July 2015

DataBox Mid-Year Securities Class Action Report

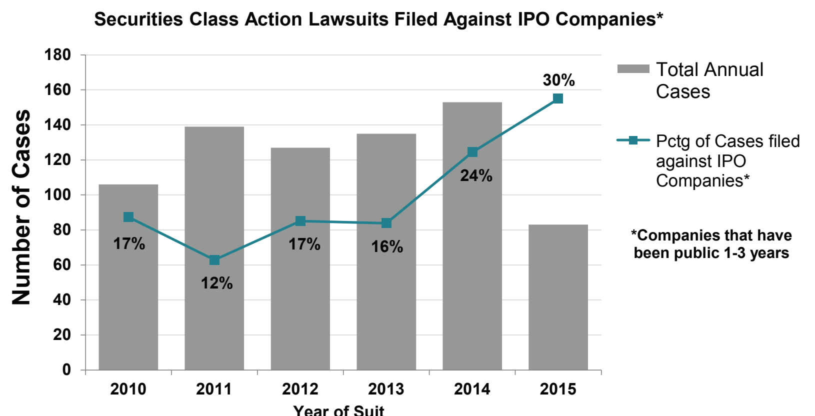
As of June 30, 2015

Woodruff-Sawyer & Co. is pleased to present the latest information concerning securities litigation filed against public companies in the United States. The information below comes from the as of June 30, 2015. The DataBox tracks securities class action litigation filed against public company issuers and their directors and officers.[1]

Will This Year be a Record Year for Filings?

We have reached the mid-point of 2015 with 83 cases having been filed thru June 30, 2015. This is a **20%** increase over filings made in 2014 during the same first six-month period. With a current monthly average of 13.8 cases filed, this year could end with a total of approximately 166 cases filed. This would be the highest number of total cases filed within the last 10 years – 2005 thru 2014 – with 2005 tallying the highest number of cases at 162 suits. What is driving this activity? A couple of factors are attributed to the increase:

- **The IPO market:** Since the financial crises, the number of IPO filings has jumped from a low of fewer than 100 IPOs in 2008 to a high of approximately 300 IPOs in 2014, creating a lot of new public company targets. The rise in the number of cases against companies who have recently gone public is illustrated on the right:



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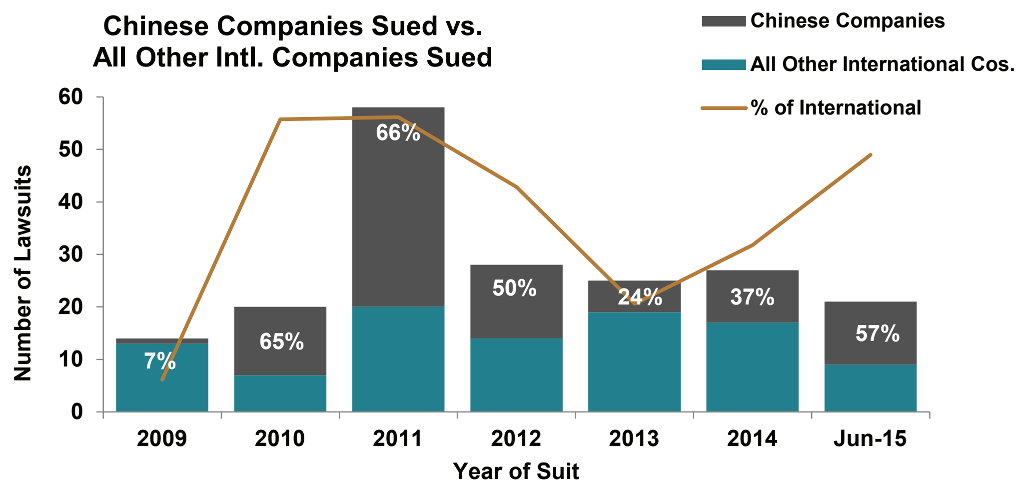
[1] For purposes of tracking issuer-related securities litigation, the D&O DataBox focuses exclusively on securities class action lawsuits filed in federal courts against public companies by holders of common or preferred stock.

- **The China Syndrome:** Beginning in 2010, lawsuits filed against Chinese companies have gone up significantly due to deficiencies in accounting matters and/or fraudulent financial reporting. The majority of the companies sued had taken advantage of entering the U.S. stock market via reverse-merger transactions that bypassed the traditional way companies entered the U.S. public stock market through the initial public offering process. While securities class action filings against "reverse-merger" companies have dropped dramatically, Chinese companies that registered shares for the U.S. public market are now the subject of class action lawsuits. Recent news of China's stock market crash that brought on a temporary ban of IPOs and in which trading was halted in about a third of listed companies in the Shanghai and Shenzhen exchanges by the Chinese government has only reinforced investors and analysts lack of confidence in the financial statements of companies listed on both the mainland China and Hong Kong exchanges. Since questions about governance, accountability and transparency continue to follow Chinese companies, we expect to see more suits filed against Chinese companies listed in the U.S. exchanges, but probably not at the high of 38 suits filed in 2011. The chart below sets forth how in the last five years since 2010 Chinese companies have fairly consistently been in the forefront in filings that have been made against international companies:



These two factors, IPO companies and Chinese companies, account for 45% of the lawsuits filed in the first half of 2015. At the other end of the spectrum, at least one-third of the remaining cases have been filed against established U.S.-based companies that have been publicly trading for 10+ years with an average public life-span of 20.3 years. An additional 21% of the companies have been publicly trading for 5-10 years.

State court filings involving Public Offerings – a new trend?

In the first half of the year there have been six companies that have been sued in California state courts for alleged Section 11 violations of the Securities Act of 1933 (the "33 Act") which imposes liability for material misstatements or omissions in registration statements. These state filings accounted for half of the Section 11 claims filed in 2015 to date. Five of these companies went public in March 2014, and the sixth went public in February 2013. They are all technology companies headquartered in Silicon Valley and were sued either in San Francisco, San Mateo or Santa Clara counties.

Why file in state court instead of federal court? Some say that state courts are viewed as plaintiff-friendly and, because pleading standards are lower (i.e. easier for plaintiffs to meet the requisite burden), a Section 11 claim brought in state court is more likely to survive the pleading stage and have a lower chance of being dismissed.

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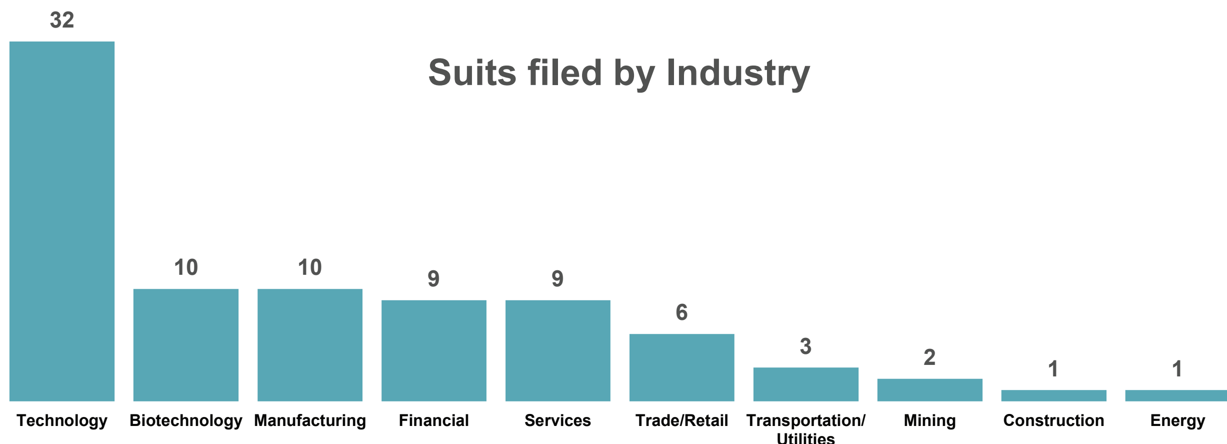
Remember too that discovery isn't automatically stayed in Section 11 cases brought in state court. It seems likely that plaintiffs are betting that these two factors – the ability for plaintiffs to pursue expensive discovery against the defendants, and the lower likelihood of the case being dismissed – will make these cases more expensive to settle compared to if they had brought the same case in federal court.

The issue of whether the plaintiffs had a right to bring Section 11 claims in state court was tested in California in 2008 when Countrywide Financial was sued by the purchasers of subprime mortgage-backed securities. The interpretation of a specific section of the 33 Act was hotly contested. On the one hand, plaintiffs argued that a strict interpretation was required, which would allow Section 11 claims to be litigated in state court. On the other hand, defendants argued that the federal legislature intended to include Section 11 cases along with other types of cases specified in the federal legislation – for example, securities class litigation brought pursuant to the 1934 Securities Exchange Act – when it enacted the legislation in 1998 and 2005 to combat frivolous lawsuits in state courts. The higher courts in California ultimately sided with the plaintiffs in their literal interpretation, and thus class action lawsuits alleging Section 11 violations (and with no added allegations under the '34 Act) can be brought in state courts.

While plaintiffs have pursued Section 11 claims in state court on a sporadic basis since then, these recent filings in 2015 are symptomatic of the robust IPO market and could lead to more filings in California state courts for companies and Ds&Os located in California. Whether or not they stay in state courts and have a better success rate for settlements vs. dismissals, remain to be seen. However, a recent attempt was made by defendants in one case to move it to federal court, but was remanded back to state court. The federal court order stated that: "Faced with inconsistent legislative history, the Court is compelled to remand because " [f]ederal jurisdiction must be rejected if there is any doubt as to the right of removal." (Alexander Liu v. Xoom Corporation, Case No. 15-CV-00602-LHK).

The Most Popular Industry

No surprise here, technology companies outpaced all other industries for class action lawsuits, comprising 48% of all suits filed – almost triple the number of suits filed against Technology companies in the same time period last year (15 suits). Early stage public technology companies accounted for 47% of the 32 suits (companies that have been public 1-3 years).



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Breaking down companies sued by market capitalization (at beginning of class period), there were only 10 companies that were over $5B in market capitalization. However, you will see below, large cap companies are making news on the settlement side of class action litigation.

Settlements and Dismissals

For the first half of 2015, settlements broke down as follows:

23 Settlements

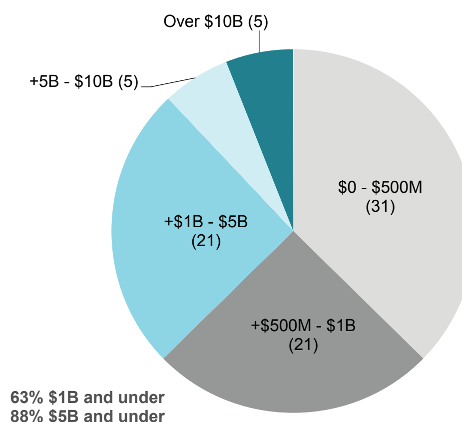
- 57% settled under $10M
- 35% settled $30M and above

Total Cash Settlements: $950.1 Million

- Average: $41.3M
- Median: $8.5M

25 Dismissals (3 withdrawals)

- 3.8 per month average through June 2015 as compared to 3.2 per month average in 2014



Entity	Suit Year	Amount ($M)	Allegation Notes
Pfizer, Inc.	2010	$400	Off-label marketing and kickbacks (DOJ settlement: $2.3B)
Sprint Nextel Corporation	2009	$131	Merger of Sprint and Nextel; $29.7B impairment charge
Hewlett-Packard Co.	2012	$100	Autonomy acquisition; $8B impairment charge
Regions Financial Corp.	2010	$90	AmSouth acquisition; $6B impairment charge
St. Jude Medical, Inc.	2010	$50	Heavy discounting of products to boost revenues
Questcor Pharmaceuticals, Inc.	2012	$38	Off-label marketing
Kinross Gold Corporation	2012	$33	Acquisition of Red Back Mining; $3.2B impairment charge
Celestica Inc.	2007	$30	Cost overruns, production delays and inventory management issues
Apollo Education Group, Inc.	2006	$13	Stock option backdating
Invacare Corporation	2013	$11	FDA compliance issues

A notable aspect of these settlements is that almost half involved a merger/acquisition that led to big losses and large class action settlements for companies with a market capitalization of over $15B. Additionally, class certification was granted in 5 of the top 10 cases that settled (Pfizer, Sprint, Regions Financial, St. Jude and Questcor). Average and median time periods for all cases settled from date first sued was 3.7 and 2.9 years (versus 2.8 and 2.5 years in 2014).

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Executive Compensation and Other Subjects

The Looming Specter of Broadened "Clawback" Rule

Since SOX was passed in 2002, there have been few instances in which the SEC has sued to recover pay from executives on behalf of companies. This is due in large part to the narrow confines of the laws and regulations in proving misconduct by executives when a restatement of earnings has occurred. Thus, clawback recoveries have been few and far in between in the last decade or so.

Recently in June 2015, the SEC announced a settlement with the former CEO of Computer Sciences Corporation in which he will return $3.7M in compensation and pay a $750k penalty. The SEC had charged the company and former executives with manipulating financial results and concealing significant problems about the company's largest and most high-profile contract. The $190M penalty to be paid by the company to the SEC coupled with the $97.5M securities class action settlement in 2013 signifies that substantial accounting issues were found for which certain members of management could not be immune from liability.

However, the threshold for accountability is about to be lowered with the SEC's proposed rule released on July 1, 2015, on clawbacks as required by the 2010 Dodd-Frank Act. Here is the proposed rule in a nutshell[2]:

- Public companies that restate their financials will be required to clawback or revoke excess incentive compensation (including stock options) from senior management.
- The rule would apply to both current and former executives that received incentive compensation for as long as three years prior to the restatement and applies to executives in a "policy-making function" thereby broadening the group of people affected.

Naturally, the proposed rule is causing a lot of concern, and the narrow 3-2 vote by the SEC's five members approving it has already garnered a lot of attention as to the divisions internally at the SEC on a plan that some view as over-reaching, burdensome and difficult to implement. A dissenting commissioner, Michael S. Piwowar, goes as far to indicate that an unintended side-effect of the proposal would be that management compensation would be increased to cover the risk of a clawback[3]. As the proposed rule receives public commentary and further debate before final approval next year, accounting issues that continue to be the leading cause for triggering securities class action lawsuits will become even more complex with the threat of potential clawbacks against its directors and officers.

Further to the subject of executive compensation, proposed regulations on the SEC's proposed pay-for-performance have been released. Below is the link to Woodruff Sawyer's "D&O Notebook: Directors and Officers Liability Blog" for further details:

- "Yet Another Set of Executive Compensation Disclosure Rules: the SEC's Proposed Pay-for-Performance Rules"

And other recent blog posts:

- "DuPont vs. Shareholder Activism: A Win for Corporate America"
- "Audit Committee Chairs: Don't Wait for the Final Draft of the Investigation Report"
- "If Your Director Compensation Plan is Vague, Now is the Time to Get Crystal Clear"

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[2] *Recommended reading on the proposed rules, "Summary of SEC's Proposed Rule on Executive Compensation Clawbacks" by Amy Seidel, Esq. of Faegre Baker Daniels*

[3] *"Dissenting Statement at Open Meeting on Clawbacks of Erroneously Awarded Compensation" by SEC Commissioner Michael S. Piwowar dated July 1, 2015*

We invite you to also take a look at our Cyber Liability Blog for information on issues pertaining to cyber liability, privacy, data breach and security.

About the D&O DataBox

D&O DataBox is Woodruff-Sawyer's proprietary director and officer litigation database. Included within the D&O DataBox is information concerning every securities class action lawsuit filed against public company directors and officers since 1988. Woodruff-Sawyer uses the D&O DataBox to help its client model their D&O litigation-related risk.

Woodruff-Sawyer is one of the largest independent insurance brokerage firms in the nation, and an active partner of Assurex Global and International Benefits Network. For 97 years, we have been partnering with clients to deliver effective insurance, employee benefits and risk management solutions, both nationally and abroad. Headquartered in San Francisco, Woodruff-Sawyer has offices throughout California and the West, including Oregon, Washington, Colorado and Hawaii.

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