel Networks [§]	Canada	2006	\$2,217,041,000
Royal Ahold NV	Netherlands	2005	\$1,100,000,000
Global Crossing Ltd.	Bermuda	2004	\$444,000,000
DaimlerChrysler	Germany	2003	\$300,000,000
Lernout & Hauspie Speech Products NV [#]	Belgium	2004	\$180,520,000
Biovail Corporation	Canada	2007	\$138,000,000
Royal Dutch/Shell Transport	Netherlands	2008	\$130,000,000
Deutsche Telekom AG	Germany	2005	\$120,000,000

[†] 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.

^{||} Partial settlement.

[#] Lernout & Hauspie Speech Products NV includes multiple partial settlements.

A significant occurrence of 2008 relates to Siemens—Europe’s largest multi-national engineering company and the largest electronics company in the world—and the settlement with regulators regarding its bribery and corruption investigation. In December 2008, Siemens settled a two-year worldwide FCPA investigation relating to allegations regarding bribery of foreign public officials and the falsification of corporate books and records. The combined settlement of \$1.6 billion (which included \$800 million to the DOJ and SEC, and other penalties imposed by German authorities) was the largest of its kind to date and the first criminal charge for internal controls violations by a company. The US sanctions were the largest monetary penalties ever imposed in an FCPA case, and in announcing the settlement the DOJ cautioned companies that it, along with other regulators, will continue to crack down around the globe on FCPA violations.

The DOJ stated in its sentencing memorandum that “since the beginning of the internal investigation, Siemens’ remediation efforts have been exceptional” and that “the reorganization and remediation efforts of Siemens have been extraordinary and have set a high standard for multi-national companies to follow.”²⁷ Siemens’ successful efforts in remediation and in establishing an effective and viable anti-corruption compliance program, along with its wide-ranging cooperation efforts throughout the investigation, were key factors in the imposed criminal fine (\$448 million) being substantially less than what could have been assessed under the applicable sentencing guidelines (ranging between \$1.35 billion and \$2.7 billion).²⁸

The second-largest fine imposed by the DOJ relating to FCPA violations for 2008 was against the Willbros Group, a construction and engineering company in the oil and gas industry, and Willbros International, a wholly owned subsidiary of Willbros Group. The companies have agreed to pay a combined \$22 million to the DOJ in connection with payments made to Nigerian and Ecuadoran government officials. The SEC also settled the civil action against Willbros Group, where the company agreed to pay \$10.3 million in disgorgement and interest.

27 www.usdoj.gov/opa/documents/siemens-sentencing-memo.pdf.

28 www.usdoj.gov/opa/documents/doj-accomplishments.pdf.

International regulation heats up

There were eight new accounting-related SEC litigation releases in 2008 charging FPIs and/or their employees. This represents an increase of 167 percent when compared to the numbers issued in each of the two preceding years: three in 2006 and three in 2007. It also represents 20 percent of the overall new accounting-related litigation releases issued during 2008—a significantly higher proportion of overall new accounting-related litigation than in previous years (i.e., 6 percent in 2007 and 9 percent in 2006).

In comparing the 2008 charges with those in 2006 and 2007, it appears that both the SEC's FPI-related activity and its enforcement focus on FCPA violations are on the rise. Three of the civil actions cited foreign companies and/or employees for violations of the books and records provision and/or the internal controls provision of the FCPA. In 2007 and 2006 combined, there was only one new accounting-related litigation release (Willbros Group in 2006) that included charges relating to the FCPA. In 2008, the three new accounting-related litigation releases alleging violations of the FCPA were:

Volvo	L.R. 20504	March 20, 2008
Siemens	L.R. 20829	December 15, 2008
Fiat	L.R. 20835	December 22, 2008

Other charges filed and/or settled against foreign companies and/or their employees in 2008 new accounting-related litigation releases primarily related to allegations of improper revenue recognition and inadequate internal controls.

Foreign companies don't just have to worry about US regulators—regulators around the globe are becoming more active and increasing cooperation as well. Chairman Cox stated that, "Over the last year, the SEC made 556 requests of foreign regulators for assistance with SEC investigations—more than one a day on average, and far higher than any previous year. Many of these investigations are linked to possible wrongdoing in the subprime area. At the same time, the SEC cooperated with 454 requests from foreign regulators for enforcement assistance."²⁹

29 SEC, *2008 Performance and Accountability Report* (November 14, 2008); www.sec.gov/about/secpar/secpar2008.pdf.

The UK's Financial Services Authority (FSA) is arguably becoming more aggressive and adopting more SEC-type tactics in its battle against insider trading and financial crimes. In 2008, the British treasury proposed to give the FSA "specified prosecutor status," a power already assigned to the Serious Fraud Office.³⁰ The ability to offer immunity from prosecution to certain witnesses could be a "significant new weapon for City regulators."³¹

In addition to prosecutorial status, in 2008 the FSA issued the highest number of fines (48) since it was granted the power to do so in 2001. The number of fines imposed was twice the number imposed in 2007 and related to various offenses including mortgage fraud and improper sales of insurance. Fines in 2008 totaled £22.6 million—four times the total issued by the regulator in 2007.³²

To assist and encourage greater cooperation in European investigations, the EU Council recently issued a framework decision to allow a new warrant for the purpose of obtaining objects, documents, and data that will be used in criminal matters. The European Evidence Warrant (EEW) will only apply to certain offenses, which include fraud, corruption, and money laundering. The EEW will apply only to objects, documents, and data that already exist, and may include those from a third party or a search of premises (including the private premises of the suspect) and historical data, such as financial transactions and historical records of statements. These include financial transactions, historical records of statements, and interviews and hearings, as well as other records such as the results of special investigative techniques. The new EEW could help investigators ensure that information and evidence can be exchanged quickly.

30 Patrick Hosking, "HBOS Investigation: Blowing the Whistle Can Help FSA Nail the Cheats," *The Times* (March 29, 2008).

31 *Ibid.*

32 Emily Flynn Vencat, "UK's FSA Imposed a Record Number of Fines in '08," *Associated Press* (December 24, 2008).

Foreign plaintiffs continue to seek recovery in US courts

Due to limited shareholder rights and protections currently available outside the US, foreign investors and pension funds continue to seek recovery of losses from US courts by filing claims and participating in US class actions. Foreign investors may have the same rights in US courts even if the securities were purchased outside US markets, provided the issuer is a registrant with the US SEC and the plaintiff can demonstrate that the violation occurred in the US. The National Association of Pension Funds (NAPF) encourages UK pension trustees to consider the benefits of joining US class actions, not only to recoup their losses but also to have the ability to “encourage reform of corporate governance practices at a company, thus protecting or enhancing shareholder value in the longer term.”³³

Despite higher recoveries when an institutional investor is the lead plaintiff, foreign pension funds generally do not seek to be lead plaintiffs due to the time and cost associated and the potential to be excluded as a plaintiff by the court. Additionally, institutions may sometimes secure higher recoveries by pursuing their own opt-out claims.

In October 2008, the United States Second Circuit Court of Appeals issued its decision in the *Morrison v. National Australia Bank* case. This was a significant decision for foreign issuers and foreign shareholders seeking recovery of losses in US courts, as it marked the first time a Second Circuit court considered what has come to be referred to as a “foreign, foreign, foreign” or “F-cubed” securities case. An F-cubed case is one in which foreign plaintiffs buy shares of a foreign private issuer on a foreign securities exchange and try to recover losses in a US District Court.

33 NAPF, “Securities Litigation—Questions for Trustees” (March 15, 2007).

Inclusion or exclusion of foreign plaintiffs by the court in F-cubed matters is generally decided based on “conduct” and “effect” of the alleged violation, to determine whether the court has jurisdiction. For example, the courts consider whether the violation was conducted in the US or on foreign soil, and whether the fraud affected US markets and investors. In the *Morrison v. National Australia Bank* case, the plaintiffs did not purchase their shares in the US, so the court only analyzed the case under the conduct test. The alleged violations of US securities laws were based on the 2001 drop in National Australia Bank’s share price. Allegedly, the share price drop was caused by the bank’s write-down of its US subsidiary upon discovery that the assumptions it used in valuing its mortgage fees were incorrect. The plaintiffs claimed that US securities laws had jurisdiction since the incorrect subsidiary value was included in the bank’s US securities filings associated with American Depositary Receipts.

The court concluded that the fraudulent conduct happened outside the US, noting that the corporate filings that contained the alleged false statements were prepared at the Australian corporate headquarters. The Second Circuit upheld the decision of the District Court dismissing the complaint by the foreign shareholders, but declined the defendant’s invitation to issue a bright-line ruling that foreign defendants in this situation are never subject to the jurisdiction of US securities laws. The court said it was “leery of rigid bright-line rules because we cannot anticipate all of the circumstances in which the ingenuity of those inclined to violate the securities laws should result in their being subject to American jurisdiction.”³⁴ Further, the court noted that it was “an American court and we cannot and should not expend our resources resolving cases that do not affect Americans or involve fraud emanating from America.”³⁵

Foreign investors have been excluded from pursuing recovery in US courts where courts have believed their native countries would not uphold the judgment or settlement. In certifying the Vivendi securities litigation case in the Southern District of New York, Judge Richard J. Holwell refused to include plaintiffs from Germany or Austria on the reasoning that the courts of Germany and Austria were hostile to opt-out procedures and therefore unlikely to give a US class action judgment or settlement a binding effect. Time will tell whether shareholders from other countries deemed hostile to opt-out procedures will also be precluded from seeking recovery in US courts.

34 Jack C. Auspitz, Joel C. Haims, Jonathan C. Rothberg, “US Court Issues Important Ruling on Foreign Issuer Securities Case,” *Journal of Banking and Finance Law and Practice* (October 2008).

35 *Ibid.*

Changes at SEC affect foreign filers

On the global front, the SEC made a number of changes which it believes will ease the burden of foreign company registration in the US:

- The SEC modernized the foreign issuer exemption from Exchange Act reporting and no longer requires issuers to provide hard copies of English translations of material disclosures required by its home jurisdiction. Foreign issuers can now provide those disclosure documents either on the issuer's website or in a publicly accessible database like the SEC's EDGAR system.
- FPIs' reporting obligations have been changed and their annual report now has to be filed no later than four months after the fiscal year-end. The SEC believes this is good for US investors because reports include important information about a foreign issuer that US investors look at when evaluating a company.
- The SEC updated its cross-border tender offer rules to provide more opportunities for US investors to participate in cross-border transactions.

Despite these changes, however, the number of foreign companies registered with the SEC continued to slide downward for a third year. The total number of foreign registrants in 2008 was 1,058, a figure that includes the 230 companies that deregistered and the 141 new companies that registered with the SEC during the year. Whether this trend reverses course in 2009 remains to be seen.

Now what? Strategic considerations for managing civil litigation after a criminal investigation has concluded

By Karen Patton Seymour and Tracy Richelle High, Partners, and William B. Monahan, Associate, Sullivan & Cromwell LLP

The 2008 Wall Street meltdown has uncovered a number of financial frauds and will no doubt lead to an increase in investigations initiated by federal prosecutors into the conduct of financial institutions and other businesses. If recent history is any guide in the new administration, the Department of Justice will resolve many of these investigations by the company entering into a deferred prosecution agreement (DPA) or non-prosecution agreement (NPA).

Much has been written about the significance to a company of resolving an investigation through a DPA or NPA—and rightly so, when compared with the alternative of an indictment. It is often tempting, however, for members of a company's board of directors to view the DPA or NPA as the conclusion to a bad chapter in the company's history, and thereafter shift their focus to compliance with the terms of the agreement. In fact, a whole new phase is often about to begin: civil litigation resulting from the conduct uncovered during the criminal investigation and any parallel investigation by the company's audit committee.

If they did not already commence litigation during the investigations, activist shareholders will race to the courthouse to file derivative actions against current and former company executives implicated in any wrongdoing—and possibly against members of the board for allegedly failing to adequately oversee the company. Plaintiffs commonly advance a broad array of claims, ranging from alleged violations of the federal securities laws to common law claims of corporate mismanagement and unjust enrichment.

If a shareholder beats the company to the courthouse, the company can expect an increase in litigation costs and a fight concerning the directors' suitability to

prosecute the company's claims. Although derivative actions are filed on behalf of the company, plaintiff shareholders are often unwilling to stand back and permit the company and its lawyers to prosecute the actions. Plaintiffs may even use the company's own words to argue that the company is unsuited to prosecute its own claims, as prosecutors typically require the company to make detailed factual admissions in DPAs and NPAs—admissions that generally cannot be denied by the company in civil actions.

Litigation costs will also increase once the shareholders seek broad discovery to support their theories of liability, including all documents produced by the company to the government and depositions of individuals with knowledge of the facts uncovered during the criminal investigation.

The company may be able to protect its right to direct its own litigation if the board appoints a Special Litigation Committee (SLC) of independent directors to investigate the claims asserted on the company's behalf. Typically, an SLC will consist of two or three directors who joined the board after the events at issue, and whose impartiality cannot legitimately be questioned. The SLC will hire its own lawyers to assist in investigating the claims. Under Delaware law, the SLC's conclusions concerning which claims are in the best interests of the company to pursue, if any, are entitled to significant deference under the business judgment rule upon a showing that the SLC acted impartially and in good faith.

The use of SLCs to defend against the prospect of shareholder-controlled derivative actions has increased over the last five years. There are risks in using an SLC, however.

The first concerns a possible waiver of the company's attorney-client privilege and work product protections. Under the DOJ's new corporate prosecution policy, federal prosecutors may not ask the company to waive its protections over "core" attorney-client communications and work product in order to receive cooperation credit.

If, however, the audit committee turns over the work product from its investigation to the SLC, the company may have unintentionally waived its protections. The Northern District of California recently ordered an SLC to produce to the plaintiff shareholder "[a]ll transcripts, notes and summaries of witness interviews conducted by the SLC (or by the [audit committee] which were relied upon by the SLC)," even though those materials were protected.³⁶

Another risk of waiver can arise if the SLC discloses its work product to individual directors who are not members of the SLC and who are represented individually by counsel. The Delaware Chancery Court recently held that by disclosing the SLC's findings to the full board (prior to the SLC's public disclosure of its report), including directors whose conduct was at issue and whose attorneys were attending the presentation, the SLC waived the company's protections over materials reviewed by the SLC and communications between the SLC and its counsel.³⁷

A second risk from using an SLC relates to timing. Generally speaking, there is no limit on the time within which an SLC must complete its investigation, and SLC investigations have taken as little as 30 days to as long as over three years to complete. As a practical matter, however, the length of the SLC's investigation can impact the company's ability to pursue its claims.

For example, securities class action and derivative litigation involving conduct similar to that under investigation by prosecutors is sometimes settled prior to or during the criminal investigation, and those settlements often include broad releases of liability (in a court order) to all of the company's current and former directors and officers. If the SLC subsequently discovers that newly discovered evidence of misconduct was fraudulently concealed from the company at the time it granted the release, the company can move to overturn that release—under Rule 60(b) of the Federal Rules of Civil Procedure—only if it does so within one year of the date of the release. Thus, as a general matter, unless the SLC's investigation concludes by the end of that one-year period, the company may risk losing the ability to prosecute any of the claims the SLC concludes it should prosecute.

These risks from using an SLC are worth taking when the other option would result in the company losing its ability to control the prosecution of its own claims. But, what if the company beats the shareholder to court in the first instance?

If it can act quickly after the resolution of the criminal investigation (and maybe even before it concludes) and file a lawsuit against those former executives who engaged in misconduct while at the company, the company may be able to avoid many of the costs from the filing of shareholder litigation and the additional risks involved in appointing an SLC in response to it.

Either way, directors must be cognizant that, as much as the company wishes to leave a dark past behind, the conclusion of the criminal investigation often only signals the beginning of a new and costly phase of civil litigation.

³⁶ *In re KLA-Tencor Corp., Shareholder Derivative Litigation*, No. 06-3445 (N.D. Cal. May 14, 2008).

³⁷ *Ryan v. Gifford*, 2007 Del. Ch. LEXIS 168 (Del. Ch. Nov. 30, 2007), certificate of appealability denied by 2008 Del. Ch. LEXIS 2 (Del. Ch. Jan. 2, 2008).

What this means for your business

**For 2009 and beyond,
eternal vigilance is the
price of admission.**

As companies look ahead to 2009 and beyond, the implications of 2008 activity are clear: Those companies that vigilantly prepare for potential crises and litigation will be better positioned to travel the bumpy road.

In the shadow of the global economic crisis, financial companies in particular face significant reputational and financial risks from ongoing shareholder and investor lawsuits and arbitration claims. They also continue to contend with regulatory authorities' inquiries and formal investigations. As such, it is imperative that companies take steps to fully understand and communicate the facts and circumstances giving rise to financial losses.

More broadly, increased international cooperation amongst regulatory agencies means companies across all industries may be more vulnerable to parallel global investigations and legal claims. Hence, legal teams may need to respond to simultaneous, and at times duplicative, inquiries and requests for information and documentation. To ensure timely responses and to demonstrate a willingness to cooperate fully, companies should consider developing and implementing strategies focused on crisis and litigation.

Litigation strategy, internal controls, and FCPA enforcement remain on radar

Over the next year, three areas where companies will want to remain especially vigilant are institutional plaintiff activity (particularly activity related to public and union pension funds), internal controls accounting-related allegations, and FCPA enforcement.

In 2008 filings, public and union pension funds continued to be most active in securities litigation where an institutional investor is named as lead plaintiff, and that trend is expected to continue in 2009. Because pension funds may opt out of a class action in order to potentially achieve higher settlements on their own, companies should be prepared to defend multiple cases related to the same matter.

With regard to internal controls, which continued to be a leading allegation in 2008 accounting-related litigations, organizations should evaluate the initiatives implemented as part of SOX and ensure that they have a sustainable and effective program in place to mitigate risks associated with these claims.

Since FCPA enforcement has continued to increase, with record penalties and disgorgement as well as individual penalties, fines, and jail sentences, companies should also proactively assess their compliance programs and monitoring efforts (including performing periodic compliance risk assessments of their global operations) and tailor their monitoring efforts accordingly. Companies need to be cognizant of current enforcement activities related to:

- Industry-wide investigations (e.g., oil for food, medical device)
- Common agent investigations (e.g., Panalpina)
- M&A activity

Companies face increasing scrutiny in 2009

As the US and countries across the world attempt to repair damage to their economies and financial markets from the global financial crisis—as governments bail out corporations and executives are taken to task—companies in all industries should take heed: Now more than ever before, they are under the microscope.

As in 2008, securities litigation activity in 2009 is likely to reflect this new era of accountability and oversight—particularly if the regulatory environment is overhauled, as most think is inevitable.

Best practice for internal investigations

By Edward J. Fuhr, Partner, Hunton & Williams

The events of the last quarter of 2008—from the sudden implosion of venerable financial institutions to the collapse of the alleged Ponzi scheme run by Bernie Madoff—ensure that many corporations will be greeting the New Year with the same question: What happened? The parties asking this question may differ. It could be the SEC, the DOJ, or a foreign regulator. It could be shareholders in the form of a derivative demand letter. It could be the company's own audit committee. Regardless of who is asking the question, the corporation will need to answer. And in many cases, providing an answer will require some form of internal investigation.

Below are issues that boards of directors and their companies should consider as they conduct such investigations in 2009 and beyond.

Preservation and collection of documents

The first step in an internal investigation is to preserve and then collect information sufficient for the investigator—whether the company itself, the board of directors, or an independent committee—to understand the facts. This should begin with appropriately targeted requests or searches at the outset of the investigation. As sources of information continue to proliferate, however, this first step is becoming increasingly difficult. An investigator may have to search not only paper files and email communications, but potentially employee blogs, instant messages, and text messages.³⁸

In many cases, an entity conducting an internal investigation needs to be as concerned about the collection of electronic information as a litigator in a civil suit. A party conducting an investigation may have to defend its efforts to a court or a government agency. If these efforts are not adequate, for whatever reason, the entire investigation may be in vain. In 2008, a court denied a board committee's motion to dismiss

shareholder litigation following an internal investigation in part because of concerns about “the depth and focus of [the committee's] inquiry.”³⁹

To avoid a similar outcome, document collection efforts generally should be transparent, appropriately thorough, and well documented, much like parties to civil litigation structure their efforts in the e-discovery context.⁴⁰

Interviews

Most investigations involve interviews of key personnel. Many investigations can benefit, however, from early informal interviews of personnel lower in the corporate hierarchy. Such persons can educate the investigator on potential sources of documentary information, the company's IT infrastructure, and the types of reports and other documents that are routinely created in various business units.

With conducting interviews—just as with collecting documents—it will often be appropriate to ensure that the results are appropriately documented. In at least one case in 2008, a court refused to defer to a Special Litigation Committee, in part because the committee's interview summaries “fail[ed] to record the witnesses' answers at all,” instead just containing “a thumbnail summary of the areas covered during the [committee's] interviews.”⁴¹ Without this information, the court was “unable to ascertain the reasonableness of the [committee's] investigation.”⁴²

Processing

Once the investigating entity has collected sufficient information, that information must be processed and analyzed. This is often the most expensive part of an investigation, as it may require counsel to review myriad documents. Accordingly, anything that can be done on the front end to decrease the quantity of information requiring review will pay big dividends.

38 See, e.g., *Flagg v. City of Detroit*, 252 F.R.D. 346, 352-53 (E.D. Mich. 2008).

39 *In re KLA-Tencor Corp. Shareholder Derivative Litigation*, Slip. Op., No. 06-3445 (N.D. Cal. December 11, 2008).

40 See *Victor Stanley, Inc. v. Creative Pipe, Inc.*, 250 F.R.D. 251, 262 (D. Md. 2008) (holding in an e-discovery dispute that “the party selecting the methodology must be prepared to explain the rationale for the method chosen to the court, demonstrate that it is appropriate for the task, and show that it was properly implemented”).

41 *Sutherland v. Sutherland*, 2008 WL 1932374, at *6 (Del. Ch. May 5, 2008).

42 *Ibid.*

One way to accomplish this goal is to use keyword searches. In one recent investigation, a Special Litigation Committee collected approximately 13 terabytes of electronic data. Thirteen terabytes is equivalent to approximately 500 million pages. After running search terms and de-duplicating, however, the committee was left with only 120 gigabytes of information to review.

Final product

Once the facts have been found, they need to be synthesized. How to accomplish this synthesis will depend on the type of investigation. In some cases, a written report will be advisable or even necessary. Deciding whether and when to issue such a report, however, can be a difficult decision. This is especially true when the shareholder derivative suit that triggered the investigation is accompanied by a parallel securities class action, which can often entail potential damages that are much greater than those in a derivative suit. Securities plaintiffs often attempt to seek discovery of reports by internal investigators to bolster their own claims.⁴³

In other situations, where a written report may not be legally required, it may not be appropriate to create one. A report can often serve as an unwitting roadmap to current or potential plaintiffs. And the mere creation of the report creates a risk that it will be discovered, despite counsel's best efforts to ensure its protection by the attorney-client and work product privileges.

The issue of privilege was addressed by the new Federal Rule of Evidence 502, which became law on September 19, 2008. Rule 502 is primarily applicable to civil litigation but may also prove useful in internal investigations involving a parallel government enforcement proceeding. Rule 502 provides that parties may agree, and the court may order, that disclosure to the government does not waive the privilege in other litigation with respect to the disclosed materials.

Involvement of outside and in-house counsel

Many investigations will require the retention of outside counsel that is both experienced and able to accomplish the goals of the investigation in a cost-effective manner. Depending on the nature of the investigation, such counsel may also need to be independent from the company, its officers or directors, or third parties.

The extent to which outside counsel can work with the company's in-house counsel generally will depend on the type of investigation. For example, if the investigation is being conducted by the company's in-house legal department, it will obviously be appropriate for outside counsel to work for and in tandem with in-house counsel. In contrast, if the investigation is being conducted by an independent board committee, close collaboration may be inappropriate, as it could raise issues regarding the independence of the committee's investigation. For example, courts have suggested that it may be inappropriate for in-house counsel to attend interviews of company personnel in connection with an independent board investigation.

In conclusion, given the unprecedented events of 2008, 2009 may be the year of the internal investigation. By considering the issues discussed in this article, boards of directors and their companies can ensure that their investigations are targeted, thorough, and effective.

⁴³ See, e.g., *Ross v. Abercrombie & Fitch Co.*, 2008 WL 1844357 (S.D. Ohio Apr. 22, 2008).

Methodology

The PricewaterhouseCoopers (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 1999–2008 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.

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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