

Securities Class Action Case Filings

2006: A Year in Review

Research Sample

- The Stanford Law School Securities Class Action Clearinghouse in cooperation with Cornerstone Research identified companies named as defendants in class action securities fraud filings from January 1, 1996 through December 18, 2006.
- The sample contains 2,461 federal class action filings, including 313 “IPO Allocation” filings, 66 “Analyst” filings and 44 “Mutual Fund” filings.

Overview

1

Class action securities fraud filings plunged to a record low in 2006, a year characterized by a strong stock market that exhibited lower volatility, and an increased focus on corporate controls. The 110 class actions filings [“filings”] in 2006 represent the smallest number of filings in a calendar year since the adoption of the Public Securities Litigation Reform Act [“PSLRA”] in 1995. Filings are down by 38 percent from the 178 filed in 2005 and are 43 percent lower than the ten-year historical average of 193.¹ The decline from historical average is statistically significant. This sharp decline in the number of companies sued in class action securities litigation began in the second half of 2005 and has now continued for 18 months.

The losses in total market capitalization associated with 2006 filings also declined substantially from already reduced levels observed in 2005. If market capitalization losses are measured as of the last day of the class period, typically the day on which the alleged fraud is disclosed (Disclosure Dollar Loss), the losses decreased by 44 percent from \$93 billion in 2005 to \$52 billion in 2006. If market capitalization losses are instead measured by the largest capitalization decline experienced during the class period (Maximum Dollar Loss) then losses decreased by 19 percent from \$362 billion in 2005 to \$294 billion in 2006.²

These dramatic declines are even starker when options backdating claims are excluded from the sample on the theory that these cases are unlikely to be repeated. Excluding the 22 options backdating cases (2 in 2005 and 20 in 2006) suggests a “core” litigation rate of 90 companies sued in 2006 (a 49 percent decline from the 2005 and 53 percent below the historic average), with Disclosure Dollar Losses of \$42 billion (a 54 percent decline from 2005 and 66 percent below the historic average), and Maximum Dollar Losses of \$198 billion (a 43 percent decline from 2005 and 71 percent below the historical average).

The lower level of litigation activity that first manifested itself in the second half of 2005 could be related to a combination of three factors. First, more vigorous enforcement activity by the SEC and the Department of Justice, combined with heightened sensitivity following high publicity filings and settlements such as Enron and WorldCom, along with the passage of the Sarbanes-Oxley Act of 2002, may have caused corporations to engage in less risky behavior, thereby reducing the number of filings and the dollars at issue in the claims that are filed. Second, U.S. stock prices have generally increased and volatility has remained low in 2005 and early 2006. Because volatility is an important determinant of the likelihood of securities litigation, lower volatility tends to be associated with a lower number of filings. Third, the dramatic boom and bust of U.S. equities in the late 1990s – early 2000s is now sufficiently far in the past that the large majority of lawsuits relating to that period are behind us.

¹ 2006 filings are those identified as of 12/18/2006 and include cases filed up to 12/11/2006. There are typically very few cases filed during the remainder of the year.

² Maximum Dollar Loss and Disclosure Dollar Loss are defined in the “Market Capitalization Declines” section.

Overview
continued

Consistent with the decline in investor losses, there was also a sharp decline in the incidence of large dollar value claims. There was 1 “mega” Disclosure Dollar Loss [DDL] filing with a DDL of \$5 billion or more in 2006, compared to 5 such filings in 2005. In 2006, there were 8 “mega” Maximum Dollar Loss [MDL] filings with an MDL of at least \$10 billion, of which 4 were options backdating-related filings. There were 9 “mega” MDL filings in 2005, only 1 of which was an option backdating-related filing.

Finally, the overall distribution of the types of complaint allegations in 2006 remained similar to the distribution observed in 2005, with the exception that the share of cases alleging GAAP violations increased from 44 percent to 68 percent, and that the incidence of option backdating litigation helped increase the “Other” classification of accounting allegations from 37 percent in 2005 to 63 percent in 2006.

2

Complaint Filings Box Score

	Average <u>(1996 – 2005)</u>	<u>2005</u>	<u>2006</u>
Class Action Filings	193	178	110
Disclosure Dollar Loss (\$ Billions)	\$124	\$93	\$52
Maximum Dollar Loss (\$ Billions)	\$680	\$362	\$294

Exhibit 1

Number of Filings³

In order to examine the trends and events in securities litigation over time, the Stanford Law School Class Action Clearinghouse in cooperation with Cornerstone Research has developed several litigation activity indices. The first group of indices measures the level of securities class action activity based solely on the number 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 related to companies listed on the NYSE, Nasdaq, and Amex as a percentage of all companies listed on these exchanges at the start of the year.

The CAF Index™ tracks the number of filings throughout the calendar year. Excluding IPO Allocation, Analyst, and Mutual Fund filings, the number of Traditional filings decreased by 38 percent from 178 in 2005 to 110 in 2006 (see Exhibit 2). The CAF Index™ demonstrates the fluctuations in litigation activity over time, with low activity in 1996 (possibly caused by the fact that plaintiff counsel accelerated filings into 1995 in order to avoid the new provisions of the PSLRA) and with the highest activity in 1998. The 110 cases filed in 2006 represent the lowest yearly activity thus far in our sample. The decline in filing activity is even greater when options backdating cases are removed; this results in a “core” litigation rate of only 90 cases in 2006.

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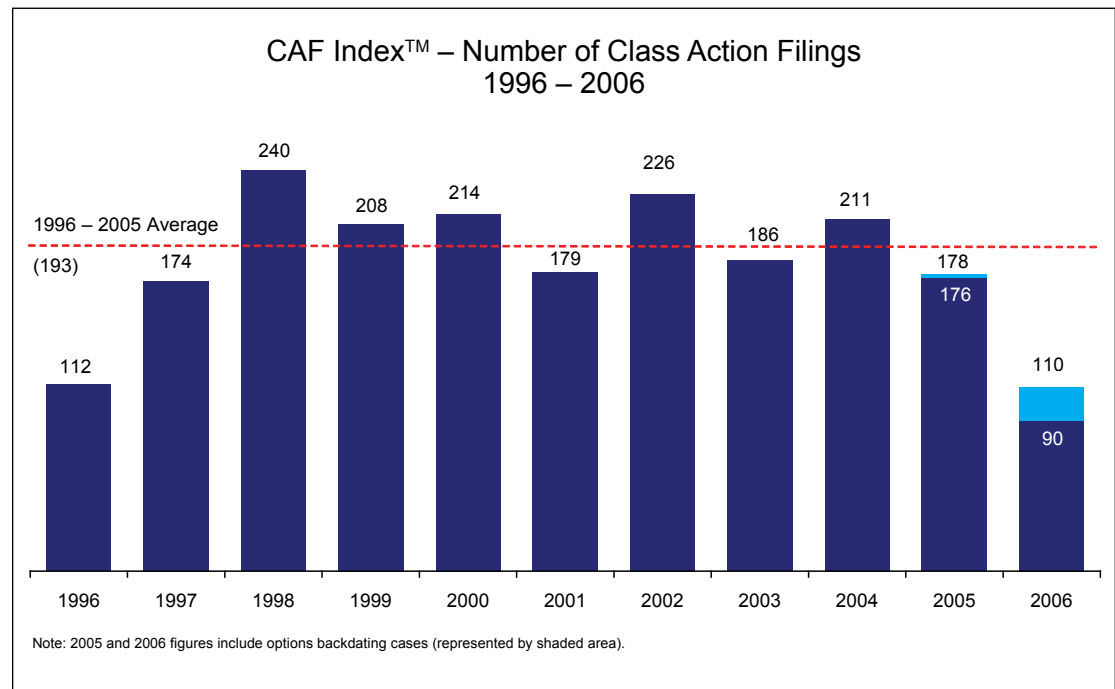


Exhibit 2

³ Classification of Filings

A new type of class action filing occurred during each year from 2001 – 2003. First, in 2001 there were over 300 “IPO Allocation” filings with allegations related to the share allocation in an initial public offering. Second, in 2002 there were a number of “Analyst” filings with allegations that defendants, primarily investment banks and individual analysts at these banks, had issued research reports and ratings that were neither independent nor objective. Third, starting in the second half of 2003, there were “Mutual Fund” filings that contained allegations related to market timing, lack of disclosure, and the breach of fiduciary duty by mutual fund companies and other financial intermediaries. In addition to mutual fund market timing cases, there were new mutual fund cases filed in 2004 and 2005 with allegations related to incentives and sales practices of the mutual funds’ financial advisors. In total, the number of “atypical” cases declined in 2005, with only 3 filings, all Mutual Fund, occurring during the year. In 2006, there was only one atypical case, a Mutual Fund filing. As a result of the atypical filings in 2001–2006, we sort filings in this report into four categories: “IPO Allocation,” “Analyst,” “Mutual Fund,” and “Traditional” filings. The IPO Allocation, Analyst, and Mutual Fund filings can be considered distinct types of class action lawsuits, having characteristics unlike the Traditional securities class action filings. Therefore, we consider the Traditional litigation to be a more appropriate measure of ongoing activity and we emphasize this measure in the comparisons provided throughout the report. Our indices and exhibits exclude IPO Allocation, Analyst, and Mutual Fund filings.

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 3). Of all the companies listed on the NYSE, Nasdaq, and Amex at the start of the year, only 1.5 percent were defendants in Traditional class action lawsuits filed in 2006, compared to 2.4 percent in 2005 and the 2.2 percent annual average for the 1996 – 2005 period. Despite the lower number of filings in 1996 compared to 2006, the FPI Index™ is higher in 2006 because the total number of companies listed on the NYSE, Nasdaq, and Amex exchanges has decreased by 25% since 1996.

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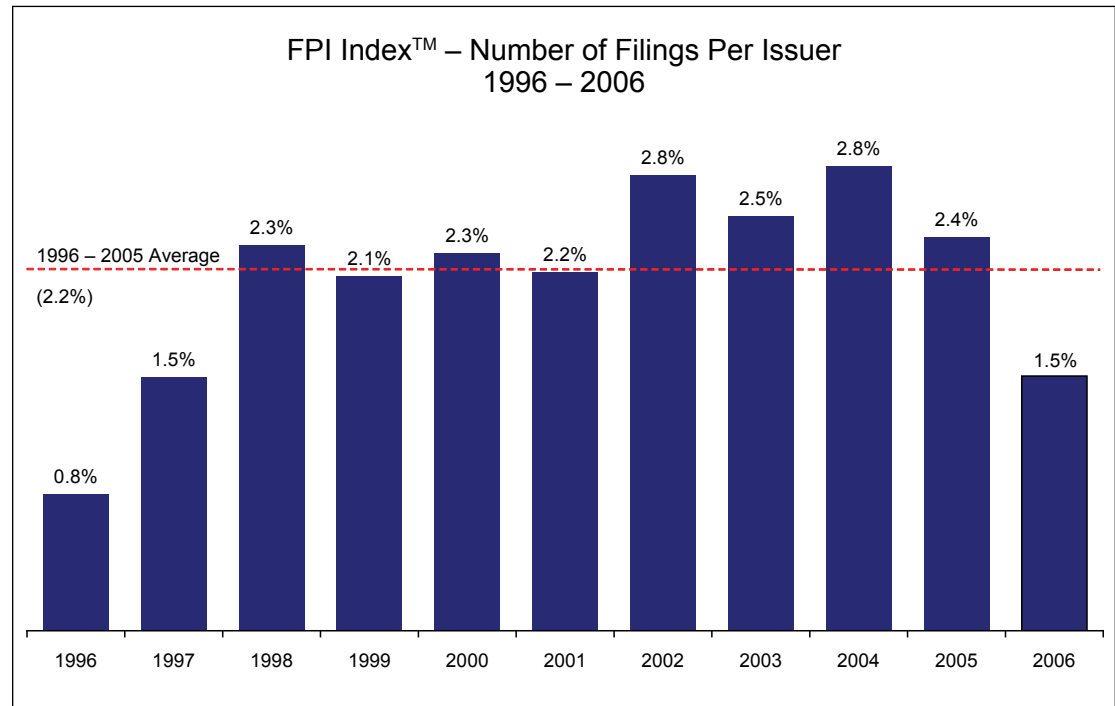


Exhibit 3

Market Capitalization Declines

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To measure the relative size of class action filings, our second group of indices tracks market capitalization declines during class periods. By reviewing measures of filing activity that distinguish between filings that involve multi-billion dollar market value declines (e.g., WorldCom) and filings that reflect much smaller market value declines, we can develop a more refined understanding of the intensity of class action activity. Specifically, for each filing we calculate two measures of decline in the defendant firm's market capitalization: "Maximum Dollar Loss" and "Disclosure Dollar Loss." These measures reveal a dramatic falloff in securities class action activity in 2003 through 2006 relative to 2001 and 2002.

The first 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. 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. The second 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. As with Disclosure Dollar Loss, Maximum Dollar Loss does not measure potential liability; rather, it provides an indication of the loss in market value irrespective of the cause.

We measure losses 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.

The DDL Index™ shows a large decrease in disclosure losses in 2006 from earlier years (see Exhibits 4 and 5). Total DDL for 2006 was \$52 billion, representing a decrease of 44 percent relative to 2005 and a decrease of 58 percent relative to the 1996 – 2005 average. Disclosure losses in 2006 were much lower than the levels reached in 2000 to 2002.

Similar to the DDL Index™, the Disclosure Percent Loss Index (DPL Index™) tracks the running sum of DDL as a percentage of the Wilshire 5000.⁴ The DPL Index™ also shows a decrease in disclosure losses in 2006 compared to 2005 and smaller losses than the historical averages (see Exhibit 5). The total DDL in 2006 represented 0.4 percent of the capitalization of the Wilshire 5000, compared to 0.8 percent of the capitalization of the Wilshire 5000 in 2005 and, on average, 1.1 percent of the capitalization of the Wilshire 5000 during 1996 – 2005.

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

Market Capitalization Declines *continued*

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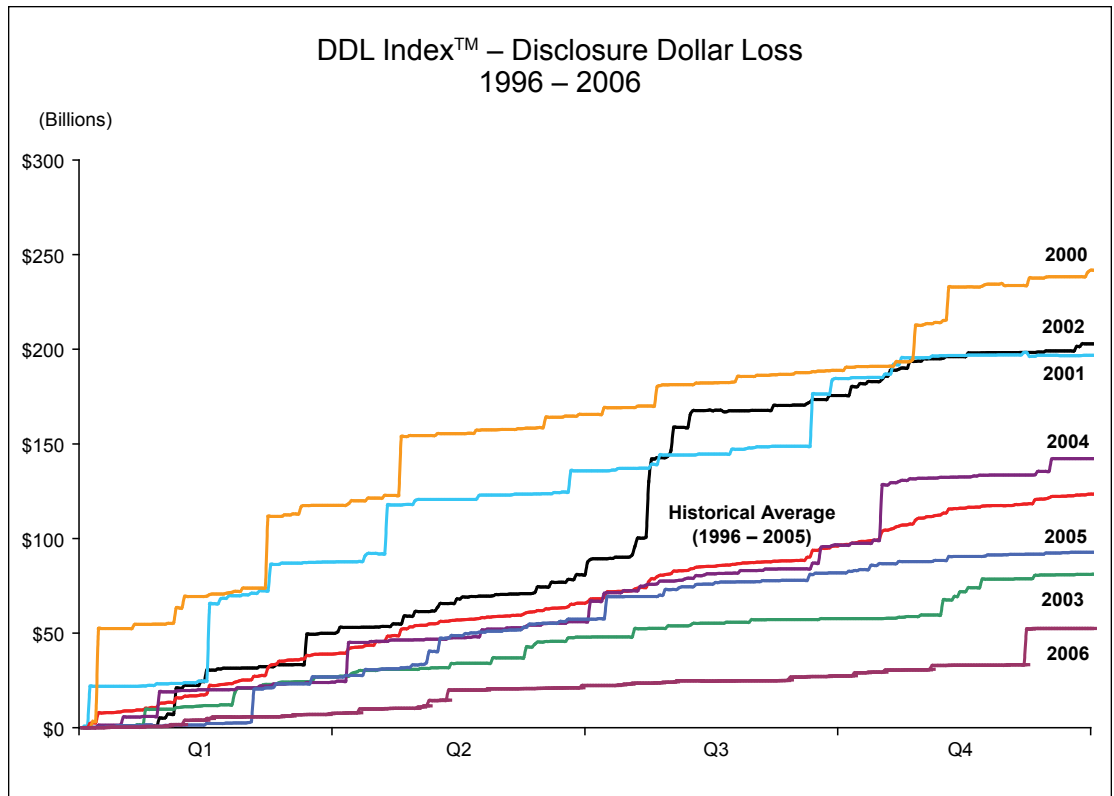


Exhibit 4

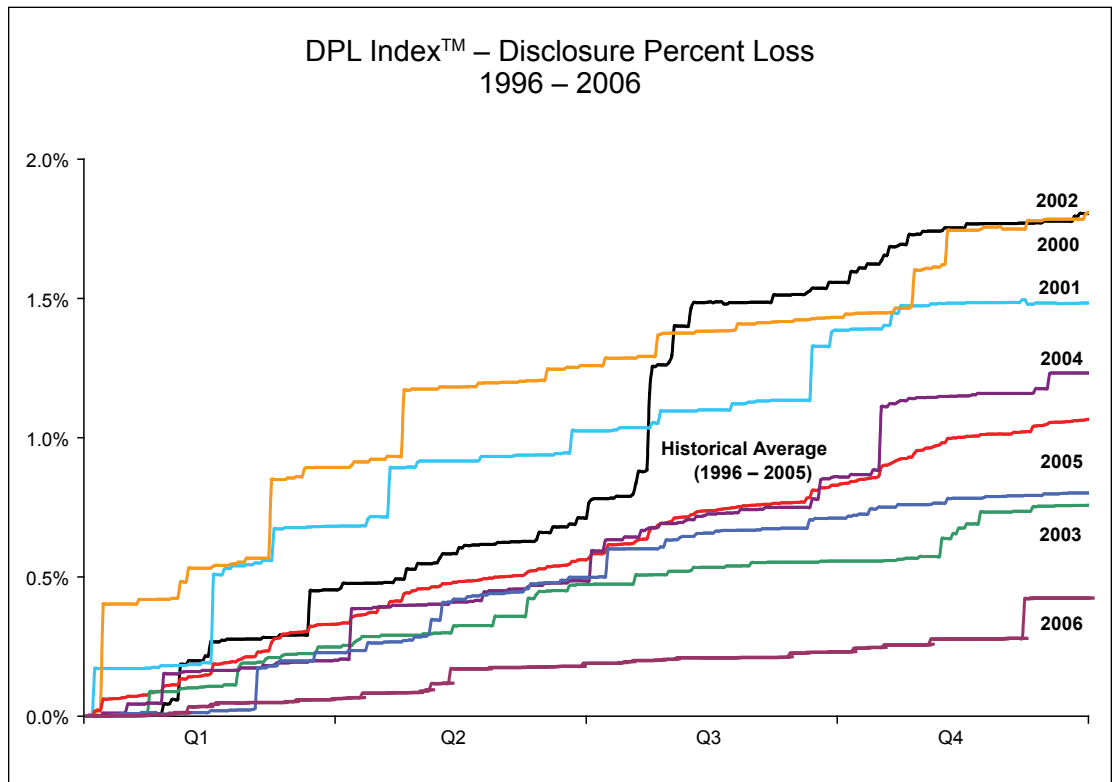


Exhibit 5

Market Capitalization Declines *continued*

As shown in Exhibit 6, Disclosure Dollar Losses in 2006 were lower than those in 2005, and much lower than the levels reached in 2000 to 2002. This decrease is the result of a combination of fewer filings and lower average DDL for cases filed in 2006 relative to 1996 – 2005. We discuss statistics for typical filings later in the report.

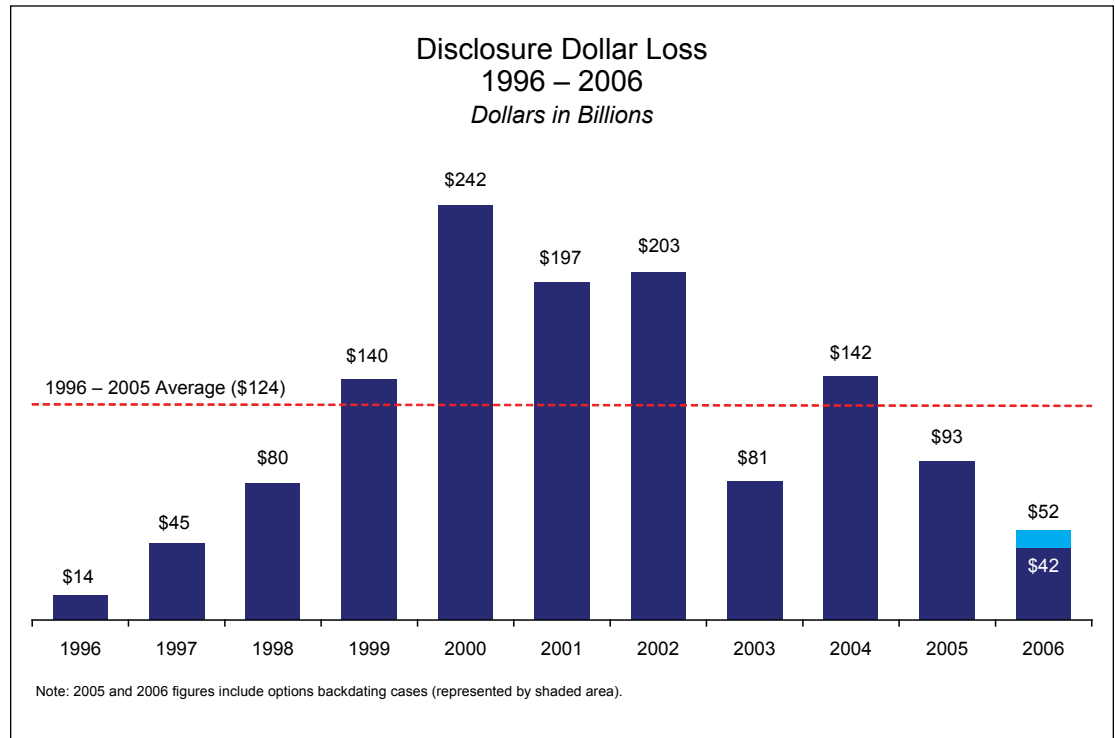


Exhibit 6

Market Capitalization Declines *continued*

The Maximum Dollar Loss Index (MDL Index™) tracks the aggregate MDL for all class action lawsuits filed year-to-date. The Maximum Percent Loss Index (MPL Index™) tracks the MDL as a percentage of the Wilshire 5000.⁵

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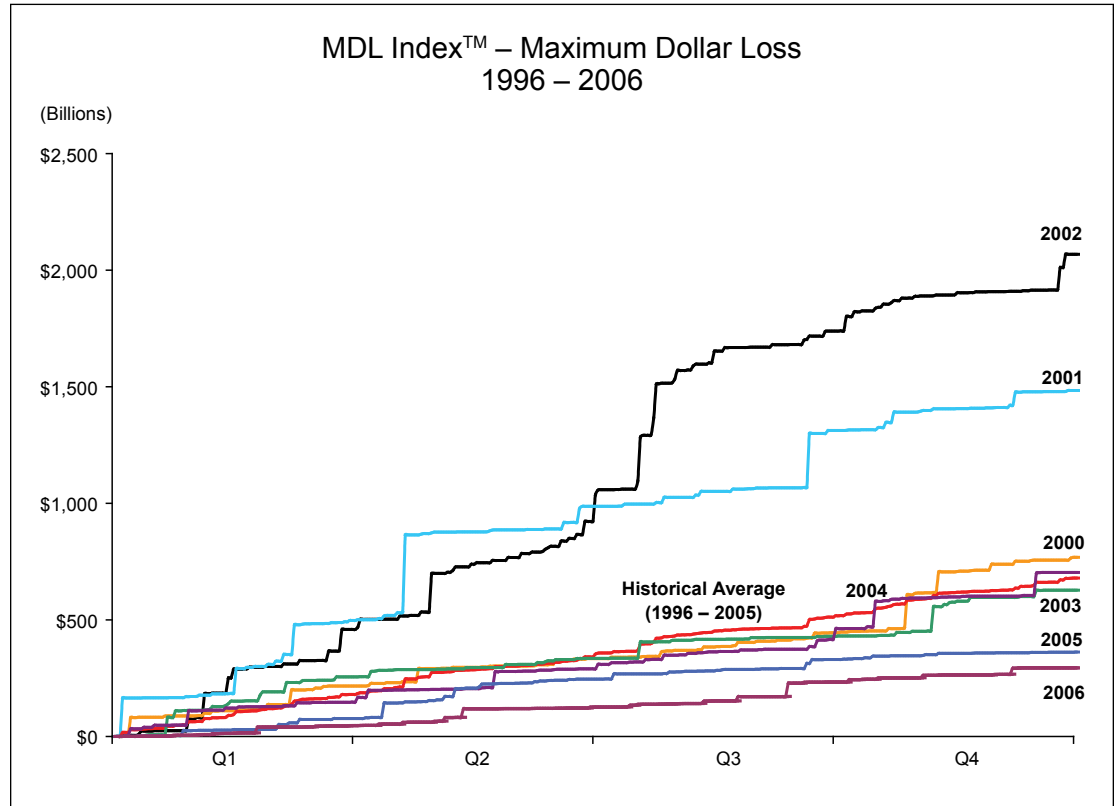


Exhibit 7

⁵ Please see securities.cornerstone.com for complete details on the MPL Index™ calculation.

Market Capitalization Declines *continued*

9

Similar to the DDL Index™, the MDL Index™ shows a decrease in market value declines for companies subject to class action filings in 2006 compared to 2005 and is dramatically lower when compared to historical averages and 2001 and 2002 (see Exhibit 7). The total MDL decreased 19 percent in 2006 relative to 2005 and was 57 percent lower than the 1996 – 2005 average. Compared to 2001 and 2002, the total MDL in 2006 decreased 80 percent and 86 percent, respectively. As in the case of Disclosure Dollar Losses, the falloff from 1996 – 2005 levels is the result of a combination of fewer filings and lower average MDL for cases filed in 2006 relative to 1996 – 2005.

A closer look at annual data reveals that the MDL Index™ was significantly higher in 2001 and 2002 than in previous years (see Exhibit 7). 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 most high profile securities class action cases related to the boom and bust had already been filed by the end of 2002. Not surprisingly, the number of case filings and the market capitalization losses underlying those filings went down in 2003 – 2006. In addition, as explained above, the lower number of filings and associated market capitalization losses may in part be 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.

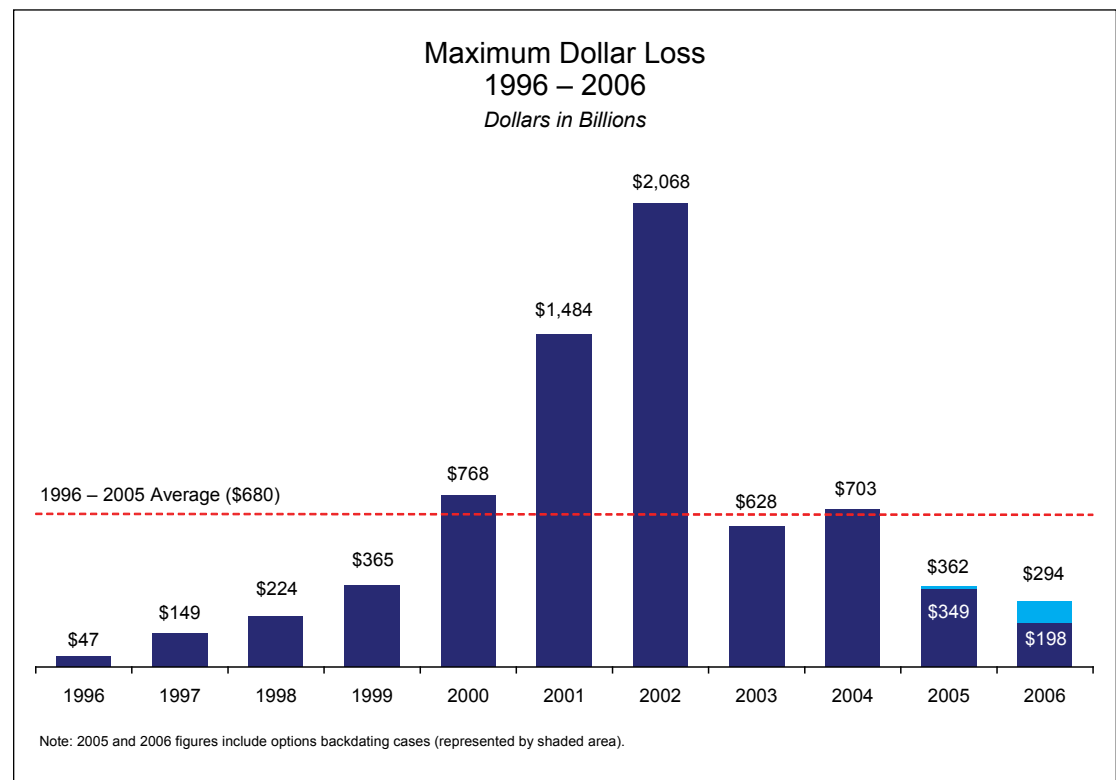


Exhibit 8

Market Capitalization Declines *continued*

The MPL Index™ shows a similar decline. The MDL for all filings in 2006 represented 2.5 percent of the Wilshire 5000 during the class periods (see Exhibit 9). This compares to 3.2 percent for filings in 2005 and 5.7 percent for cases filed during 1996 – 2005.

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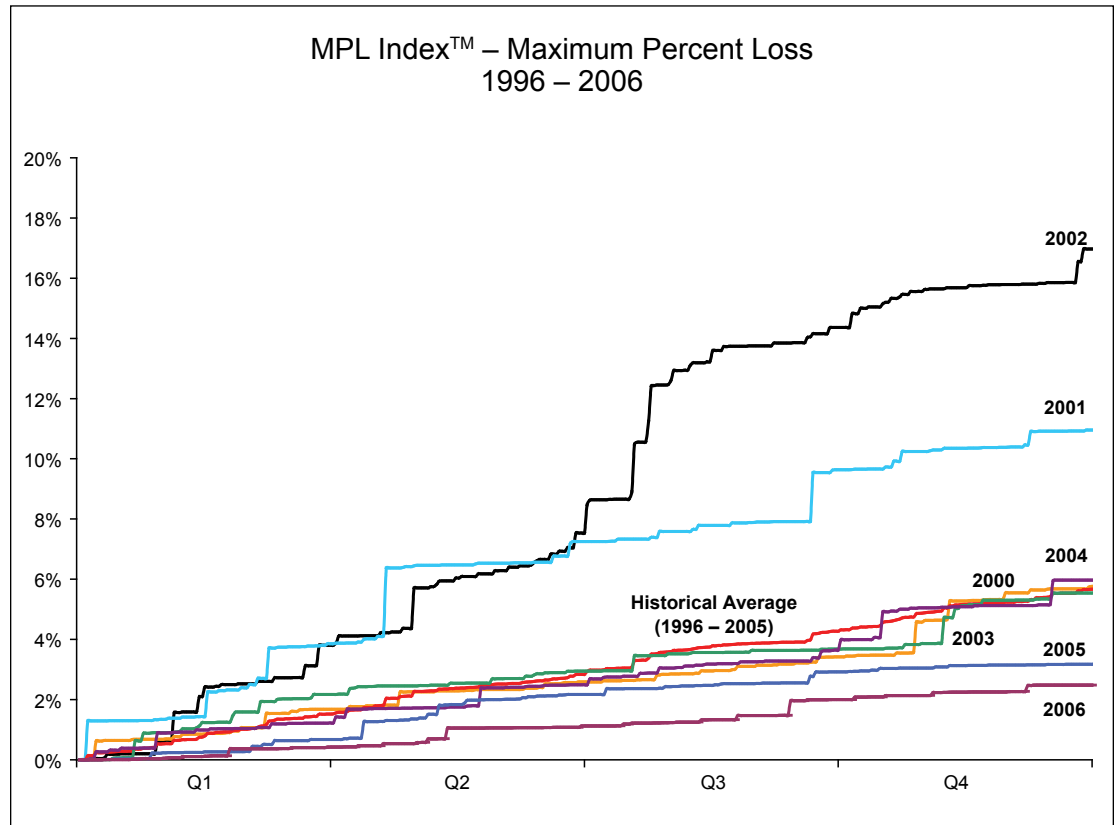


Exhibit 9

Market Capitalization Declines *continued*

11

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

Exhibit 10 provides a more detailed look at the typical filing. The size of Disclosure Dollar Losses of the median filing in 2006 was lower than 2005 and even further below historical averages. The DDL of the average filing decreased 13 percent, from \$595 million in 2005 to \$519 million in 2006, and decreased 24 percent from the historical average of \$683 million. The median DDL of \$111 million for 2006 decreased 28 percent from 2005 with a median DDL of \$154 million, but increased 10 percent from the historical median of \$101 million. The median MDL in 2006 was \$0.4 billion, compared to \$0.5 billion in 2005 and \$0.6 billion during 1996 – 2005. The MDL of the average filing increased 26 percent, from \$2.3 billion in 2005 to \$2.9 billion in 2006, and declined 22 percent from the historical average of \$3.7 billion.

Filings Comparison			
	Average (1996 – 2005)	2005	2006
Class Action Filings	193	178	110
Disclosure Dollar Loss			
Total (\$ Millions)	\$123,650	\$92,748	\$52,398
Average (\$ Millions)	\$683	\$595	\$519
Median (\$ Millions)	\$101	\$154	\$111
Maximum Dollar Loss			
Total (\$ Billions)	\$680	\$362	\$294
Average (\$ Billions)	\$3.7	\$2.3	\$2.9
Median (\$ Billions)	\$0.6	\$0.5	\$0.4

Exhibit 10

⁶ In April 2005, the Supreme Court ruled that plaintiffs in a securities class action case are required to establish a causal connection between alleged wrongdoing and subsequent shareholder losses. Plaintiffs therefore cannot merely allege that a stock price was inflated by fraud at the time they purchased their shares. Instead, they must allege and prove that the losses they ultimately suffered were caused by the fraud and not by other intervening factors, such as a general decline in the stock market, or a sector-specific stock price decline. The Supreme Court's decision reversed a holding by the Ninth Circuit Court of Appeals that, had it survived review, could have materially increased the volume of securities fraud litigation by allowing plaintiffs to file weaker claims alleging only a remote connection to the plaintiffs' actual losses. The decision in *Dura* also clearly calls into question plaintiff-style damage calculations that seek to measure damages as the simple difference between inflation at the time of purchase and inflation as of the date of the corrective disclosure without taking into account the influence of other non-fraud factors on the issuer's stock price. *Dura* thereby also underscores the value of careful economic analysis in identifying the portions of a stock price decline that are caused by factors other than the fraud and that therefore cannot support the award of damages.

Mega Filings

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

Disclosure Dollar Loss

In 2006 there was only 1 “mega” DDL filing, i.e. a filing with a DDL of \$5 billion or more. This 1 filing is responsible for 36 percent of the total DDL in 2006. In contrast, there were 5 “mega” DDL filings responsible for 44 percent of the total DDL in 2005.

Maximum Dollar Loss

In 2006 there were 8 “mega” MDL filings, i.e. filings with an MDL of \$10 billion or more. These 8 filings were responsible for 67 percent of the total MDL in 2006. This compares with 9 “mega” MDL filings responsible for 58 percent of the total MDL in 2005. Options backdating cases contributed 4 “mega” MDL filings in 2006 and 1 in 2005, representing 18% and 3% of the total MDL, respectively.

There were 54 “mega” DDL filings and 132 “mega” MDL filings during 1996 – 2006. Of these, 27 “mega” DDL filings and 73 “mega” MDL filings were concentrated in 2000–2002. These findings are consistent with our earlier observation that many securities lawsuits related to the boom and bust of U.S. equities at the turn of the century were filed during 2000–2002.

Exchange

The years 2005 and 2006 were characterized by similar patterns in the numbers of securities class action filings for companies listed on Nasdaq versus the NYSE and Amex. In 2006, cases were filed against 49 firms whose stocks traded on the NYSE/Amex, compared to 58 firms whose stocks traded on Nasdaq. In 2005, cases were filed against 75 firms whose stocks traded on the NYSE/Amex compared to 86 firms whose stocks traded on Nasdaq.⁷ Overall, during 1996 – 2006, with the exception of 2001, there have been more class action filings against Nasdaq firms than against NYSE/Amex firms.

The total MDL was actually higher for Nasdaq firms than NYSE and Amex in 2006, as seen only in 2001. This finding is surprising since the typical firm listed on NYSE and Amex is bigger than the typical firm listed on Nasdaq. Specifically,

- The total DDL for NYSE/Amex firms in 2006 was \$41 billion compared to \$11 billion for Nasdaq firms.
- The midpoint (median) DDL for NYSE/Amex firms in 2006 was \$204 million compared to \$62 million for Nasdaq firms.
- The total MDL for NYSE/Amex firms in 2006 was \$144 billion compared to \$150 billion for Nasdaq firms.
- The median MDL for NYSE/Amex firms in 2006 was \$0.6 billion compared to \$0.4 billion for Nasdaq firms. The Nasdaq median MDL was close to the 1996 – 2005 average, while the NYSE/Amex median MDL was 46 percent lower.

13

	Filings by Exchange Listing					
	Average (1996 – 2005)		2005		2006	
	NYSE/Amex	Nasdaq	NYSE/Amex	Nasdaq	NYSE/Amex	Nasdaq
Class Action Filings	71	98	75	86	49	58
Filings per Issuer	1.96%	2.26%	2.11%	2.69%	1.38%	1.81%
Disclosure Dollar Loss						
Total (\$ Millions)	\$86,945	\$35,024	\$65,455	\$26,253	\$41,409	\$10,951
Average (\$ Millions)	\$1,283	\$350	\$977	\$313	\$920	\$203
Median (\$ Millions)	\$238	\$77	\$310	\$118	\$204	\$62
Maximum Dollar Loss						
Total (\$ Billions)	\$406	\$257	\$291	\$62	\$144	\$150
Average (\$ Billions)	\$5.6	\$2.6	\$4.3	\$0.7	\$3.2	\$2.8
Median (\$ Billions)	\$1.1	\$0.4	\$1.0	\$0.4	\$0.6	\$0.4

Exhibit 11

⁷ 3 filings in 2006 and 17 filings in 2005 were for companies not listed on the NYSE, Amex, or Nasdaq.

NYSE/Amex firms contributed a higher percentage of the annual MDL and annual DDL in every year since the adoption of the PSLRA, except for 2001 and 2006. In 2001, there were twice as many cases filed against companies listed on the Nasdaq as there were against companies listed on the NYSE/Amex (110 to 55). Also in 2001, the total DDL for Nasdaq firms was \$118 billion versus \$79 billion for NYSE/Amex firms, while the total MDL for Nasdaq firms was \$1,135 billion versus \$345 billion for NYSE/Amex firms.

In 2006, compared to previous years, the total and average MDL were much higher for Nasdaq firms because 6 out of the top 10 MDL filings were against companies listed on the Nasdaq.

This change from historic patterns is attributable to the presence of option backdating cases which are more prevalent among Nasdaq issuers than among NYSE and Amex firms. Of the 20 options backdating cases in 2006, 16 involved companies listed on Nasdaq. Both of the options backdating cases in 2005 involved companies listed on Nasdaq. Removing these 22 cases from our sample reverses the split of cases and results in a higher number of cases filed against NYSE/Amex firms compared to Nasdaq firms: 45 versus 42, respectively. In addition, the removal of these cases reverses the unusual split of total MDL and results in a more typical higher MDL for cases filed against NYSE/Amex firms compared to Nasdaq firms: \$125 million versus \$73 million, respectively. The dramatic decline in MDL for cases filed against Nasdaq firms is due to the reduction in the number of such cases, as well as the decline in average MDL to \$1.9 billion from \$2.8 billion, as a result of the removal of the options backdating cases.

Circuit⁸

15

The top four circuits in terms of the number of 2006 filings were the Second Circuit (New York) with 31 filings, Ninth Circuit (California) with 25 filings, and Third Circuit (Delaware/Pennsylvania) and Eleventh Circuit (Florida/Georgia/Alabama) with 11 filings each (see Exhibit 12). The top circuits in number of filings in 2005 were the Second Circuit with 42 filings, Ninth Circuit with 39 filings and Third Circuit (Delaware/Pennsylvania/New Jersey) with 18 filings (see Exhibit 12).

During 1996 – 2005, the Ninth Circuit had the greatest average number of class action filings with 50 per year. This is 28 percent higher than the next highest average number of class action filings (the Second Circuit with 39). Many Ninth Circuit filings were against Internet-related companies that were most affected by the boom and the bust of U.S. equities at the turn of the century. Progressively fewer cases were filed in the Ninth Circuit in 2002 and 2003 after the decline of the Nasdaq stock market, where most of these companies traded. In 2004, there was a resurgence of filing activity in the Ninth Circuit, with many filings against technology companies, especially software firms. In 2005, there was again a decline in filings in the Ninth Circuit, with many fewer filings associated with technology- and Internet-related issuers. In 2006, Ninth Circuit filings declined in a comparable proportion to the decline in all filings. In contrast, the Sixth (Kentucky/Tennessee/Ohio/Michigan), Seventh (Wisconsin/Illinois/Indiana), and Tenth Circuits (Colorado/Kansas/Oklahoma/New Mexico/Utah/Wyoming) experienced disproportionate slowdowns. The Eleventh Circuit actually was the only circuit that had an increased number of filings in 2006.

More than half (11 out of the 20) of the options backdating cases in 2006 were filed in the Ninth Circuit. Both of the options backdating cases filed in 2005 were filed in the Ninth Circuit. Of these 13 options backdating cases filed in the Ninth Circuit, all but 1 was filed in California and 8 were filed in the Northern District of California. In terms of ranking by the number of options backdating cases, the First Circuit came a distant second, with only 3 of such cases.

Filings by Court Circuit									
<i>Dollars in Billions</i>									
Circuit	Class Actions Filings			Disclosure Dollar Loss			Maximum Dollar Loss		
	Average 1996 – 2005	2005	2006	Average 1996 – 2005	2005	2006	Average 1996 – 2005	2005	2006
1	11	10	6	\$7	\$18	\$1	\$25	\$64	\$2
2	39	42	31	\$27	\$30	\$26	\$192	\$157	\$54
3	17	18	11	\$23	\$10	\$1	\$81	\$27	\$5
4	7	7	4	\$3	\$3	\$0	\$18	\$5	\$2
5	15	12	6	\$10	\$1	\$2	\$47	\$4	\$58
6	10	11	4	\$10	\$4	\$1	\$40	\$11	\$2
7	10	9	2	\$6	\$4	\$0	\$28	\$16	\$1
8	8	11	6	\$3	\$3	\$6	\$12	\$7	\$23
9	50	39	25	\$22	\$9	\$7	\$180	\$30	\$98
10	7	8	3	\$3	\$2	\$0	\$14	\$7	\$1
11	19	10	11	\$7	\$8	\$8	\$29	\$36	\$45
12	1	1	1	\$3	\$0	\$0	\$12	\$1	\$2
Total	193	178	110	\$124	\$93	\$52	\$680	\$362	\$294

Exhibit 12

⁸ Circuit information corresponds to the first identified complaint.

Circuit
continued

The circuits with the highest levels of DDL in 2006 were the Second Circuit with \$26 billion, the Eleventh Circuit with \$8 billion, and the Ninth Circuit with \$7 billion. In 2006, the Second, Eleventh, and Ninth Circuits represented a larger proportion of DDL compared to 2005. The circuits with the highest levels of DDL in 2005 were the Second Circuit with \$30 billion, the First Circuit (Massachusetts/ Maine/ New Hampshire/Rhode Island) with \$18 billion, and the Third Circuit with \$10 billion. Historically, the Second, Third, and Ninth Circuits have had the largest DDL.

When the circuits are ranked by MDL, the top three circuits in 2006 were the Ninth Circuit with \$98 billion, the Fifth Circuit (Texas/Louisiana/Mississippi) with \$58 billion, and the Second Circuit with \$54 billion. The Ninth Circuit filings in 2006 were dominated by four of the eight “mega” MDL filings (three of which were options backdating cases), while the Second Circuit and Fifth Circuit each contributed one “mega” MDL filing. In 2006, the Fifth and Ninth Circuits represented a larger proportion of MDL compared to 2005, due to the effect of these “mega” filings. The top three circuits by MDL in 2005 were the Second Circuit with \$157 billion, the First Circuit with \$64 billion, and the Eleventh Circuit with \$36 billion. The Second Circuit contributed three out of the top five “mega” MDL filings in 2005. Historically, the Second, Third, and Ninth Circuits have experienced the largest MDL.

Industry ⁹

17

As in 2005, Consumer Non-Cyclicals experienced the largest number of filings in 2006.¹⁰ In 2006, the Technology sector had the second largest number of filings, compared to the Consumer Cyclical sector in 2005.¹¹ During 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 also had the highest DDL in 2006, representing 65 percent of the total, and Consumer Cyclical and Technology in distant second and third positions. 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 declined 68 percent, almost double the 36 percent decline in DDL in all other sectors.

Technology, Consumer Non-Cyclical, and Consumer Cyclical sectors had the highest MDL in 2006. These three sectors together accounted for 87 percent of the total MDL. The Technology sector alone accounted for 46 percent of the MDL, largely due to 5 of the top 10 MDL cases being in the Technology sector. Of these 5 cases in the Technology sector, 3 are options backdating cases. During 1996 – 2005, Communications (which includes, under Bloomberg's classification, most Internet-related companies) was the biggest contributor to the MDL Index™. Compared to 2005, MDL in Technology and Communications sectors combined increased 131 percent in 2006, while MDL in all other sectors declined 53 percent.

Industry	Class Actions Filings			Disclosure Dollar Loss			Maximum Dollar Loss		
	Average 1996 – 2005	2005	2006	Average 1996 – 2005	2005	2006	Average 1996 – 2005	2005	2006
Consumer Non-Cyclical	45	51	36	\$36	\$45	\$34	\$133	\$198	\$82
Technology	32	20	21	\$20	\$18	\$5	\$95	\$49	\$135
Communications	38	26	13	\$29	\$4	\$2	\$244	\$18	\$21
Industrial	18	14	13	\$9	\$4	\$2	\$32	\$15	\$8
Consumer Cyclical	25	32	13	\$8	\$8	\$6	\$55	\$45	\$38
Finance	24	27	10	\$16	\$11	\$3	\$80	\$29	\$10
Energy	4	4	3	\$4	\$0	\$0	\$20	\$1	\$1
Basic Materials	3	3	1	\$1	\$1	\$0	\$5	\$7	\$0
Utilities	4	1	0	\$2	\$0	\$0	\$15	\$0	\$0
Total	193	178	110	\$124	\$93	\$52	\$680	\$362	\$294

Exhibit 13

⁹ For the purposes of this analysis, we use the sector classifications provided by Bloomberg. According to Bloomberg, "sector" is the broadest classification that represents the 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.

¹⁰ The Consumer Non-Cyclical sector includes agriculture, beverages, biotechnology, commercial services, cosmetics/personal care, food, healthcare-products, healthcare-services, household products/wares, and pharmaceuticals.

¹¹ The 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. The Technology sector includes computers, office/business equipment, semiconductors, and software.

Reversal of Class Certification in the IPO Allocation Litigation

In a decision with implications that reach far beyond class action securities fraud litigation, a panel of the United States Court of Appeals for the Second Circuit vacated an order granting class action certification in the IPO allocation litigation. The court ruled that plaintiffs seeking certification have the burden of establishing that each element of the class certification test has been satisfied, and that it is insufficient for the plaintiffs simply to make “some showing” with regard to each of these elements, as had been approved by the lower court. Because the lower court had applied an improper standard, the certification order was vacated and the case was remanded for further consideration, but with observations suggesting that plaintiffs would have great difficulty in certifying a class. The opinion suggests that there will be substantial additional litigation over the question of class certification in a large number of securities fraud cases, particularly those involving initial public offerings and securities that trade in markets that are arguably not efficient.

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.¹² Because there are no material barriers to entry in the plaintiff class action sector, and because there is a large supply of firms and lawyers with the ability and incentive to pursue class action securities fraud litigation, this indictment does not appear to explain the decline in class action securities fraud activity.

Backdating of Stock Options

Executive compensation has come under increasing scrutiny in 2006 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. To date, 22 securities class actions lawsuits with options backdating allegation have been filed. As previously indicated, 20 of these were filed in 2006 and they increased the number of companies sued by 22 percent from 90 to 110; increased the total Disclosure Dollar Loss by 24% from \$42 billion to \$52 billion; and increased the total Maximum Dollar Loss by 48 percent from \$198 billion to \$294 billion. The 2 cases with options backdating claims filed in 2005 increased the number of companies sued by 1 percent from 176 to 178; had no sizeable impact on DDL; but increased the MDL by 4 percent from \$349 billion to \$362 billion.

¹² “Milberg Indicted On Charges Firm Paid Kickbacks,” the *Wall Street Journal*, May 19, 2006.

Classification of Complaints¹³

19

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

- 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 at a similar level (92 percent) during 2006. However, while the percentage of filings alleging false forward looking statements had increased last year (from 67 percent in 2004 to 82 percent in 2005), 2006 suggests a modest downward reversion with only 73 percent of cases containing such allegations.¹⁴
- To the extent that specific accounting allegations could be identified in complaints and/or press releases, the percent of such allegations increased in 2006. The percentage of complaints alleging specific accounting irregularities increased to 68 percent in 2006 from 44 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 of a firm’s activities.
- “Other” accounting allegations increased markedly in 2006, comprising 63 percent of cases with accounting allegations compared with only 37 percent in 2005. Accounting for option issuance seems to be the most popular Other category this year, with 43 percent of cases containing Other allegations related to accounting for executive option issuance.
- No lawsuits were filed subsequent to bankruptcies in 2006 while companies sued in 8 out of the 178 lawsuits (4.5 percent) filed in 2005 had claimed bankruptcy by the time the complaints were filed.

¹³ The classifications are based on first identified complaint. Additional allegations and defendants may be added in subsequent complaints and not captured in these analyses.

¹⁴ Some filings are included in multiple classifications.

Classification of
Complaints *continued*

20

Allegation Box Score

	2005		2006	
	Number	Percentage of total filings	Number	Percentage of total filings
General Characteristics				
10b-5 claims	165	93%	97	88%
Section 11 claims	16	9%	13	12%
Section 12(2) claims	9	5%	10	9%
Underwriter defendant	9	5%	5	5%
Auditor defendant	5	3%	1	1%
Allegations				
Misrepresentations in financial documents	157	88%	101	92%
False forward looking statements	146	82%	80	73%
GAAP violations	78	44%	75	68%
Insider trading	80	45%	42	38%
		Percentage of cases with alleged GAAP violations		Percentage of cases with alleged GAAP violations
Specifics of Accounting Allegations				
Understatement of expenses	20	26%	36	48%
Revenue recognition	41	53%	27	36%
Overstatement of other assets [1]	9	12%	9	12%
Understatement of liabilities	14	18%	8	11%
Overstatement of accounts receivable	16	21%	6	8%
Overstatement of inventory	12	15%	4	5%
Acquisition accounting	3	4%	4	5%
Non-recurring items	4	5%	3	4%
Estimates	8	10%	1	1%
Derivatives/hedging	5	6%	0	0%
Other	29	37%	47	63%

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

Exhibit 14

**Cornerstone
Research
Publications**

Post-Reform Act Securities Settlements: 2005 Review and Analysis
Laura E. Simmons and Ellen M. Ryan

Demystifying Financial Derivatives
Rene M. Stulz

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

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

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

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

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

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

Bank Charter Values and Risk Taking
Michael C. Keeley

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