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Securities Class Action Filings

2008 Mid-Year Assessment

Research Sample

- The Stanford Law School Securities Class Action Clearinghouse, in cooperation with Cornerstone Research, has identified 2,653 federal securities class action filings occurring between January 1, 1997 and June 30, 2008.
- These filings include 313 “IPO Allocation” filings, 69 “Analyst” filings, 49 “Mutual Fund” filings, 38 “Options Backdating” filings, and 97 “Subprime Mortgage/Credit Crunch” filings; the latter category includes 17 filings related to auction rate securities.
- The sample used in this report excludes IPO Allocation, Analyst, and Mutual Fund filings.

Overview

Federal securities class action filings in the first half of 2008 continued the rebound that started in the second half of 2007, following a two-year period of reduced activity. There were 110 filings in the first half of 2008, slightly more than the 107 filings in the second half of 2007 (see Figure 1).[1] In contrast, there were 63 semiannual filings on average in the prior two years (July 2005–June 2007), a level 38.2 percent below the average for the nine years ending June 2005. About half of the filings so far in 2008 were driven by the subprime mortgage/credit crunch, with 58 filings in the first half of the year containing related allegations. If the filing rate for the first half of the year continues in the second, 220 securities class actions will be filed in 2008.

Market capitalization losses for defendant firms associated with filings in the first half of 2008 were higher than the average semiannual losses in the eleven preceding years. Large market capitalization losses for filings in the first half of 2008 and second half of 2007 reflect both the large number of filings and the high average per filing loss in these periods. Disclosure Dollar Losses (DDL) totaled $106 billion in the first half of 2008, a slight drop from the second half of 2007 but one and a half times the historical average. Maximum Dollar Losses (MDL) were $587 billion, a 16.5 percent increase from the second half of 2007 and nearly 70 percent above the historical average.[2] The median market losses in the past six months for both DDL and MDL were more than twice the historical average. The large market capitalization losses associated with filings in the past twelve months rival the historical highs seen in 2000–02.

Figure 1

Complaint Filings Box Score: 6-Month Periods

	Average (1997 H1 – 2007 H2)	2005 H2	2006 H1	2006 H2	2007 H1	2007 H2	2008 H1
Class Action Filings	96	69	62	53	66	107	110
Disclosure Dollar Loss ($ Billions)	$65	$35	$22	$31	$36	$115	$106
Maximum Dollar Loss ($ Billions)	$348	$116	$124	$169	$170	$504	$587

[1] The indices and charts throughout exclude IPO Allocation, Analyst, and Mutual Fund filings. In 2001 there were more than 300 IPO Allocation filings with allegations related to the allocation of shares in initial public offerings. In 2002 there were a number of Analyst filings with allegations that investment banks and individual analysts at these banks had issued research reports and ratings that were neither independent nor objective. Starting in the second half of 2003 there were Mutual Fund filings containing allegations related to market timing, lack of disclosure, and breach of fiduciary duty by mutual fund companies and other financial intermediaries.
[2] Disclosure Dollar Loss and Maximum Dollar Loss are defined in the section titled “Market Capitalization Declines.”

Overview
continued

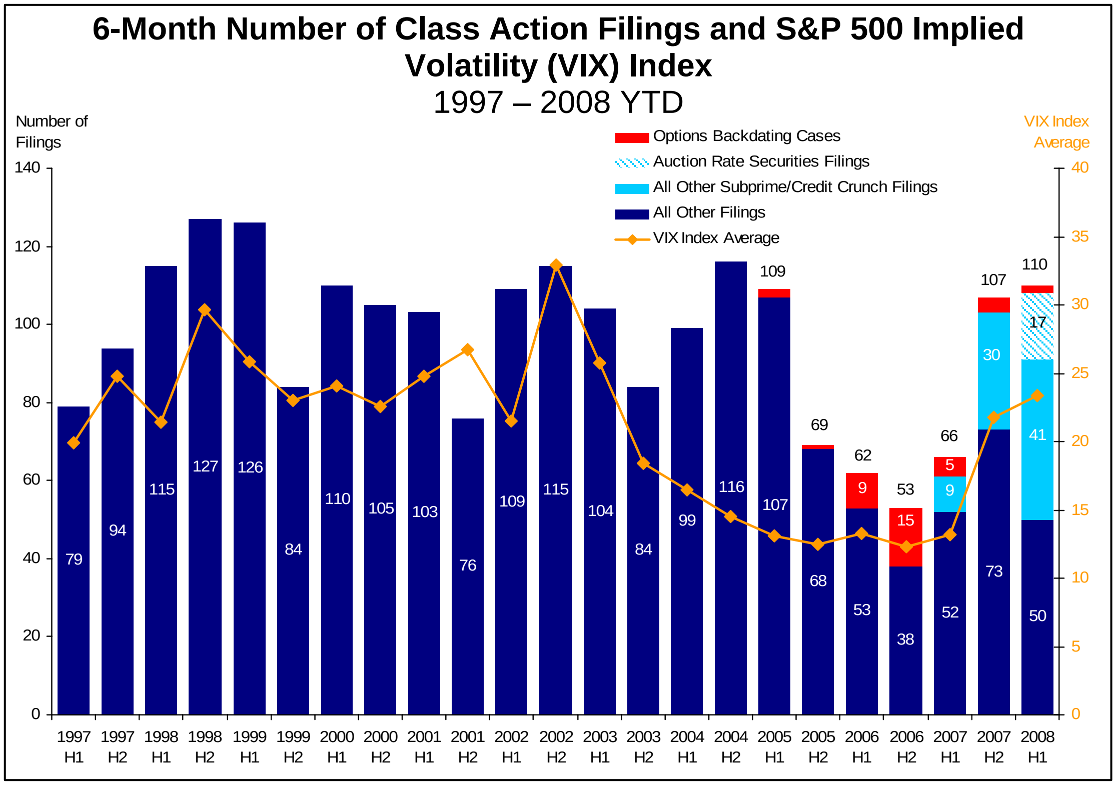
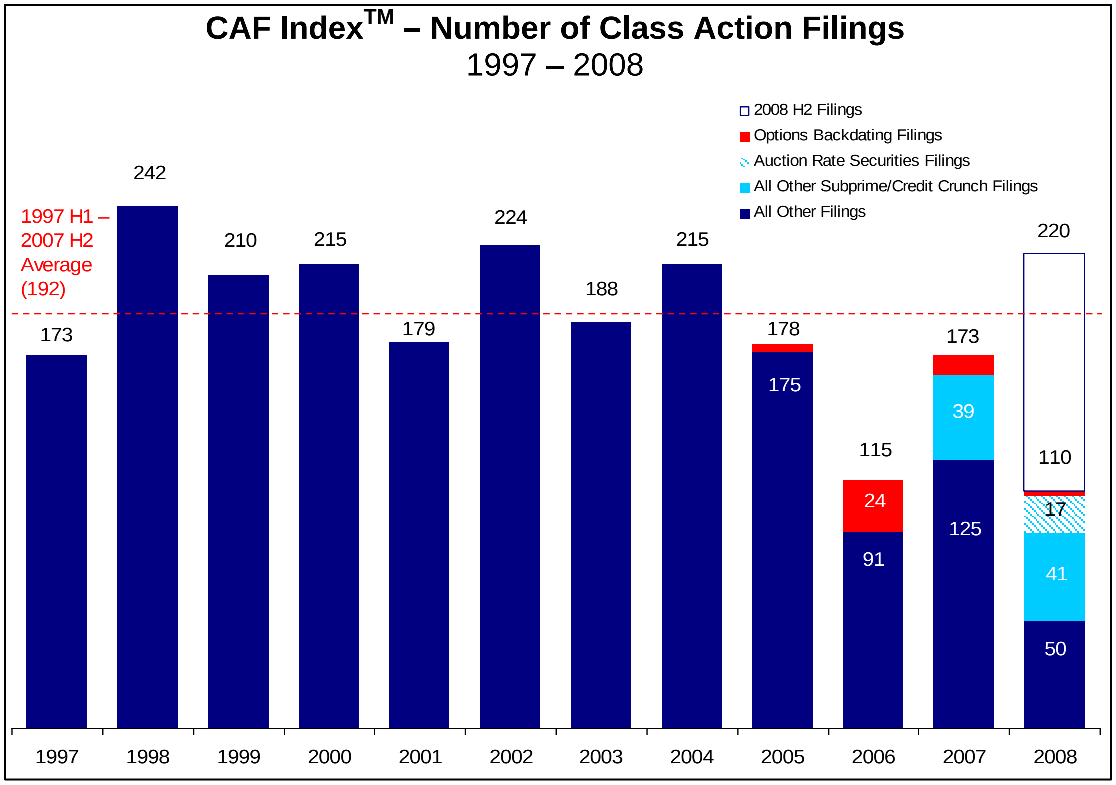


Figure 2

In past reports we suggested that the two-year lull in filing activity that began in mid-2005 was partly due to a strong stock market with low volatility. Consistent with this hypothesis, the high level of filings in the past twelve months coincided with a marked increase in stock market volatility (see Figure 2). Filings jumped from 119 for the twelve months ending June 2007 to 217 for the next twelve months, and stock market volatility doubled over the same time horizon.

Number of Filings

Figure 3

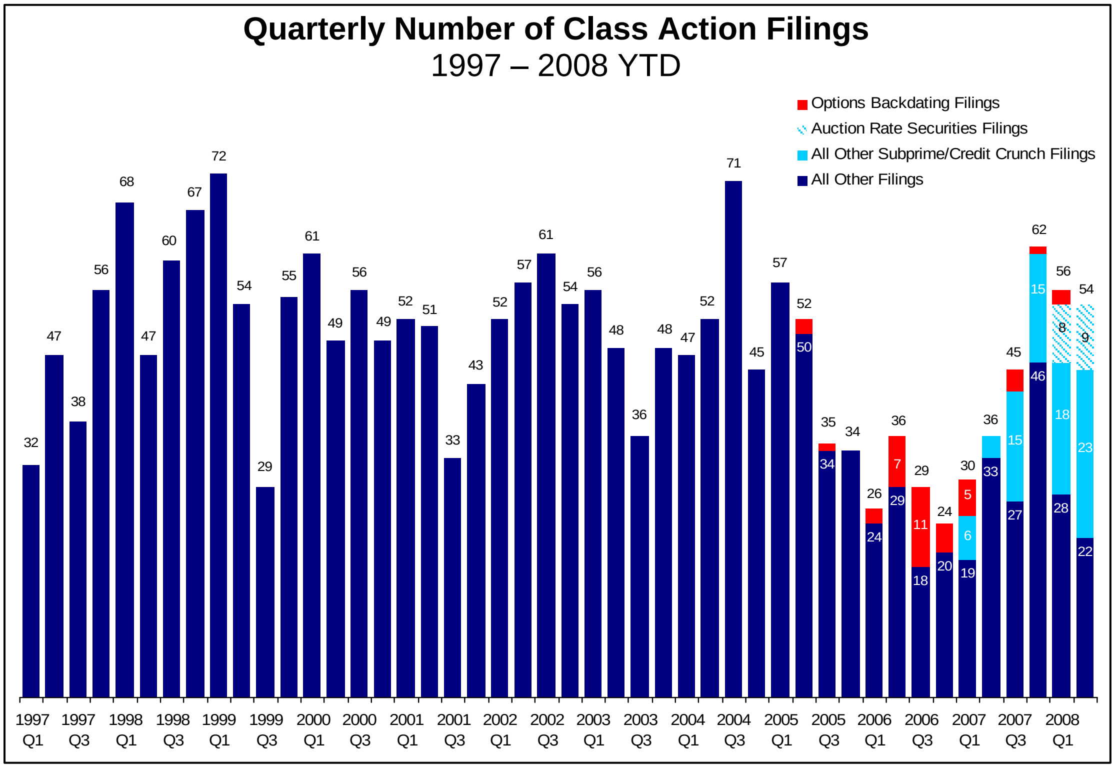


The Class Action Filings Index (CAF Index™) tracks the number of class action filings over time. There were 110 traditional filings in the first half of 2008 (see Figure 3). If this filing frequency persists, the 220 filings in 2008 will represent a 27.2 percent increase over 2007 and a 14.6 percent increase over the annual average for the eleven years ending December 2007. The number of filings in the first half of 2008 was heavily influenced by subprime/credit crunch issues. During this period there were 58 filings related to subprime/credit crunch allegations, 17 of which involved auction rate securities.

Number of Filings
continued

On a quarterly basis, the CAF Index™ shows the short-term fluctuations in litigation activity (see Figure 4). The number of filings fell 9.7 percent between the fourth quarter of 2007 and the first quarter of 2008, and dropped another 3.6 percent in the second quarter of 2008. Despite these declines relative to 2007, the average number of filings in the first two quarters of 2008 was markedly higher than the quarterly average of 31 for the third quarter of 2005 through the second quarter of 2007.

Figure 4



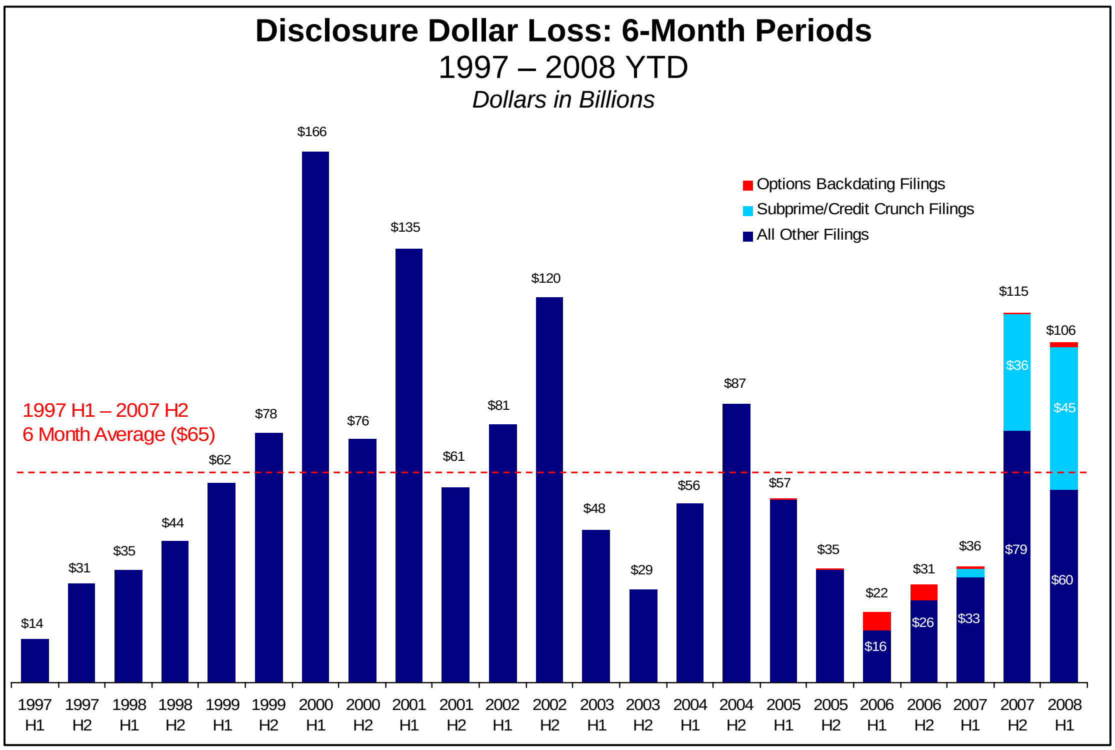
Market Capitalization Losses

To measure the size of class action filings, our second group of indices tracks market capitalization losses for defendant firms during and at the end of class periods.[3] Declines in market capitalization over extended periods may be driven by market and industry factors. To the extent that the observed losses reflect factors unrelated to specific allegations in class action complaints, indices based on class period losses would not be representative of potential defendant exposure in the class action litigation. This is especially relevant for the post-*Dura* securities litigation environment.[4]

We measure market capitalization losses at the *end* of each class period using Disclosure Dollar Loss (DDL). DDL is calculated as the dollar value 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. DDL should not be considered a measure of liability; instead, it estimates 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 Disclosure Dollar Loss Index (DDL Index™) tracks the sum of DDL for all class action lawsuits filed (shown on a semiannual basis in Figure 5).

The DDL Index™ was high in the second half of 2007 and the first half of 2008 relative to historical levels. DDL for the first half of 2008 totaled $106 billion, well above the semiannual average of $65 billion for the eleven years ending December 2007. If this level of disclosure losses persists throughout 2008, DDL for the year would be 40.4 percent higher than in 2007 and 64.9 percent higher than the annual average for the eleven years ending December 2007. This annualized increase in DDL in 2008 relative to 2007 is driven by the higher number of filings and by a higher average DDL per filing.

Figure 5



[3] Filings involving auction rate securities are not included in the market capitalization measures because these securities were not publicly traded.

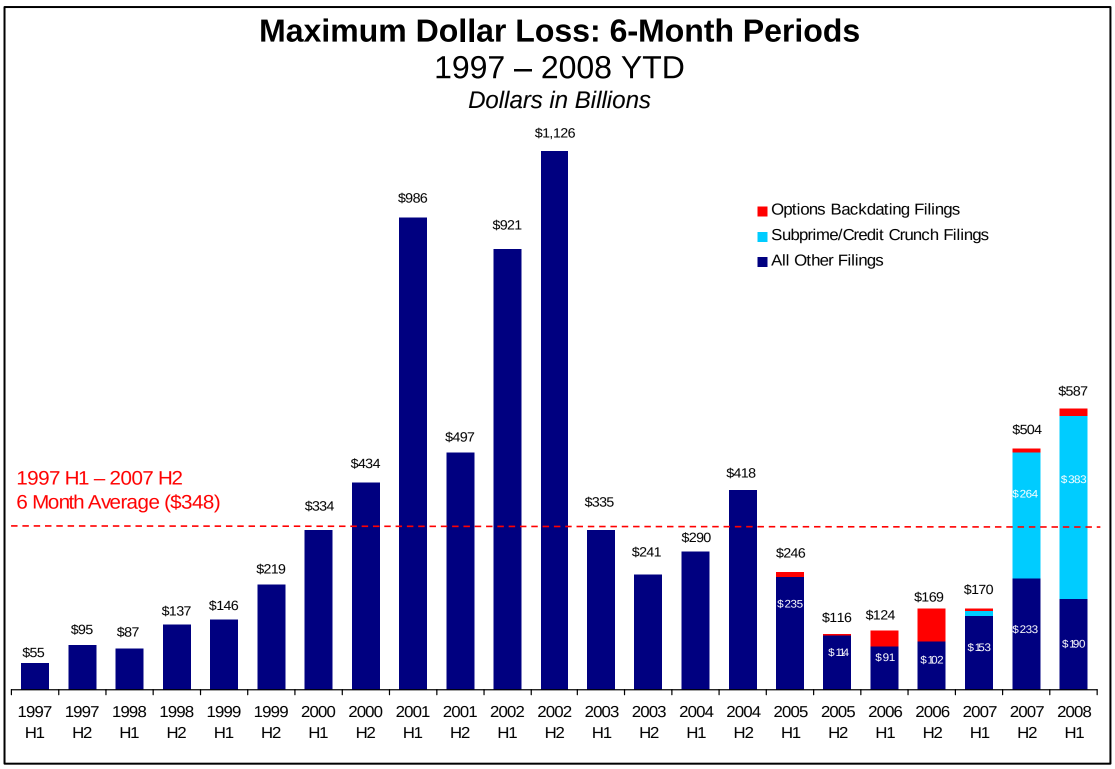
[4] In April 2005 the Supreme Court ruled that plaintiffs in a securities class action case are required to establish a causal connection between alleged wrongdoing and subsequent shareholder losses. See our 2006 report, *Securities Class Action Case Filings 2006: A Year in Review,* for discussion of the *Dura Pharmaceuticals* decision, available at http://securities.cornerstone.com.

Market Capitalization Losses *continued*

We measure the market capitalization loss *during* the class period using Maximum Dollar Loss (MDL). MDL is calculated as the dollar value decrease in the market capitalization of the defendant firm from the trading day when the firm's market capitalization reached its peak during the class period to the trading day immediately following the end of the class period. As with DDL, MDL should not be considered a measure of liability; instead it estimates the impact of the market, industry, and firm-specific information revealed during the class period, including information unrelated to the litigation. The Maximum Dollar Loss Index (MDL Index™) tracks the aggregate MDL for all class action lawsuits filed (shown on a semiannual basis in Figure 6).

As with the DDL Index™, the MDL Index™ shows large declines in market value for filings in the second half of 2007 and the first half of 2008. MDL in the first half of 2008 totaled $587 billion, the fourth highest semiannual total since 1997 and the highest since the second half of 2002. If this level of market value declines persists throughout 2008, MDL for the year would be 74.2 percent higher than in 2007 and 68.8 percent higher than the annual average for the eleven years ending December 2007.

Figure 6



Market Capitalization Losses ***continued***

Figure 7 provides a more detailed look at the typical filing. The median DDL of $243 million in the first half of 2008 was larger than in any previous half-year and more than two times the semiannual average for the eleven years ending December 2007. Similarly, the median MDL of $1.57 billion in the first half of 2008 was larger than in any previous half-year and more than two and a half times the semiannual average for the eleven years ending December 2007.

Figure 7

Filings Comparison: 6-Month Periods

	Average (1997 H1 – 2007 H2)	2005 H2	2006 H1	2006 H2	2007 H1	2007 H2	2008 H1
Class Action Filings	96	69	62	53	66	107	110
Disclosure Dollar Loss							
Total ($ Millions)	$64,575	$35,388	$21,836	$30,545	$36,424	$115,201	$106,466
Average ($ Millions)	$732	$562	$412	$611	$650	$1,164	$1,500
Median ($ Millions)	$110	$167	$129	$97	$148	$136	$243
Median % DDL Decline	23.7%	21.4%	13.6%	14.3%	16.3%	20.0%	18.2%
Maximum Dollar Loss							
Total ($ Billions)	$348	$116	$124	$169	$170	$504	$587
Average ($ Billions)	$3.93	$1.84	$2.34	$3.39	$3.04	$5.09	$8.27
Median ($ Billions)	$0.61	$0.51	$0.42	$0.44	$0.77	$0.64	$1.57

Mega Filings

Analysis of “mega” filings shows that most market capitalization losses associated with class action filings are due to just a few filings.

Disclosure Dollar Loss

In the first half of 2008 there were 7 mega DDL filings—those with a DDL of $5 billion or more. These 7 filings accounted for 63.1 percent of DDL in that period. In 2007 there were 9 mega DDL filings, accounting for 58.4 percent of DDL that year.

Maximum Dollar Loss

In the first half of 2008 there were 17 mega MDL filings—those with an MDL of $10 billion or more. These 17 filings accounted for 85.0 percent of MDL in the first half of 2008, the largest semiannual share in the prior eleven and a half years. This compares with 16 mega MDL filings in 2007, accounting for 74.5 percent of MDL that year. Some of these mega MDL filings were especially large, with 9 filings exceeding $25 billion in 2007 and 6 in the first half of 2008.

Industry

As in the two preceding half-years, the Financial sector led litigation activity as measured by the number of filings, with 63 filings in the first half of 2008. Consumer Non-Cyclical had the next highest level of activity with 19 filings, followed by Consumer Cyclical with 8 filings (see Figure 8).[5] The unusually high activity of Financial filings in 2008 was driven by the subprime/credit crunch, with 56 of the 63 filings related to the crisis. Further, in 2007 and the first half of 2008, 87 of the 97 subprime/credit crunch-related filings were in the Financial sector. Over the eleven years ending December 2007, Consumer Non-Cyclical and Communications had the highest average number of filings, averaging 23 and 18 per half-year, respectively.

The Financial and Consumer Non-Cyclical sectors had the highest DDL in the first half of 2008, together representing 78.7 percent of the total, with Communications dropping from second in 2007 to a distant third in the DDL rankings. Filings in Consumer Non-Cyclical and Communications had the largest average semiannual DDLs in the eleven years ending December 2007.

The Financial sector also had a much higher MDL than any other sector for the second consecutive half-year, and in the first half of 2008 it accounted for 65.2 percent of MDL, up from 49.2 percent in the second half of 2007. This large MDL in Financial was driven by 8 mega MDL filings in the first half of 2008 and 6 mega MDL filings in 2007 in the sector.

During the eleven years ending December 2007, Communications (which includes, under Bloomberg's classification, most Internet-related companies) was the biggest contributor to the MDL Index™. On an annualized basis, MDL in the Communications sector was down 56.3 percent in 2008 relative to 2007, while MDL rose 116.3 percent in all other sectors over the same period. This decline was driven by fewer Communications filings in 2008; there were only 4 filings involving defendants in the Communications sector (including 1 mega MDL filing), down from 32 filings (including 4 mega MDL filings) in 2007.

Figure 8

Filings by Industry: 6-Month Periods

Dollars in Billions

	Class Action Filings							Disclosure Dollar Loss							Maximum Dollar Loss						
Industry	Average 1997 H1 – 2007 H2	2005 H2	2006 H1	2006 H2	2007 H1	2007 H2	2008 H1	Average 1997 H1 – 2007 H2	2005 H2	2006 H1	2006 H2	2007 H1	2007 H2	2008 H1	Average 1997 H1 – 2007 H2	2005 H2	2006 H1	2006 H2	2007 H1	2007 H2	2008 H1
Communications	18	5	8	7	14	18	4	$15	$1	$1	$1	$11	$31	$9	$119	$3	$12	$9	$33	$132	$36
Financial	13	7	8	3	19	30	63	9	3	1	2	2	36	45	45	6	3	7	9	248	383
Consumer Non-Cyclical	23	23	21	15	13	22	19	20	10	11	23	18	40	38	72	39	36	44	99	91	102
Consumer Cyclical	12	16	6	7	8	15	8	4	6	5	0	3	5	4	28	29	35	3	16	21	20
Industrial	9	6	6	7	7	5	6	4	2	1	1	1	1	1	16	10	2	6	10	2	2
Technology	15	9	10	12	3	9	5	9	14	2	4	0	3	2	49	29	35	101	1	8	16
Energy	2	2	2	2	2	4	3	2	0	0	0	0	0	5	9	0	1	1	2	1	25
Utilities	2	1	0	0	0	1	1	1	0	0	0	0	0	0	7	0	0	0	0	0	1
Basic Materials	2	0	1	0	0	3	1	0	0	0	0	0	0	0	2	0	0	0	0	0	3
Total	96	69	62	53	66	107	110	$65	$35	$22	$31	$36	$115	$106	$348	$116	$124	$169	$170	$504	$587

[5] This analysis uses the sector classifications provided by Bloomberg Finance. 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. 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 Consumer Non-Cyclical sector includes agriculture, beverages, biotechnology, commercial services, cosmetics/personal care, food, healthcare products, healthcare services, household products/wares, and pharmaceuticals.

Subprime/Credit Crunch

Subprime Mortgage Market

Troubles in the subprime mortgage market and the related credit crunch continued in the first half of 2008. The crisis—which escalated in 2007 as default rates on subprime loans skyrocketed and financial institutions began to call in their loans—caused a flood of foreclosures and a severe tightening in credit markets. It led to an increase in bankruptcy filings in 2007, a trend expected to continue in 2008. According to the Jones Day law firm, four of the ten largest bankruptcy filings in 2007 were directly related to the subprime/credit crunch, and at least fifty subprime lenders filed for bankruptcy or ceased doing business.[6]

Moreover, the subprime/credit crunch fallout affected the financial results of many solvent companies. In June 2008 more than $350 billion in writedowns were associated with the crisis.[7] The International Monetary Fund (IMF) has estimated that "losses and writedowns on U.S. assets could total $945 billion."[8]

As noted, there were 58 subprime/credit crunch-related filings in the first half of 2008, including 17 related to auction rate securities. The 41 remaining subprime/credit crunch-related filings accounted for $45 billion in DDL in the first half of 2008 (41.9 percent of the total) and $383 billion in MDL (65.3 percent of the total). Further, 2 of the 7 mega DDL filings and 10 of the 17 mega MDL filings in 2008 were due to subprime/credit crunch allegations.

Auction Rate Securities

During the first half of 2008 there were 17 cases filed against underwriters and brokers of auction rate securities. Auction rate securities are long-term bonds that are repackaged into securities whose rates are reset either weekly or monthly in an auction system. These securities were allegedly marketed to investors as liquid assets and as an alternative to money market funds. In early 2008 many of the auctions in this $330 billion market failed to attract enough bidders, leaving investors with illiquid auction rate securities.[9] The complaints in the 17 cases filed against the underwriters and brokers allege that they misinformed investors about the liquidity of auction rate securities. The Securities and Exchange Commission is currently investigating sales practices for these securities.[10]

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[6] Stephen Taub, "Subprime Crisis Foments Bankruptcy Surge," *CFO.com*, March 12, 2008.
[7] Landon Thomas, Jr., "Prosecutors Build Bear Stearns Case on E-Mails," *nytimes.com*, June 20, 2008.
[8] Krishna Guha, "IMF Points to High Cost of Global Credit Crisis," *FT.com*, April 8, 2008.
[9] Liz Rappaport and Craig Karmin, "Train Pulls Out on New Corner of Debt Market—Auction-Rate Securities Failing to Draw Bidders; A Toll on Port Authority," *The Wall Street Journal*, February 14, 2008.
[10] Jaime Levy Pessin, "Auction-Rate Securities Probed," *The Wall Street Journal*, April 8, 2008.

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