

CORNERSTONE RESEARCH

Economic and Financial Consulting and Expert Testimony

Accounting Class Action Filings and Settlements

2018 Review and Analysis

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Executive Summary

Securities class action filings involving accounting allegations remained at uncharacteristically high levels as the trend of core filings against larger defendant firms continued. The total value of accounting class action settlements rebounded to the second-highest level in the last 10 years, with all five mega settlements involving an accounting allegation.

- There were 143 securities class actions involving accounting allegations (accounting case filings) during 2018, nearly 86 percent more than the historical average.¹ (page 2)
- Total accounting case filings far exceeded post-PSLRA (Private Securities Litigation Reform Act) levels for the second year in a row. The total was driven by the filing of 79 merger and acquisition (M&A) accounting case filings alleging failure to reconcile a non-GAAP measure to a GAAP measure.² (pages 2, 4)
- Market capitalization losses for core accounting case filings³ rose to its highest level in the last 10 years as the trend of filings against larger defendant firms continued. (pages 5, 10)
- The number of accounting case settlements declined relative to 2017 and the prior five years but remained above the lows in 2011–2012. (page 8)
- The value of accounting case settlements more than quintupled compared to the prior year, comprising almost 90 percent of total settlement value in 2018. (page 9)
- The average settlement for accounting cases increased dramatically due to a handful of large settlements. In addition, the median settlement amount for accounting cases overall increased by almost 60 percent, indicating a broader shift in the typical case size.⁴ (pages 1, 11)

Figure 1: Filings and Settlements Summary Statistics

(Dollars in Millions)

	Accounting Cases		Non-Accounting Cases	
	2017	2018	2017	2018
Filings Summary				
Total Number of Filings	165	143	247	260
Total Number of Core Filings	58	64	152	157
Total Disclosure Dollar Losses (DDL)	\$20,103	\$53,864	\$114,903	\$276,863
Settlements Summary				
Number of Settlements	49	41	32	37
Total Settlement Value	\$882.6	\$4,481.4	\$628.5	\$582.9
Median Settlement	\$6.0	\$9.5	\$4.2	\$14.8
Average Settlement	\$18.0	\$109.3	\$19.6	\$15.8

Note: Total Number of Filings includes core and M&A cases; Total Disclosure Dollar Losses and settlements figures reflect core cases only. Dollar values are adjusted for inflation; 2018 dollar equivalent figures are used.

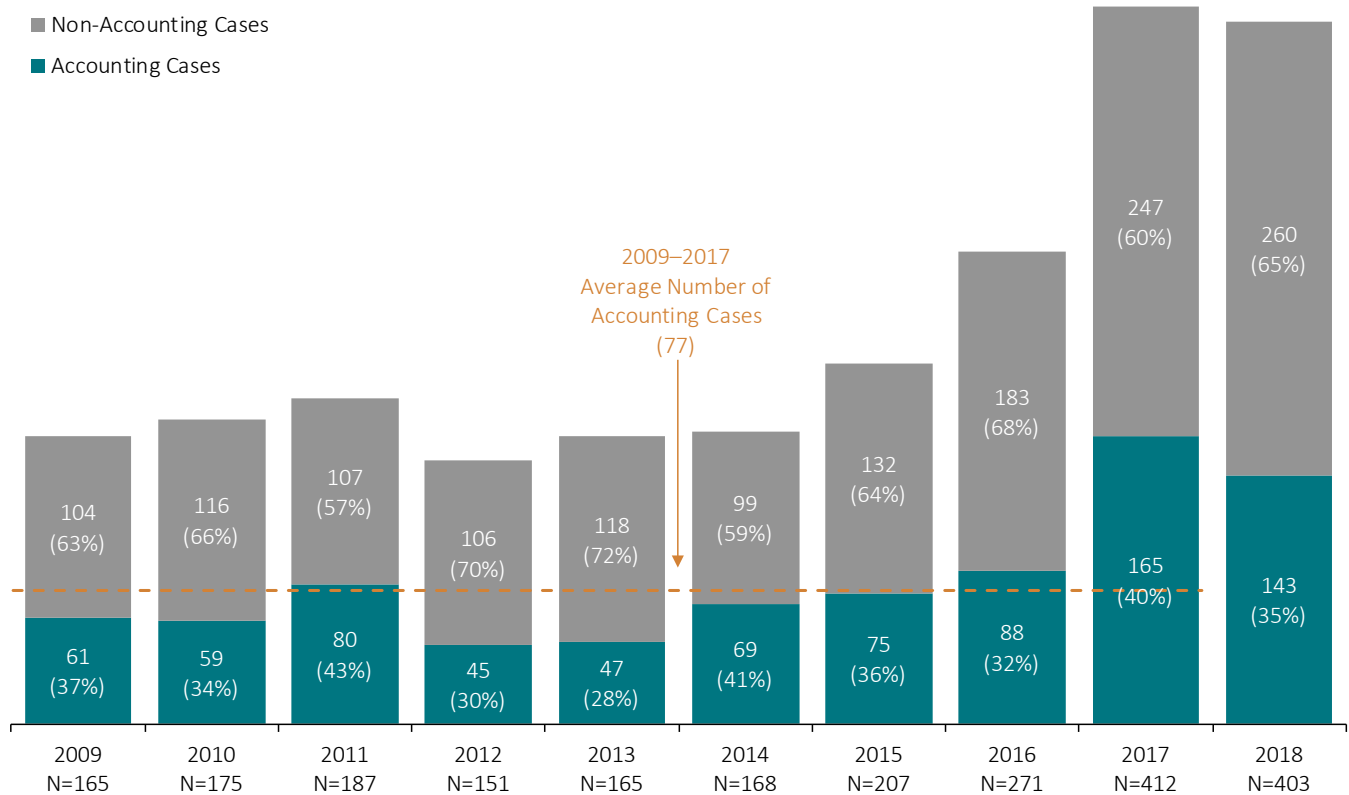
Filings

Number of Accounting Case Filings

- Plaintiffs filed 143 accounting cases in 2018, the second highest on record after 2017.
- Accounting case filings declined by 13 percent in 2018, driven by fewer M&A-related accounting case filings.
- Despite the decline in accounting case filings in 2018, the proportion of accounting cases to total cases (35 percent), remained consistent with the historical average proportion (36 percent).
- The total number of accounting case filings in 2018 was 86 percent higher than the 2009–2017 average of 77.

Total accounting case filings remained at near record levels.

Figure 2: Accounting Case Filings as a Percentage of Total Filings 2009–2018



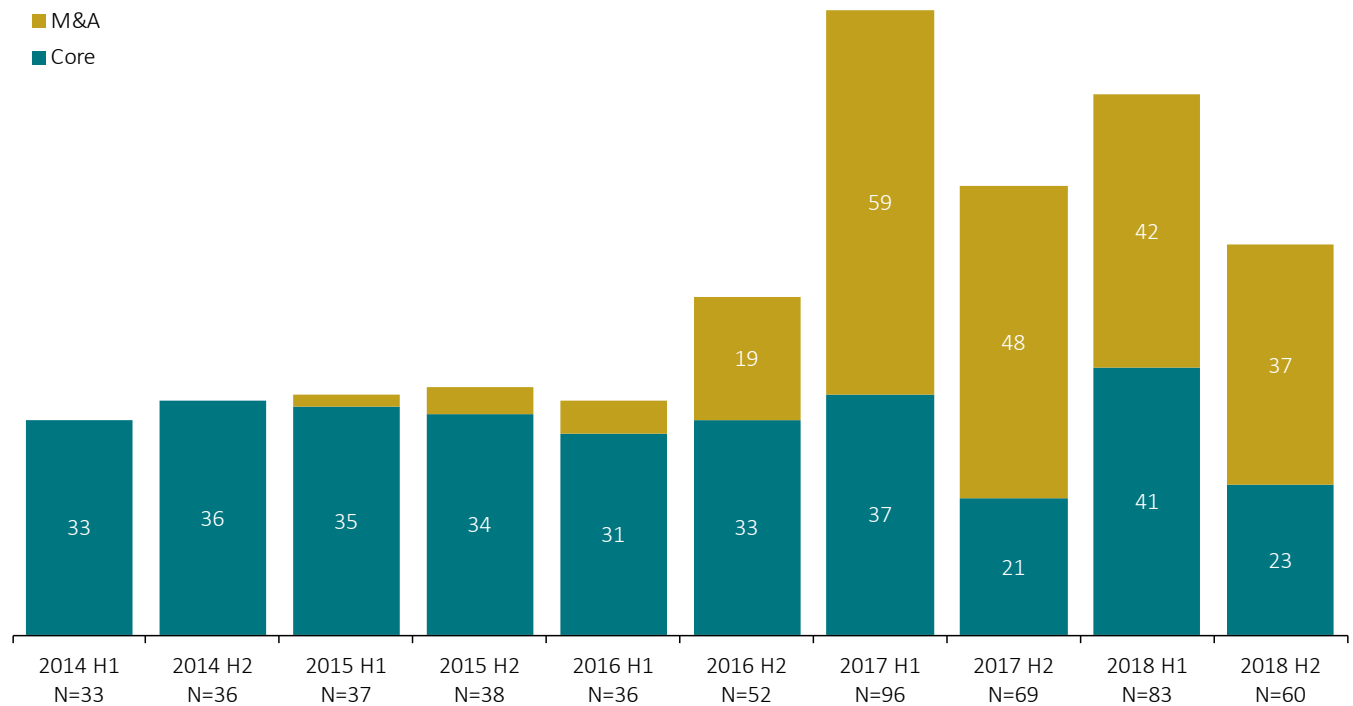
Note: N refers to the number of observations.

Semiannual Accounting Case Filings

- Total accounting case filing activity decreased by 28 percent in the second half of 2018 compared to the first half of the year.
- The second-half decline in 2018 accounting case filings (28 percent) is significantly greater than the second-half decline in total filings (2 percent).
- Although the pace of M&A accounting case filings slowed in the second half of 2018, the number of cases filed remained at relatively high levels.
- Two-thirds of core accounting cases were filed in the first half of 2018, mirroring the filing activity in 2017.

For the second consecutive year, the pace of accounting case filings slowed significantly in the latter half of the year.

Figure 3: Semiannual Accounting Case Filings 2014–2018

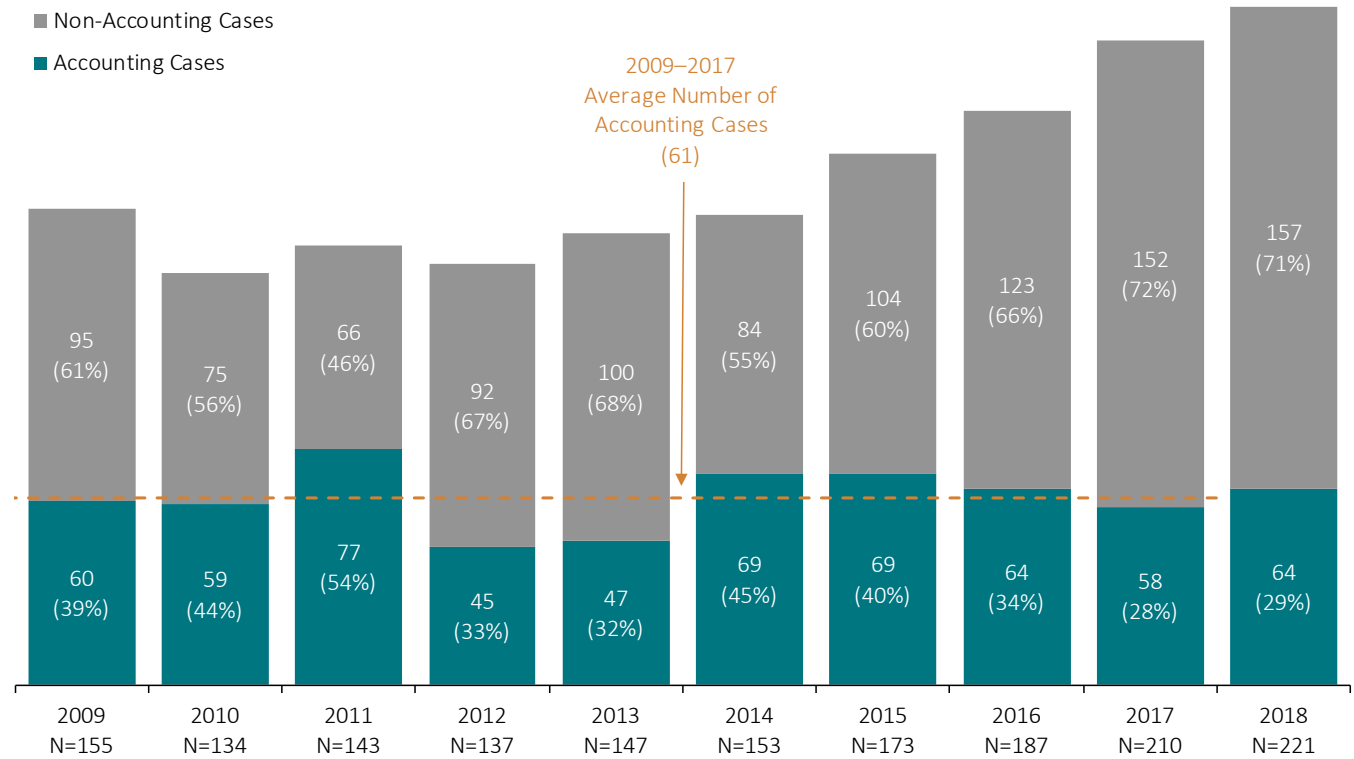


Core Accounting Case Filings

- There were 64 core accounting case filings in 2018, an increase of 10 percent from 2017.⁵
- As a percentage of total core filings, core accounting cases were largely unchanged from 2017. The number of accounting case filings in 2018 was slightly higher than the 2009–2017 average.

The number of core accounting case filings increased for the first time since 2014.

Figure 4: Core Accounting Case Filings as a Percentage of Total Core Filings 2009–2018



Core Accounting Case Filings and Market Capitalization Losses

Disclosure Dollar Loss Index® (DDL Index®)

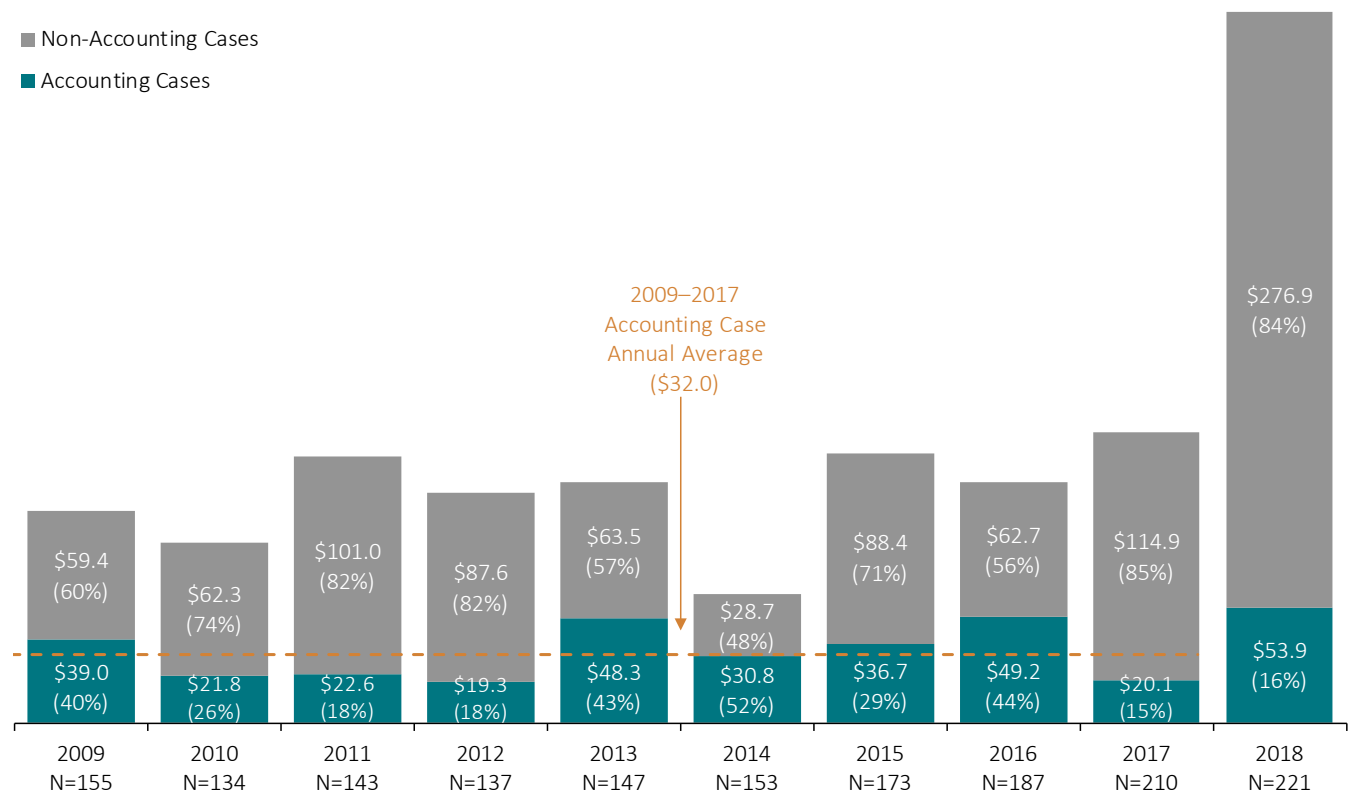
This index measures the aggregate DDL for all filings over a period of time. DDL is the dollar value change in the defendant firm’s market capitalization between the trading day immediately preceding the end of the class period and the trading day immediately following the end of the class period. DDL should not be considered an indicator of liability or measure of potential damages.

The DDL Index for accounting cases increased to its highest level in the last 10 years.

- DDL for accounting cases in 2018 was 68 percent greater than the average annual DDL for all accounting cases over the last 10 years.
- In 2018, there were three accounting cases with a DDL of at least \$5 billion (mega DDL cases). The three mega DDL cases accounted for approximately one-third of the total accounting case DDL in 2018.
- The increase in 2018 DDL was not solely the result of mega DDL cases—DDL for accounting case filings increased by approximately 80 percent excluding mega DDL cases. This trend is consistent with the increase in the size of issuer defendants as measured by market capitalization.

Figure 5: Disclosure Dollar Loss Index® (DDL Index®) 2009–2018

(Dollars in Billions)



Note: DDL dollars are adjusted for inflation; 2018 dollar equivalent figures are used.

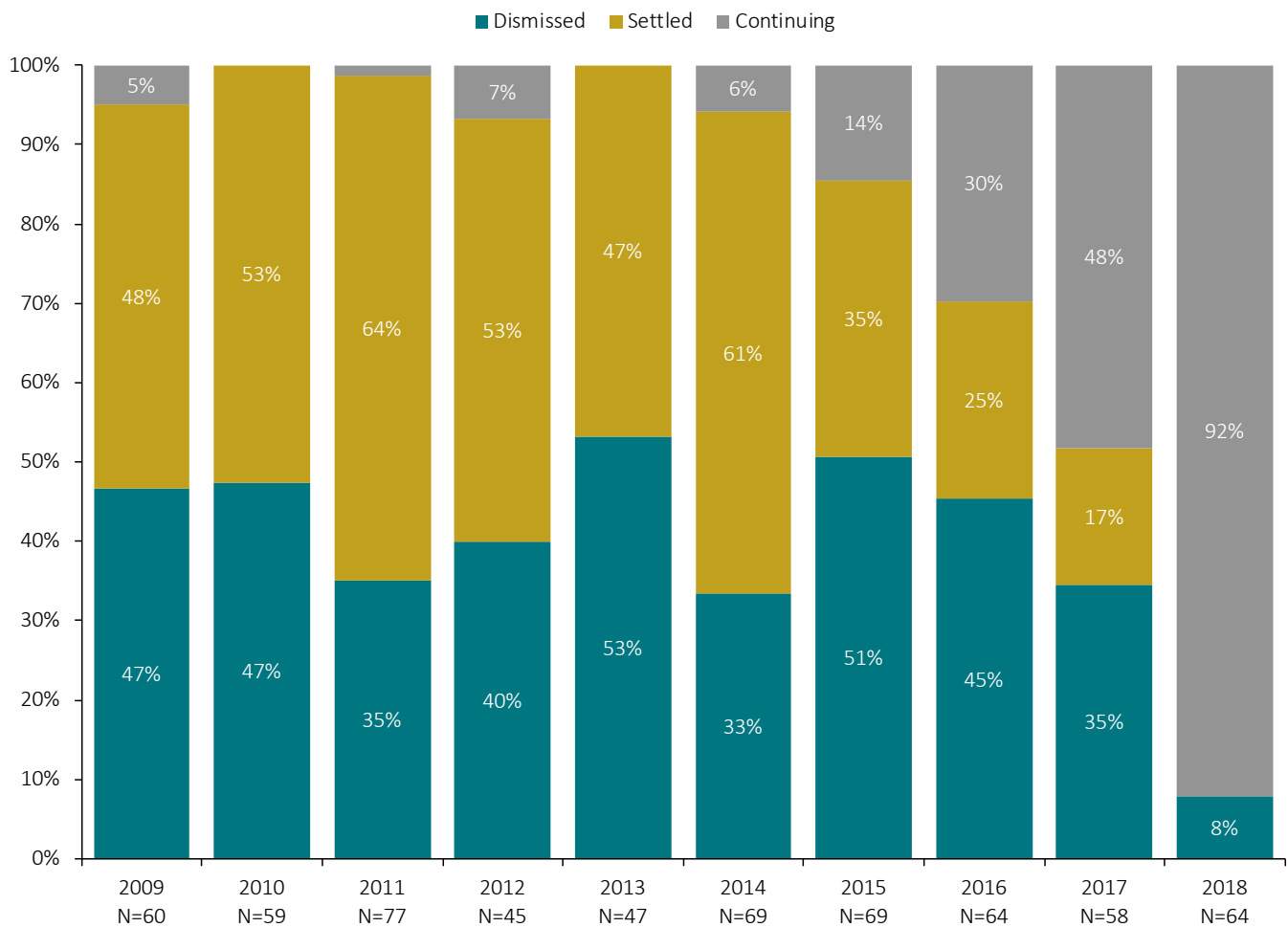
Status of Core Accounting Case Filings

This analysis examines whether filing outcomes have changed over time and compares the outcomes of filing cohort groups. As each cohort ages, a larger percentage of cases are resolved—whether through dismissal, settlement, or trial verdict outcome.

- From 2009 through 2017, 45 percent of core accounting cases settled, 43 percent were dismissed, and 12 percent are continuing.
- Dismissal rates for M&A accounting cases filed in the past two years have been significantly higher than the rates for core accounting cases. The majority of 2017 and 2018 M&A accounting cases have been dismissed—94 percent and 68 percent, respectively.

Core accounting cases filed from 2009 through 2017 were almost 50 percent more likely to settle than core non-accounting cases.

Figure 6: Status of Core Accounting Case Filings by Year 2009–2018



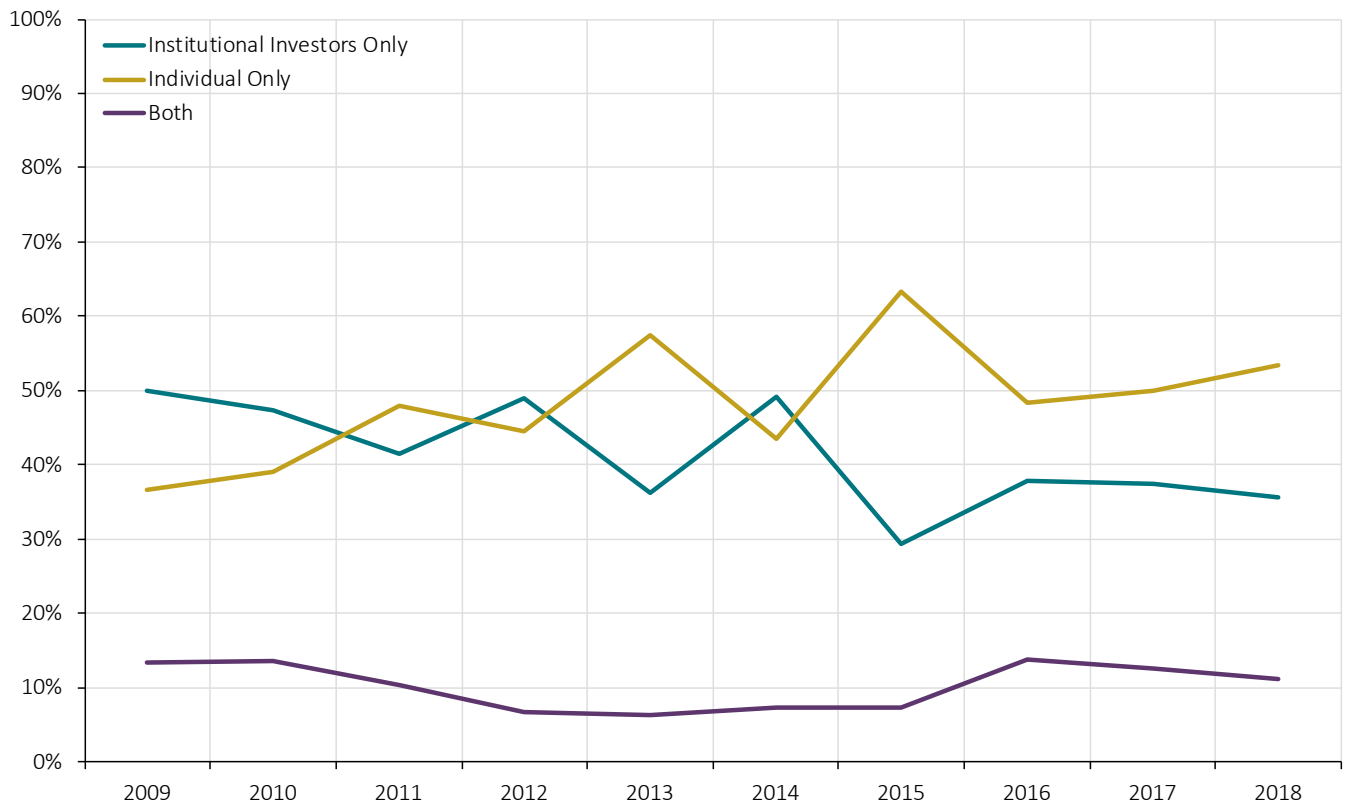
Core Accounting Case Filings by Lead Plaintiff

This analysis examines how frequently individual or institutional investors were appointed as lead plaintiffs in core accounting cases.

Individuals were more often appointed as the lead plaintiff in core accounting cases in each of the last four years.

- On average, individual investors were appointed as lead plaintiffs in 48 percent of core accounting cases over the last 10 years.
- Institutional investors were appointed as lead plaintiffs more often than individual investors in only four of the last 10 years and not since 2014. A similar pattern exists for all core securities class action filings.⁶

Figure 7: Percentage of Core Accounting Case Filings by Lead Plaintiff 2009–2018



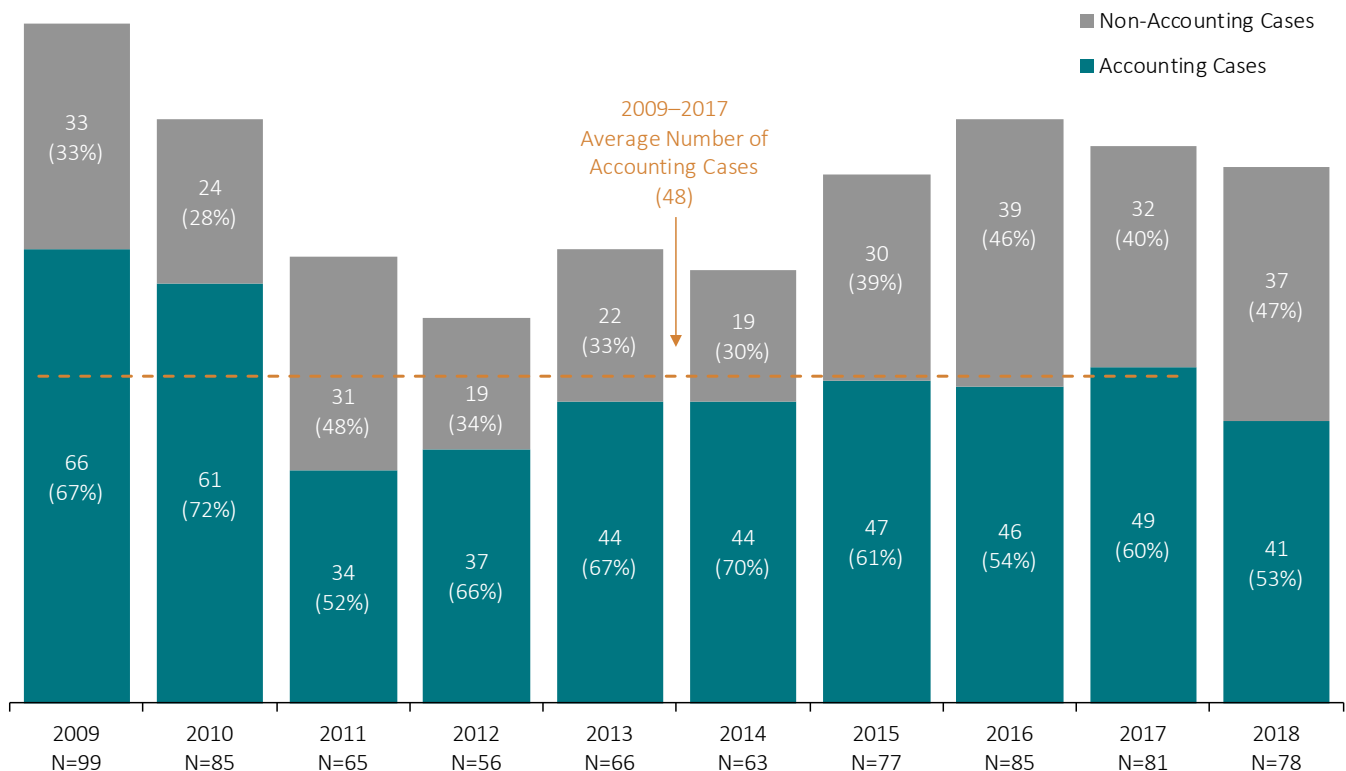
Settlements

Number of Accounting Case Settlements

- The proportion of accounting case settlements in relation to all settlements decreased in 2018 to the second-lowest level over the last 10 years.
- The number of accounting cases as a percentage of settlements remained higher than the percentage of filings. This is because accounting cases have historically been less likely to be dismissed (and thus more likely to settle), and accounting allegations are often added as cases progress beyond the initial complaint.
- Each of the three plaintiff law firms that have been associated with event-driven litigation⁷ was involved as lead or co-lead counsel in more accounting case settlements than any other plaintiff law firm. This may suggest that even cases initially brought as a result of an operating event often incorporate accounting allegations prior to reaching settlement.

Although fewer than the last several years, the number of accounting case settlements remained above the lows in 2011–2012.

Figure 8: Accounting Case Settlements as a Percentage of Total Settlements 2009–2018



Accounting Case Settlement Size

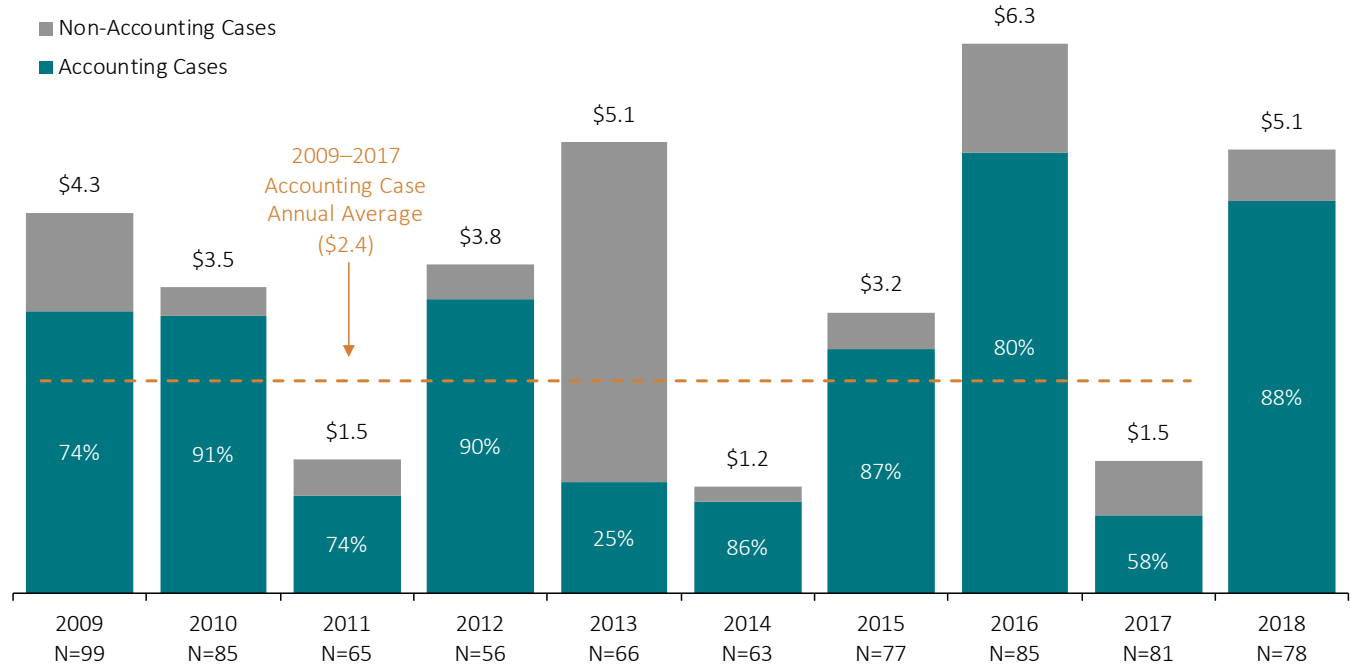
- With the addition of settlements in 2018, total settlement dollars for all post-PSLRA cases reached more than \$100 billion, of which approximately \$86 billion comprised accounting case settlements.
- Total settlement dollars continues to vary substantially from year to year due to the presence or absence of very large settlements.
- At \$4.48 billion, the total settlement value of accounting cases in 2018 was the second highest over the last 10 years.

The aggregate settlement value for accounting cases in 2018 rebounded to almost 90 percent of all settled cases.

- Overall, in 2018, five settlements were \$100 million or more (mega settlements). All five of these settlements involved alleged weaknesses in internal controls,⁸ and four out of the five involved allegations of GAAP violations.

Figure 9: Accounting Case Settlement Dollars as a Percentage of Total Settlement Dollars 2009–2018

(Dollars in Billions)



Note: Settlement dollars are adjusted for inflation; 2018 dollar equivalent figures are used.

Firm Size

Core Accounting Cases by Firm Size

This analysis examines whether the size of defendant firms has changed over time based on their pre-disclosure market capitalization.

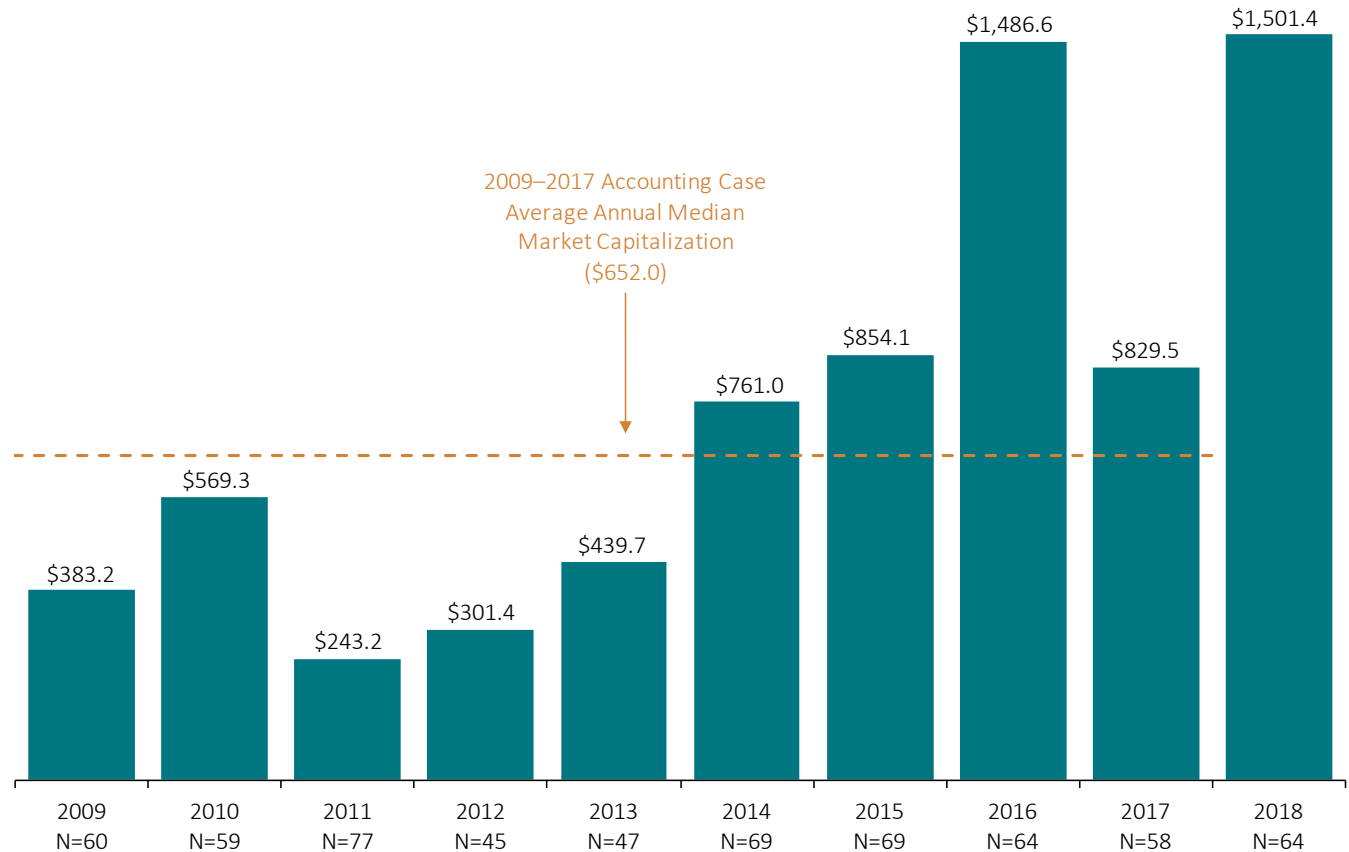
- Over the past five years, accounting cases have been filed against larger issuer defendants than in prior years.
- At \$1.5 billion, median market capitalization of issuer defendants was more than double the 2009–2017 average.

- Median market capitalization in 2018 for issuer defendants in the Industrial sector was more than five times greater than the median market capitalization for all core accounting cases.

The size of issuer defendants reached a record level in 2018.

Figure 10: Core Accounting Cases and Median Market Capitalization of Issuer Defendants 2009–2018

(Dollars in Millions)



Note: Market capitalization dollars are adjusted for inflation; 2018 dollar equivalent figures are used.

Accounting Case Settlements by Firm Size

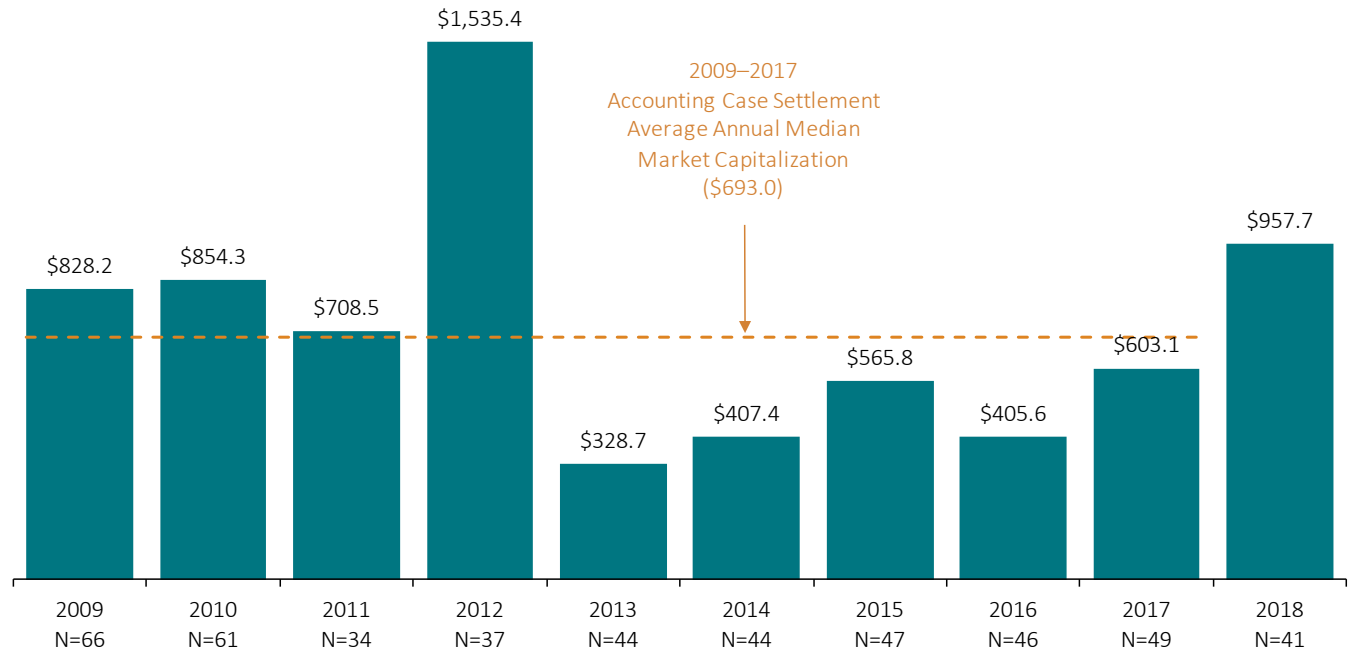
- In 2018, the size of issuer defendants involved in accounting case settlements, as measured by median market capitalization, increased by almost 60 percent compared to 2017.

The median size of issuer defendants in accounting case settlements was the second largest in the last 10 years.

- Larger issuer defendant firms are generally associated with higher accounting case settlement amounts.
- Historically, accounting cases involving larger issuer defendants have also been associated with institutional lead plaintiffs and longer periods from filing to settlement; however, neither of these patterns was true in 2018.

Figure 11: Accounting Case Settlements and Median Market Capitalization of Issuer Defendants 2009–2018

(Dollars in Millions)



Note: Settlement dollars are adjusted for inflation; 2018 dollar equivalent figures are used.

Industry

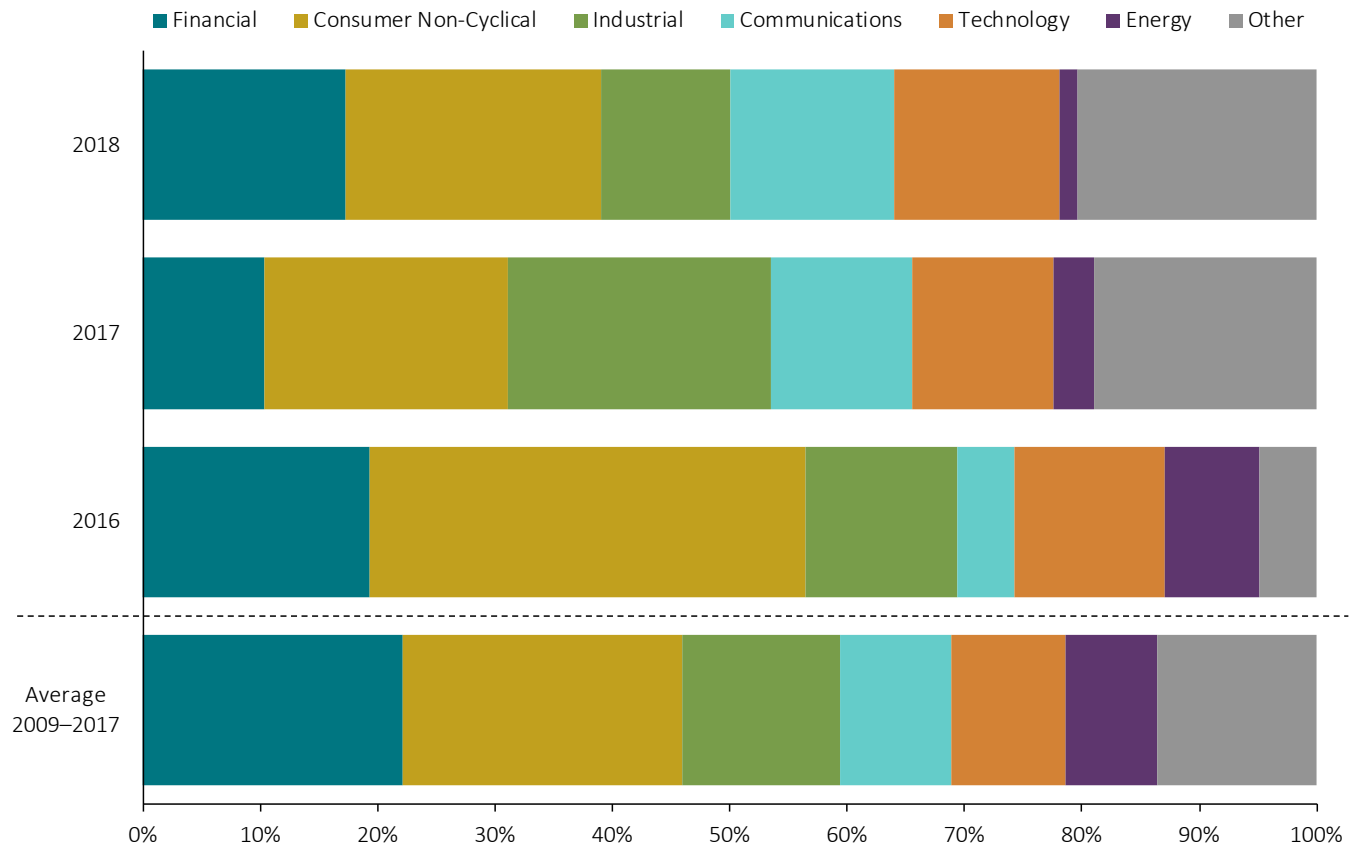
Core Accounting Case Filings by Industry

- Despite the large increase in DDL for Industrial sector accounting cases, the number of cases in this sector decreased by 46 percent from 2017, dropping below its historical average.
- There were more cases in the Consumer Non-Cyclical sector (which includes biotechnology, healthcare, and pharmaceutical companies) than any other sector. The DDL for these cases was over 20 percent greater than the historical average for this sector.
- The number of accounting cases filed in the Financial sector increased by 83 percent in 2018.

The DDL for accounting cases in the Industrial sector in 2018 was the highest among all sectors for the second consecutive year.

- Cases in the Energy sector declined for the second year to their lowest level since 2009.

Figure 12: Number of Core Accounting Case Filings by Industry



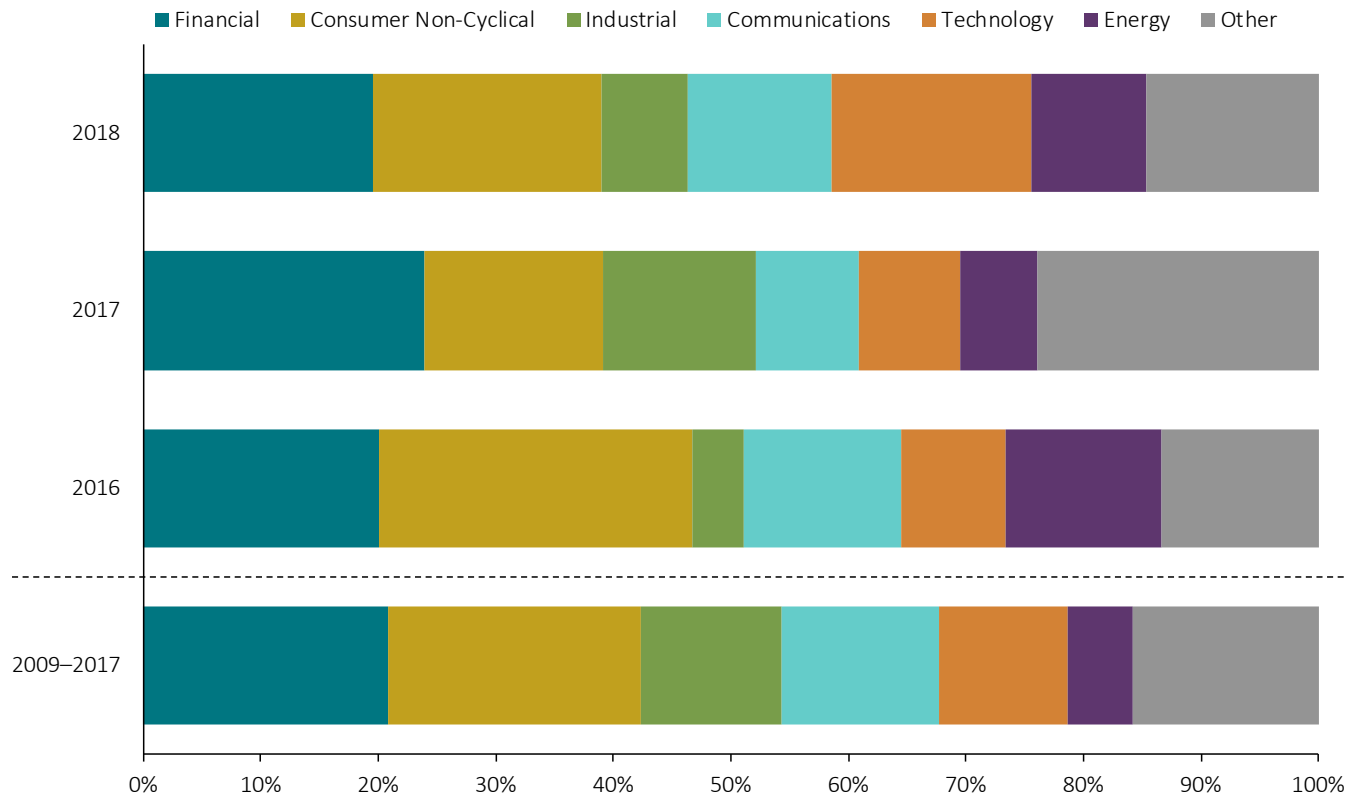
Note: Industries that comprise “Other” are Consumer Cyclical, Basic Materials, Utilities, and Diversified.

Accounting Case Settlements by Industry

- Energy sector accounting case settlements represented nearly 70 percent of the total dollar value for all accounting settlements even though they only comprised 10 percent of accounting settlements.
- In 2018, the dominance of Energy sector accounting case settlements is in sharp contrast to non-accounting cases, which had no Energy sector settlements.
- The number of accounting case settlements in the Financial sector was similar to 2016 and earlier years. However, the proportion of accounting case settlement dollars represented by financial firms was substantially lower, indicating that these cases settled for smaller amounts than in prior years.
- The number of accounting case settlements in the Consumer Non-Cyclical sector increased slightly, but the value of these settlements declined over 30 percent compared to 2017.

The number of accounting case settlements in the Technology sector in 2018 increased 55 percent compared to the average for 2009–2017.

Figure 13: Number of Accounting Case Settlements by Industry



Note: Industries that comprise “Other” are Consumer Cyclical, Basic Materials, and Utilities.

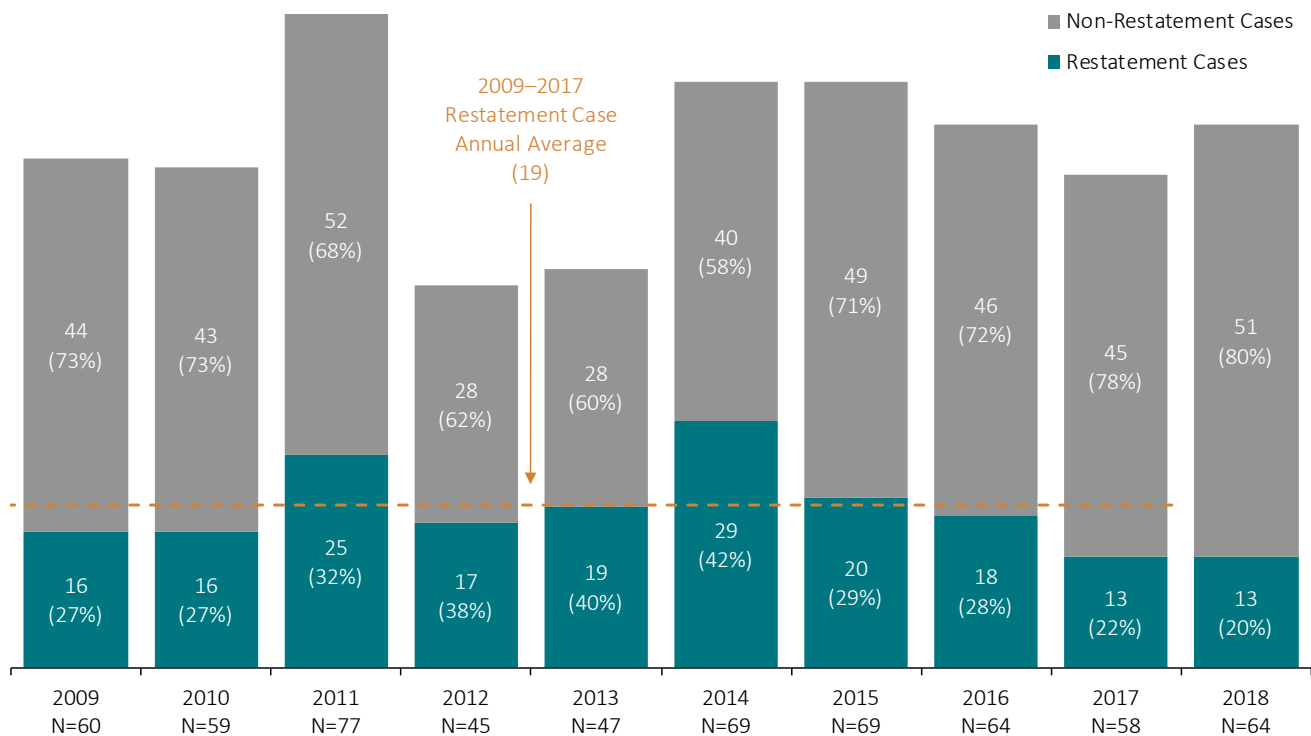
Restatements

Core Accounting Case Filings Involving Restatements

- Cases involving financial statement restatements were 20 percent of the total number of core accounting cases.
- Companies in the Technology and Industrial sectors accounted for more than half of the restatement cases. Only one other sector, Basic Materials, had more than one case.

The DDL for accounting cases involving restatements was at its highest level in four years.

Figure 14: Core Accounting Case Filings Involving Restatements 2009–2018

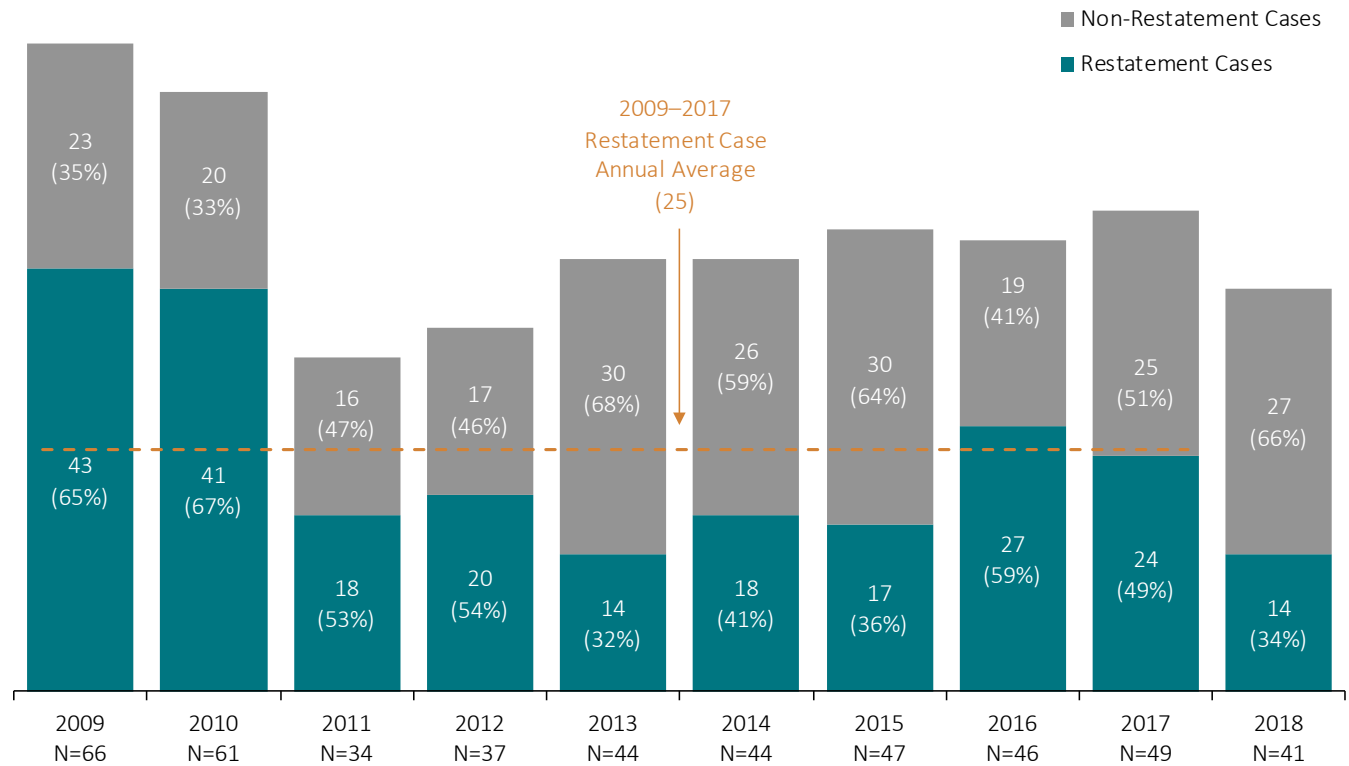


Accounting Case Settlements Involving Restatements

- Both the number and proportion of accounting case settlements involving financial statement restatements was the lowest since 2013.
- The decline in settlements involving restatements is consistent with observations made in other literature regarding an overall decline in the number of financial statement restatements by publicly traded firms in the United States.⁹
- Settled cases involving restatements tend to involve allegations of internal control weaknesses and longer class periods.
- Similar to accounting cases overall, the three plaintiff law firms that have been associated with the rise in event-driven litigation were also frequently involved with settlements involving restatements. Specifically, these three firms served as lead plaintiff counsel in 10 out of 14 settlements involving restatements (sometimes with other co-lead counsel).

Three out of the five largest securities class action settlements in 2018 involved financial statement restatements.

Figure 15: Accounting Case Settlements Involving Restatements 2009–2018



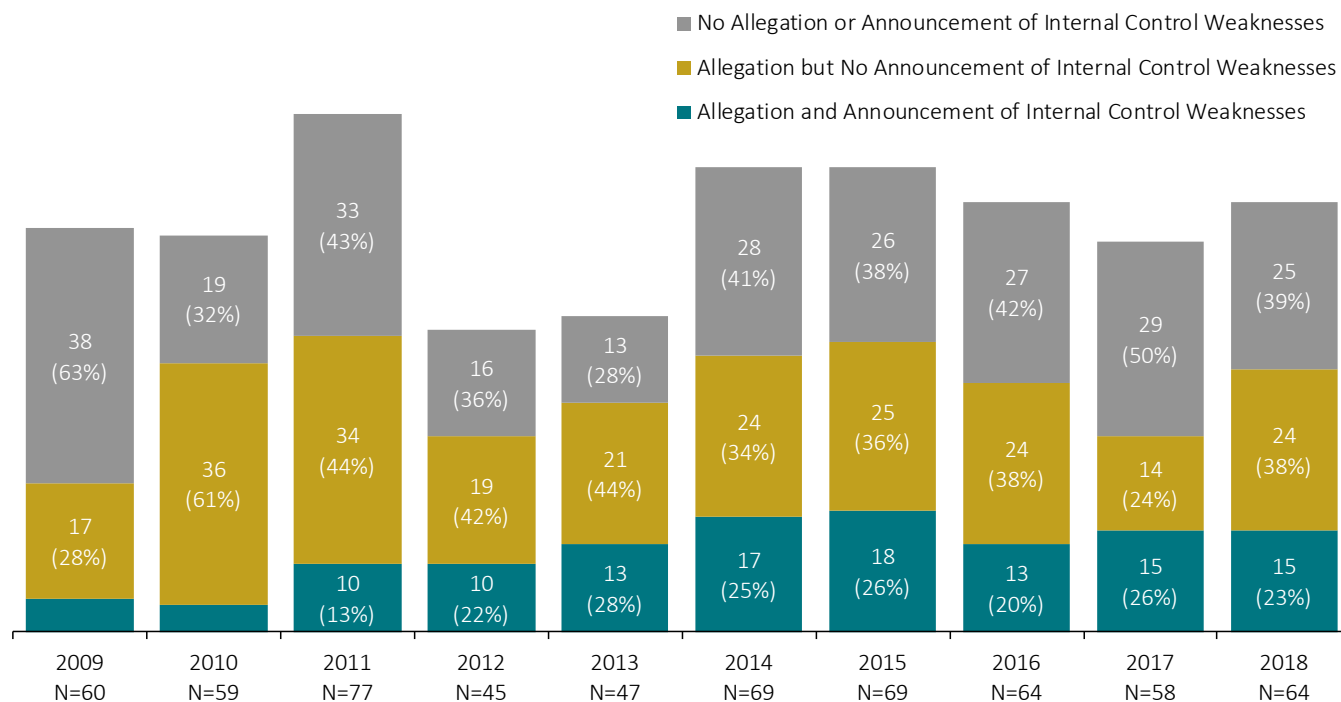
Internal Control Weaknesses

Core Accounting Case Filings Involving Allegations of Internal Control Weaknesses

- After a significant drop in 2017, cases with an allegation of an internal weakness but no announcement of an internal control weakness returned to historical levels.
- The number of accounting cases containing an allegation *and* announcement of internal control weaknesses exceeded the historical average for the sixth consecutive year.
- Allegations of internal control weaknesses arose in more than three out of four restatement cases.

The DDL for accounting cases with an allegation of internal control weaknesses was at its highest level in five years.

Figure 16: Core Accounting Case Filings Involving Allegations of Internal Control Weaknesses 2009–2018

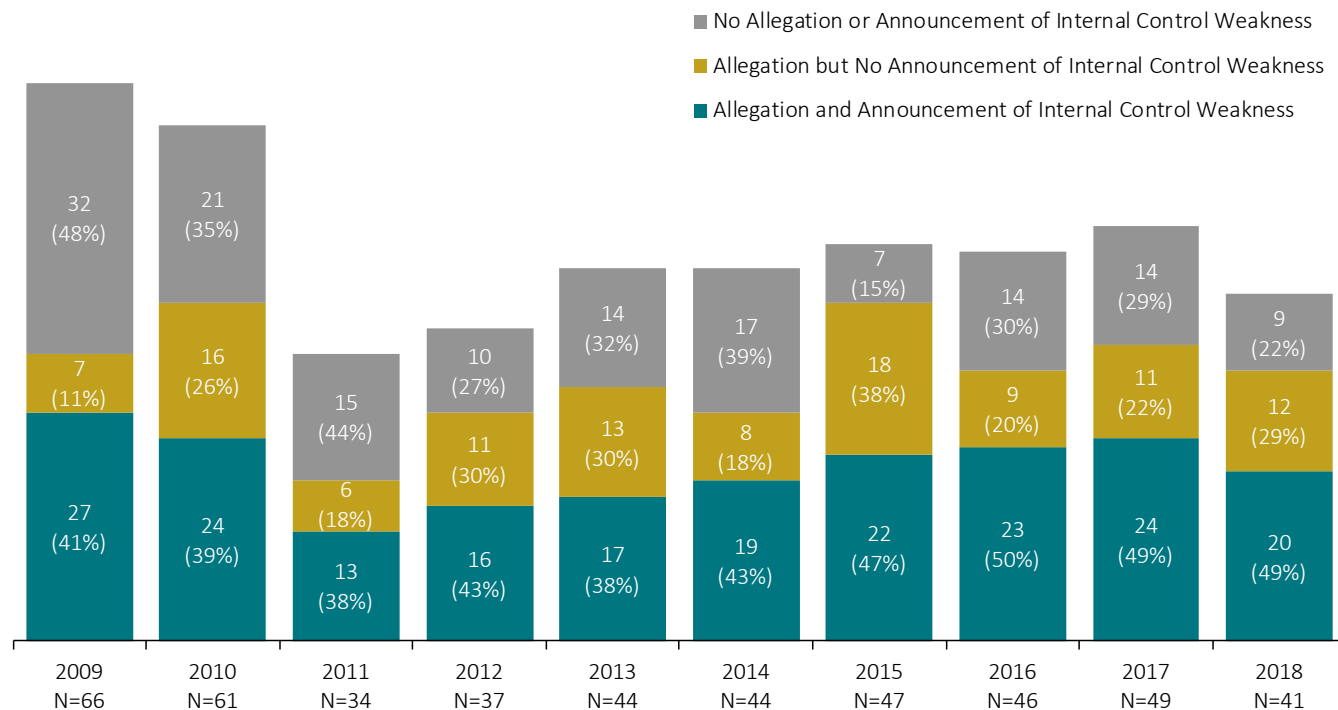


Accounting Case Settlements Involving Allegations of Internal Control Weaknesses

- The number of accounting case settlements involving an allegation *and* announcement of internal control weaknesses declined for the first time in seven years.
- The majority of accounting case settlements continue to involve allegations of internal control weaknesses (with and without accompanying announcements).
- Settlements of cases involving announcements of internal control weaknesses are more frequently associated with institutional investors as lead plaintiffs and accompanying derivative actions.
- While allegations of internal control weaknesses are common, they are not associated with higher settlement amounts, based on a regression analysis that accounts for several factors affecting settlements.

The number of accounting case settlements involving an allegation but no announcement of internal control weaknesses increased for the second year in a row.

Figure 17: Accounting Case Settlements Involving Allegations of Internal Control Weaknesses 2009–2018



Factors Affecting Settlements of Cases Involving GAAP Allegations

Median “Simplified Tiered Damages”

This section takes a closer look at settlement amounts across two major categories of GAAP allegations—write-downs and restatements¹⁰—and examines settlements across these categories in relation to a simplified proxy for plaintiff-style damages. This relationship is important to consider because a proxy for damages is the single most important determinant of settlement amounts.

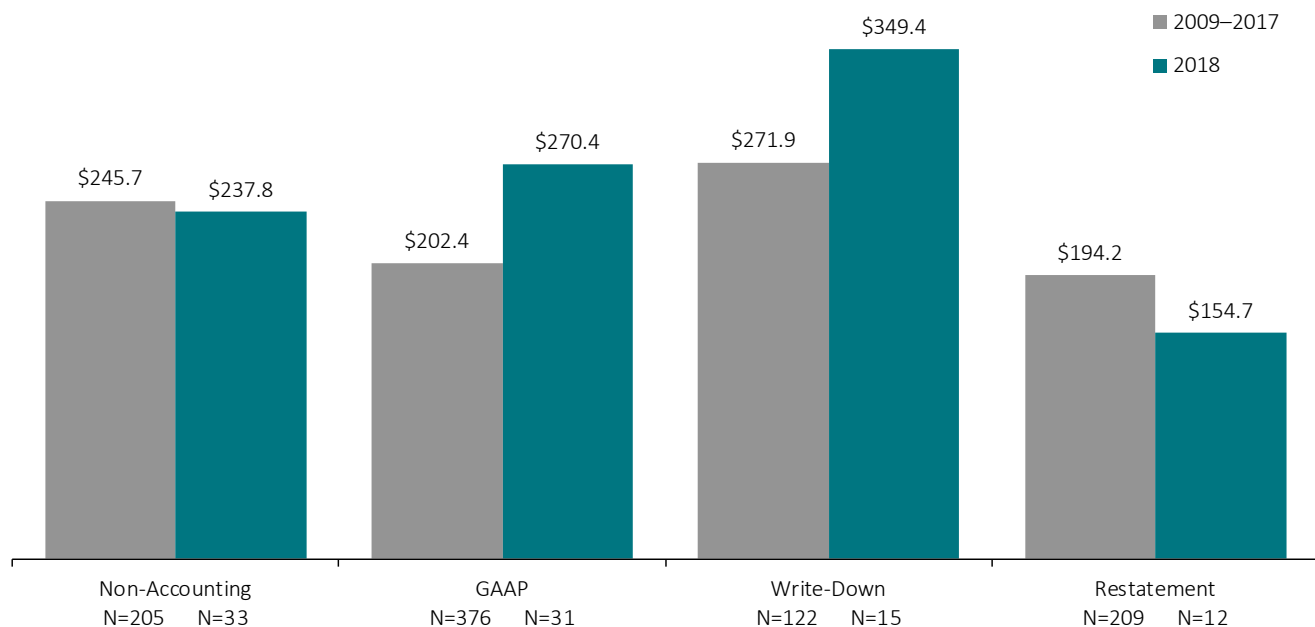
The proxy used in this report is referred to as “simplified tiered damages” and bases per-share inflation estimates on the value of a defendant’s stock price movements for the dates detailed in the plan of allocation per the settlement notice. This proxy is further described in *Securities Class Action Settlements—2018 Review and Analysis*.¹¹

Median “simplified tiered damages” for accounting cases was the highest since 2012.

- After an unusually low year in 2017, median “simplified tiered damages” for cases involving GAAP allegations rebounded to above the median for the prior nine years.
- Settled cases involving write-downs were larger, as measured by “simplified tiered damages,” compared to both non-accounting cases and cases involving other types of GAAP allegations.
- Financial sector firms were named as defendants in six out of the 15 settlements involving write-downs.
- Four accounting case settlements in 2018 involved an auditor as a named defendant. Auditors tend to be named in larger cases—median “simplified tiered damages” for settlements involving auditor defendants were over 65 percent higher than for cases involving GAAP allegations overall.

Figure 18: Median “Simplified Tiered Damages” in Settlements of Cases Involving GAAP Allegations

(Dollars in Millions)



Note: “Simplified tiered damages” are adjusted for inflation based on class period end dates; 2018 dollar equivalent figures are used.

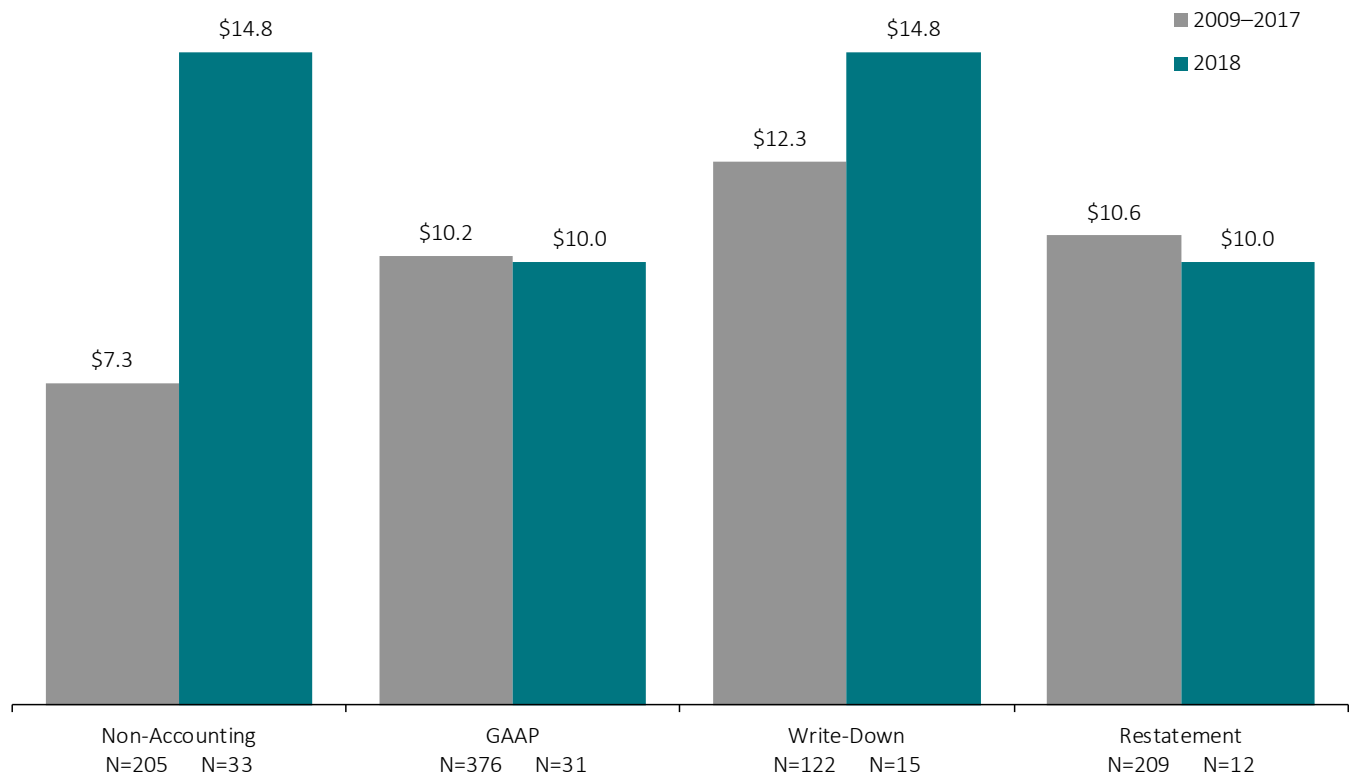
Median Settlement Amounts

- Overall, median settlement amounts for accounting cases increased almost 60 percent from 2017 to 2018.
- However, for the first time since 2014, median settlement amounts for accounting cases were lower than for non-accounting cases.
- Average settlement amounts for accounting cases were more than six times larger than the average for non-accounting cases.
- There were two case settlements involving reported accounting irregularities (acknowledged intentional misstatements or omissions). Both of these cases were among the five largest settlements in 2018.
- Cases involving write-downs typically take longer to settle than cases involving financial statement restatements.

Median settlement amounts for cases involving GAAP allegations almost doubled—from \$5.5 million in 2017 to \$10 million in 2018.

Figure 19: Median Settlement Amounts in Cases Involving GAAP Issues

(Dollars in Millions)



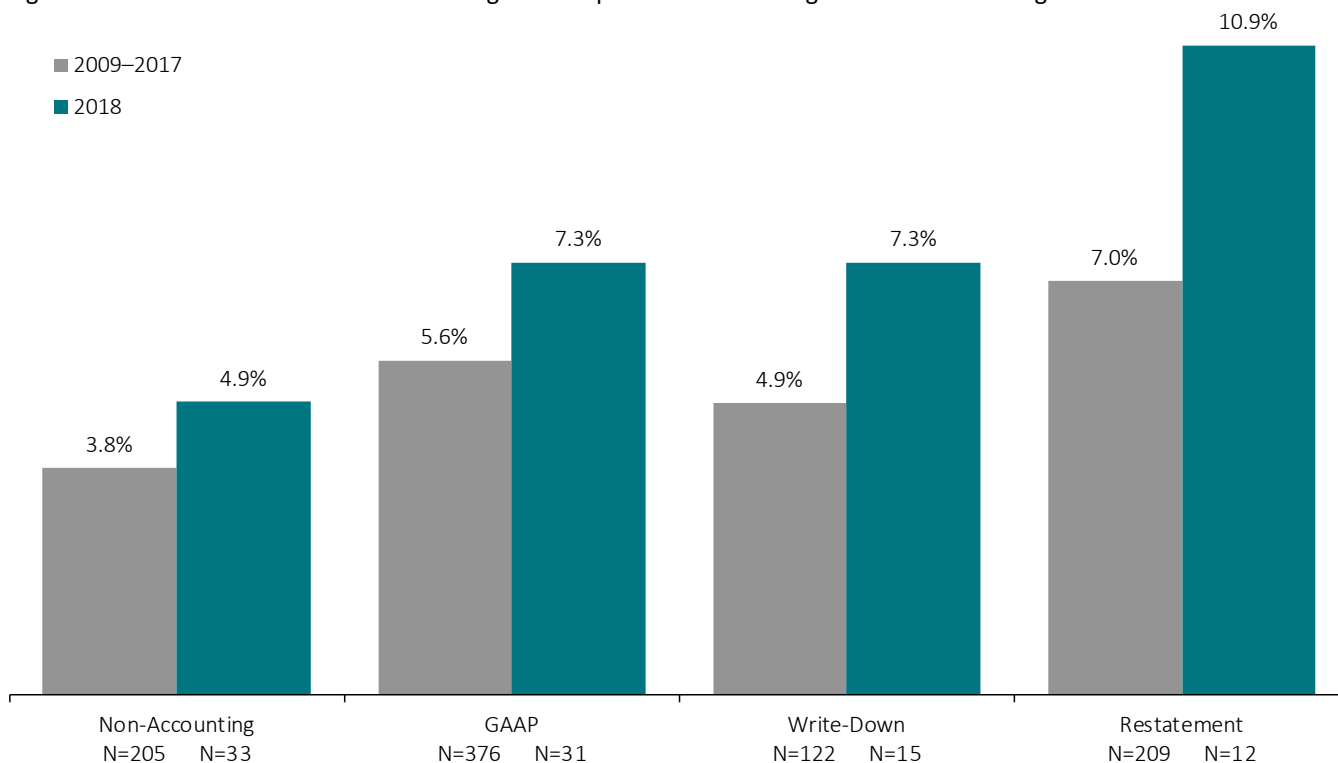
Note: Settlement dollars are adjusted for inflation; 2018 dollar equivalent figures are used.

Median Settlements as a Percentage of “Simplified Tiered Damages”

- Compared to the median for 2009–2017, cases involving GAAP allegations settled for a higher percentage of “simplified tiered damages.”
- Settlements as a percentage of “simplified tiered damages” generally decrease as case size increases. Nevertheless, in 2018, settlements as a percentage of “simplified tiered damages” increased for settled accounting cases, despite overall growth in “simplified tiered damages” for these cases.
- Following a sharp decrease in median settlements as a percentage of “simplified tiered damages” for settled cases involving restatements in 2017, this percentage surged in 2018 and was higher than the percentage for all settled cases involving GAAP allegations.

Cases involving GAAP allegations continued to settle for higher proportions of “simplified tiered damages” relative to non-accounting cases.

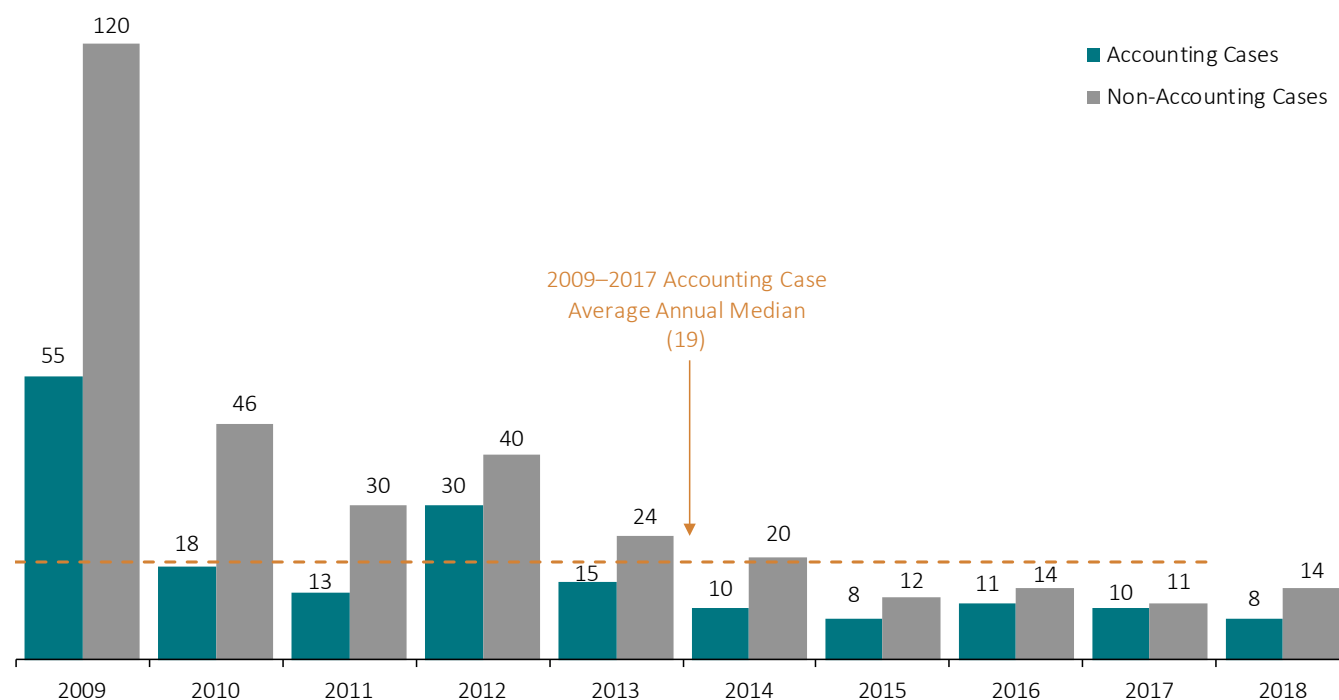
Figure 20: Median Settlements as a Percentage of “Simplified Tiered Damages” in Cases Involving GAAP Issues



Appendices

Appendix 1: Core Accounting Cases—Annual Median Lag between Class End Date and Case Filing Date

(Number of Days)



Appendix 2: Core Accounting Cases and Exchange

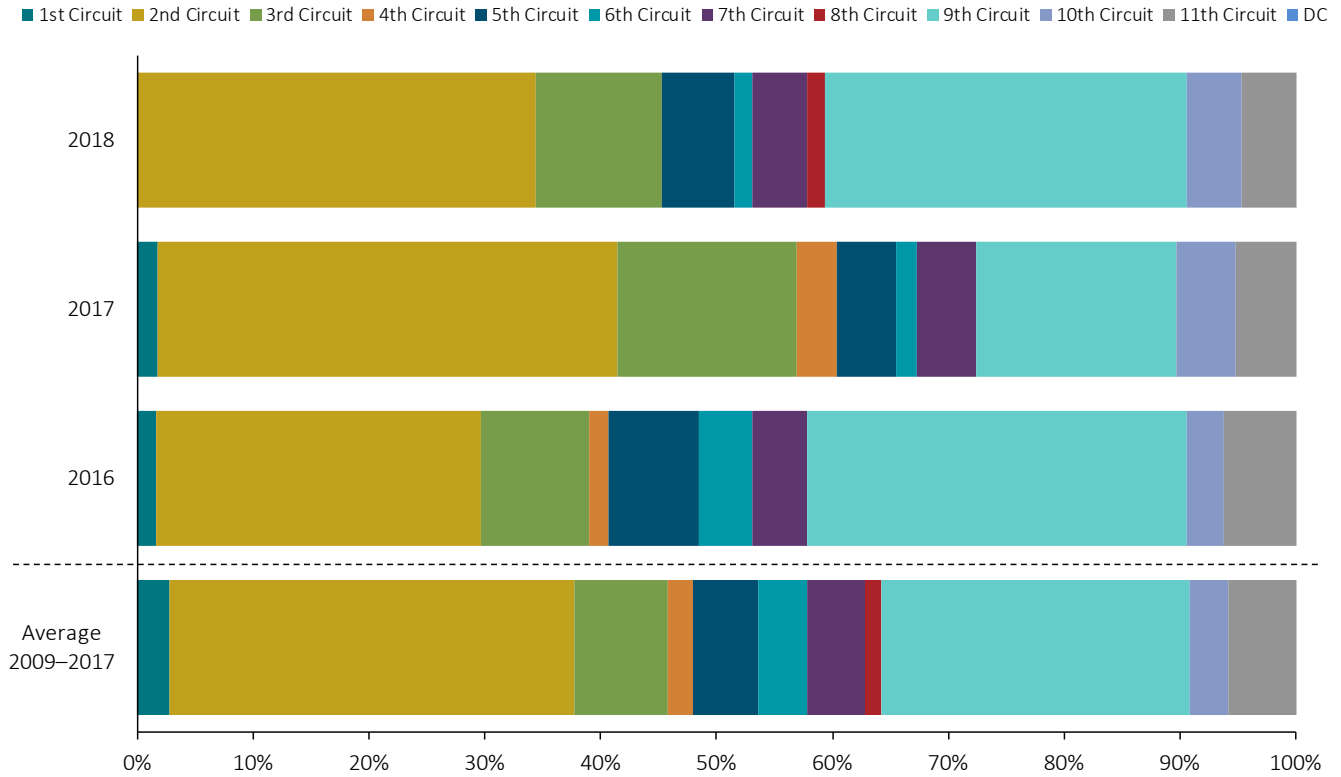
(Dollars in Millions)

	Average 2009–2017		2017		2018	
	NYSE/Amex	NASDAQ	NYSE	NASDAQ	NYSE	NASDAQ
Total Filings	233	248	24	28	29	33
Annual Average Filings	26	28	-	-	-	-
Disclosure Dollar Losses (DDL)						
Total	\$183,328	\$102,986	\$9,700	\$10,404	\$29,643	\$22,110
Annual Average	\$20,370	\$11,443	-	-	-	-
Average across Cases	\$837	\$420	\$422	\$385	\$1,059	\$670
Median across Cases	\$153	\$72	\$172	\$91	\$200	\$92

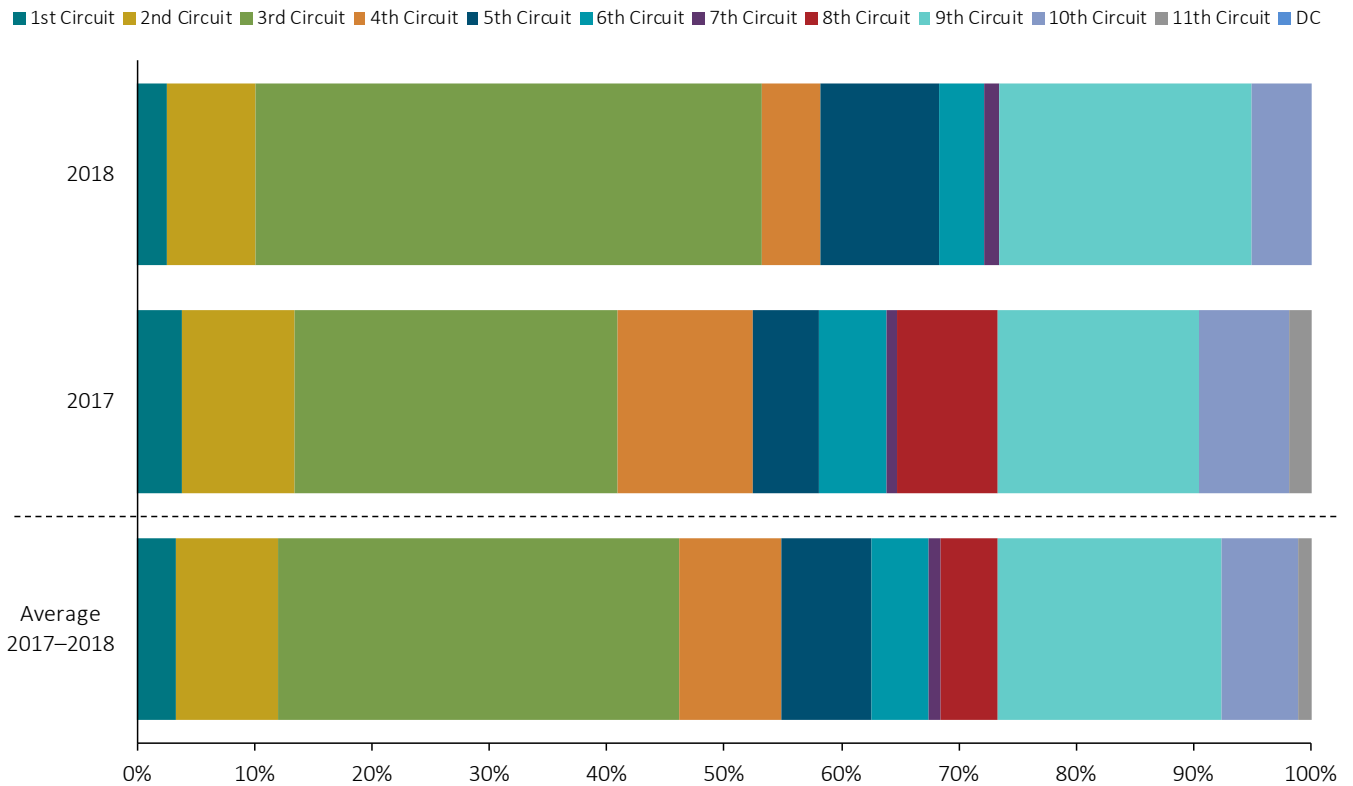
Note:

1. DDL dollars are adjusted for inflation; 2018 dollar equivalent figures are used.
2. Average and median numbers are calculated only for filings with DDL data.
3. This figure shows only accounting case filings against issuers listed on indicated exchanges.

Appendix 3: Core Accounting Cases by Circuit



Appendix 4: M&A Accounting Cases by Circuit



Note: The average case filings by circuit is computed for the past two years.

Research Sample

This report utilizes the databases described in *Securities Class Action Filings—2018 Year in Review* and *Securities Class Action Settlements—2018 Review and Analysis*.

Endnotes

- ¹ Filings are considered “accounting filings” if they involve allegations related to Generally Accepted Accounting Principles (GAAP) violations, violations of other reporting standards, auditing violations, or weaknesses in internal controls over financial reporting.
- ² Merger and acquisition (M&A) filings are securities class actions that have Section 14 claims, but no Rule 10b-5, Section 11, or Section 12(2) claims, and involve M&A transactions. “M&A accounting filings” are M&A filings containing accounting-related allegations.
- ³ Core filings are all federal securities class actions excluding those defined as M&A filings, consistent with *Securities Class Action Filings—2018 Year in Review*, Cornerstone Research, 2019.
- ⁴ For related discussion, see *Securities Class Action Settlements—2018 Review and Analysis*, Cornerstone Research, 2019.
- ⁵ Core cases are the primary focus of the remainder of this report because many of the metrics that are reported (e.g., filing lag and DDL) apply only to core cases. As such, unless specified otherwise, all subsequent references to accounting cases for both filings and settlements information are based on these cases (i.e., excluding M&A).
- ⁶ See *Securities Class Action Filings—2018 Year in Review*, Cornerstone Research, 2019, p. 18.
- ⁷ See, for example, Whitney Ross, “Another Banner Year for Securities Class-Action Lawsuits,” Willis Towers Watson, April 12, 2018, <https://www.willistowerswatson.com/en-US/insights/2018/04/finex-observer-2017-securities-class-actions>.
- ⁸ References to allegations or announcements of internal control weaknesses throughout this report refer to internal controls over financial reporting.
- ⁹ See, for example, Kevin LaCroix, “Number of Restatements Continues to Decline,” *D&O Diary*, June 26, 2018, <https://www.dandodiary.com/2018/06/articles/financial-reporting/number-restatements-continues-decline/>.
- ¹⁰ Within cases involving GAAP issues (i.e., cases with allegations of GAAP violations), write-down cases are those with allegations involving an asset write-down or reserve increase, and restatement cases are those involving a restatement (or announcement of a restatement) of financial statements.
- ¹¹ See *Securities Class Action Settlements—2018 Review and Analysis*, Cornerstone Research, 2019, p. 7. “Simplified tiered damages” provides a measure of potential shareholder losses that allows for consistency across a large volume of cases but is not intended to represent actual economic losses borne by shareholders.

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