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Securities Class Action Case Filings

2006 Mid-Year Assessment

Research Sample

- The Stanford Law School Securities Class Action Clearinghouse, in cooperation with Cornerstone Research, identified securities class action filings as of 7/24/06.
- The sample includes 2,420 federal class action cases filed since the beginning of 1996 through 6/30/06.
- The class action filings include 313 "IPO Allocation" filings, 66 "Analyst" filings and 43 "Mutual Fund" filings.

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Overview[1]

Securities class action filing activity has decreased noticeably in the first half of 2006. In total, there were 61 "Traditional" securities class action filings ["filings"] in the first half of 2006,[2] a 45 percent decrease compared to the 111 filings observed in the first half of 2005. This represents the lowest level of filing activity during a six-month period since 1996, the year immediately following the adoption of the Private Securities Litigation Reform Act of 1995 ["PSLRA"]. On an annualized basis, the 2006 data suggest that approximately 123 companies will be sued this year.[3] If this extrapolation turns out to be appropriate, then 2006 will display the lowest annual level of filing activity since 1996, and will represent a 31 percent decrease from the 179 filings in 2005, and a 36 percent decrease from the 1996–2005 average of 194 annual filings.

Total market capitalization losses associated with filings in the first half of 2006 also decreased substantially from the already reduced levels observed in 2005. The annualized Maximum Dollar Losses (MDL) in the first half of 2006 amounted to $255 billion, a 44 percent decline from 2005, and the annualized Disclosure Dollar Losses (DDL) amounted to $45 billion, a 55 percent decline from 2005.[4]

In our 2005 *Year in Review* publication, we suggested that the lower level of litigation activity in 2005 could be related to a combination of three factors. First, the dramatic boom and bust of U.S. equities in late 1990s–early 2000s is now sufficiently far in the past that the large majority of lawsuits relating to fraud during that period are behind us. Second, it is also possible that improvements in corporate governance following high publicity filings and settlements such as Enron and WorldCom, along with the passage of the Sarbanes Oxley Act of 2002, have influenced the number of filings. Third, the U.S. stock market became less volatile in 2005 than at any time since 1996. Because volatility is an important determinant of the likelihood of securities litigation, lower volatility tends to be associated with lower number of filings. With the exception of a modest pickup in volatility in May and June 2006, these three factors remained in place in the first half of 2006.

In the first half of 2006 there were 3 "mega" MDL filings with an MDL of $10 billion or more and no "mega" DDL filings, i.e. filings with a DDL of $5 billion or more.

Finally, the distribution of the types of complaint allegations in the first half of 2006 remained similar to the distribution observed in 2005, with two exceptions. First, the share of cases alleging GAAP violations increased from 45 percent to 67 percent. Second, a number of complaints alleged lack of internal controls, causing the "Other" classification of accounting allegations to increase from 36 percent in 2005 to 66 percent in the first half of 2006.

These findings are described in greater detail below.

Exhibit 1

Complaint Filings Box Score

	Average (1996 – 2005)	2005	2006 YTD	2006 Annualized
Class Action Filings	194	179	61	123
Maximum Dollar Loss ($ Billions)	$690	$456	$127	$255
Disclosure Dollar Loss ($ Billions)	$124	$100	$22	$45

1 Our indices and exhibits exclude IPO Allocation, Analyst and Mutual Fund filings as described in detail in our earlier publication, "Securities Class Action Filings. 2005: A Year in Review."

2 Traditional filings are typical cases, excluding IPO Allocation, Analyst, and Mutual Fund filings.

3 For comparison purposes, when appropriate, we annualize figures for the period from 1/1/06 to 6/30/06, based on a 365-day period.

4 Maximum Dollar Loss and Disclosure Dollar Loss are defined in the "Market Capitalization Declines" section.

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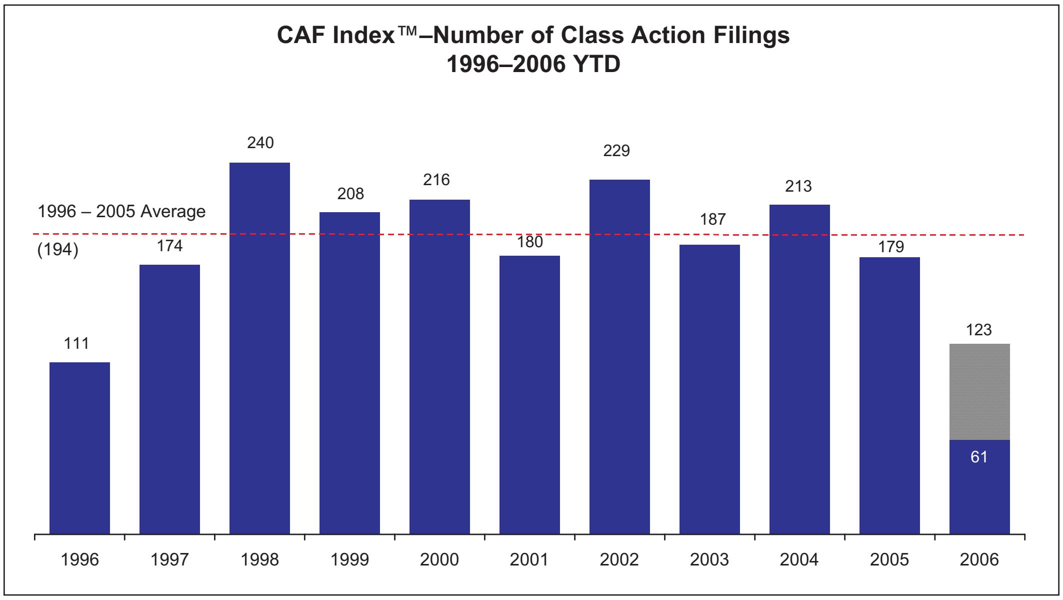
Number of Filings

The Class Action Filings Index (CAF Index™) tracks the number of class action filings throughout the calendar year. There were 61 filings in the first half of 2006. On an annualized basis, the number of Traditional filings decreased by 31 percent, from 179 filings in 2005 to only 123 filings in the first half of 2006 (see Exhibit 2). The CAF Index™ demonstrates the fluctuations in litigation activity over time, with the lowest activity in 1996, possibly in response to the 1995 adoption of the PSLRA.

Exhibit 2



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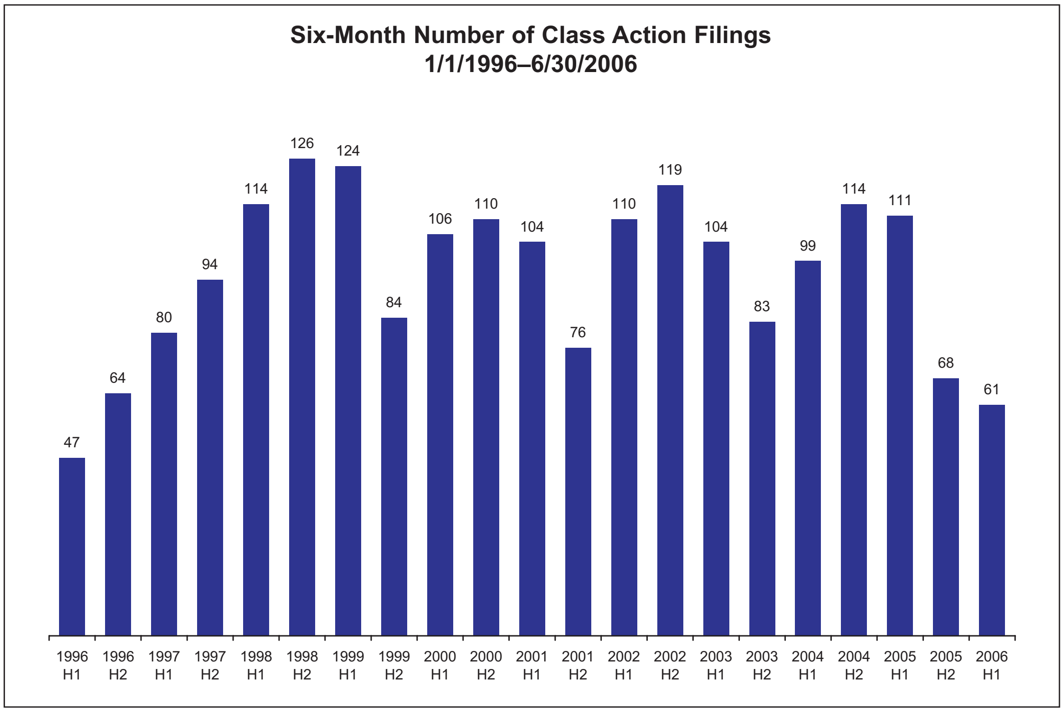
Number of Filings *continued*

61 filings in the first half of 2006 is the lowest six–month level since 1996 (see Exhibit 3). The number of filings in the first half of 2006 is lower than the average number of filings seen from 1997–2005, and this difference is statistically significant at a 5 percent confidence level.[5] In addition, the 129 filings over the full year ending June 30, 2006 is the lowest twelve-month level since 1996.

Exhibit 3



5 A t-test was used to check whether there is a statistically significant change in the number of filings per half year between the first half of 2006 and during 1997–2005.

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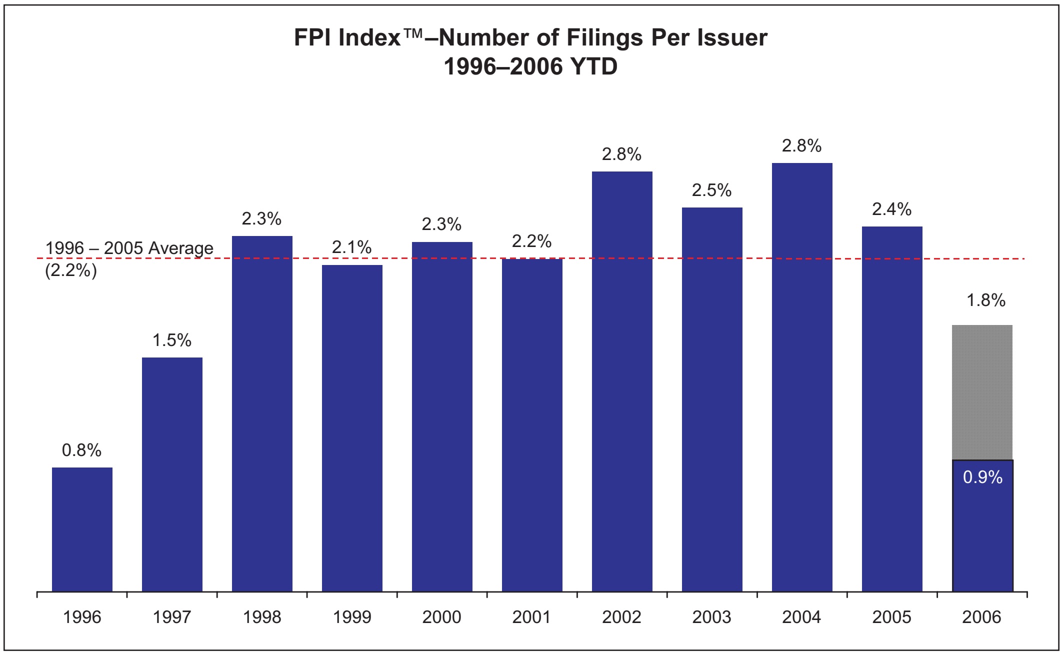
Number of Filings *continued*

The Filings Per Issuer Index (FPI Index™) also shows a decrease in litigation activity in 2006 relative to 2005 (see Exhibit 4). Of the total companies listed on the NYSE, Nasdaq, and Amex at the start of the year, 1.8 percent were defendants in Traditional class action lawsuits filed in the first half of 2006 on an annualized basis, as compared to 2.4 percent in 2005 and the 2.2 percent annual average for the post-PSLRA period.

Exhibit 4



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Market Capitalization Declines

To measure the relative size of class action filings, our second group of indices tracks market capitalization declines during class periods. The Maximum Dollar Loss Index (MDL Index™) tracks the aggregate Maximum Dollar Loss for all class action lawsuits filed year-to-date. It 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; rather, it provides an indication of the loss in market value irrespective of the cause.

The MDL Index™ shows a large decrease in market value declines for companies subject to class action filings in 2006 compared to 2005 and historical averages (see Exhibit 5). Total MDL for the first six months of 2006 was $127 billion. On an annualized basis, total MDL decreased 44 percent in 2006 relative to 2005 and is 63 percent lower than the 1996–2005 average. Compared to 2001 and 2002, the total MDL decreased 83 percent and 88 percent, respectively. The falloff from 2001 and 2002 levels can be attributed to the combination of lower number of fillings in 2006 and lower market capitalization loss for the average filing. Specifically, the average filing in 2006 had an MDL of $2.3 billion, compared to an average of $3.8 billion for 1996–2005.

A closer look at annual data reveals that the MDL Index™ was much higher in 2001 and 2002 than in previous years (see Exhibit 5). As we noted in our 2005 annual publication, many of the cases filed between 2000 and 2002 were related to the boom and bust of U.S. equities in the late 1990s–early 2000s. It is likely that by the end of 2002, most high profile securities class action cases related to alleged fraud during this period had already been filed. Not surprisingly, the numbers of case filings and the underlying losses of market capitalization went down in 2003–2006. At the same time, it is not unreasonable to suggest that the lower number of filings and associated market capitalization losses are a result of improvements in corporate governance following high profile filings such as Enron and WorldCom and the passage of the Sarbanes Oxley Act of 2002.

The continued low levels of stock market volatility in 2006 may be yet another reason for the lower number of securities class action filings. Because volatility is an important determinant of the likelihood of securities litigation, lower volatility tends to be associated with a lower number of filings. If the pickup in market volatility in May and June 2006 persists, it may present an opportunity to test this last hypothesis empirically.

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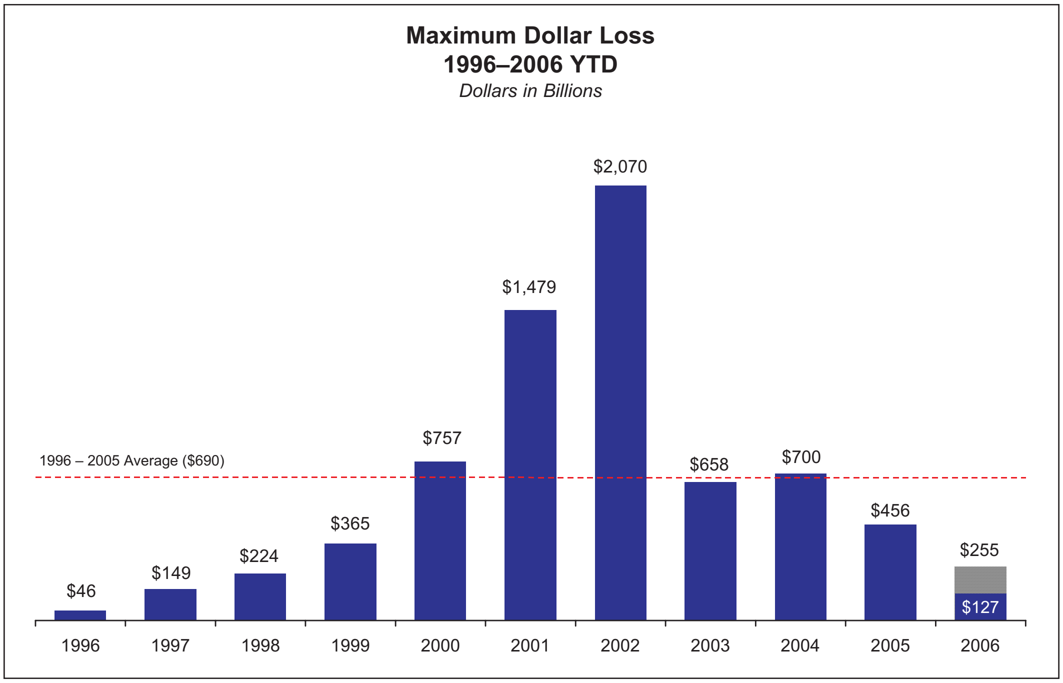
Market Capitalization Declines *continued*

Exhibit 5



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. This is especially relevant for the post-*Dura* securities litigation environment.[6] We also track the market capitalization decrease at the end of each class period using Disclosure Dollar Loss, using both simple dollar totals and totals relative to the size of the overall stock market.

The Disclosure Dollar Loss Index (DDL Index™) tracks the running sum of Disclosure Dollar Loss for all class action lawsuits filed year-to-date. It is calculated as the decrease in the market capitalization of the defendant firm from the trading day immediately preceding the end of the 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; it only represents an estimate of the impact of the market-, industry-, and firm-specific information revealed at the end of the class period, including information unrelated to the litigation.

[6] See our 2005 annual publication for discussion of *Dura Pharmaceuticals* decision.

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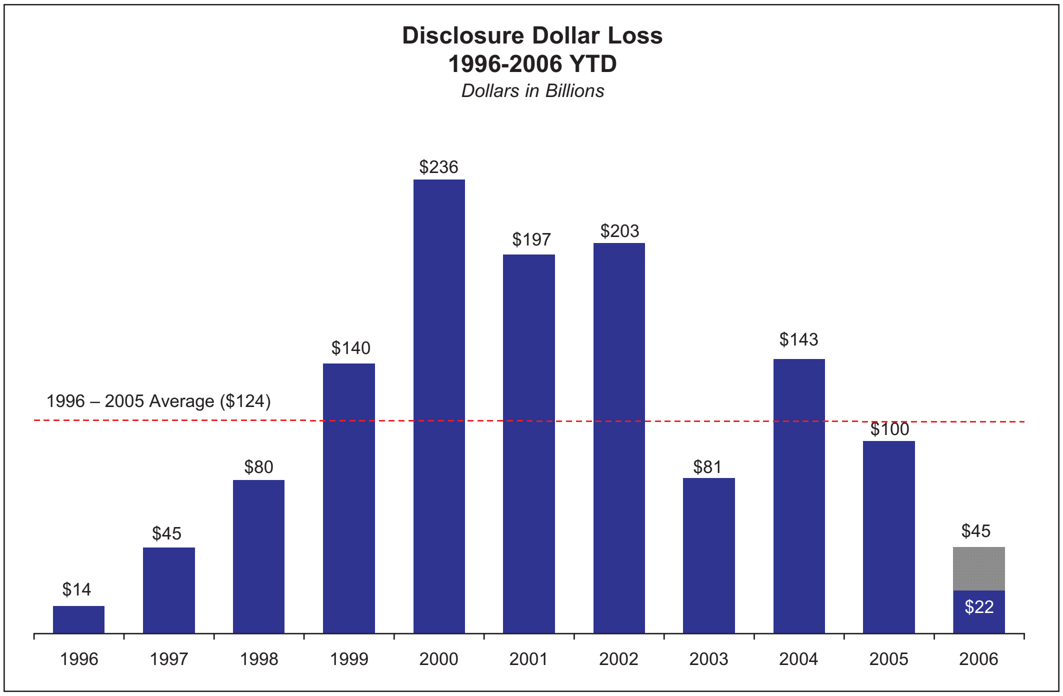
Market Capitalization Declines *continued*

Exhibit 6



Similar to the MDL Index™, the DDL Index™ shows a large decrease in disclosure losses in 2006 from earlier years (see Exhibit 6). Total DDL for the first six months of 2006 was $22 billion. On an annualized basis, this represented a decrease of 55 percent relative to 2005 and a decrease of 64 percent relative to the 1996–2005 average. Disclosure Dollar Losses in 2006 were much lower than the levels reached in 2000 to 2002.

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Market Capitalization Declines *continued*

Exhibit 7 provides a more detailed look at the typical filing. The median DDL of $129 million in 2006 was larger than historical averages, but smaller than the median DDL in 2005. The median MDL of $0.4 billion in 2006 was a decrease from the 2005 level of $0.5 billion, and an even further decrease from the historical average of $0.6 billion during 1996–2005. At the same time, the distribution of DDL became more balanced as the average DDL and median DDL moved closer together. This finding could be related to the decrease in the number of "mega" filings as described in the next section.

Filings Comparison

	Average (1996 – 2005)	2005	2006 YTD	2006 Annualized
Class Action Filings	194	179	61	123
Maximum Dollar Loss				
Total ($ Billions)	$690	$456	$127	$255
Average ($ Billions)	$3.8	$2.9	$2.3	$2.3
Median ($ Billions)	$0.6	$0.5	$0.4	$0.4
Disclosure Dollar Loss				
Total ($ Millions)	$123,803	$100,092	$22,325	$45,019
Average ($ Millions)	$681	$638	$406	$406
Median ($ Millions)	$100	$155	$129	$129

Exhibit 7

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Mega Filings[7]

Analysis of "mega" filings offers additional evidence of the decrease in litigation activity from 2005 to 2006.

Maximum Dollar Loss

In the first half of 2006 there were 3 "mega" MDL filings, i.e. filings with an MDL of $10 billion or more. These 3 filings were responsible for 58 percent of total MDL in 2006. This compares with 10 "mega" MDL filings responsible for 67 percent of total MDL in 2005. One filing in the first half of 2006 had an MDL of over $25 billion, compared to 3 filings for the full-year 2005.

Disclosure Dollar Loss

In the first half of 2006 there have been no "mega" DDL filings, i.e. filings with either a DDL of $5 billion or more. In contrast, there were 6 "mega" DDL filings responsible for 48 percent of total DDL in 2005.

7 All numbers in this section are year-to-date and not annualized.

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Industry[8]

Similar to 2005, the Consumer Non-Cyclical sector led litigation activity by the number of filings in the first half of 2006.[9] From 1996–2005, Consumer Non-Cyclical and Communications had the highest average number of filings with 45 and 38 filings per year, respectively.

Consumer Non-Cyclical, Consumer Cyclical, and Technology sectors had the highest MDL in 2006. Consumer Non-Cyclical and Consumer Cyclical together accounted for almost 60 percent of the MDL. During 1996–2005, Communications (which includes, under Bloomberg's classification, most Internet-related companies) was the biggest contributor to the MDL Index™. In 2006 compared to 2005, MDL in Technology and Communications sectors combined was up 43 percent compared to a 59 percent decline in MDL in other sectors on an annualized basis.

Consumer Non-Cyclical and Consumer Cyclical had the highest DDL in 2006, representing 77 percent of the total, with Technology in a distant third position. Filings in Consumer Non-Cyclical and Communications represented the greatest DDL during 1996–2005. In 2006 compared to 2005, DDL in Technology and Communications sectors combined were down 73 percent compared to a 50 percent decline in DDL in other sectors on an annualized basis.

Exhibit 8

Filings by Industry

Dollars in Billions

	Class Actions Filings				Maximum Dollar Loss				Disclosure Dollar Loss			
Industry	Average 1996 – 2005	2005	2006 YTD	2006 Annualized	Average 1996 – 2005	2005	2006 YTD	2006 Annualized	Average 1996 – 2005	2005	2006 YTD	2006 Annualized
Consumer Non-Cyclical	45	49	23	46	$136	$197	$39	$78	$36	$45	$12	$23
Technology	32	20	9	18	$94	$49	$35	$71	$19	$18	$2	$4
Communications	38	26	7	14	$245	$17	$12	$24	$29	$4	$1	$2
Finance	24	27	7	14	$90	$124	$3	$6	$17	$18	$1	$2
Industrial	18	14	6	12	$32	$15	$2	$5	$9	$4	$1	$3
Consumer Cyclical	25	35	6	12	$55	$46	$35	$71	$8	$9	$5	$10
Energy	5	4	2	4	$20	$1	$1	$1	$4	$0	$0	$0
Utilities	4	1	0	0	$15	$0	$0	$0	$2	$0	$0	$0
Basic Materials	3	3	1	2	$5	$7	$0	$0	$1	$1	$0	$0
Total	194	179	61	123	$690	$456	$127	$255	$124	$100	$22	$45

8 For the purposes of this analysis, we use the sector classifications provided by Bloomberg. See our 2005 annual publication for discussion of the Bloomberg classifications.

9 Consumer Cyclical sector includes airlines, apparel, auto manufacturers, auto parts and equipment, distribution/wholesale, entertainment, food service, home builders, home furnishings, housewares, leisure time, lodging, office furnishings, retail and storage/warehousing. Consumer Non-Cyclical sector includes agriculture, beverages, biotechnology, commercial services, cosmetics/personal care, food, health-care-products, healthcare-services, household products/wares, and pharmaceuticals.

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New Developments

The Milberg Weiss Indictment

On May 18, 2006 a federal grand jury named the law firm of Milberg Weiss Bershad & Schulman and two of its senior partners in an indictment on charges of conspiracy, racketeering, mail fraud, money laundering, filing false tax returns and obstruction of justice.[10] At this point, it is too early to tell whether the Milberg indictment will have an impact on the level of securities class action filings.

Backdating of Stock Options

Executive compensation has come under increasing scrutiny in the last six months due to widening SEC investigations regarding stock option grant practices. These practices allegedly involved backdating the stock option grants to take advantage of temporary drops in stock prices to increase the value of option compensation. As of June 30, 2006, concerns associated with executive stock options has not had as large of an impact as expected on securities class action filings as there have been only 8 securities class actions filed related to options backdating allegations.

[10] "Milberg Indicted On Charges Firm Paid Kickbacks," *The Wall Street Journal,* May 19, 2006.

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Classification of Complaints[10]

In addition to the level of filing activity, this report tracks the content of class action complaints. While the mix of allegations is largely similar, in percentage terms, a comparison of Traditional class action cases filed in the first half of 2006 with those filed in 2005 does reveal some changes in the content of securities class action complaints.

- In the 2005 *Year in Review* we noted marked increases in the percentage of filings that alleged misrepresentations in financial documents and false forward-looking statements. The percentage of filings alleging misrepresentations in financial documents was 88 percent in 2005, and it remained the same level (90 percent) during the first half of this year.
- To the extent that specific accounting allegations could be identified in complaints and/or press releases, such allegations increased during the first half of 2006. The percentage of complaints alleging specific accounting irregularities increased to 67 percent in the first half of 2006 from 45 percent in 2005. This trend continues to suggest that the litigation market is now more focused on the validity of financial results and accounting treatment.
- "Other" accounting allegations increased markedly in the first half of 2006, comprising 66 percent of cases with accounting allegations compared with only 36 percent in 2005. The lack of appropriate internal controls was the most popular "Other" accounting allegation thus far in 2006 (52 percent of "Other" cases contained such allegations). Accounting for option issuance is another popular "Other" category this year, occurring in 22 percent of cases containing "Other" allegations.

[10] The classifications are based on first identified complaint. Additional allegations and defendants may be added in subsequent complaints and not captured in these analyses.

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Classification of Complaints *continued*

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Allegations Box Score

	2005		2006 Half-Year		
	Number	**Percentage of total filings**	**Number (YTD)**	**Number (Annualized)**	**Percentage of total filings**
General Characteristics					
10b-5 claims	166	93%	56	113	92%
Section 11 claims	16	9%	8	16	13%
Section 12(2) claims	9	5%	5	10	8%
Underwriter defendant	9	5%	2	4	3%
Auditor defendant	5	3%	1	2	2%
Allegations					
Misrepresentations in financial documents	158	88%	55	111	90%
False forward looking statements	146	82%	45	91	74%
GAAP violations	80	45%	41	83	67%
Insider trading	79	44%	24	48	39%
	Number	**Percentage of cases with alleged GAAP violations**	**Number (YTD)**	**Number (Annualized)**	**Percentage of cases with alleged GAAP violations**
Specifics of Accounting Allegations					
Revenue recognition	41	51%	18	36	44%
Understatement of expenses	21	26%	14	28	34%
Overstatement of accounts receivable	17	21%	4	8	10%
Understatement of liabilities	14	18%	3	6	7%
Overstatement of other assets [1]	9	11%	3	6	7%
Non-recurring items	4	5%	3	6	7%
Overstatement of inventory	12	15%	2	4	5%
Acquisition accounting	5	6%	1	2	2%
Estimates	8	10%	0	0	0%
Derivatives/hedging	6	8%	0	0	0%
Other	29	36%	27	54	66%
Total Cases	**179**		**61**	**123**	

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

Exhibit 9

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