



When Are Securities Class Actions Dismissed, When Do They Settle, and For How Much? An Update

by Michael Klausner, Jason Hegland and Matthew Goforth

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Two years ago, we published two articles in the PLUS *Journal* that reported data on the timing of dismissals and settlements in securities class actions and on the extent to which D&O insurance protects corporations and their officers and directors from liability in these cases. This article is the first of two updates of those reports. This article will cover dismissal timing, settlement timing, and the relationship between settlement timing and the size of settlement payments. In the next issue of the PLUS *Journal*, we will publish an update on the protection that D&O insurance has provided to officers and directors in securities class actions. These articles are based on a database that we have collected and will continue maintaining on securities class actions and SEC enforcement actions beginning in 2000.

In this article, we address the following questions:

- How long are securities class actions litigated before they are either dismissed or settled?

- How many times do courts give plaintiffs an opportunity to amend a complaint before finally dismissing a case with prejudice?¹
- How often do cases settle during the pleading stage—that is, before a final ruling on a motion to dismiss?
- For cases that are not dismissed, how long do the parties continue litigating before settling?
- How is settlement size related to settlement timing?

These questions are potentially important to lawyers, claims officers, monitoring counsel and others involved in the litigation and settlement process. They are important from a policy perspective

as well because they can help us assess the total cost of this type of litigation.

The data for the statistics presented here are taken from all securities class actions filed between 2006 and 2010.² Our selection of this time period reflects a tradeoff between our interest in analyzing up-to-date data, yet having a substantial number of completed cases from which to report data. Of the cases filed during this time period, 82% have been resolved and 18% are ongoing.

In total, there were 652 cases filed during this period, 253 of which settled, 206 of which were dismissed with prejudice, 74 of which were voluntarily dropped by plaintiffs, and 119 of which are still pending. Figure 1 presents some basic information about these cases.

Figure 1: Basic Case Information

Cases Filed 2006 - 2010 ¹			
		Settlements*	
Settled	40% (257)	Mean	Median
Dismissed w/ Prejudice	32% (206)	\$36 million	\$9 million
Voluntarily Dropped	11% (74)		
Ongoing	18% (119)		
Total	100% (652)		
		Parallel SEC Action?	
		Yes	14% (89)
		No	86% (563)

*Excludes Third Party Payments

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Overview of Settlement and Dismissal Timing

A common perception of securities class actions is that they entail a drawn-out pleading stage, with judges giving plaintiffs numerous attempts to plead a case in sufficient detail to go to discovery, and then lengthy discovery in which each side grinds the other down until settlement finally occurs on the eve of trial, after many millions of dollars have been spent on the litigation. While this description certainly fits some cases, it does not fit the typical case. Over half of all securities class actions end well before discovery and before even a second complaint is filed.

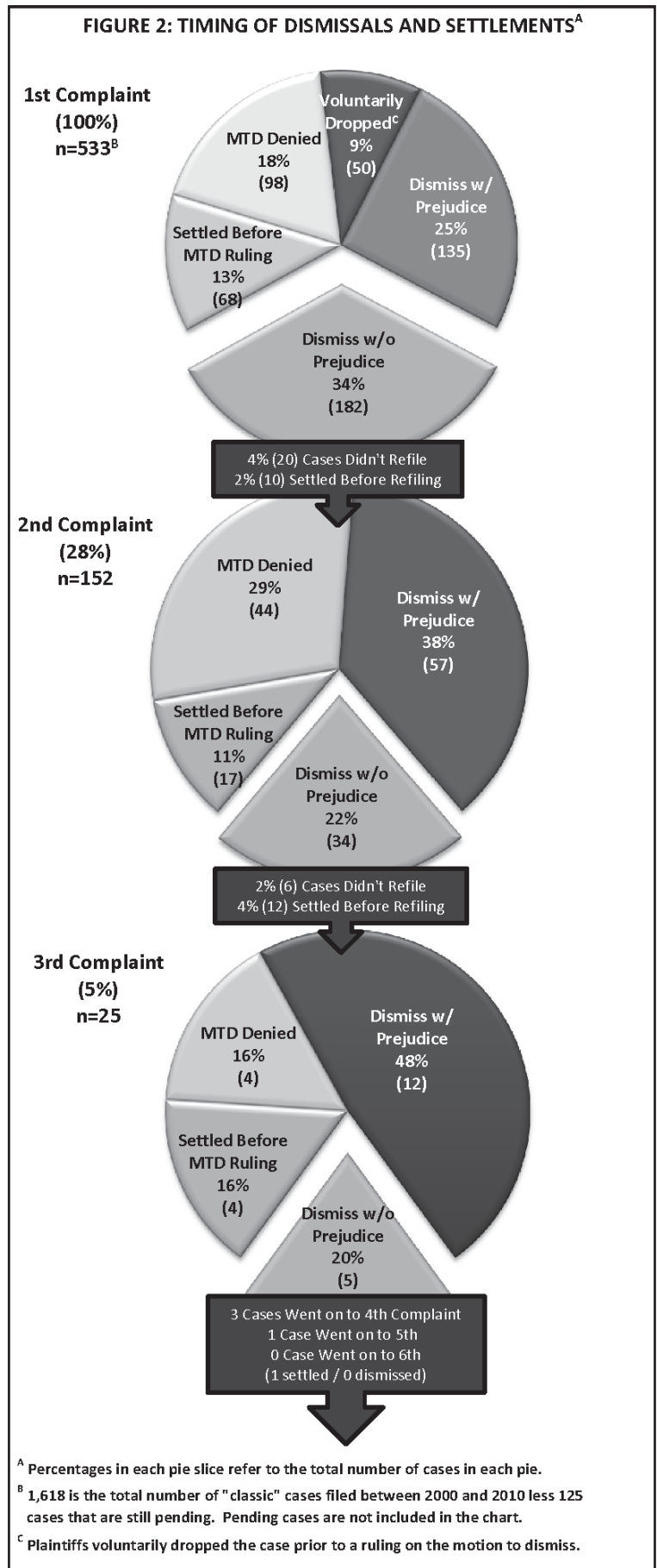
Figure 2 shows the outcome of all securities class actions during our time period as they proceeded through the litigation process. The upper pie chart shows the disposition of cases following the filing of the first consolidated complaint (or the appointment of a lead plaintiff).³ In 25% of all resolved cases, the judge granted the defendants' motion to dismiss (MTD) the first consolidated complaint with prejudice, and the case ended. On average, 19 months passed between the time these cases were first filed and the date they were dismissed. An additional 9% of cases were voluntarily dropped before the motion to dismiss was ruled on, and another 4% were dropped after the motion to dismiss was granted without prejudice. Thus, in total, 38% of cases ended relatively quickly and painlessly for the defendants.

A substantial number of cases settled relatively quickly as well. Thirteen percent of cases settled before the court ruled on the first motion to dismiss, and another 2% of cases settled after the court granted a motion to dismiss without prejudice but before the plaintiff filed a second consolidated complaint. These cases—15% in all—entailed costs to defendants and their insurers, but they did not involve extended litigation.

In 18% of cases, the first motion to dismiss was denied, and the case moved toward discovery. Virtually all of these cases were ultimately settled rather than tried.

In 34% of cases filed, the court granted the defendants' first motion to dismiss without prejudice. Among those, 85% of plaintiffs

FIGURE 2: TIMING OF DISMISSALS AND SETTLEMENTS^A

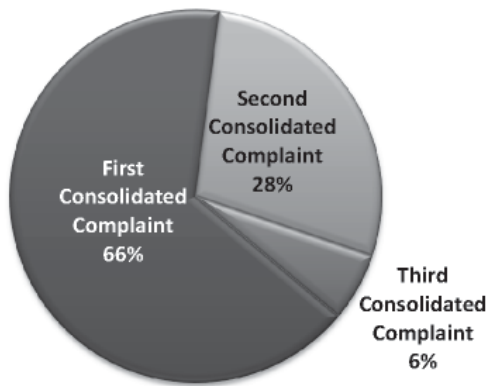


^A Percentages in each pie slice refer to the total number of cases in each pie.

^B 1,618 is the total number of "classic" cases filed between 2000 and 2010 less 125 cases that are still pending. Pending cases are not included in the chart.

^C Plaintiffs voluntarily dropped the case prior to a ruling on the motion to dismiss.

Figure 3: Number of Complaints Before Dismissal With Prejudice



*1 case was dismissed on the 4th complaint and 5th complaint

filed a second consolidated complaint. The distribution of settlements and dismissals once a second consolidated complaint was filed is shown in the middle pie chart. The distribution roughly parallels the disposition of cases at the first-complaint stage, with the primary difference being that more cases were moved out of the pleading stage—38% were dismissed with prejudice, and 29% of motions to dismiss were denied. On average 30 months passed between the time these cases were filed and the time these second MTDs were ruled on.

Only five percent of cases filed reached a point at which at least two complaints were dismissed without prejudice and a third complaint was filed. One of those went on to a fourth complaint and another to a fifth. Perhaps among the cases that are still ongoing, this number will rise, but based on our full dataset, going back to 2000, we can safely predict that it will not rise by more than a percent or two.

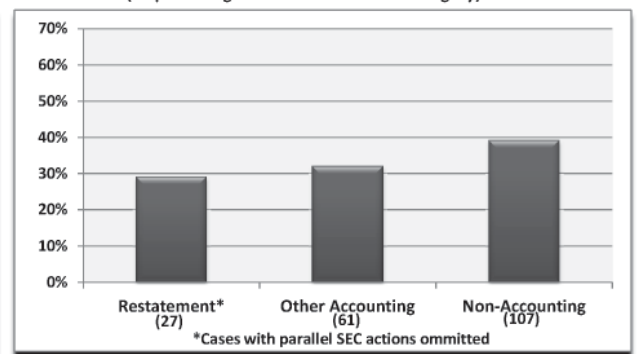
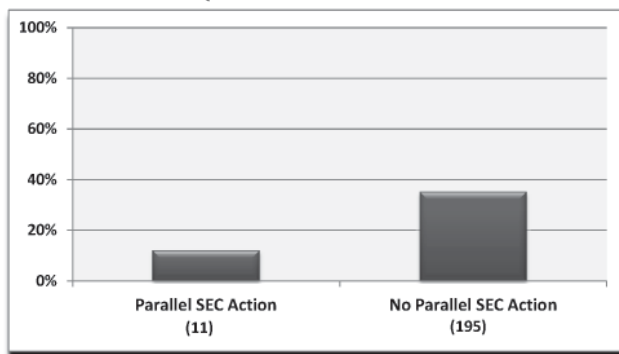
Another way to assess the efficiency with which courts review cases and either dismiss them or allow them to proceed is to look at when dismissals with prejudice occurs—that is, finally dismissal with no opportunity to file another complaint. Figure 3 provides

an answer to that question. Sixty-six percent of dismissals occur on the basis of a single consolidated complaint. Twenty-eight percent occur on the basis of the second complaint and 6% on third complaint. These figures do not include cases that were voluntarily dropped or abandoned after a dismissal without prejudice.

What sorts of cases are ultimately dismissed or dropped, and when?

Figure 4 shows the frequency with which cases are ultimately dismissed or dropped, broken down by whether there is a parallel SEC action and, if not, the nature of the allegations.

FIGURE 4: FREQUENCY OF DISMISSED OR DROPPED CASES BASED ON NATURE OF SUIT (As percentage of cases filed in each category)



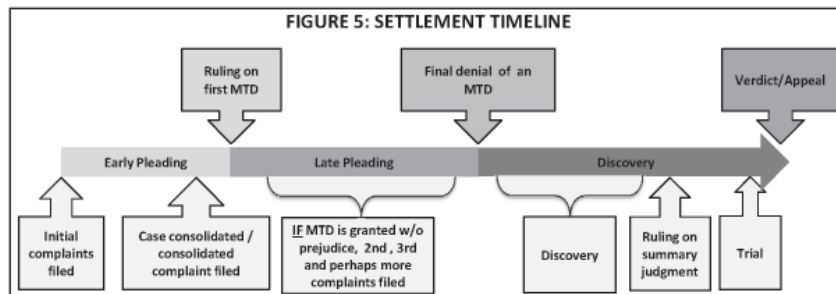
Where the SEC has filed a parallel enforcement action—based on the same allegations made in a class action complaint—the class action was dismissed in only 12% of cases. Leaving aside class actions with parallel SEC actions, cases that involved restatements were dismissed less frequently than cases that involve non-restatement accounting issues, which in turn were dismissed less frequently than are non-accounting cases. These differences are statistically significant.

How often do cases settle during the pleading stage and how often during discovery?

As shown in Figure 2, some cases settle before the ruling on the first motion to dismiss; some settle later in the pleading process, after an initial dismissal without prejudice; and some settle after a motion to dismiss has been denied and a case heads toward discovery and potentially to trial.

Figure 5 shows a timeline of a typical case with three phases of litigation delineated: Early Pleading, Late Pleading, and Discovery. We divide settled cases into three groups based on the phase in which they settled. Settlements in the Early Pleading Phase occur before a ruling on the *first* motion

FIGURE 5: SETTLEMENT TIMELINE

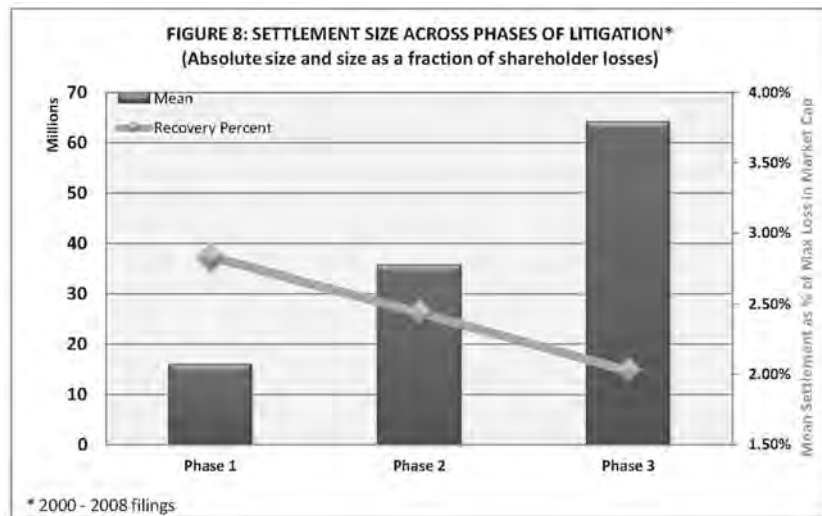
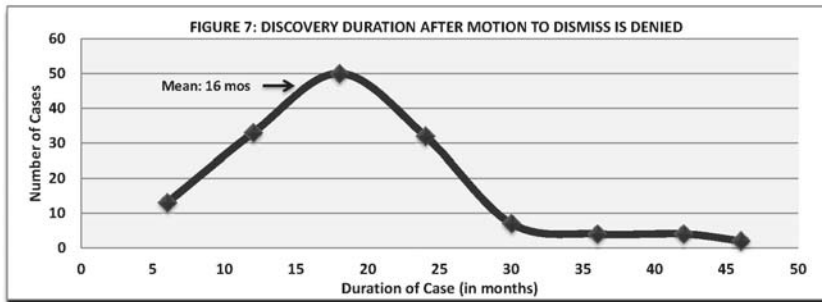
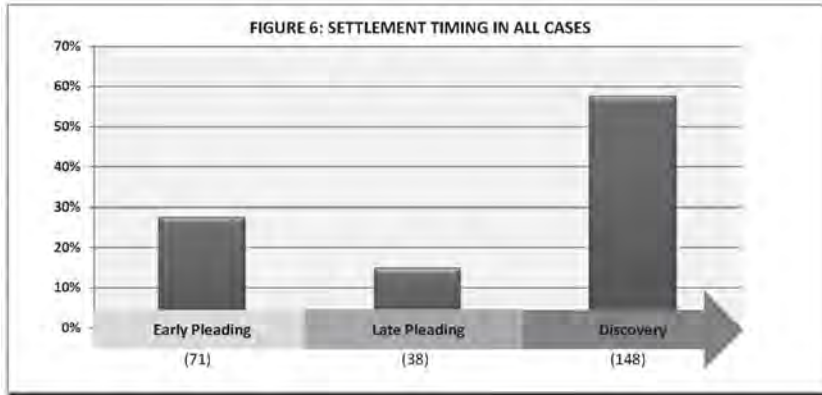


to dismiss. Settlements in the Late Pleading Phase occur after a case has been dismissed without prejudice but before a final ruling on a later motion to dismiss⁴—that is, while there is still a possibility that the case will be dismissed. Settlements in the Discovery Phase occur after a motion to dismiss has been denied, at which point the stay of discovery is lifted. Discovery Phase

settlements include cases that settle soon after the motion to dismiss has been denied, in which case actual discovery has not begun, and cases that settle on the eve of trial after full discovery. We break these settlements down further below.

Figure 6 shows the distribution of settlements across these three phases of litigation. Forty-three percent of

settlements occur in the Early or Late Pleading Phase—that is, while there is still a possibility of dismissal. This is true of cases with and without parallel SEC cases. There is also no significant difference among cases alleging misstatements related to restatements, those related to accounting misstatements where there was no restatement, and those that allege misstatements unrelated to accounting.



Once discovery begins, how long is it until the case settles?

Just under 60% of all settlements occur in the Discovery Phase—some shortly after the motion to dismiss is denied, in which case no discovery occurs, and others after lengthy discovery. Figure 7 shows the distribution of settlement timing for these cases. The mean length of time before a case settles once a motion to dismiss has been denied is 16 months. The median is essentially the same. The full range of settlement timing for these cases runs from one month to 46 months after the motion to dismiss is denied. The top end of the range of settlement times and the mean and median times could increase once all ongoing cases are resolved, but probably not by a lot. If we look at all cases resolved between 2007 and 2012, the maximum duration between dismissal of the motion to dismiss and settlement is 46 months. The mean for those cases is also 16 months.

Is settlement size related to settlement timing?

Is there any relationship between settlement timing and the size of settlements? One can hypothesize a number of cross-cutting influences on this relationship. Untangling these factors is a task that lies beyond the scope of this article. Nonetheless, we briefly explore how settlement timing is related to settlement size.

Figure 8 shows two, apparently contradictory relationships. The bar graph shows mean settlement amounts⁵

for cases that settle in each of the three phases of the litigation.⁶ Those amounts are measured on the left-hand vertical scale. A line graph is superimposed on the bar graph and is measured on the right-hand vertical scale. The line graph shows mean settlements as a percentage of shareholder losses (measured crudely by the difference of the maximum price of a company's shares during the class period minus its share price the day after the end of the class period.⁷) While settlement size increases as cases move from the Early Pleading to the Discovery Phase, settlement size as a fraction of shareholder losses decreases.

What explains this inverse relationship? Shareholder losses are a function of company size and the size of the stock drop, measured in percentage terms. We compared each of these factors across cases that settled in each phase and found that company size is the explanation. Large companies tend to settle later than smaller companies and, not surprisingly, large company settlements tend to be larger in absolute

terms than small company settlements. On the other hand, small companies tend to settle for a larger fraction of shareholder losses than do larger companies. The relationship between company size and settlement timing appears as well when we look at settlement timing within the Discovery Phase. Large companies tend to settle later in discovery than do small companies.

Conclusion

This analysis of settlements and dismissals of securities class actions reveals several facts of interest. First, over half of securities class actions end early in the pleading stage, either as a result of dismissal or settlement. Second, relatively few cases entail the filing of a second, third, or later consolidated complaint. Third, among cases that settle, nearly half settle during the pleading stage—before a final ruling on a motion to dismiss. Finally, cases that settle early in the litigation process tend to settle for less than do cases that settle

later. This, however, is due to the fact that small companies tend to settle earlier than large companies. Then measured as a fraction of shareholder losses, settlements that occur early are larger than settlements that occur later—because small companies tend to settle for a larger percentage of losses than do large companies. Comparing these findings to our findings two years ago, based on cases filed between 2000 and 2004, there are no appreciable differences. It appears that the forces shaping the patterns of dismissal and settlement over the past decade have remained stable. 🍀

For more information regarding the Stanford Securities Litigation Analytics project, and to support the SLA's effort of building an interactive analytic tool for practitioners, please visit SecuritiesAnalytics.stanford.edu.

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Endnotes

- 1 A dismissal with prejudice is a final dismissal, whereas a dismissal without prejudice allows the plaintiff to amend and refile the complaint to cure whatever shortcoming the judge initially found.
- 2 Because they differ from typical securities class actions in various ways, we have omitted from the analysis presented here cases beginning in 2010 that are part of the current wave of takeover-related litigation. Data analyzed here come from a comprehensive database that we maintain containing data on securities class actions, SEC enforcement action, and criminal securities fraud prosecutions.
- 3 The vast majority of cases are consolidated. In relatively few cases, there is only one complaint filed and therefore no need to consolidate. In those cases, the sole plaintiff that files a case is named lead plaintiff. In either case, we refer to the first complaint as the first consolidated complaint.
- 4 If there is a reversal on appeal, we substitute the appellate court's ruling for the district court's ruling.
- 5 Settlement amounts exclude payments by third parties such as accounting firms and investment banks.
- 6 Due to a disproportionately high number of ongoing cases involving large cap companies during the period we are analyzing, we used data on 2000 - 2008 filings to illustrate the inverse relationship between absolute settlement size and settlement as a *percentage* of shareholder losses.
- 7 Use of other measures of shareholder losses do not affect the relationship shown here.

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