CORNERSTONE RESEARCH

www.cornerstone.com
securities.cornerstone.com

# Securities Class Action Case Filings

# 2007: A Year in Review

## Research Sample

- The Stanford Law School Securities Class Action Clearinghouse in cooperation with Cornerstone Research identified securities class action filings as of 12/17/07.
- Between the start of 1996 and December 17, 2007, 2,646 federal class action cases were filed.
- The class action filings include 313 “IPO Allocation” filings, 66 “Analyst” filings, 49 “Mutual Fund” filings, 34 “Options Backdating” filings and 32 “Subprime” filings.
- The sample used in this report is 2,218 cases, because it excludes "IPO Allocation," "Analyst," and "Mutual Fund" filings.

## Overview

Securities class action filing activity ("filings") increased to 166 filings in 2007 from 116 filings in 2006.[1] Notwithstanding the 43 percent increase in filings from 2006, 2007 represents the third lowest annual level of filings since the adoption of the Private Securities Litigation Reform Act ("PSLRA") in 1995. This level of activity is 14 percent below the average for the prior ten years (1997–2006). Although filings for 2007 as a whole were below historical levels, litigation activity jumped in the second half of the year as the subprime mortgage crisis unfolded and stock market price volatility increased. One hundred companies were sued in the second half of the year, a litigation rate that reversed a trend of four consecutive six-month periods with well below average litigation activity.

Interestingly, 23 of the 100 filings in the second half of 2007 were associated with subprime issues. As explained below, the impact of issues in the subprime market on litigation activity was likely a "one time" event, and may not be indicative of future filing activity.



Total market capitalization losses associated with filings in 2007 also increased from 2006, reflecting both an increase in the number of filings and an increase in the size of the loss associated with the average filing. Disclosure Dollar Losses ("DDL") in 2007 amounted to $151 billion, almost three times the total in 2006 and Maximum Dollar Losses ("MDL") in 2007 amounted to $669 billion, more than double the total in 2006.[2] While Disclosure Dollar Losses for 2007 were above the historical average for the prior ten year period, Maximum Dollar Losses were slightly below the historical average.

Complaint Filings Box Score

| | Average (1997 – 2006) | 2006 | 2007 |
|---|---|---|---|
| Class Action Filings | 194 | 116 | 166 |
| Disclosure Dollar Loss ($ Billions) | $127 | $52 | $151 |
| Disclosure Percent Loss (%) | 1.1% | 0.4% | 0.5% |
| Maximum Dollar Loss ($ Billions) | $706 | $293 | $669 |
| Maximum Percent Loss (%) | 5.7% | 2.5% | 2.4% |

Exhibit 1

[1] 2007 filings include cases identified as of 12/17/2007. There are typically few cases filed during the last two weeks of the year. All other years include filings through 12/31.

[2] Maximum Dollar Loss and Disclosure Dollar Loss are defined in the "Market Capitalization Declines" section.

**Overview**
***continued***



A new analysis in this *Year in Review* tracks the outcome of case filings. Focusing on cases filed in 1996 though 2001 where almost all of these cases have reached a conclusion, we find that 35 percent of these cases were dismissed and 64 percent have settled. In addition, the median/midpoint time from filing to settlement for these cases was 33 months.

Three additional events that occurred in 2007 are worth noting in the overview, as these events will likely affect class action activity in coming years. These events include defendants prevailing in the JDS Uniphase securities trial, the Supreme Court's decision in the Tellabs case, and William Lerach's guilty plea.

Finally, it is useful to contrast the two-year low filing activity period ending June 2007 with the most recent six-month period to examine what factors may have led to these contrasting patterns of filing activity. In our most recent mid-year review, we had asked the question whether two years of low filing activity had led to a permanent shift in the securities class action landscape. The answer to this question depended on the cause of the decrease in filings. Specifically, did the decreased level of filings owe to "less fraud" or to a "strong stock market" combined with low volatility?

The "less fraud" hypothesis suggests that the decline in class action securities litigation resulted from changed corporate behavior. The "strong stock market" hypothesis suggests that the decline in class action activity owed to a strong stock market and low volatility.

The "less fraud" and "strong stock market" theories for the lower level of filings over the recent two-year period are not mutually exclusive—the decline seen in 2005 and 2006 could be the result of a combination of both factors—but the two hypotheses do lead to differing expectations of the level of filings in the future. The "less fraud" theory suggests a significant and permanent shift in the class action landscape is not consistent with the recent increase in filings.

The "strong stock market" with low volatility explanation suggests a temporary shift in the landscape—one that will continually change with the strength and volatility of the stock markets. As has been seen in the second half of 2007, there has been an increase in stock market volatility along with a corresponding increase in the number of filings.

Although we need to wait for additional data to test the hypotheses more precisely, early indications support both the "strong stock market" hypothesis and the "less fraud" propositions. Our analysis of the two theories and other findings are described in greater detail in this report.

## Is There Less Fraud?

Professor Joseph Grundfest of the Stanford Law School explains that recent levels of class action filings are consistent with the “less fraud” hypothesis:

“I have previously suggested that the decline in litigation activity in the second half of 2005 and in 2006 is consistent with the observation that managements may be engaged in less fraud because of increased federal enforcement activity and improved monitoring by boards and auditors. If this observation is correct, then we should expect fewer securities fraud filings in the future than in the past. Is the increase in filing activity in 2007 inconsistent with this hypothesis? Not at all. The 2007 litigation rate was below historical norms, even in the face of the subprime crisis. The ‘core litigation rate,’ i.e., the litigation rate observed net of one-time systemic shocks such as the options backdating scandals and the subprime crisis, also continues to run well below historical norms. [See below] To be sure, it will take several more years’ worth of data to be able to assert with any real statistical confidence that there is a decline in the filing rate that can be attributed to a reduction in the incidence of alleged frauds, but the data to date are not-inconsistent with that hypothesis. Indeed, emerging academic literature suggests that managements have become more conservative and accurate in reporting financial results since the Enron and Worldcom scandals. Those findings are quite consistent with the fraud reduction hypothesis.

## The Core Litigation Rate

Large one-time events contributed significantly to litigation activity in both 2006 and 2007. Backdating contributed to 2006 litigation, and the subprime crisis added to litigation in 2007. But what would the litigation rate have been absent those one-time events? This question is meaningful because it suggests that there is a ‘core litigation rate’ that persists in the marketplace and that clear, identifiable systemic shocks can cause a spike in litigation activity above that core rate. If the backdating and subprime cases, along with the IPO Allocation filings, are excluded from the sample in order to generate a ‘core litigation rate,’ we find that litigation activity remains well below historical norms. The average core litigation rate from 1997 through 2006 indicates that 192 companies are sued each year. The annualized core litigation rate for the second half of 2005 was 136. The annual core litigation rate for 2006 was 92, and for 2007 it was 126. Thus, even though the core rate shows an increase from its 2006 lows, it still remains well below its historical mean.”

6-Month Number of Class Action Filings
1996 – 2007

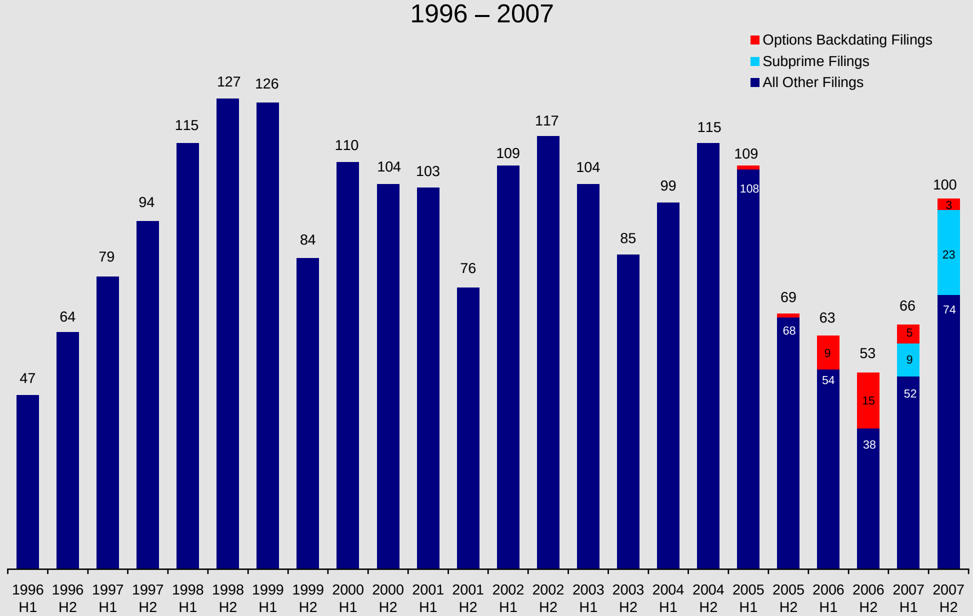



Exhibit 2

## Number of Filings

The CAF Index™ tracks the number of class action filings by year.[3] The number of traditional filings in 2007 is higher than in 2006, with 166 filings in 2007 compared to 116 filings in 2006 (see Exhibit 3). However, this is well below the 194 per year average for the ten year period ending December 2006. The CAF Index™ demonstrates the fluctuations in litigation activity over time, with the lowest activity in 1996, possibly in response to the late 1995 adoption of the PSLRA. The 166 filings in 2007 was the second lowest level since 1996, after 2006 with 116 filings. Looking at filings on a six-month basis, Exhibit 2 (above) shows a marked increase in the level of filings for the second half of 2007 to 100 filings. As discussed, 23 of the filings in the second half of the year were associated with subprime issues.



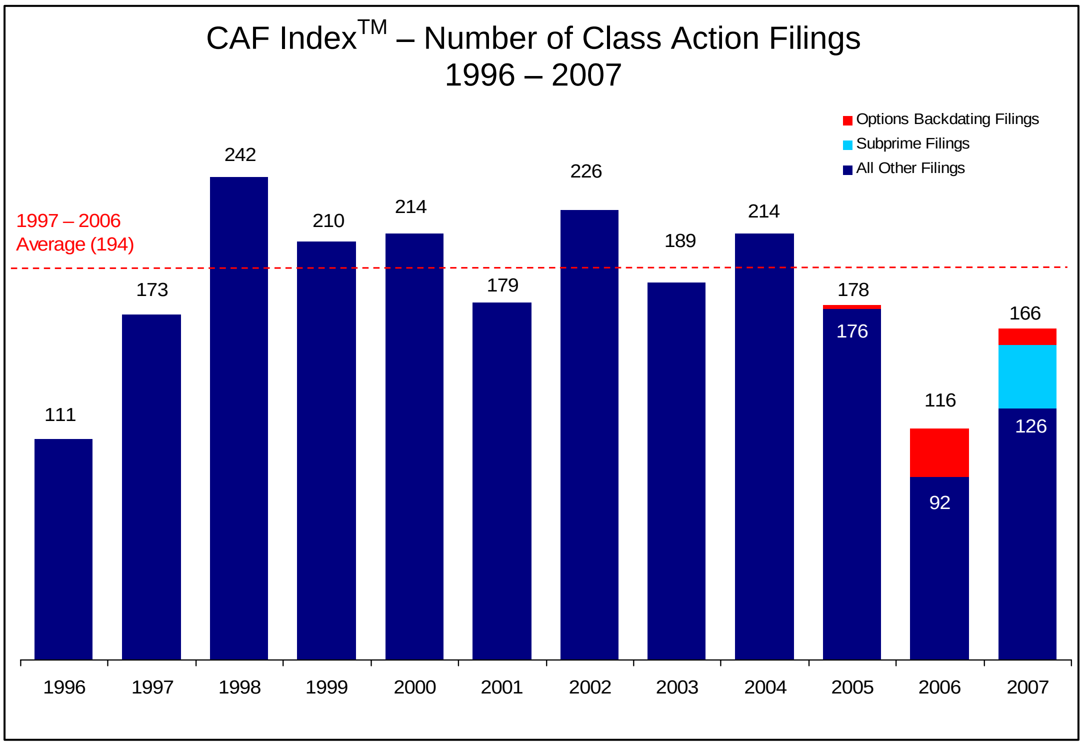



Exhibit 3

3 Our indices and exhibits exclude IPO Allocation, Analyst and Mutual Fund filings.

**Number of Filings *continued***

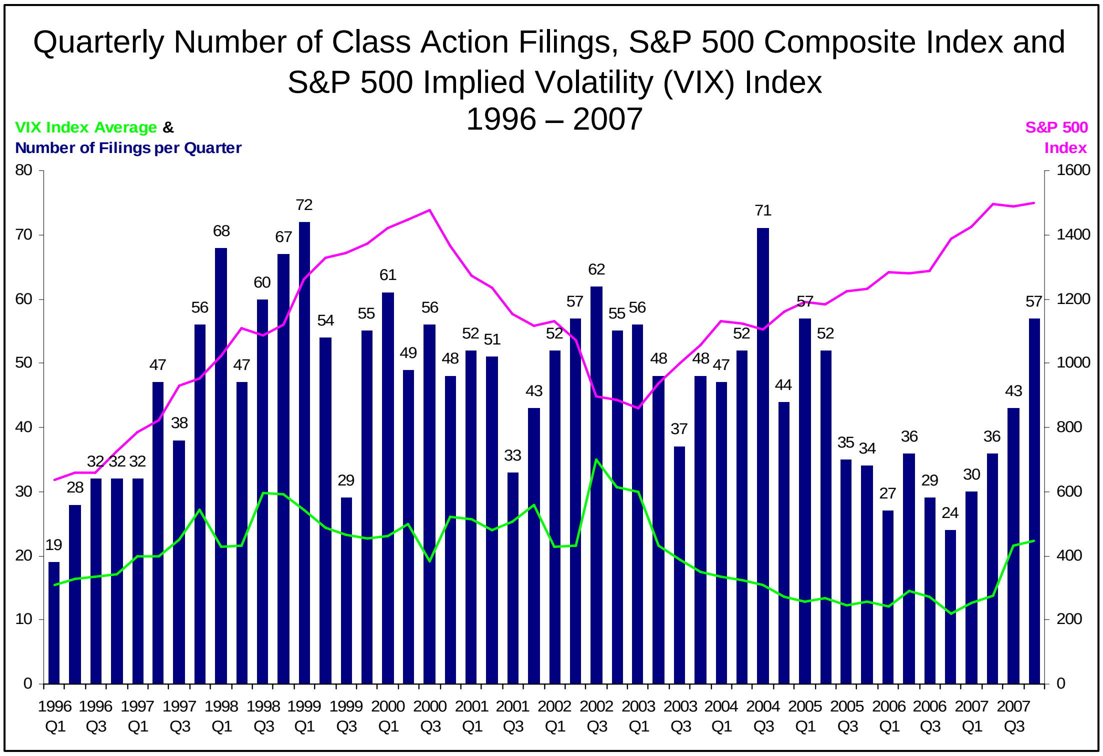


Exhibit 4 shows that the increase in filings in the second half of 2007 coincided with an increase in volatility of the U.S. stock market from the historically low levels that prevailed in 2006 and the first half of 2007. Exhibit 4 suggests a link between the increase in filings in the second half of 2007 and stock market volatility (as measured by the VIX index of implied volatility of the S&P 500). However, it is not clear from the exhibit whether the decrease in the level of filings during the two-year period from the third quarter 2005 to the second quarter of 2007 was related to the low volatility during this period. While volatility was indeed low from mid-2005 through mid-2007, there is not a noticeable difference in volatility when compared to the eighteen-month period of normal to high filing activity that began in early 2004. The relationship between stock market return and the number of filings is even less clear. The number of filings was on the rise during the bull market of the late-1990s, but was declining during the bull market of 2003–07.

To analyze the relationship between stock market volatility, stock market returns, and the number of filings we performed a series of statistical tests. First, we investigated whether the average stock market volatility and stock market returns, measured over different periods, help explain the quarterly number of filings. We found that stock market volatility is important in explaining the number of filings. For example, a 10 point increase in the quarterly average VIX index was associated with 12 more filings per quarter, on average. Stock market return had no explanatory power for the number of filings.

Once the link between the quarterly number of filings and market volatility was established, the next question was whether this relationship changed over time. Even taking into account different patterns of market volatility and related variations in the number of filings, we find that there have been 9 fewer lawsuits a quarter on average starting in the third quarter of 2005.[4] Thus, the results are consistent with both the "lower volatility" hypothesis and the "less fraud" hypotheses.[5]

Exhibit 4




[4] The coefficient on the indicator variable for quarters starting in the later half of 2005 is statistically significant even when we control for the quarterly average volatility of the S&P 500 in regressions explaining quarterly number of filings.

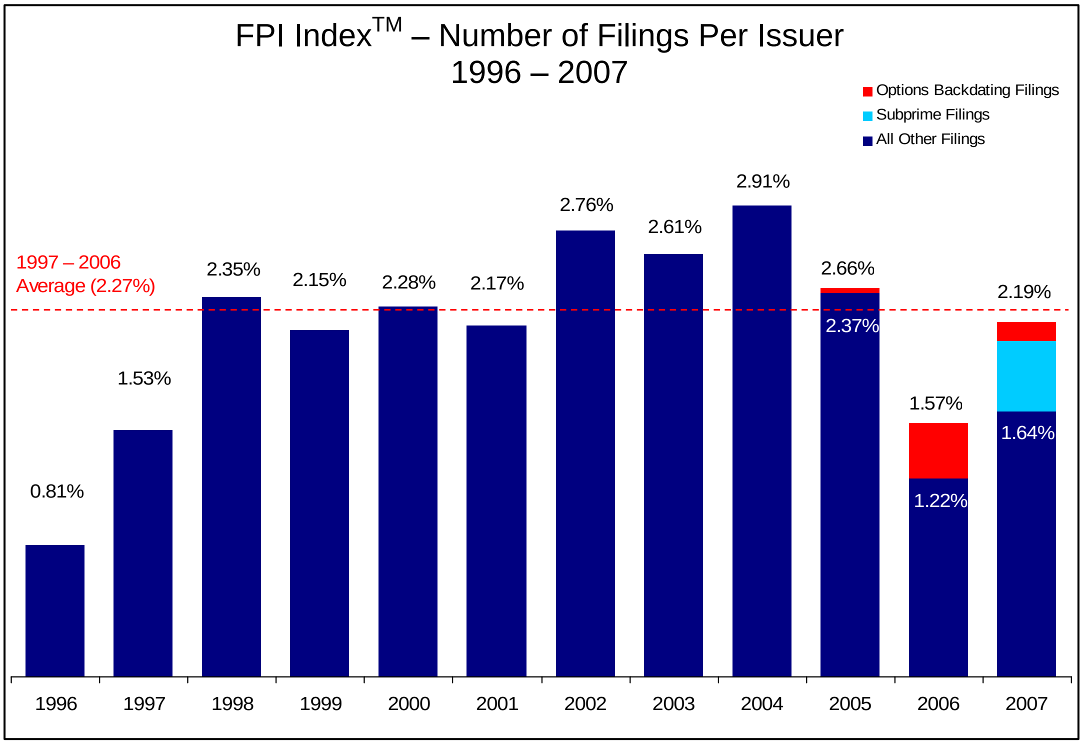
[5] As with any statistical test, it is helpful to have more rather than less data. Our tests rely on a split of the sample into 38 quarterly observations through the first half of 2005 and 10 quarterly observations beginning with the second half of 2005. The low number of observations in the second sample makes our test imprecise and we plan to revisit our conclusions in future publications.

**Number of Filings**
***continued***

The Filings Per Issuer Index (FPI Index™ ) also highlights the increased litigation activity in 2007 (see Exhibit 5). Of the total companies listed on the NYSE, Nasdaq, and Amex at the start of the year, 2.19 percent were defendants in traditional class action lawsuits filed in 2007, on an annualized basis, as compared to 1.57 percent in 2006 and the 2.27 percent ten-year average from 1997–2006.



Exhibit 5



## Market Capitalization Declines

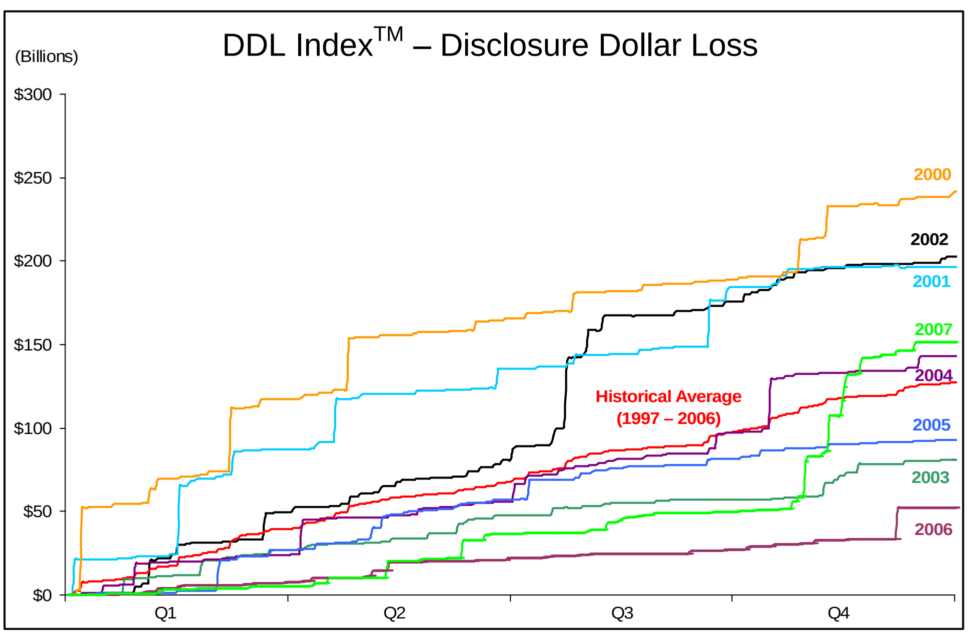
To measure the relative size of class action filings, our second group of indices tracks market capitalization declines at the end of and during class periods. Market capitalization declines over extended periods of time may be driven by market and industry factors. To the extent that these declines 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 track the market capitalization decrease at the end of each class period using Disclosure Dollar Loss and the market capitalization decrease throughout the class period using Maximum Dollar Loss.

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 the class period to the trading day immediately following the end of the class period. 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. Disclosure Dollar Loss and Maximum Dollar Loss should not be considered measures of liability; they only represent estimates 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.

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 an increase in disclosure losses in 2007 from 2006, mostly driven by several large case filings in the fourth quarter of 2007 (see Exhibit 6). Total annualized DDL for 2007 was $151 billion, representing an increase of 188 percent relative to 2006 and an 18 percent increase relative to the ten-year average from 1997–2006 (see Exhibit 7).

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.[7] The DPL Index™ also shows an increase in disclosure losses in 2007 compared to 2006, but smaller losses than the historical averages (see Exhibit 8). The total DDL in 2007 represented 0.5 percent of the capitalization of the Wilshire 5000, compared to 0.4 percent in 2006 and 1.1 percent on average from 1997–2006.

Exhibit 6




[6] See our 2006 annual publication for discussion of the *Dura Pharmaceuticals* decision.
[7] Please see http://securities.cornerstone.com for complete details on the DPL Index™ calculation.

**Market Capitalization Declines**
***continued***



Exhibit 7

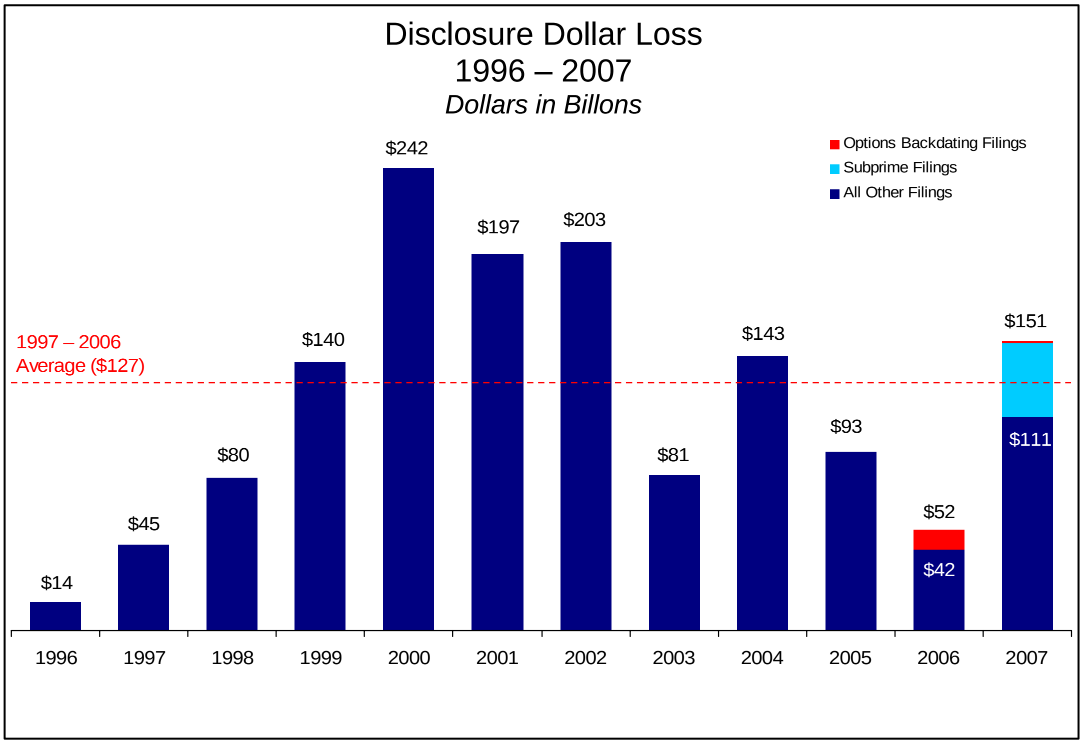
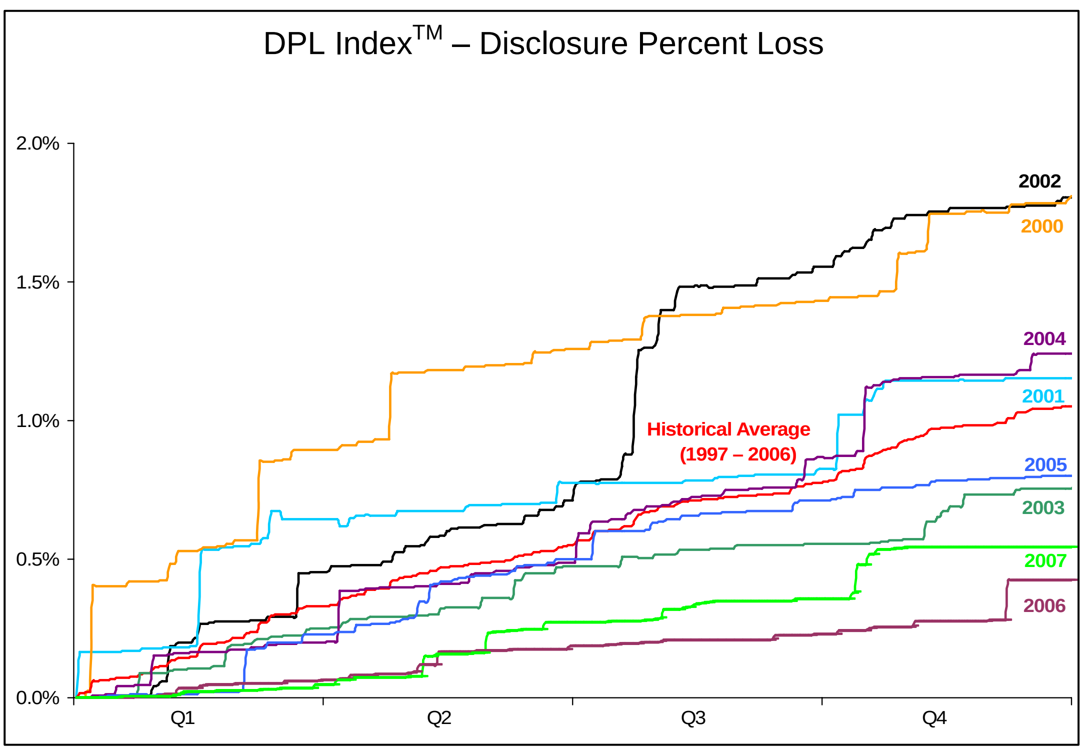



Exhibit 8



**Market Capitalization Declines** ***continued***

Similar to the DDL Index™, the Maximum Dollar Loss Index (MDL Index™) shows a large increase in market value declines for companies subject to class action filings in 2007 compared to 2006 (see Exhibits 9 and 10). Total MDL for 2007 was $669 billion, which was a 128 percent increase relative to 2006. As in the case of the DDL Index, the increase in the MDL Index was driven by several large case filings in the fourth quarter of 2007.



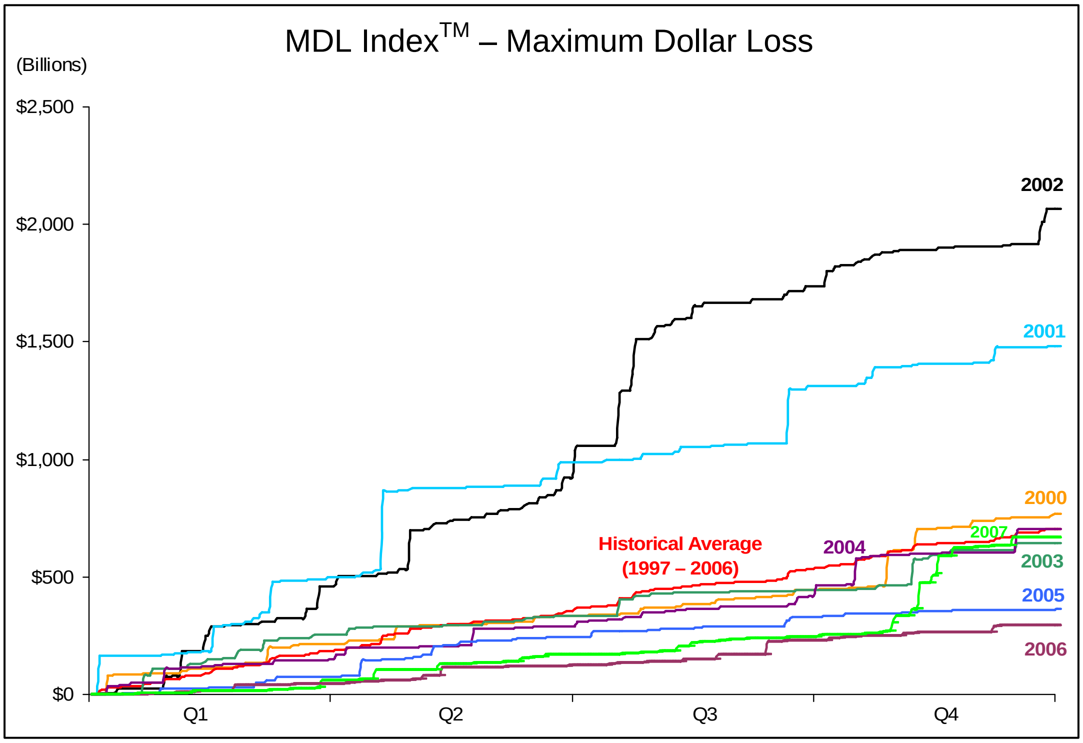



Exhibit 9

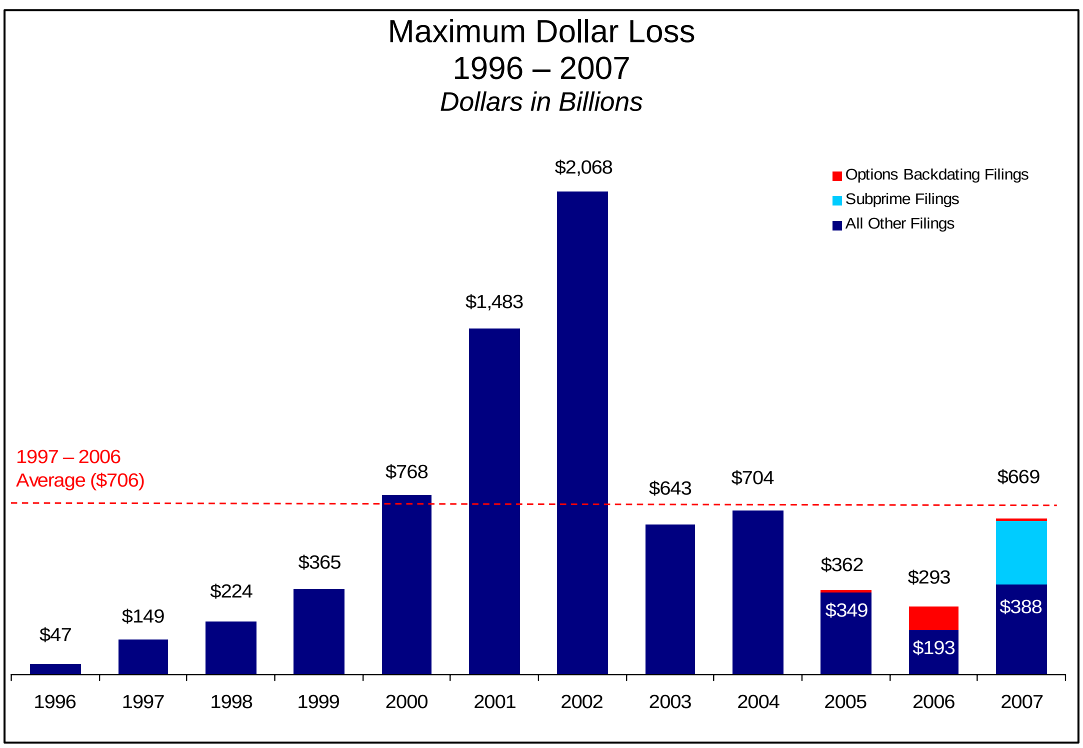


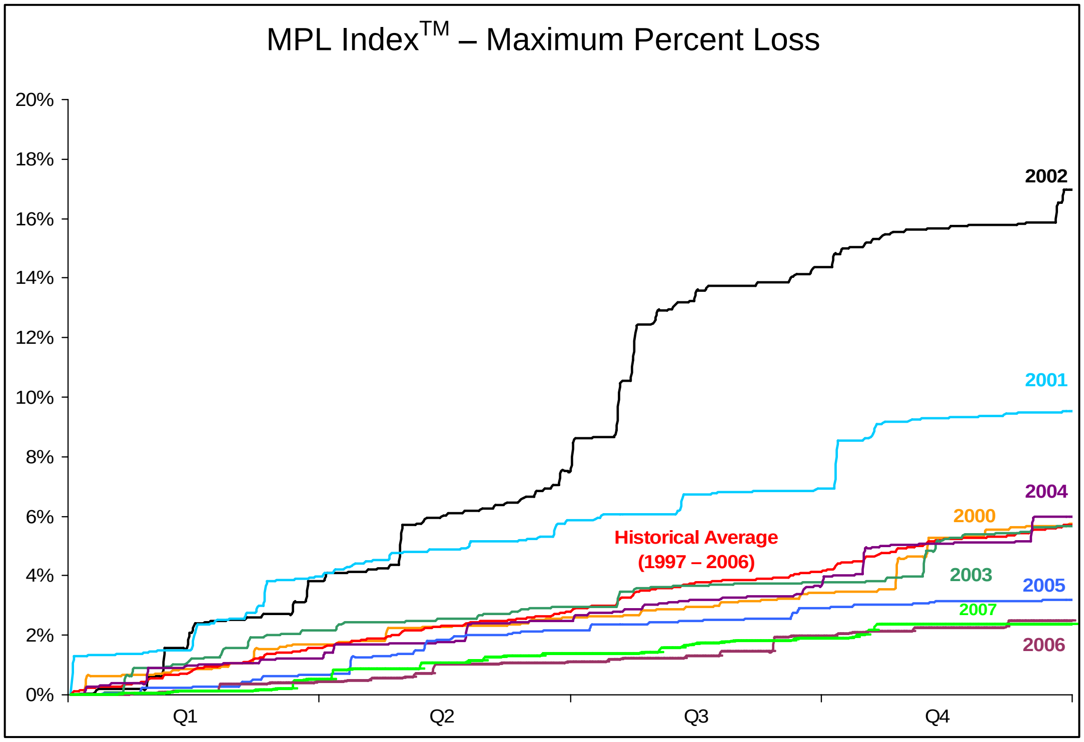

Exhibit 10

**Market Capitalization Declines**
***continued***

The MPL Index™ shows a slight decline.[8] The MDL for all filings in 2007 represented 2.4 percent of the Wilshire 5000 during the class periods (see Exhibit 11). This compares to 2.5 percent for filings in 2006 and 5.7 percent for cases filed during 1997–2006. In fact, the relative market capitalization declines measured by the MPL Index hit their lowest level since 1997.

11

Exhibit 11




[8] Please see http://securities.cornerstone.com for complete details on the MPL Index™ calculation.

**Market Capitalization Declines**
***continued***

Exhibit 12 provides a more detailed look at the typical filing. The median DDL was larger in 2007 compared to 2006 and the historical average for the ten-year period ending in 2006. The median MDL of $0.7 billion in 2007 rose from 2006 back closer to historical levels. Finally, the median class-end stock price percentage decline for cases filed in 2007 was 19.7 percent, higher than the 2006 decline of 14.2 percent, but lower than the median decline of 24.2 percent for cases filed during the period between 1997 and 2006. The differences in the typical class-end percent declines are related to changes in the stock market volatility, as shown in Exhibit 13.

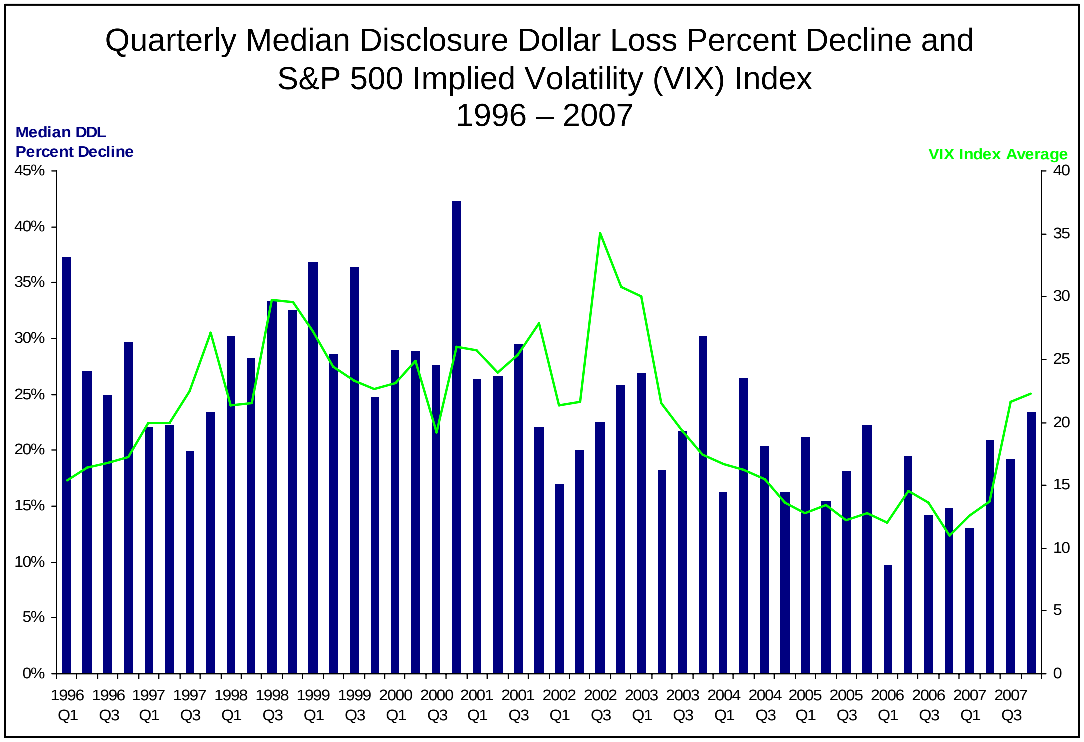
12

Exhibit 12

Filings Comparison

| | Average (1997 – 2006) | 2006 | 2007 |
|---|---|---|---|
| Class Action Filings | 194 | 116 | 166 |
| Maximum Dollar Loss | | | |
| Total ($ Billions) | $705.9 | $293.1 | $668.8 |
| Average ($ Billions) | $4.0 | $2.8 | $4.5 |
| Median ($ Billions) | $0.6 | $0.4 | $0.7 |
| Disclosure Dollar Loss | | | |
| Total ($ Millions) | $127,447 | $52,381 | $150,991 |
| Average ($ Millions) | $720 | $509 | $1,007 |
| Median ($ Millions) | $107 | $111 | $154 |
| Median % DDL Decline | 24.2% | 14.2% | 19.7% |

Exhibit 13



## Mega Filings

Analysis of "mega" filings shows that the majority of total market capitalization losses associated with class action filings are attributable to relatively few cases.

### Disclosure Dollar Loss

In 2007 there were 9 "mega" DDL filings, i.e. filings with a DDL of $5 billion or more. These 9 filings comprised 59 percent of total DDL in 2007. In contrast, there was 1 "mega" DDL filing in 2006 and it comprised 36 percent of total DDL for that year. Most of the "mega" DDL filings in 2007 were filed in the second half of the year.

### Maximum Dollar Loss

In 2007 there were 16 "mega" MDL filings, i.e. filings with a MDL of $10 billion or more. These 16 filings comprised 75 percent of total MDL in 2007. This compares with 8 "mega" MDL filings in 2006 comprising 67 percent of total MDL for that year. Of these totals, there were 9 filings in 2007 and 3 filings in 2006 with an MDL in excess of $25 billion. Most of the "mega" MDL filings in 2007 were filed in the second half of the year.

## Case Status

Tracking the outcome of the cases in the Clearinghouse filings database, 19 percent of the cases are continuing, primarily those cases filed in the past few years. Of the 81 percent of cases that have been resolved, 41 percent were dismissed and 59 percent settled (see Exhibit 14). Of the cases that were dismissed, 73 percent were dismissed after the first ruling on motion to dismiss but before ruling on summary judgment, while 60 percent of settled cases were resolved in this stage. For the 1996 through 2001 case cohorts, where almost all of the cases have been resolved, the median time to resolution is 33 months. Differentiating between settled and dismissed cases, the median time to settlement is 36 months while the median time to dismissal is 25 months.

The data on the outcomes of lawsuits provides an opportunity to pose some intriguing questions. For example, what are the characteristics of the cases from the last bear market of 2000–02 that still continue? The average DDL of cases that were either settled or dismissed was $1.1 billion. In comparison, the average DDL of continuing cases was $2.0 billion. Similarly, the median DDL of cases that were either settled or dismissed was $114 million. In comparison, the median DDL of continuing cases from these cohorts was $299 million. These statistics suggest that cases with higher shareholder losses are likely to take longer to resolve.



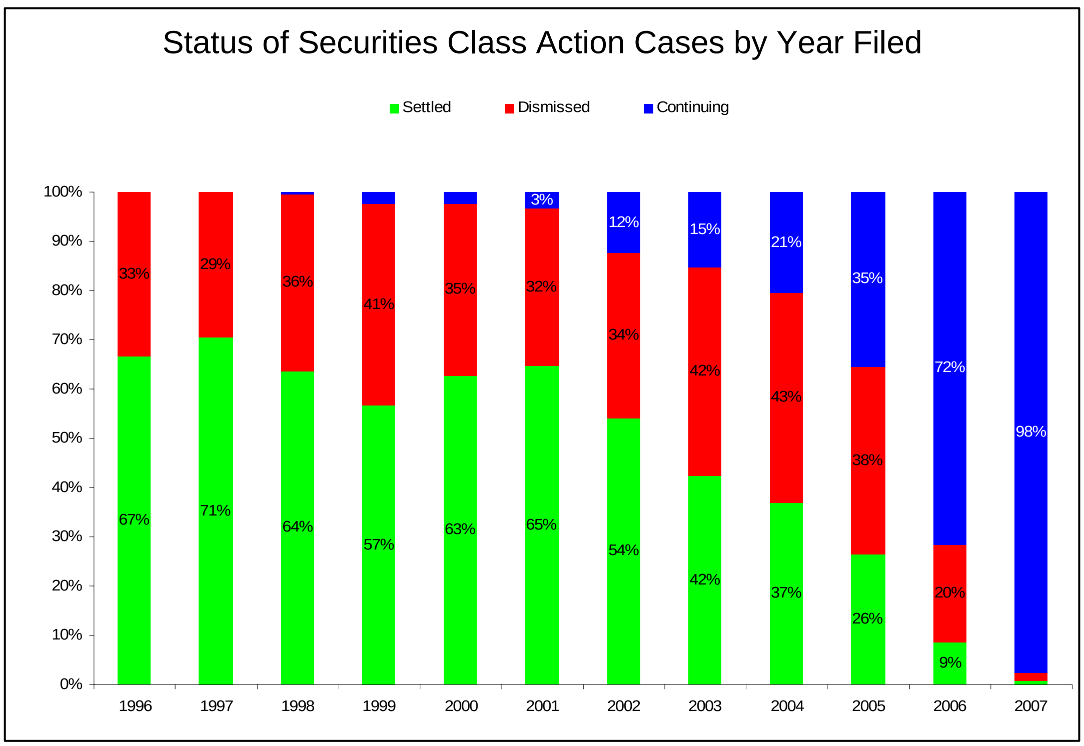



Exhibit 14

## Case Status *continued*

For cases that have been resolved, Exhibit 15 shows the breakdown of what percentage were resolved through settlement or dismissal. Because the typical time to dismissal is shorter than the typical time to settlement, we observe more dismissals than settlements among resolved cases in young cohorts. The mix of settled and dismissed cases evens out as cohorts age.

15

Status of Resolved (Non-Continuing) Securities Class Action Cases by Year Filed

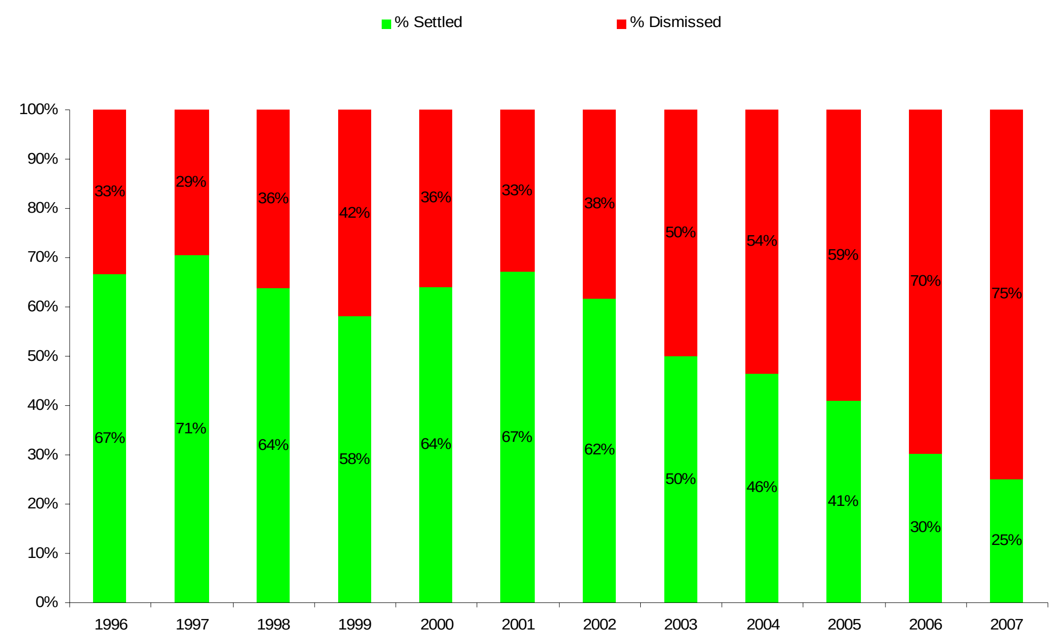



Exhibit 15

## Industry[9]

In 2007, the Finance sector replaced the Consumer Non-Cyclical sector in the lead position in litigation activity as measured by the number of filings (see Exhibit 16).[10] The surge of 47 Finance cases in 2007 was driven by the subprime crisis. Most of the 32 subprime-related filings in the Clearinghouse filings database were in the Finance sector. From 1997–2006, Consumer Non-Cyclical and Communications had the highest average number of filings with 46 and 37 filings per year, respectively.

Finance, Consumer Non-Cyclical, and Communications had the highest MDL in 2007 and together accounted for 92 percent of the total. Historically, Communications (which includes, under *Bloomberg*'s classification, most Internet-related companies) was the biggest contributor to the MDL Index™.

Consumer Non-Cyclical, Communications, and Finance had the highest DDL in 2007, representing 92 percent of the total. Filings in Consumer Non-Cyclical and Communications represented the largest DDL historically.



### Filings by Industry

*Dollars in Billions*

| | Class Actions Filings | | | Maximum Dollar Loss | | | Disclosure Dollar Loss | | |
|---|---|---|---|---|---|---|---|---|---|
| Industry | Average 1997 – 2006 | 2006 | 2007 | Average 1997 – 2006 | 2006 | 2007 | Average 1997 – 2006 | 2006 | 2007 |
| Finance | 24 | 11 | 47 | $81 | $10 | $257 | $16 | $3 | $38 |
| Consumer Non-Cyclical | 46 | 37 | 36 | $140 | $80 | $191 | $39 | $34 | $58 |
| Communications | 37 | 15 | 33 | $246 | $21 | $165 | $29 | $2 | $42 |
| Consumer Cyclical | 24 | 13 | 19 | $58 | $38 | $33 | $8 | $6 | $7 |
| Industrial | 19 | 13 | 10 | $34 | $8 | $11 | $9 | $2 | $2 |
| Technology | 32 | 22 | 12 | $107 | $136 | $9 | $20 | $5 | $3 |
| Energy | 5 | 4 | 6 | $20 | $1 | $2 | $4 | $0 | $1 |
| Utilities | 4 | 0 | 1 | $15 | $0 | $0 | $2 | $0 | $0 |
| Basic Materials | 3 | 1 | 2 | $5 | $0 | $0 | $1 | $0 | $0 |
| Total | 194 | 116 | 166 | $706 | $293 | $669 | $127 | $52 | $151 |

Exhibit 16

[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. 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.

## Exchange

The years 2006 and 2007 were characterized by a slight deviation from the typical pattern in the numbers of securities class action filings for companies listed on Nasdaq versus the NYSE and Amex (see Exhibit 17). In 2007, cases were filed against 73 firms whose stocks traded on the NYSE/Amex, compared to 77 firms whose stocks traded on Nasdaq. In 2006, cases were filed against 49 firms whose stocks traded on the NYSE/Amex compared to 60 firms whose stocks traded on Nasdaq.[11] Overall, during 1996–2006, with the exception of 2002, there have been more class action filings against Nasdaq firms than against NYSE/Amex firms.

The total DDL and MDL were higher for NYSE and Amex firms than Nasdaq firms in 2007, corresponding to the historical trend. This is not surprising since the typical firm listed on NYSE and Amex is larger than the typical firm listed on Nasdaq. Specifically,

- The total DDL for NYSE/Amex firms in 2007 was $110 billion compared to $41 billion for Nasdaq firms.
- The average DDL for NYSE/Amex firms in 2007 was $1.6 billion compared to $552 million for Nasdaq firms.
- The total MDL for NYSE/Amex firms in 2007 was $533 billion compared to $133 billion for Nasdaq firms.
- The average MDL for NYSE/Amex firms in 2007 was $7.7 billion compared to $1.8 billion for Nasdaq firms, similar to the historical averages.

17

Exhibit 17

### Filings by Exchange Listing

| | Average (1997 – 2006) NYSE/Amex | Average (1997 – 2006) Nasdaq | 2006 NYSE/Amex | 2006 Nasdaq | 2007 NYSE/Amex | 2007 Nasdaq |
|---|---|---|---|---|---|---|
| Class Action Filings | 74 | 99 | 49 | 60 | 73 | 77 |
| Filings per Issuer | 2.06% | 2.41% | 1.37% | 1.79% | 1.97% | 2.46% |
| Maximum Dollar Loss | | | | | | |
| Total ($ Billions) | $420 | $271 | $142 | $151 | $533 | $133 |
| Average ($ Billions) | 5.8 | 2.9 | 3.2 | 2.7 | 7.7 | 1.8 |
| Median ($ Billions) | 1.2 | 0.4 | 0.6 | 0.4 | 1.3 | 0.4 |
| Disclosure Dollar Loss | | | | | | |
| Total ($ Millions) | 90,378 | 35,646 | 41,254 | 11,075 | 110,038 | 40,820 |
| Average ($ Millions) | 1,344 | 362 | 917 | 201 | 1,595 | 552 |
| Median ($ Millions) | 249 | 80 | 204 | 64 | 297 | 89 |

However, 2006 was an exception with a higher MDL for Nasdaq firms. NYSE/Amex firms have 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 2006, compared to previous years, the total MDL was higher for Nasdaq firms because 6 out of the top 10 MDL filings were against companies listed on Nasdaq. This change from historical patterns is attributable to the presence of option backdating cases which are more prevalent among Nasdaq issuers than among NYSE and Amex firms.

[11] 16 filings in 2007 and 7 filings in 2006 were for companies not listed on the NYSE, Amex, or Nasdaq.

## Circuit[12]

The top three circuits in terms of the number of 2007 filings were the Second Circuit (New York) with 58 filings, Ninth Circuit (California) with 39 filings, and the Eleventh Circuit (Florida/Georgia/Alabama) with 18 filings (see Exhibit 18). These were the same top circuits in 2006 and historically. However, historically from 1997–2006, the Ninth Circuit had the greatest average number of class action filings with 50 per year, followed by the Second Circuit with 40 filings per year. 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.

The circuits with the highest levels of DDL in 2007 were the Second Circuit with $93 billion, the Ninth Circuit with $21 billion, and the Third Circuit (Delaware/New Jersey/Pennsylvania) with $12 billion. The circuits with the highest levels of DDL in 2006 were the Second Circuit with $25 billion and the Ninth Circuit and Eleventh Circuit with $8 billion each. Historically, the Second, Third, and Ninth Circuits have had the largest DDL. The Second Circuit contributed seven out of the nine "mega" DDL filings.



When the circuits are ranked by MDL, the top three circuits in 2007 were the Second Circuit with $443 billion, the Ninth Circuit with $105 billion, and the Third Circuit with $39 billion. The Second Circuit filings in 2007 were dominated by eleven of the sixteen "mega" MDL filings, while the Ninth Circuit contributed three "mega" MDL filings and Third Circuit contributed one. The top three circuits by MDL in 2006 were the Ninth Circuit with $100 billion, the Fifth Circuit (Texas/Louisiana/Mississippi) with $58 billion, and the Second Circuit with $52 billion. Historically, the Second, Ninth, and Third Circuits have experienced the largest MDL.

Exhibit 18

### Filings by Court Circuit
*Dollars in Billions*

| | Class Actions Filings | | | Maximum Dollar Loss | | | Disclosure Dollar Loss | | |
|---|---|---|---|---|---|---|---|---|---|
| Circuit | Average 1997 – 2006 | 2006 | 2007 | Average 1997 – 2006 | 2006 | 2007 | Average 1997 – 2006 | 2006 | 2007 |
| 1 | 11 | 6 | 2 | $25 | $2 | $1 | $7 | $1 | $0 |
| 2 | 40 | 31 | 58 | $197 | $52 | $443 | $30 | $25 | $93 |
| 3 | 18 | 12 | 10 | $83 | $5 | $39 | $24 | $1 | $12 |
| 4 | 7 | 4 | 5 | $18 | $2 | $2 | $3 | $0 | $0 |
| 5 | 15 | 6 | 8 | $62 | $58 | $6 | $12 | $2 | $1 |
| 6 | 10 | 4 | 5 | $40 | $2 | $2 | $10 | $1 | $1 |
| 7 | 10 | 2 | 8 | $28 | $1 | $27 | $6 | $0 | $5 |
| 8 | 8 | 6 | 3 | $14 | $23 | $9 | $3 | $6 | $7 |
| 9 | 50 | 28 | 39 | $189 | $100 | $105 | $22 | $8 | $21 |
| 10 | 6 | 3 | 6 | $14 | $1 | $6 | $3 | $0 | $4 |
| 11 | 19 | 13 | 18 | $33 | $45 | $17 | $7 | $8 | $6 |
| 12 | 1 | 1 | 4 | $4 | $2 | $12 | $1 | $0 | $1 |
| Total | 194 | 116 | 166 | $706 | $293 | $669 | $127 | $52 | $151 |

[12] Circuit information corresponds to the first identified complaint.

## New Developments



### Subprime Mortgage Market

A number of the class action filings in the second half of 2007 were associated with concerns over the subprime mortgage market. Over two dozen lenders have filed for bankruptcy, sought buyers, or ceased operations. Meanwhile, both delinquency rates and foreclosures have risen sharply. Investors in mortgage-backed securities have realized substantial losses. Analysts have estimated that losses from the collapse in the value of subprime mortgage assets could range between $300 billion and $400 billion worldwide, and so far more than $40 billion has been written down.[13] There have been at least 32 filings with allegations related to the subprime mortgage market. These 32 cases have a combined MDL of $269 billion, or 40 percent of the 2007 total, and a combined DDL of $39 billion, 26 percent of the 2007 total. The finance sector has been impacted the most, with 25 subprime cases representing more than half of the 47 filings in the industry in 2007.

### Lerach Guilty Plea

William Lerach recently retired and pleaded guilty to conspiracy for his role in an alleged scheme to bribe people to become plaintiffs in securities class action lawsuits. Mr. Lerach pleaded to one count of conspiracy to obstruct justice and making false statements. The plea deal also calls for him to forfeit $7.75 million to the government and accept a sentence of one to two years in prison. Prosecutors said the firm previously known as Milberg Weiss Bershad & Schulman paid $11.3 million in kickbacks in lawsuits targeting large companies. Prosecutors also said the firm made an estimated $250 million by filing the cases.[14]

### JDS Uniphase Wins Shareholder Lawsuit

On November 27, a jury in a rare class action trial found JDS Uniphase Corp. and four former executives not liable for securities fraud and insider trading. The plaintiffs, who can appeal the ruling, were seeking more than $20 billion in damages over claims that investors lost money because of the company's alleged wrongdoing.[15] The lawsuit is a rare case of a shareholder class action going to trial instead of being settled out of court. The ruling for defendants is consistent with prior class action trial experiences. Specifically, of the eleven securities class action trials for cases filed in the post-PSLRA period, five received verdicts for the defense and four settled during the trial proceedings.

### *Tellabs v. Makor* Issues and Rights

In a recent case the Supreme Court issued an opinion that requires plaintiffs to show convincing evidence of fraud before they can even initiate a lawsuit.[16] "To qualify as 'strong,'" Justice Ginsburg wrote, "an inference of [knowing wrongdoing] must be more than merely plausible or reasonable—it must be cogent and at least as compelling as any opposing inference of a lack of non-fradulent intent." She continued, "The inference…must be more than merely 'reasonable' or 'permissible'—it must be cogent and compelling, thus strong in light of other explanations. A complaint will survive only if a reasonable person would deem the inference of [wrongful intent]…at least as compelling as any opposing inference one could draw from the facts alleged." This opinion requires that plaintiffs show stronger evidence of fraud than what had previously been required.

[13] Stephen Taub, "Subprime Losses Could Reach $400 Billion, A Deutsche Bank report predicts that eventually, 30-40 percent of subprime debt will default," *CFO.com*., November 13, 2007.
[14] "Lawyer Pleads Guilty To Class-Action Kickbacks," *CNN.com*, October 29, 2006.
[15] Jordan Robertson, "JDS Uniphase Wins Shareholder Lawsuit," *The Associated Press,* November 27, 2007.
[16] Tellabs v. Makor Issues and Rights, Supreme Court Opinion, 6/21/2007, http://www.supremecourtus.gov/opinions/06pdf/06-484.pdf.

## Classification of Complaints[17]

The Stanford Law School Class Action Clearinghouse, in cooperation with Cornerstone Research, tracks the content of the first-identified class action complaints in addition to the level of filing activity. While the mix of allegations is largely similar, in percentage terms, a comparison of class action cases filed in 2007 with those filed in 2006 does reveal some changes in the allegations mix (see Exhibit 19).

- In the 2006 *Year in Review* we noted stabilization in the percentage of filings that alleged misrepresentations in financial documents and a moderate decline in filings alleging false forward-looking statements. The stabilization continued in 2007. The percentage of filings alleging misrepresentations in financial documents was 92 percent in both 2006 and 2007. The percentage of filings alleging false forward-looking statements continued to modestly decline, with only 63 percent of cases containing such allegations this year as opposed to 71 percent in 2006.[18]
- The share of cases naming an underwriter as a defendant increased from 4 percent in 2006 to 11 percent in 2007. This rise seems related to the increased proportion of cases including Section 11 claims (up to 19 percent in 2007 from 11 percent in 2006).
- The percentage of cases alleging insider trading continued to decline, from 38 percent of cases in 2006 to 28 percent in 2007.
- To the extent that allegations of GAAP violations could be identified in complaints and/or press releases, such allegations declined during 2007. The percentage of complaints alleging specific accounting irregularities decreased to 42 percent in 2007 from 66 percent in 2006. This decline seems to suggest a movement away from the focus in recent years on the validity of financial results and accounting treatment.
- It is noteworthy that approximately 19 percent of all cases in 2007 were specifically linked to issues in the subprime lending market. These subprime cases have caused a shift in emphasis from allegations related to traditional income statement line items to allegations related to balance sheet components. The share of cases alleging GAAP violations that specified revenue recognition decreased from 35 percent in 2006 to 20 percent in 2007, and cases alleging understatement of expenses decreased from 47 percent to 23 percent. Meanwhile, the percentage of GAAP-related cases alleging the understatement of liabilities, the overstatement of accounts receivable or of other assets, or problems with estimates all increased from 2006 to 2007.
- "Other" accounting allegations also decreased in 2007, comprising only 33 percent of cases with accounting allegations compared with 62 percent in 2006. Accounting for option issuance continued to be a popular type of "other" accounting allegation in 2007. However, the percentage of "other" cases containing such allegations was 35 percent, a decline from the proportion of such cases in 2006 (44 percent).



[17] The classifications are based on first identified complaint. Additional allegations and defendants may be added in subsequent complaints and are not captured in these analyses.
[18] Some filings are included in multiple classifications.

**Classification of Complaints**
***continued***



## Allegations Box Score

| | 2006 Number | 2006 Percentage of total filings | 2007 Number | 2007 Percentage of total filings |
|---|---|---|---|---|
| **General Characteristics** | | | | |
| 10b-5 claims | 102 | 88% | 132 | 80% |
| Section 11 claims | 13 | 11% | 31 | 19% |
| Section 12(2) claims | 10 | 9% | 17 | 10% |
| Underwriter defendant | 5 | 4% | 19 | 11% |
| Auditor defendant | 2 | 2% | 2 | 1% |
| **Allegations** | | | | |
| Misrepresentations in financial documents | 107 | 92% | 152 | 92% |
| False forward looking statements | 82 | 71% | 104 | 63% |
| GAAP violations | 77 | 66% | 69 | 42% |
| Insider trading | 44 | 38% | 47 | 28% |

| | 2006 Number | 2006 Percentage of cases with alleged GAAP violations | 2007 Number | 2007 Percentage of cases with alleged GAAP violations |
|---|---|---|---|---|
| **Specifics of Accounting Allegations** | | | | |
| Revenue recognition | 27 | 35% | 14 | 20% |
| Understatement of expenses | 36 | 47% | 16 | 23% |
| Overstatement of accounts receivable | 7 | 9% | 10 | 14% |
| Understatement of liabilities | 8 | 10% | 14 | 20% |
| Overstatement of other assets [1] | 9 | 12% | 22 | 32% |
| Non-recurring items | 3 | 4% | 1 | 1% |
| Overstatement of inventory | 4 | 5% | 7 | 10% |
| Acquisition accounting | 4 | 5% | 4 | 6% |
| Estimates | 1 | 1% | 12 | 17% |
| Derivatives/hedging | 0 | 0% | 2 | 3% |
| Other | 48 | 62% | 23 | 33% |

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

Exhibit 19

## Classification of Complaints *continued*



Exhibit 20 continues our analysis of settled, dismissed, and continuing cases. It compares allegations for these three groups of filings from the 2002 cohort, the first year we started collecting such data. Although there are no apparent differences in allegations along some dimensions across the three groups, some intriguing comparisons do arise:

- Continuing cases filed in 2002 had a much higher percentage of insider trading allegations compared to those resolved. At the same time, dismissed cases had a slightly lower incidence of insider trading allegations than did settled cases. This may suggest that cases without insider trading allegations are more likely to be dismissed. It may also be that defendants and plaintiffs have different views about the importance of these allegations past the dismissal stage, which takes them longer to arrive at the settlement price.
- Continuing cases also had a higher percentage of understatement of liabilities and overstatement of other assets compared to resolved cases. To the extent that this observation can be applied to newer cases, we can expect the cases from the 2007 cohort where such allegations are prevalent, including subprime cases, to take longer to be resolved than other types of cases.
- Settled cases filed in 2002 had the highest percentage of GAAP violations, while dismissed cases had the lowest. This may suggest that cases without allegations of GAAP violations are more likely to be dismissed and cases with such allegations are more likely to settle faster.
- Dismissed cases filed in 2002 had the lowest percentage of false forward looking statements. This may suggest that cases without allegations of false forward-looking statements are more likely to be dismissed.
- Dismissed cases also had the lowest percentage of revenue, expense, and accounts receivable related allegations among the GAAP violation cases. This may suggest that allegations regarding these items are viewed as more serious by judges considering dismissal of securities class action lawsuits.

**Classification of Complaints**
***continued***



## Allegations Box Score – Cases Filed in 2002 by Stage of Litigation

| | Percentage of Total Filings | | | |
|---|---|---|---|---|
| | **Total** | **Settled** | **Dismissed** | **Continuing** |
| **General Characteristics** | | | | |
| 10b-5 claims | 87% | 90% | 84% | 79% |
| Section 11 claims | 11% | 11% | 9% | 14% |
| Section 12(2) claims | 9% | 8% | 8% | 18% |
| Underwriter defendant | 5% | 6% | 5% | 0% |
| Auditor defendant | 7% | 7% | 7% | 7% |
| **Allegations** | | | | |
| Misrepresentations in financial documents | 81% | 84% | 79% | 79% |
| False forward looking statements | 69% | 73% | 63% | 71% |
| GAAP violations | 58% | 68% | 43% | 50% |
| Insider trading | 27% | 26% | 22% | 43% |

| | Percentage of cases with alleged GAAP violations | | | |
|---|---|---|---|---|
| | **Total** | **Settled** | **Dismissed** | **Continuing** |
| **Specifics of Accounting Allegations** | | | | |
| Revenue recognition | 49% | 52% | 36% | 64% |
| Understatement of expenses | 52% | 60% | 33% | 50% |
| Overstatement of accounts receivable | 52% | 55% | 39% | 64% |
| Understatement of liabilities | 12% | 10% | 12% | 29% |
| Overstatement of other assets [1] | 23% | 19% | 27% | 36% |
| Non-recurring items | 10% | 10% | 6% | 21% |
| Overstatement of inventory | 11% | 6% | 21% | 14% |
| Acquisition accounting | 8% | 8% | 3% | 21% |
| Estimates | 6% | 6% | 9% | 0% |
| Derivatives/hedging | 4% | 4% | 6% | 0% |
| Other | 5% | 6% | 3% | 0% |

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

Exhibit 20

## Contact

Please direct any questions or requests for additional information to:

*Alexander Aganin*
650.853.1660 or aaganin@cornerstone.com

## Cornerstone Research Offices

**Boston**
699 Boylston Street, 5th Floor
Boston, MA 02116-2836
617.927.3000

**Los Angeles**
633 West Fifth Street, 10th Floor
Los Angeles, CA 90071-2225
213.553.2500

**Menlo Park**
1000 El Camino Real, Suite 250
Menlo Park, CA 94025-4327
650.853.1660

**New York**
599 Lexington Avenue, 43rd Floor
New York, NY 10022-7642
212.605.5000

**San Francisco**
353 Sacramento Street, 23rd Floor
San Francisco, CA 94111-3656
415.229.8100

**Washington, D.C.**
1919 Pennsylvania Avenue, NW, Suite 600
Washington, DC 20006-3420
202.912.8900

www.cornerstone.com
securities.cornerstone.com