

## Securities Class Action Case Filings

# 2002: A Year in Review

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### Research Sample

- The sample includes 708 federal class action filings in calendar year 2001 and 2002.
- The class action filings include 313 “IPO Allocation” filings.
- Filings were identified by the Stanford Law School Securities Class Action Clearinghouse in cooperation with Cornerstone Research as of March 7, 2003.

## Overview

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A review of securities class action filings in calendar year 2002 reveals a number of interesting findings. Most notably, the high level of securities litigation filing activity has continued in 2002 with a total of 224 “non-IPO Allocation/non-Analyst” securities class action filings. After removing special case filings (described in more detail below), the number of securities class action suits filed in 2002 was 31 percent greater than the number of cases filed in 2001 [171] and the second highest of any year since the passing of the Private Securities Litigation Reform Act of 1995 [“PSLRA”]. In addition, there was a significant increase in loss of market capitalization underlying the typical (median) filing in 2002 relative to 2001. Finally, a new type of securities class action suit emerged in 2002. In these “Analyst” cases, the investment banks and securities analysts following a company are named as defendants in separate filings. This *Year in Review* describes these and other findings in more detail. Exhibit 1, the “Complaint Filings Box Score,” provides a general overview.

### Complaint Filings Box Score

	2001	2002
Class Action Filings	171	224
Maximum Dollar Loss (\$ Billions)	\$1,547	\$1,912
Disclosure Dollar Loss (\$ Billions)	\$206	\$206

Note: All figures exclude IPO Allocation filings.

Exhibit 1

## Classification of Filings

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# 3

Class action filings in 2001 and 2002 were influenced by two types of securities class action lawsuits that were atypical of traditional securities class action filings. In 2001, there were a number of “IPO Allocation” filings with allegations related to the allocation of shares in the initial public offering. The Analyst cases contained allegations that defendants, primarily investment banks and individual analysts at these banks, had issued research reports and ratings that were neither independent nor objective. As a result of the atypical filings in 2001 and 2002, we sort filings in this report into two categories: IPO Allocation filings and “non-IPO/non-Analyst” filings. The Analyst filings are not included in the statistics presented in this report.

From many perspectives, the IPO Allocation and Analyst filings can be considered a different type of class action lawsuit and have characteristics unlike the traditional securities class action filing. Therefore, the non-IPO/non-Analyst litigation is more likely an accurate measure of ongoing activity and is emphasized in the comparisons provided throughout this report.

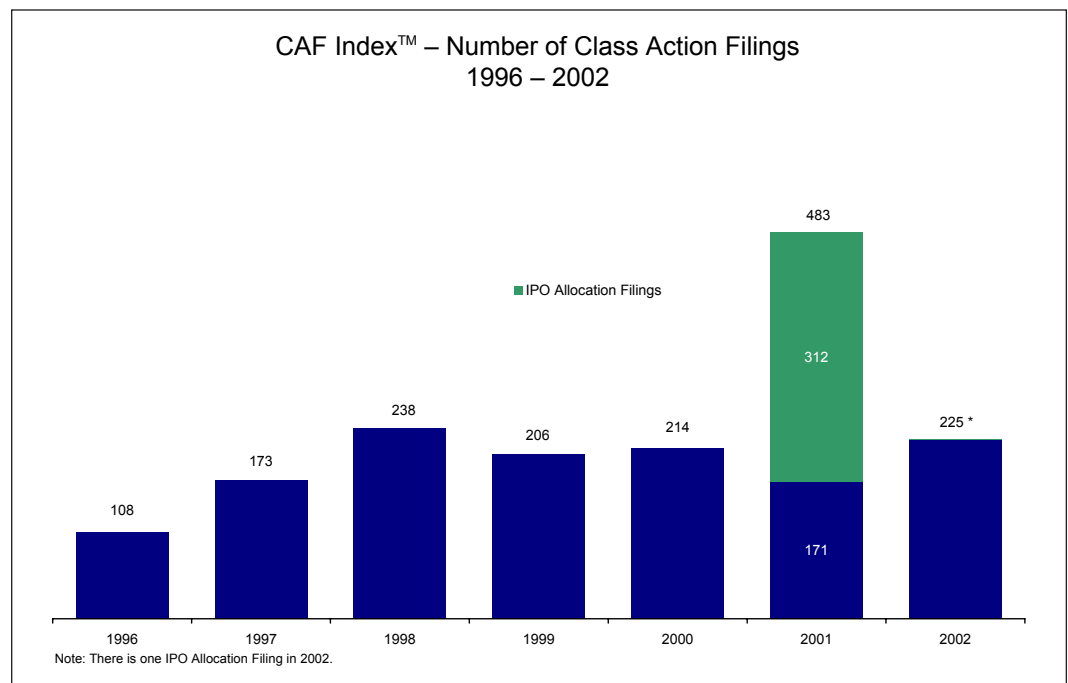


Exhibit 2

## Number of Filings<sup>1</sup>

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In order to evaluate trends and events in litigation over time, the Stanford Law School Class Action Clearinghouse in cooperation with Cornerstone Research has originated several litigation activity indices. The first group of indices measures the level of securities class action activity based solely on the count of filings. The Class Action Filings Index (CAF Index™) tracks a simple count of new cases and the Filings per Issuer Index (FPI Index™) tracks filings as a percentage of companies listed on the NYSE, Nasdaq and Amex at the start of the year.

The CAF Index™ tracks the number of filings throughout the calendar year. Excluding the 313 IPO Allocation filings in 2001 and 2002, the number of non-IPO/non-Analyst filings increased by 31 percent from 171 in 2001 to 224 in 2002 (see Exhibit 2). The CAF Index™ shows fluctuations in litigation activity over time, with 1996 showing the lowest activity, possibly responding to the adoption of PSLRA in 1995, and 1998, 2001 and 2002 showing the highest activity. Furthermore, the number of securities class action suits filed in 2002 was the second highest of any year following the passing of the PSLRA.

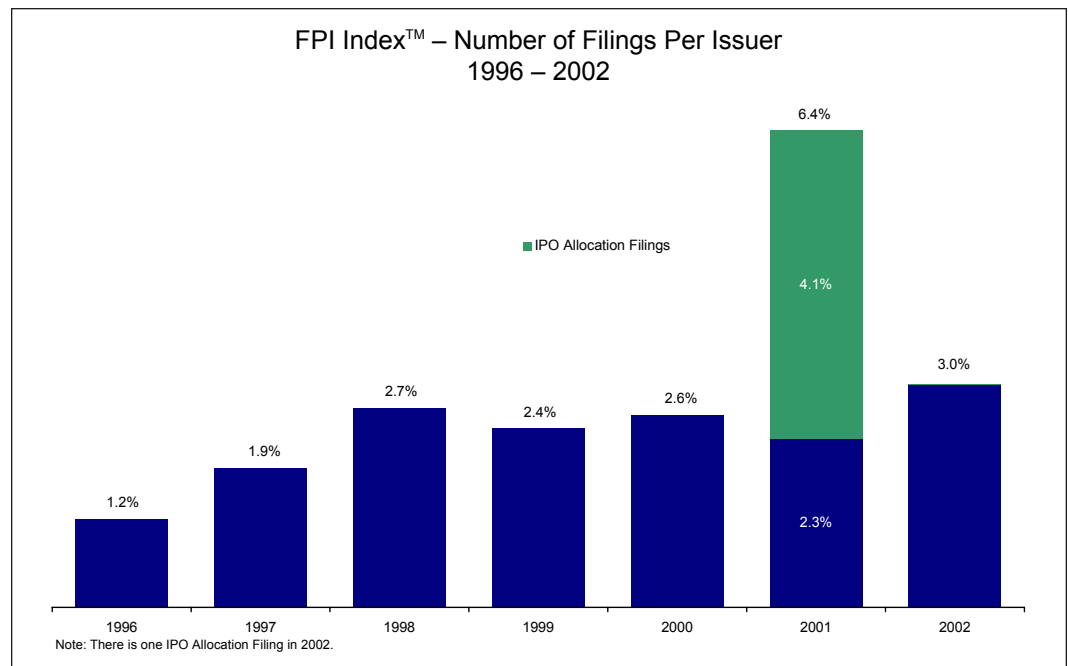


Exhibit 3

The FPI Index™ also shows an increase in litigation activity in 2002 relative to 2001 (see Exhibit 3). Without the IPO Allocation cases, 3 percent of companies were defendants in class action lawsuits filed in 2002 compared to 2.3 percent in 2001. Regardless of the inclusion of IPO Allocation filings, the FPI Index™ in 2002 was slightly above the 1996–2001 average of 2.9 percent.

<sup>1</sup> Please visit [securities.cornerstone.com](http://securities.cornerstone.com) for up-to-date information on the indices of litigation activity presented in this report.

## Market Capitalization Declines

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The second group of indices tracks market capitalization declines during class periods to measure the relative size of class action filings. By assigning values that distinguish between multi-billion dollar market value loss filings (e.g. WorldCom) and much smaller market value loss filings, we develop a more comprehensive understanding of class action activity. Specifically, for each filing, we calculate two measures of decline in the market capitalization of the defendant firm: “maximum dollar loss” and “disclosure dollar loss.”

The first measure, maximum dollar loss, is calculated as the dollar value decrease in the market capitalization of the defendant firm from the trading day on which the defendant firm’s market capitalization reached its maximum during the class period to the trading day immediately following the end of the class period. Maximum dollar loss does not measure potential liability, but gives an indication of the loss in market value irrespective of the cause. The second measure, disclosure dollar loss, is calculated as the decrease in the market capitalization of the defendant firm from the trading day immediately preceding the end of class period to the trading day immediately following the end of the class period. As with the maximum dollar loss, the disclosure dollar loss should not be considered a measure of liability, but only represents a rough estimate of the impact of market, industry and firm specific information that was revealed at the end of the class period, including information unrelated to the litigation.

We track maximum dollar losses and disclosure dollar losses using both simple dollar totals and totals relative to the size of the overall stock market. The Maximum Dollar Loss Index (MDL Index™) tracks the sum of maximum dollar loss for all class action lawsuits filed year-to-date. The Maximum Percent Loss Index (MPL Index™) tracks the maximum dollar loss as a percentage of the Wilshire 5000.<sup>2</sup>

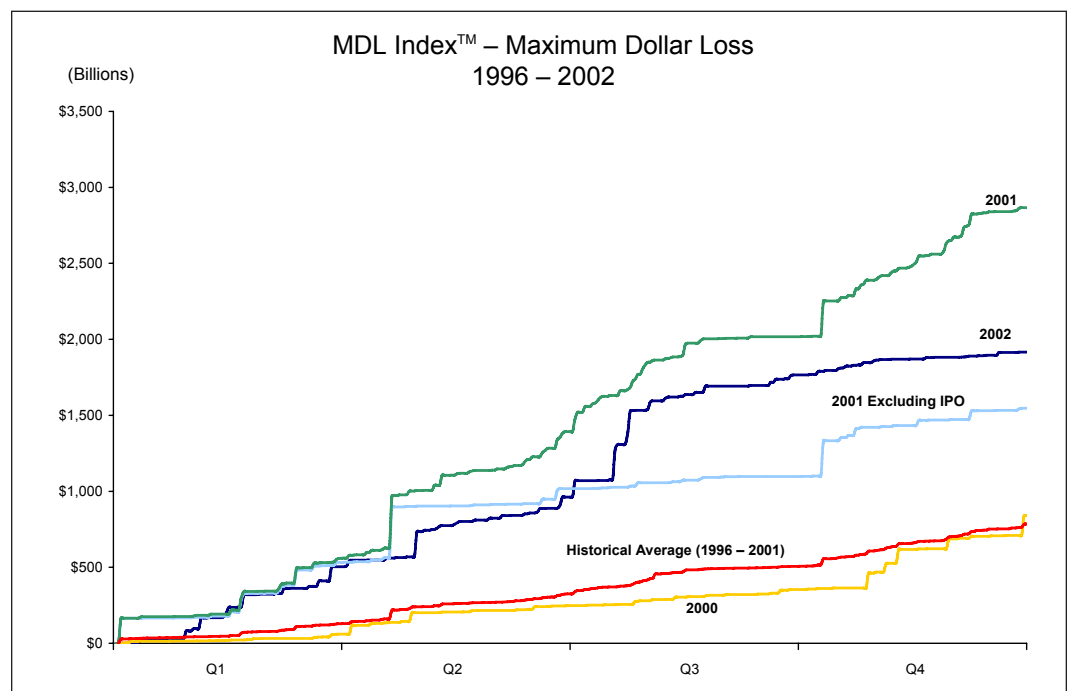


Exhibit 4

<sup>2</sup> Please see securities.cornerstone.com for complete details on the MPL Index™ calculation.

## Market Capitalization Declines *continued*

The MDL Index™ shows that the market value impact of all companies subject to class action filings in 2002 was above that in 2001 and significantly above historical averages (see Exhibit 4). Excluding the IPO Allocation cases, the total maximum dollar loss increased 24 percent in 2002 relative to 2001. Further, Exhibit 5 shows that the total maximum dollar loss was significantly higher in 2001 and 2002 than in prior years.

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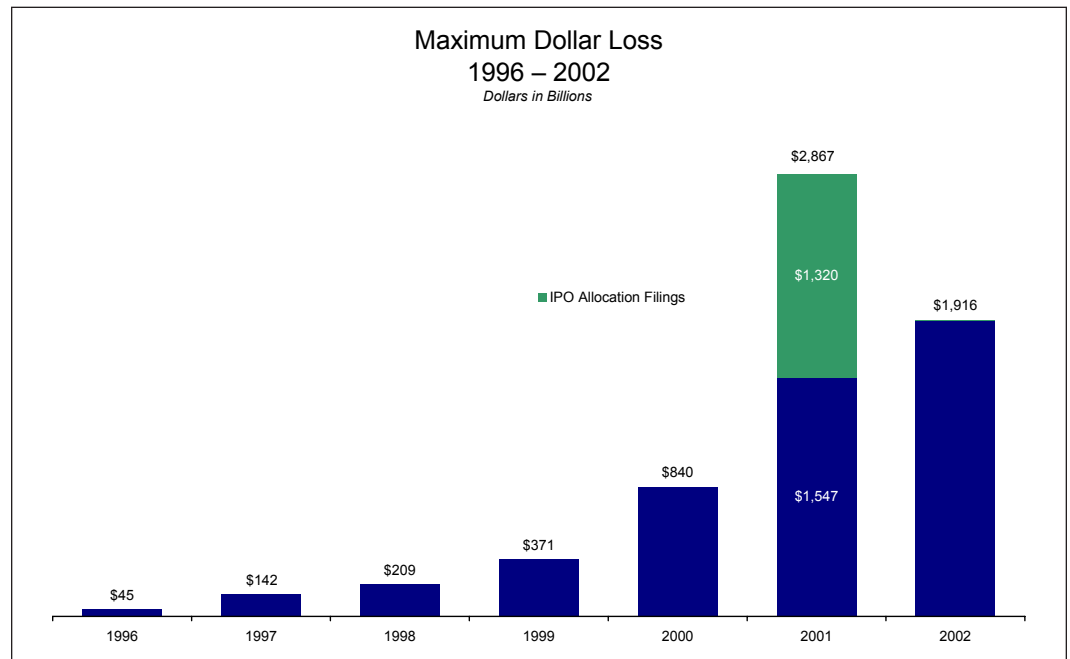


Exhibit 5

## Market Capitalization Declines *continued*

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The MPL Index™ shows that the maximum dollar loss for all filings in 2002 represented 15.9 percent of the Wilshire 5000 during the class periods (see Exhibit 6). This compares to 11.5 percent for filings in 2001. Similar to the maximum dollar losses, the maximum percent losses in 2001 and 2002 were significantly higher than in prior years.

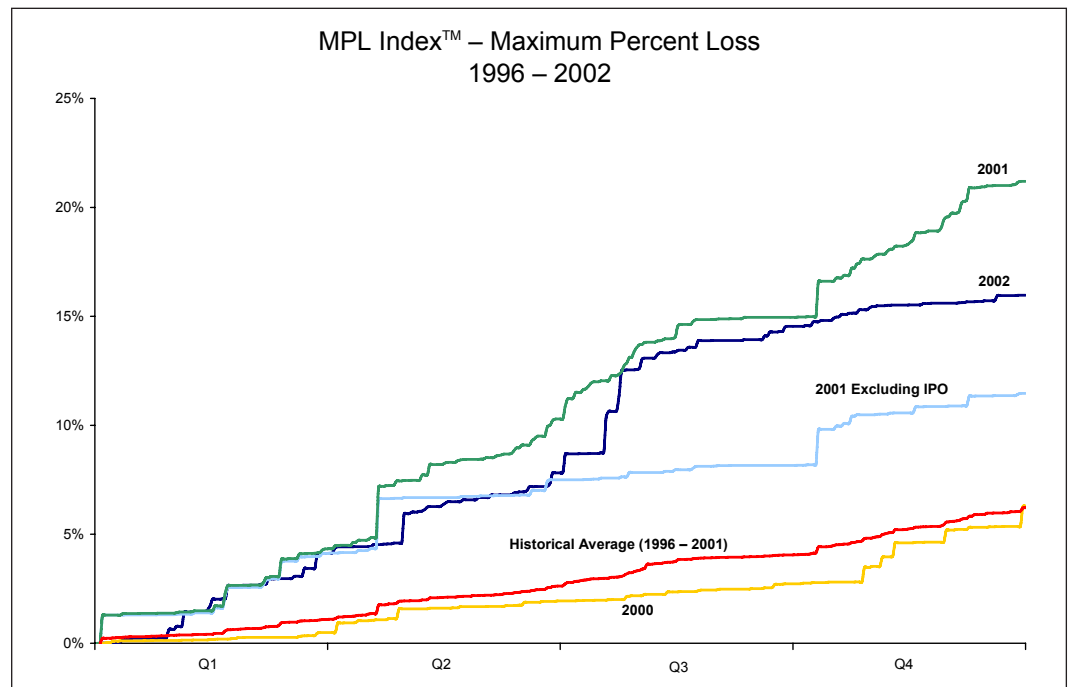


Exhibit 6

Clearly, market capitalization declines over extended periods of time may be driven by market and industry factors. To the extent that these declines are unrelated to specific allegations in class action complaints, indices based on aggregate losses during class periods would not be representative of potential defendant exposure to class action activity.

In addition to measuring the maximum market capitalization decrease that occurred in each class period, we also track the market capitalization decrease at the end of each class period using disclosure dollar loss. We track disclosure dollar losses using both simple dollar totals and totals relative to the size of the overall stock market.<sup>3</sup>

<sup>3</sup> The disclosure dollar loss statistics exclude IPO Allocation filings. Most of the class periods associated with the IPO Allocation filings end on December 6, 2000, when allegations of fraudulent IPO allocation practices were detailed in a *Wall Street Journal* article. The disclosure dollar losses in IPO Allocation filings tend to be very low, in some cases even negative.

**Market Capitalization Declines *continued***

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The Disclosure Dollar Loss Index (DDL Index™) tracks the running sum of disclosure dollar loss for all class action lawsuits filed year-to-date. Similarly, the Disclosure Percent Loss Index (DPL Index™) tracks the running sum of disclosure dollar loss as a percentage of the Wilshire 5000.<sup>4</sup>

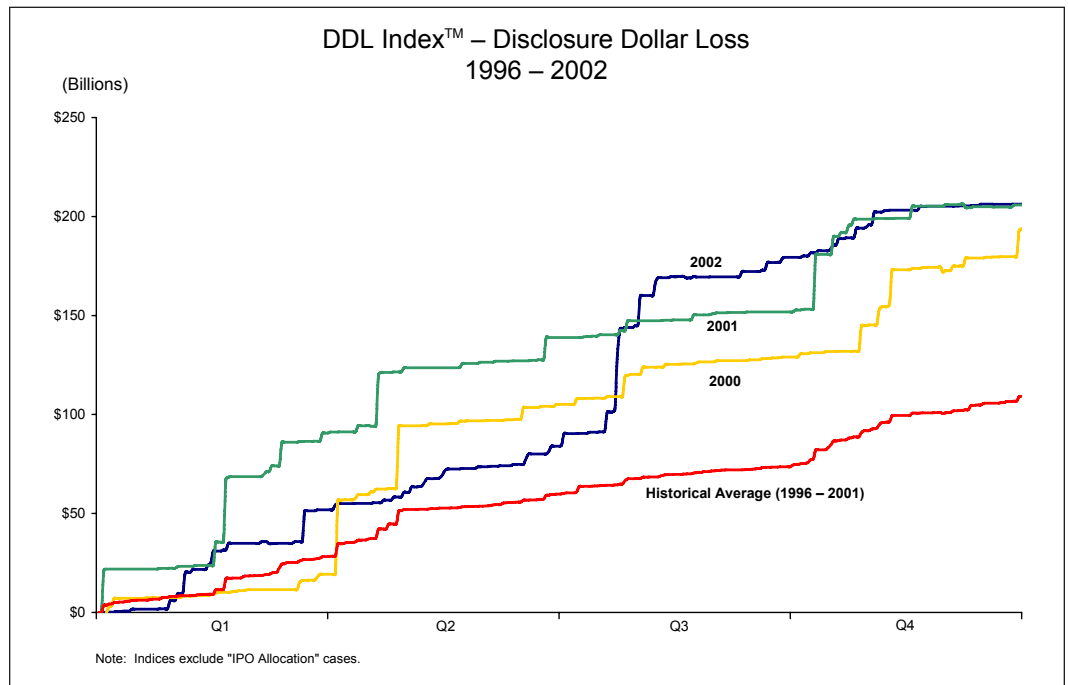


Exhibit 7

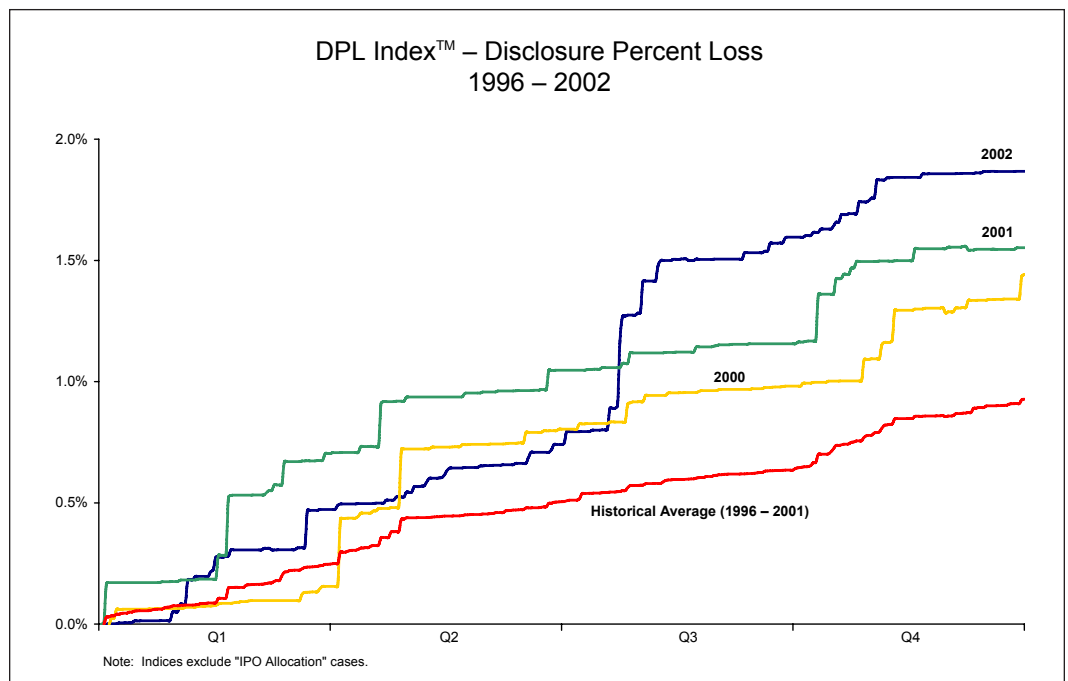


Exhibit 8

<sup>4</sup> Please see securities.cornerstone.com for complete details on the DPL Index™ calculation.

## Market Capitalization Declines *continued*

The DDL Index™ and the DPL Index™ show that disclosure losses in 2002 were very similar to 2001 (see Exhibits 7 and 8). The total disclosure dollar loss in 2002 was \$206 billion, or 1.9 percent of the capitalization of the Wilshire 5000 index. The same dollar loss represented 1.6 percent of the capitalization of the Wilshire 5000 index in 2001. As shown in Exhibit 9, disclosure dollar losses have increased significantly beginning in 2000.

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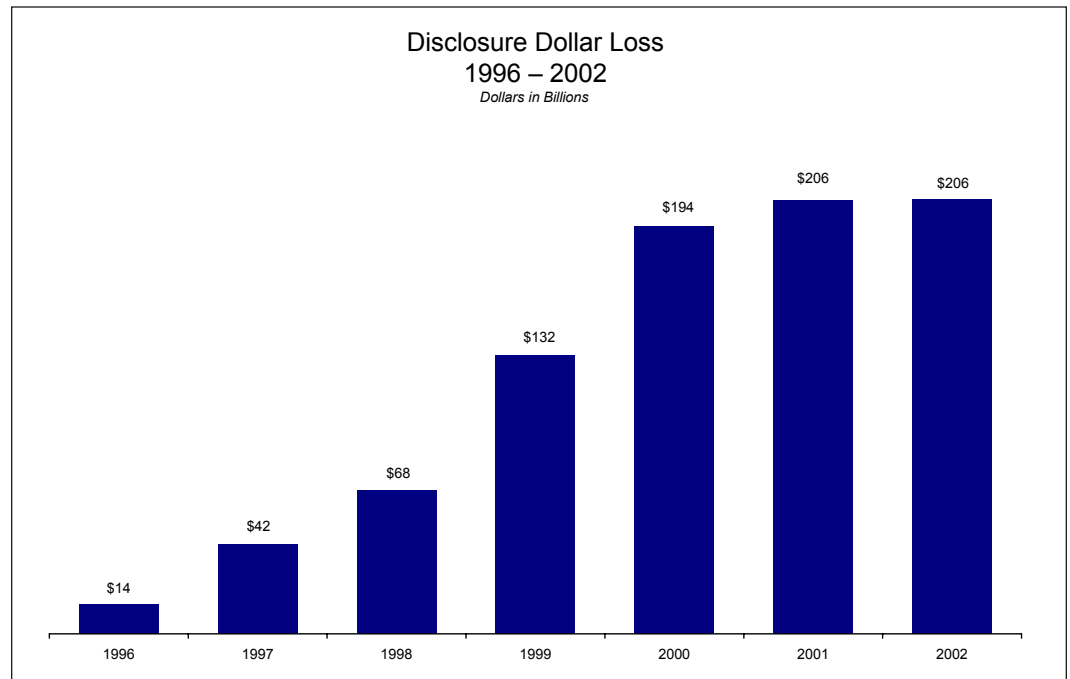
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Exhibit 9

## Market Capitalization Declines *continued*

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Exhibit 10 provides a more detailed look at the “average” or “median” filing. The more detailed analysis reveals that the size of market capitalization losses of the median (midpoint) filing in 2002 was over twice that of 2001 and significantly above historical averages. The median maximum dollar loss of \$1.5 billion in 2002 was a 109 percent increase over the median in 2001 and a 160 percent increase over the historical average of \$440 million during 1996–2001. The median disclosure dollar loss of \$152 million for 2002 represented a 65 percent increase over the \$92 million median for 2001 and a 79 percent increase relative to the historical average of \$85 million.

Filings Comparison			
	2001	2002	Average (1996-2001)
Class Action Filings	171	224	185
Maximum Dollar Loss			
Total (\$ Billions)	\$1,547	\$1,912	\$526
Average (\$ Billions)	\$9.7	\$9.3	\$3.1
Median (\$ Billions)	\$0.7	\$1.5	\$0.4
Disclosure Dollar Loss			
Total (\$ Millions)	\$205,818	\$206,287	\$109,436
Average (\$ Millions)	\$1,286	\$1,001	\$626
Median (\$ Millions)	\$92	\$152	\$85
Note: All figures exclude IPO Allocation filings.			

Exhibit 10

## Mega Filings

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### Maximum Dollar Loss

The maximum dollar loss totals in both 2001 and 2002 were dominated by a number of “mega” filings. For example,

- There were 40 filings in 2002 with a maximum dollar loss of \$10 billion or more. These 40 filings were responsible for 82 percent of total maximum dollar loss in 2002.
- There were 20 filings in 2001 with a maximum dollar loss of \$10 billion or more. These filings represented 85 percent of the total maximum dollar loss in 2001.
- The maximum dollar loss represented more than 50 percent loss in market capitalization for most of the “mega” filings in 2002.
- No “mega” filing in 2002 had a maximum dollar loss comparable to the top two “maximum dollar losses” in 2001.

### Disclosure Dollar Loss

The disclosure dollar loss totals in both 2001 and 2002 were also dominated by a number of “mega” filings. For example,

- There were 10 filings in 2002 with a disclosure dollar loss of \$5 billion or more. These filings accounted for 52 percent of total disclosure dollar loss in 2002.
- There were 9 filings in 2001 with a disclosure dollar loss of \$5 billion or more. These filings represented 73 percent of the total disclosure dollar loss in 2001.

## Exchange Listing

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2002 was characterized by a shift towards parity in terms of the number of securities class action filings for companies listed on Nasdaq relative the NYSE and Amex. In 2002, cases were filed against 113 firms whose stocks traded on the NYSE/Amex compared to 85 firms whose stocks traded on Nasdaq.<sup>5</sup> Similar to prior periods, the median maximum dollar loss and disclosure dollar loss for NYSE and Amex firms were significantly higher than the medians for Nasdaq firms in 2002 (see Exhibits 11A and 11B). This finding is not surprising since the typical firm listed on NYSE is bigger than the typical firm listed on Nasdaq. Interestingly, the 2002 statistics confirm that the higher total maximum dollar loss and disclosure dollar loss observed for Nasdaq firms in 2001 was a historical aberration. NYSE firms had higher contribution to the annual maximum dollar loss and annual disclosure dollar loss in all other years since the adoption of the PSLRA. Specifically,

- The total maximum dollar loss for NYSE/Amex firms in 2002 was \$1.3 trillion compared to \$540 billion for Nasdaq firms.
- The maximum dollar loss for the average NYSE/Amex firm in 2002 was \$12.7 billion compared to \$6.7 billion for the average Nasdaq firm.
- The midpoint (median) maximum dollar loss for NYSE/Amex firms in 2002 was \$3.7 billion compared to \$0.8 billion for Nasdaq firms.
- The total disclosure dollar loss for NYSE/Amex firms in 2002 was \$170 billion compared to \$29 billion for Nasdaq firms.
- The disclosure dollar loss for the average NYSE/Amex firm in 2002 was \$1.6 billion compared to \$363 million for the average Nasdaq firm.
- The midpoint (median) disclosure dollar loss for NYSE/Amex firms in 2002 was \$436 million compared to \$113 million for Nasdaq firms.

<sup>5</sup> 26 case filings in 2002 were for companies not listed on the NYSE, Amex, or Nasdaq.

Exchange Listing  
continued

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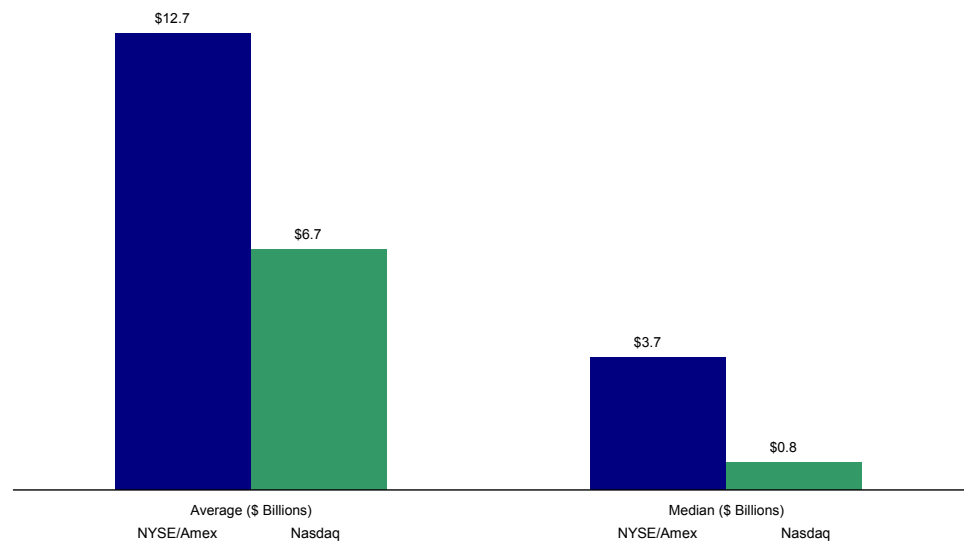
### Filings by Exchange Listing

	2001		2002	
	NYSE/Amex	Nasdaq	NYSE/Amex	Nasdaq
Class Action Filings	57	101	113	85
Maximum Dollar Loss				
Total (\$ Billions)	\$433	\$1,110	\$1,330	\$540
Average (\$ Billions)	\$8.2	\$11.0	\$12.7	\$6.7
Median (\$ Billions)	\$1.6	\$0.6	\$3.7	\$0.8
Disclosure Dollar Loss				
Total (\$ Millions)	\$88,792	\$116,966	\$170,401	\$29,432
Average (\$ Millions)	\$1,675	\$1,158	\$1,623	\$363
Median (\$ Millions)	\$246	\$65	\$436	\$113

Note: All figures exclude IPO Allocation filings.

Exhibit 11A

### Typical Maximum Dollar Loss by Exchange Listing 2002



Note: All figures exclude IPO Allocation filings

Exhibit 11B

Circuit<sup>6</sup>

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The top three circuits in number of filings in 2002 were Circuit 2 (New York) with 53 filings, Circuit 9 (California) with 43 filings, and Circuit 3 (Delaware/Pennsylvania) with 22 filings (see Exhibit 12). The top circuits in number of filings were similar in 2001 with Circuit 9 with 55 filings, Circuit 2 with 32 filings, and Circuits 3 and 11 (Alabama/Florida/Georgia) with 14 filings each.

Circuit	Class Actions Filings		Maximum Dollar Loss		Disclosure Dollar Loss	
	2001	2002	2001	2002	2001	2002
1	9	9	\$21	\$30	\$5	\$6
2	32	53	\$223	\$850	\$36	\$63
3	14	22	\$75	\$214	\$20	\$43
4	8	6	\$6	\$34	\$1	\$7
5	11	20	\$67	\$156	\$6	\$18
6	8	16	\$174	\$53	\$25	\$7
7	7	16	\$3	\$87	\$1	\$17
8	5	15	\$7	\$32	\$1	\$5
9	55	43	\$878	\$299	\$93	\$16
10	8	4	\$78	\$91	\$16	\$6
11	14	19	\$14	\$66	\$4	\$17
12	0	1	\$0	\$0	\$0	\$0

Note: All figures exclude IPO Allocation filings.

Exhibit 12

It is also interesting to rank the Circuits by maximum dollar loss and disclosure dollar loss. The top three circuits in maximum dollar loss in 2002 were Circuit 2 (New York) with \$850 billions, Circuit 9 (California) with \$299 billion, and Circuit 3 (Delaware/Pennsylvania) with \$214 billion. The Circuit 2 filings in 2002 were dominated by three of the top five maximum dollar loss “mega” filings.

The top circuits in disclosure dollar loss in 2002 were Circuit 2 (New York) with \$63 billion, Circuit 3 (Delaware/Pennsylvania) with \$43 billion and Circuit 5 (Texas) with \$18 billion. The Circuit 2 filings in 2002 were dominated by three of the top five disclosure dollar loss “mega” filings.

<sup>6</sup> Circuit information corresponds to first identified complaint.

Industry<sup>7</sup>

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The top three sectors in 2002 in terms of number of filings, maximum dollar loss and disclosure dollar loss were Communications, Finance, and Consumer Non-Cyclical (see Exhibit 13). Overall, the dominance of the Technology and Communication sectors seen in 2001 was not repeated in 2002. The Communications sector (which includes, under Bloomberg's classification, most Internet-related companies) continued to be the biggest contributor to the MDL Index<sup>TM</sup>. The Consumer Non-Cyclical sector was the biggest contributor to the DDL Index<sup>TM</sup> in 2002 with \$79 billion in disclosure dollar loss. Interestingly, this sector also had the biggest contribution to the disclosure dollar loss in five out of seven years since the adoption of PSLRA.

Filings by Industry						
<i>Dollars in Billions</i>						
Industry	2001			2002		
	Class Actions Filings	Maximum Dollar Loss	Disclosure Dollar Loss	Class Actions Filings	Maximum Dollar Loss	Disclosure Dollar Loss
Technology	26	\$475	\$66	20	\$80	\$5
Communications	66	\$745	\$87	58	\$881	\$40
Basic Materials	1	\$1	\$0	4	\$3	\$0
Finance	10	\$17	\$2	33	\$281	\$33
Industrial	20	\$8	\$2	16	\$97	\$15
Utilities	3	\$9	\$0	18	\$126	\$15
Consumer Cyclical	17	\$184	\$28	16	\$59	\$7
Consumer Non-Cyclical	26	\$62	\$18	47	\$314	\$79
Energy	2	\$45	\$4	12	\$71	\$13

Note: All figures exclude IPO Allocation filings.

Exhibit 13

<sup>7</sup> For the purposes of this analysis, we use the sector classifications provided by Bloomberg. According to Bloomberg, "sector" is the broadest classification that represents general economic activities of a company. Bloomberg divides companies into 10 sectors: Basic Materials, Communications, Consumer Cyclical, Consumer Non-Cyclical, Diversified, Energy, Financial, Industrial, Technology and Utilities.

## New Developments: The Analyst Cases

The Analyst cases were a new type of securities class action case that emerged in 2002. The first of these cases was filed against Morgan Stanley Dean Witter and the firm's Internet stock analyst, Mary Meeker, related to her coverage of eBay, Amazon.com and AOL Time Warner. The initial complaints were dismissed by Judge Milton Pollack of the U.S. Southern District of New York.<sup>8</sup>

A number of other cases were filed in 2002 naming securities analysts and investment banks as defendants. These filings included allegations that analysts issued recommendations and price targets without any "reasonable factual basis" and that they did not disclose "significant material conflicts of interest."

<sup>8</sup> See, for example, "Judge Dismisses Investor Suits Vs M. Stanley's Meeker," *Dow Jones Newsires*, August 21, 2001.

## Classification of Complaints

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In addition to tracking filing activity, Cornerstone Research and Stanford Law School have initiated an ongoing analysis of the content of class action complaints. The initial review of class action case filings in 2002 indicates the following:

- The majority of cases filed—191 cases or 85 percent—involved Section 10b-5 claims. Section 11 claims (29 cases or 13 percent) and Section 12(2) claims (22 cases or 10 percent) were less common.<sup>9</sup>
- Auditors were named as defendants in 15 cases (7 percent). Underwriters were named as defendants in 15 cases (7 percent).
- Misrepresentations in financial documents (184 cases or 82 percent), false forward-looking statements (151 cases or 67 percent), and GAAP violations (133 cases or 59 percent) were the most common allegations.
- Plaintiffs alleged that defendants used “insider” information to benefit from trades of the company’s common stock in 58 cases (26 percent) filed in 2002.
- To the extent that we could identify specific accounting allegations based on information contained in the complaints and/or press releases, those allegations varied greatly from case to case. Allegations of improper revenue recognition were the most common, with 66 cases, or 50 percent of all cases with alleged GAAP violations, having such allegations. The second most common accounting allegation, overstatement of assets other than inventory and accounts receivable, was found in 30 cases, or 23 percent of all cases with alleged GAAP violations.
- In 10 out of the 224 filings during 2002 (4 percent), the companies sued had filed for bankruptcy by the time the lawsuits were filed. The companies sued in an additional 10 filings filed for bankruptcy between the time the lawsuits were filed and year-end 2002.

Allegations Box Score 2002		
	Number	Percentage of total filings
<b>General Characteristics</b>		
<i>10b-5 claims</i>	191	85%
<i>Section 11 claims</i>	29	13%
<i>Section 12(2) claims</i>	22	10%
<i>Auditor Defendant</i>	15	7%
<i>Underwriter Defendant</i>	15	7%
<b>Allegations</b>		
<i>Misrepresentations in financial documents</i>	184	82%
<i>False forward looking statements</i>	151	67%
<i>GAAP violations</i>	133	59%
<i>Insider Trading</i>	58	26%
	Number	Percentage of cases with alleged GAAP violations
<b>Specifics of Accounting Allegations</b>		
<i>Non-recurring items</i>	13	10%
<i>Revenue recognition</i>	66	50%
<i>Understatement of liabilities</i>	19	14%
<i>Overstatement of inventory</i>	13	10%
<i>Overstatement of accounts receivable</i>	19	14%
<i>Overstatement of other assets [1]</i>	30	23%
<i>Acquisition accounting</i>	9	7%
<i>Estimates</i>	8	6%
<i>Derivatives/hedging</i>	6	5%
<i>Other</i>	4	3%

[1] Defined as all assets other than accounts receivable and inventory.

Exhibit 14

<sup>9</sup> Some filings are included in multiple classifications.

### Cornerstone Research Publications

The following publications are also available from our offices:

Post-Reform Act Securities Lawsuits: Settlements Reported Through December 2001  
*by Laura E. Simmons*

Securities Lawsuits: Settlement Statistics for Post-Reform Act Cases  
*by Laura E. Simmons*

Estimating Damages in Patent Infringement Cases: An Economic Perspective  
*by Michael C. Keeley*

Securities Class Action Litigation in First Quarter 1998  
*by Joseph A. Grundfest, Michael A. Perino, Paul Lomio, Erika V. Wayne  
and Rilla Reynolds*

Securities Lawsuits: Settlement Statistics for 10b-5 Cases  
*by Laura E. Simmons*

Securities Reform: Implications for Damages  
*by William H. Beaver, James K. Malernee and Cynthia L. Zollinger*

Market Maker Activity on Nasdaq: Implications for Trading Volume  
*by John F. Gould and Allan W. Kleidon*

Stock Trading Behavior and Damage Estimation in Securities Cases  
*by William H. Beaver, James K. Malernee and Michael C. Keeley*

The Corporate Veil: When is a Subsidiary Separate and Distinct From its Parent?  
*by Ben C. Ball, Jr., Matthew S. Miller and Christine S. Nelson*

Estimating Damages in Securities Fraud Cases  
*by William H. Beaver and James K. Malernee*

Bank Charter Values and Risk Taking  
*by Michael C. Keeley*

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