

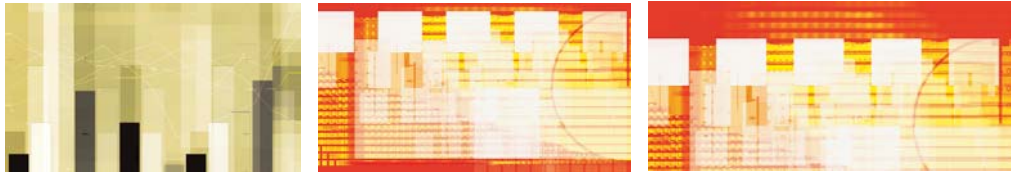
CORNERSTONE RESEARCH

Post-Reform Act Securities Lawsuits

Settlements Reported
Through December 2003

Laura E. Simmons
Ellen M. Ryan



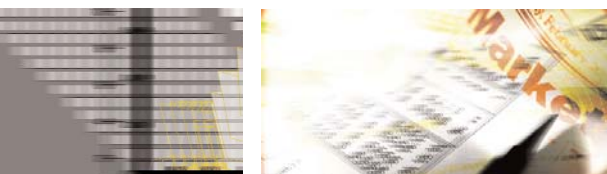


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POST-REFORM ACT SECURITIES LAWSUITS: SETTLEMENTS REPORTED THROUGH DECEMBER 2003

This monograph on securities class action settlements updates our prior reports on settlements of cases filed after passage of the Private Securities Litigation Reform Act (Reform Act) by extending the analysis to cover settlements reported through December 2003. In addition, we have expanded the factors considered in our study, as well as incorporated analyses that in prior years were separately reported in our settlements *Year in Review* publications.

Our sample includes settlements for 503 securities cases filed after December 22, 1995 (passage of the Reform Act).¹ Cases are limited to those including allegations of fraudulent inflation in the price of a corporation's common stock. These cases were identified from issues of the *Securities Class Action Alert (SCAA)*.

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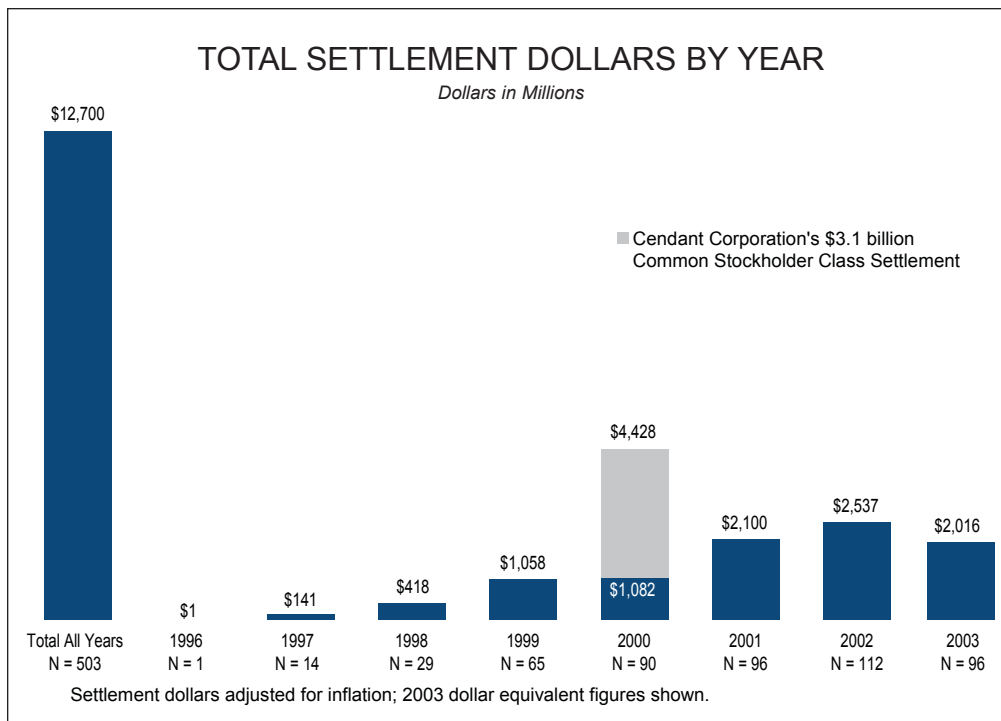
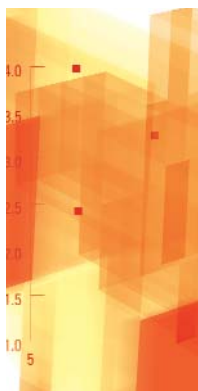


Figure 1

Figure 1 shows the total value of cases settled each year, adjusted for the effects of inflation.² As shown, 2003 was the first year since the passage of the Reform Act in which the total value of cases settled declined from the prior year (excluding the extraordinarily large settlement by Cendant Corporation in 2000). This decline was driven by a decrease in the number of settlements occurring during the year.³

The decrease in the number of settlements occurring during 2003 may be due in part to a decrease in the number of securities class actions filed in 2001, as well as an increase in the length of time that cases are taking to settle.⁴ On average, settlements in 2003 occurred three and a half years after the class actions were filed.



2

On an inflation-adjusted basis, median settlement amounts in 2003 were slightly higher, overall, than for prior post-Reform Act years. Average settlement amounts were also higher in 2003 than in prior post-Reform Act years, excluding the Cendant Corporation settlement of \$3.1 billion⁵ in year 2000.

In spite of the increase in median and average settlement amounts in 2003, when factors that significantly affect settlements are considered (e.g., an estimate of plaintiff-style damages and the nature of the allegations), settlements in 2003 were actually lower than in prior years.

SETTLEMENT SUMMARY STATISTICS

	2003 Only	All Post-Reform Act Settlements
Minimum	\$250,000	\$110,447
Median	\$6.2 million	\$6.0 million
Average	\$21.0 million	\$18.6 million
Maximum	\$517.3 million	\$517.3 million
Total Amount	\$2.0 billion	\$9.4 billion

Note: Settlement dollars adjusted for inflation; 2003 dollar equivalent figures shown. Statistics for All Post-Reform Act Settlements exclude Cendant Corporation's settlement of \$3.1 billion (unadjusted for inflation) in 2000. Including this settlement, the average and total amount of All Post-Reform Act Settlements are \$25.2 million and \$12.7 billion, respectively.

Figure 2

Almost 85% of all settlements in 2003 were for less than \$20 million. While there were no settlements between \$60 million and less than \$100 million during 2003, there were five cases in 2003 that settled for amounts in excess of \$100 million. The issuer defendants in these cases were Oxford Health Plans, Mattel, Inc., Computer Associates International, Inc., Lucent Technologies and DPL, Inc.⁶ All of these cases involved accounting allegations and a decline in the market capitalization of the issuer defendant during the class period in excess of \$2 billion.

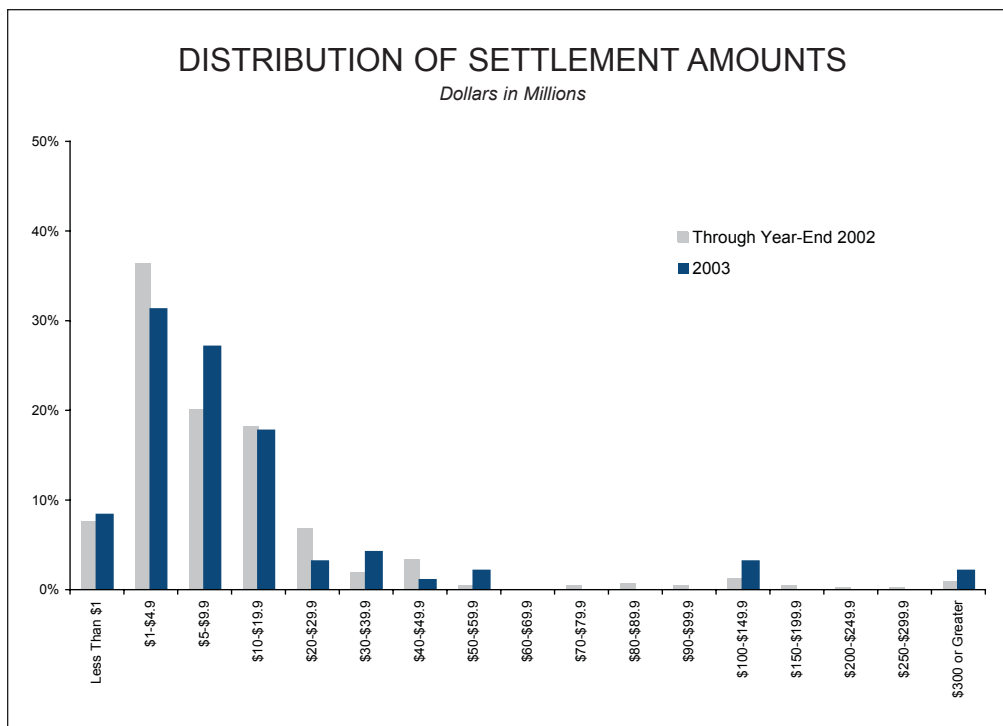


Figure 3



4

For purposes of our research on settlements, we apply a highly simplified approach to estimate damages, adopted with certain modifications, from one of the methodologies often used by plaintiffs.⁷ Accordingly, the damage amounts presented in this research are not intended to be indicative of actual damages incurred by shareholders. However, by applying a consistent method in our computation of damages we can examine trends in “estimated damages.”

Figure 4 shows that, even adjusted for inflation, average “estimated damages” have consistently increased over the last six years. Moreover, there were substantial increases in average “estimated damages” in both 2002 and 2003. On the other hand, the figures for median “estimated damages” demonstrate no clear trend, and median “estimated damages” actually declined in 2003 from the prior year. The discrepancy between the median and average statistics arises from a small number of cases for which “estimated damages” are extremely large (i.e., over \$5 billion); these cases have a significant impact on the average, but have little effect on the median.⁸

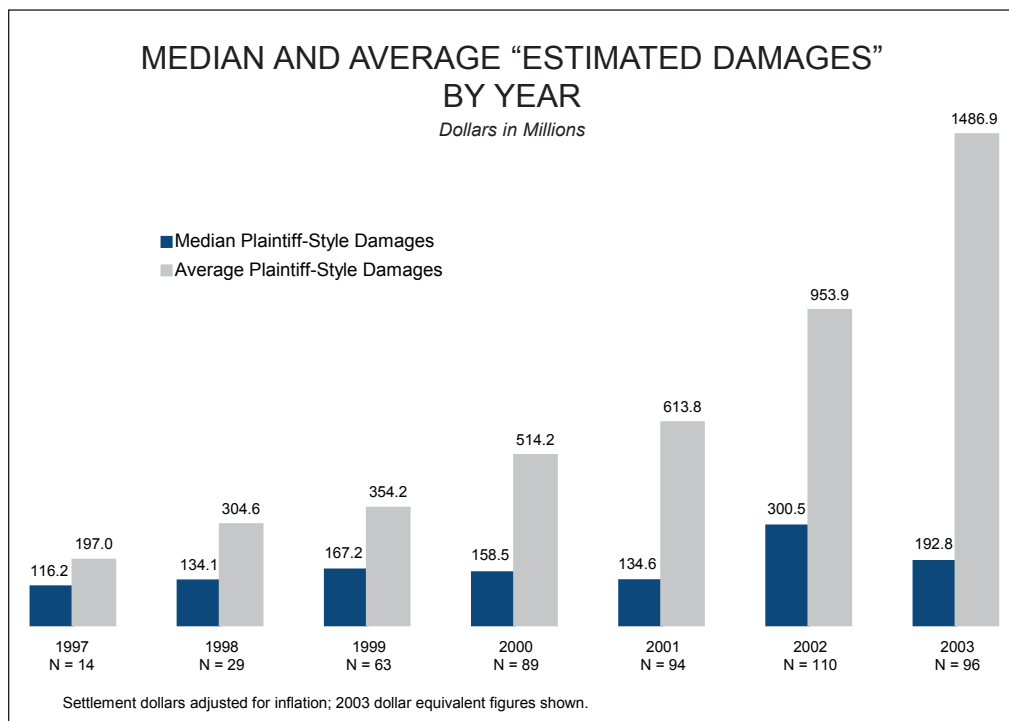


Figure 4



As we have observed in prior years, settlements as a percentage of “estimated damages” generally decline as damages increase, although historically that has not been true for very large cases (i.e., cases with “estimated damages” greater than \$1 billion). The pattern of declining settlements as a percentage of “estimated damages” as “estimated damages” increase, combined with the fact that overall “estimated damages” grew significantly in 2003, helps to explain the overall decrease in settlements as a percentage of “estimated damages” in 2003, relative to prior post-Reform Act years.

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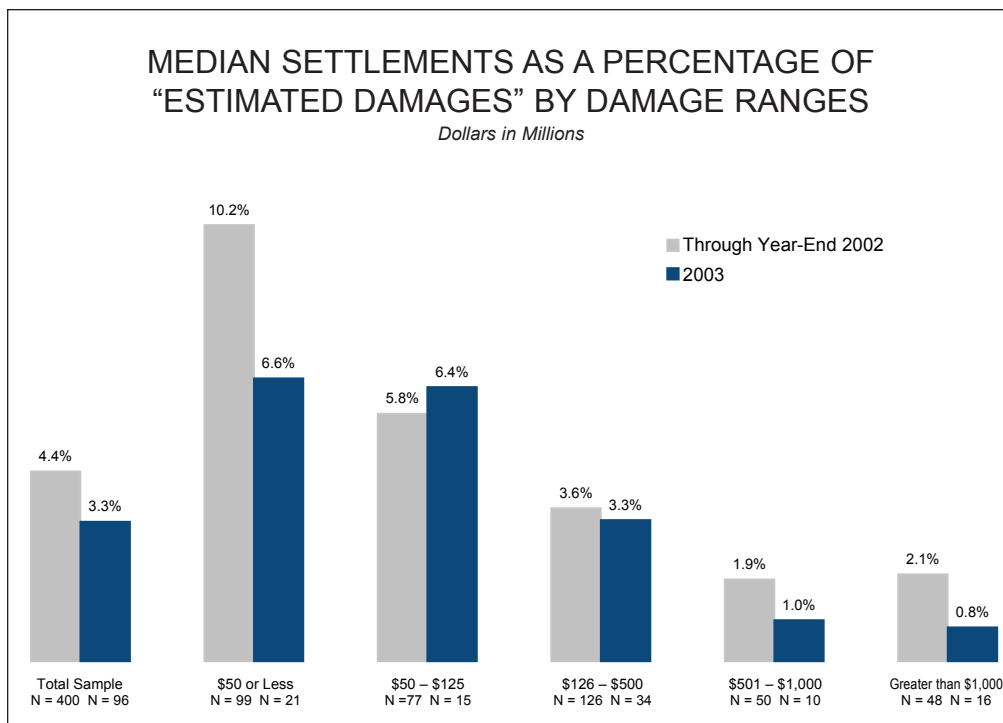


Figure 5

Figure 6 shows the median settlements as a percentage of “maximum dollar loss” (MDL) by MDL ranges. The 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. This measure is not intended to represent an estimate of damages, as it makes no attempt to isolate movements in the defendant’s stock price that are unrelated to case allegations. Nor does this measure apply a trading model to estimate the number of shares damaged.⁹

Compared to prior post-Reform Act years, in 2003 settlements as a percentage of MDL are lower overall, as well as for each of the MDL ranges presented.

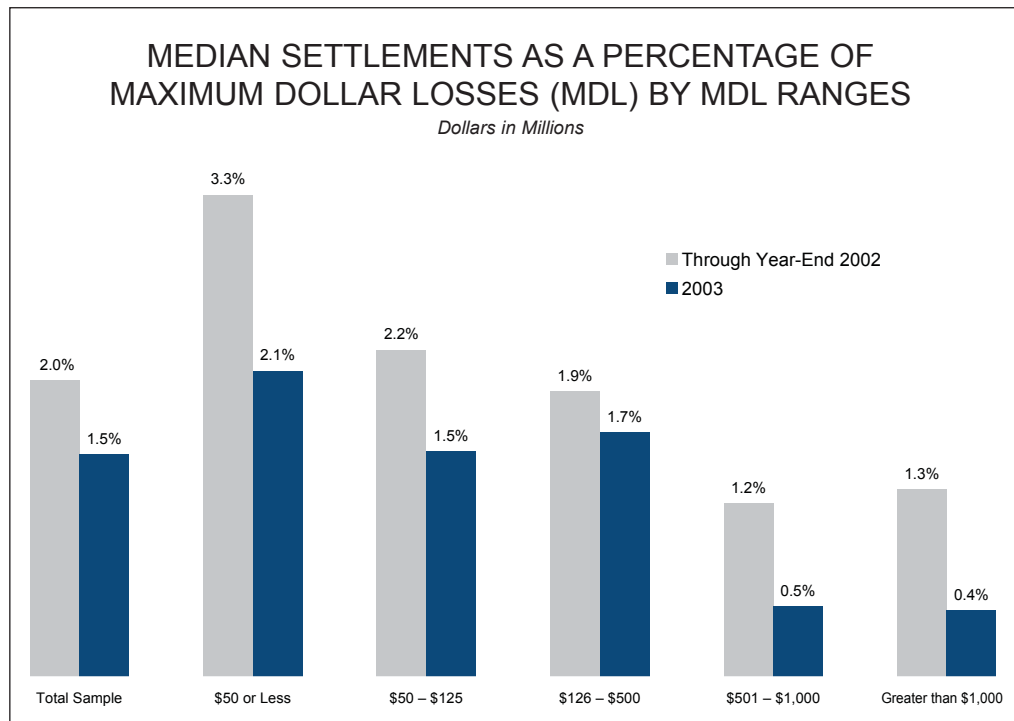


Figure 6

Cases involving accounting allegations continue to settle for higher proportions of “estimated damages,” relative to cases not involving accounting allegations. Almost 55% of all cases involve GAAP allegations, and over half of those cases involve a restatement of the financial statements.

Settlements as a percentage of “estimated damages” are the highest for those cases in which an accountant is named as a co-defendant in the class action.

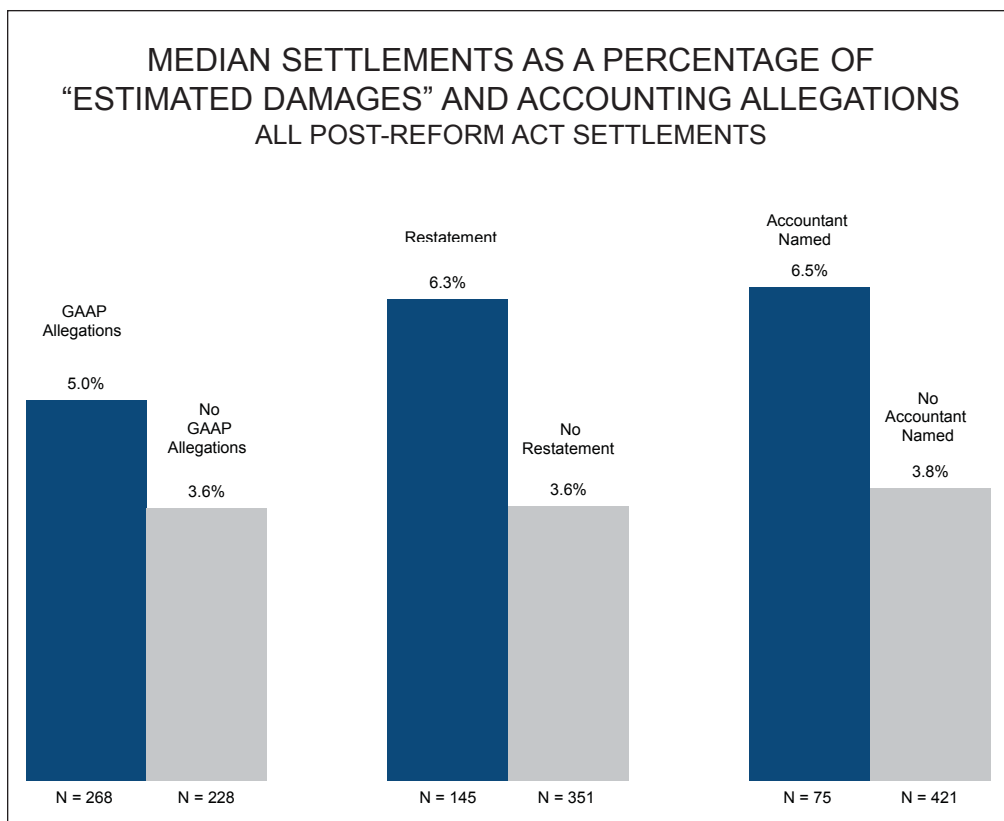


Figure 7



8

Almost 20% of all post-Reform Act settlements have involved Section 11 or 12(a)(2) claims. Median settlements as a percentage of “estimated damages” are significantly higher for these cases, relative to cases not involving these allegations. Settlements as a percentage of “estimated damages” are even higher for those cases involving an underwriter as a named defendant. There is substantial overlap between Section 11 or 12 (a) (2) cases and the inclusion of an underwriter as a named defendant. When controlling for the presence of an underwriter defendant, Section 11 or 12 (a) (2) claims are not associated with a statistically significant increase in settlement amounts.

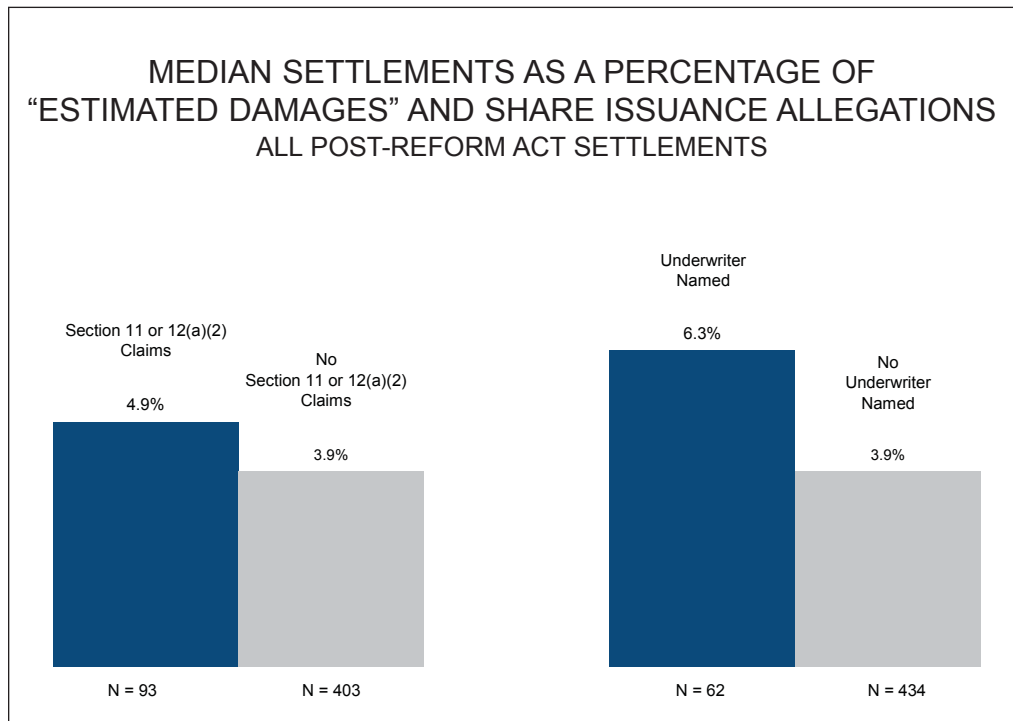


Figure 8

Approximately 30% of all post-Reform Act settlements have involved institutions serving as lead plaintiffs. This represents an increase in institutional participation compared to pre-Reform Act settlements. Thus, it appears that the Reform Act was successful in increasing the amount of institutional participation in securities class actions, one of the intended objectives of the legislation.

As shown, settlement amounts are higher for cases in which an institutional investor serves as lead plaintiff. Overall, institutions tend to serve as lead plaintiffs in larger cases, as measured by “estimated damages” and defendant asset size. Reflecting this pattern, settlements as a percentage of “estimated damages” are actually lower for cases involving institutions as lead plaintiffs, compared to cases not involving institutions in a lead plaintiff role. However, when controlling not only for “estimated damages,” but also for other factors that affect settlement amounts (such as the nature of the allegations), the presence of an institutional investor as lead plaintiff is associated with an increase in settlement size.

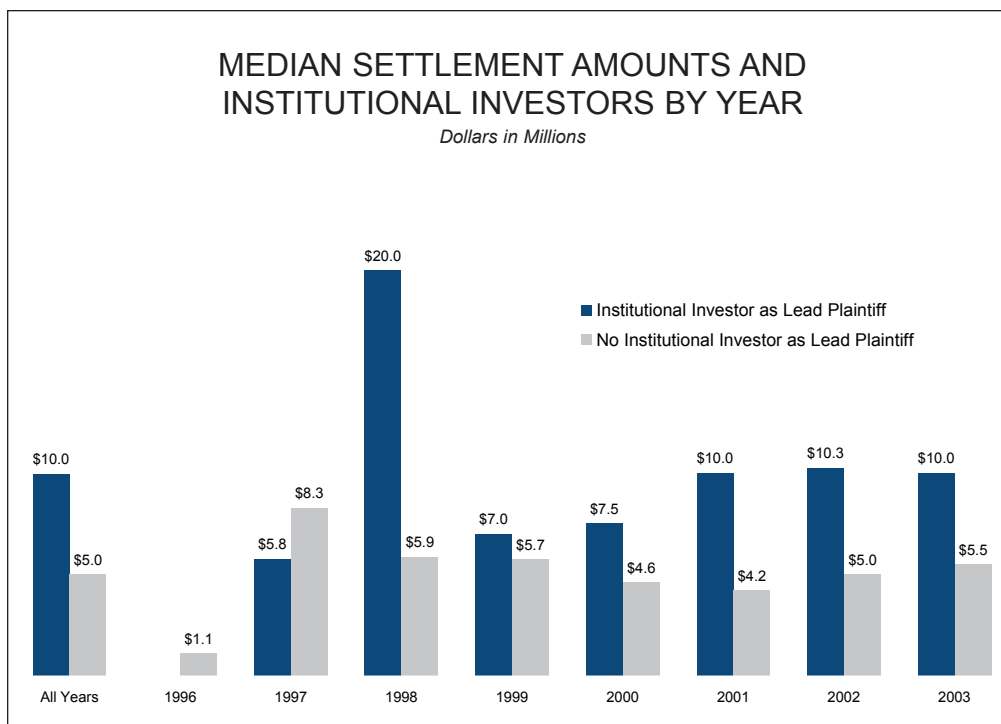


Figure 9



Over 20% of all post-Reform Act settlements have been for cases involving actions by the SEC in the form of a litigation release or administrative proceeding. Overall, such actions tend to occur in cases involving accounting allegations and higher “estimated damages.” Settlement amounts are significantly higher for cases involving SEC actions, and settlements as a percentage of “estimated damages” are also higher.

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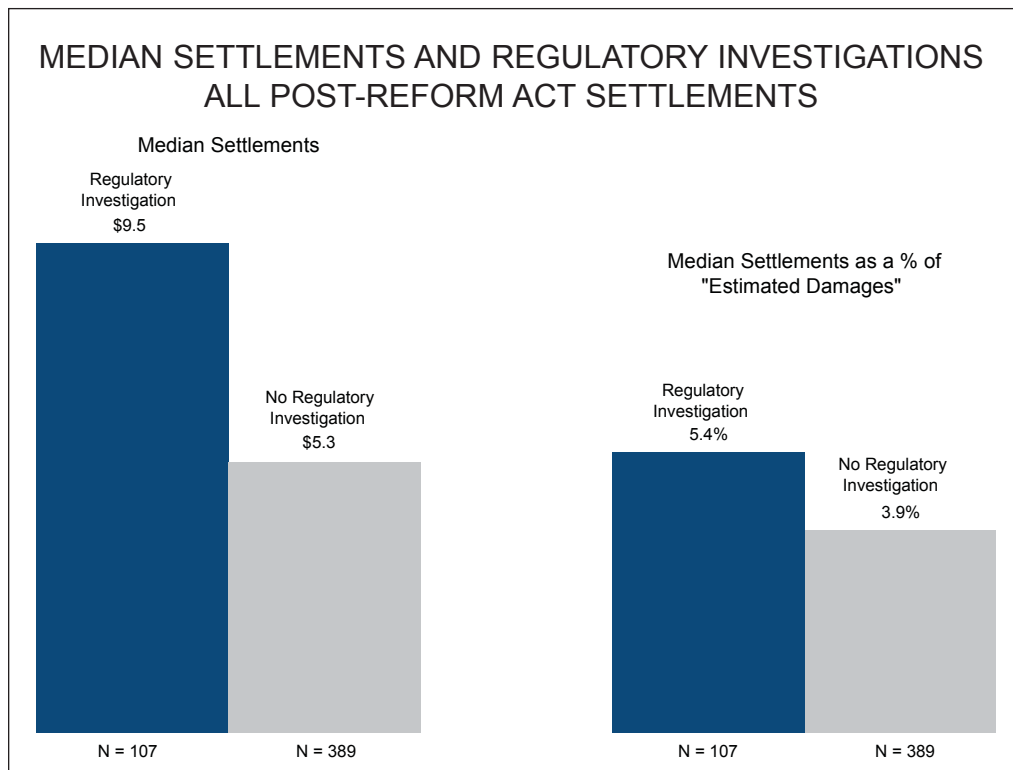


Figure 10

Less than 15% of the cases in our sample were accompanied by the filing of a derivative action. For purposes of this study, a derivative action, generally a case filed against the officers and directors on behalf of the issuer corporation, must have allegations similar to the class action in nature and time period in order to be considered an accompanying action.¹⁰

Derivative cases are frequently resolved with changes to the issuer's corporate governance practices and little or no cash payment.

While the settlement of a derivative action does not necessarily result in a cash payment, as shown in Figure 11, settlement amounts for class actions accompanied by derivative cases are significantly higher than for cases not involving derivative actions. However, settlements as a percentage of "estimated damages" are very similar to cases not involving accompanying derivative actions. Contributing to this pattern, derivative suits tend to be associated with class actions involving higher "estimated damages." Class actions accompanied by derivative cases are also more likely to involve accounting allegations, SEC investigations, and the presence of an institutional lead plaintiff.

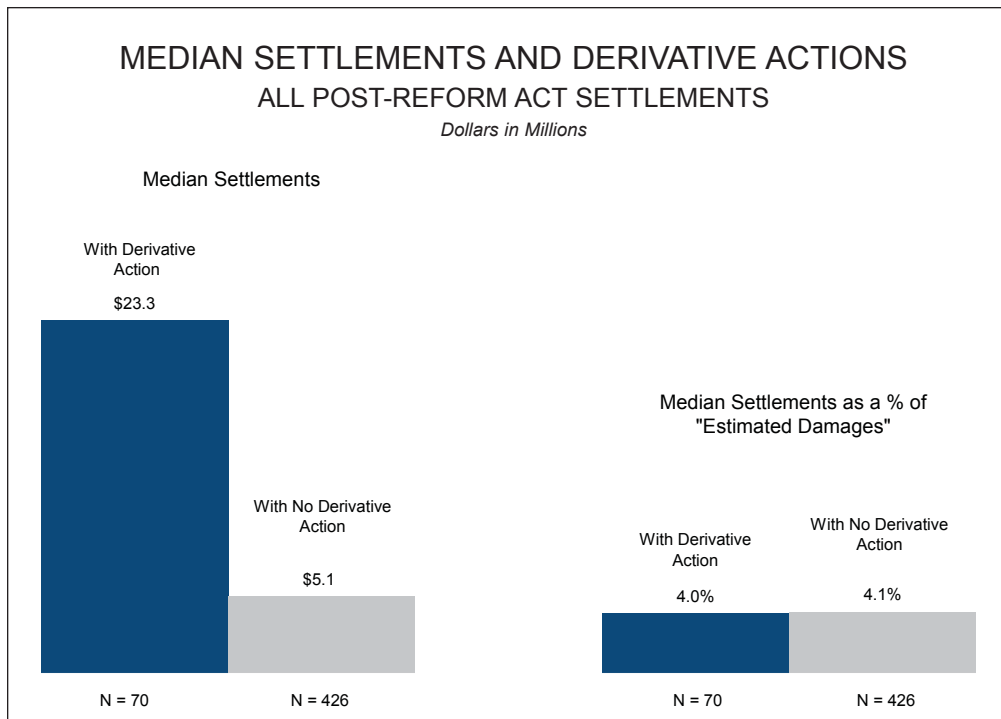
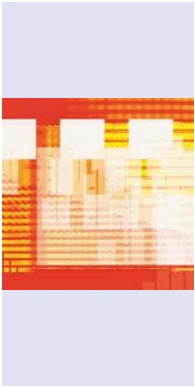


Figure 11



12

Comparable to prior years, just over 25% of cases settled in 2003 included allegations of insider trading. While cases involving insider-trading allegations have settled for higher amounts than cases not involving these allegations, they have settled for a lower percentage of “estimated damages.” Moreover, when other factors (such as “estimated damages”) are considered, statistical tests indicate that insider trading allegations are not a significant determinant of settlement amounts.

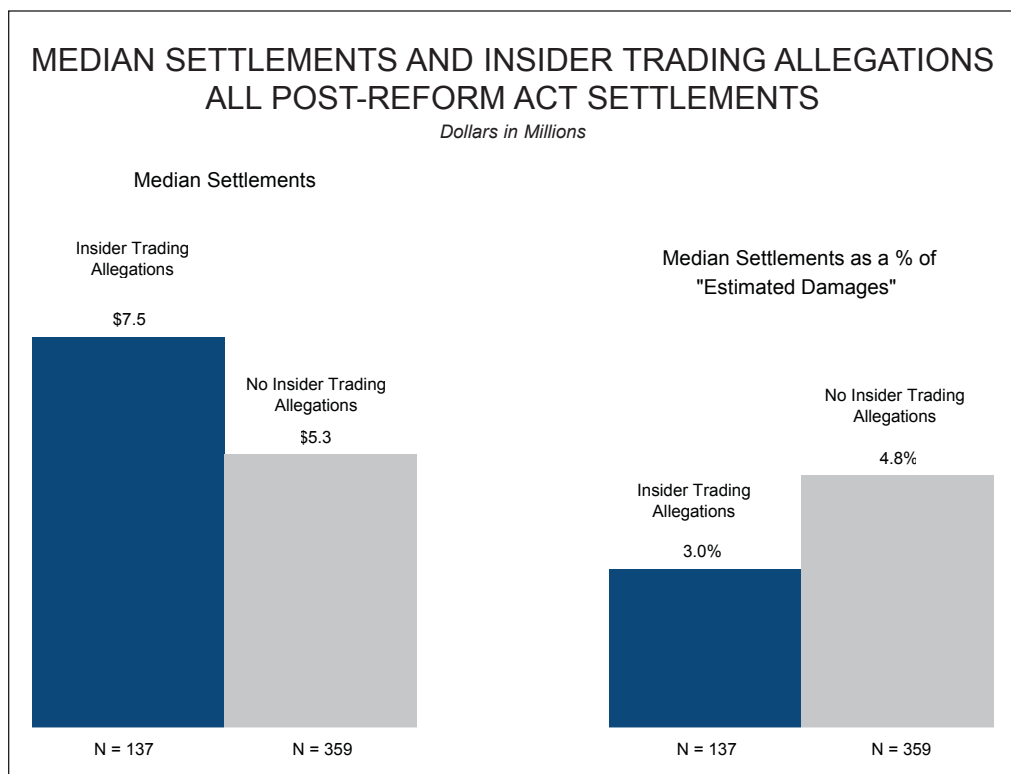


Figure 12

The percentage of cases involving non-cash components as part of the settlement fund continued to decrease in 2003. For cases that do involve non-cash components, the median proportion of the settlement value from the non-cash components was approximately 65% over the past two years.

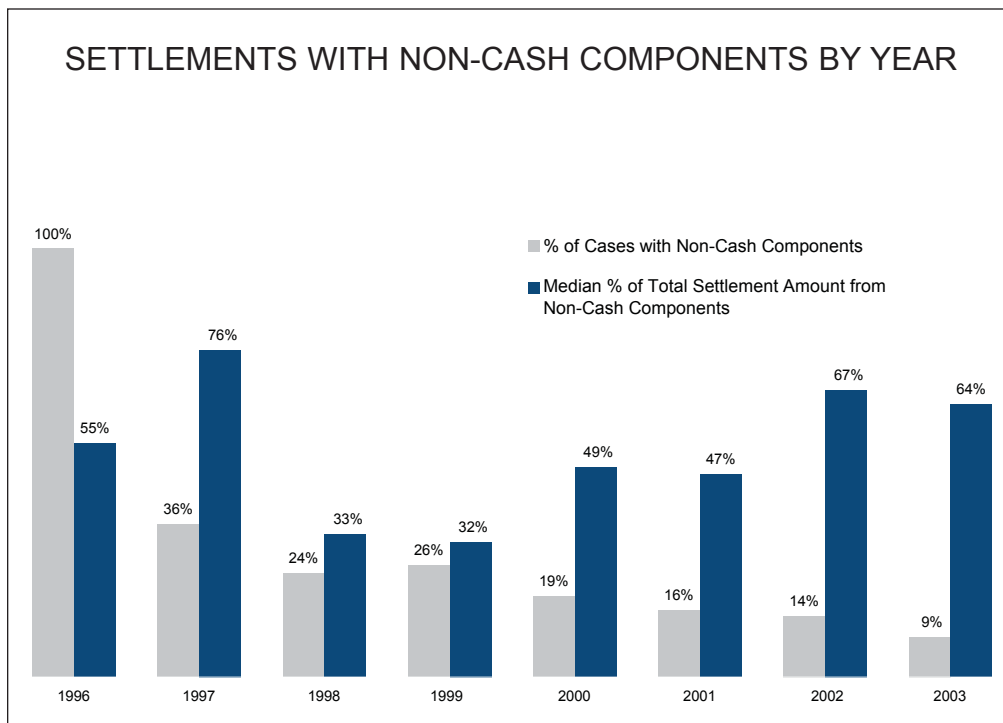
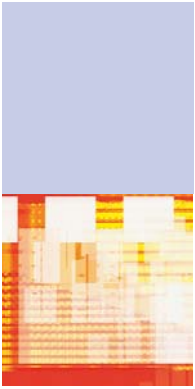


Figure 13



14

As shown in Figure 14, the law firm of Milberg Weiss Bershad Hynes & Lerach, LLP was involved as lead or co-lead plaintiff counsel in over 50 percent of all post-Reform Act cases settled to date. The next nine most dominant firms (as measured by the frequency of appearance in settled post-Reform Act cases) were involved as lead or co-lead plaintiff counsel in less than 10 percent of all settlements.¹¹

SETTLEMENTS BY PLAINTIFF ATTORNEY ALL POST-REFORM ACT SETTLEMENTS		
Plaintiff Law Firm	% of Settlements	Median Settlement as a % of Estimated Damages
1 Milberg Weiss Bershad Hynes & Lerach LLP	53%	3.9%
2 Berger & Montague, PC	8%	3.4%
3 Stull Stull & Brody	8%	4.7%
4 Abbey Gardy, LLP	7%	3.9%
5 Wolf Popper LLP	7%	6.1%
6 Berman DeValerio Pease Tabacco Burt & Pucillo	7%	3.1%
7 Bernstein Litowitz Berger & Grossmann LLP	7%	3.6%
8 Weiss & Yourman	6%	3.6%
9 Barrack, Rodos & Bacine	5%	4.1%
10 Bernstein Liebhard & Lifshitz, LLP	4%	3.6%

Figure 14

Settlements as a percentage of “estimated damages” have been highest for cases involving defendants in the pharmaceutical and healthcare industry sectors. In contrast, the highest settlement dollar amounts, overall, have involved defendants in the telecommunications and financial sectors (not shown).¹²

Industry variables are correlated with other factors that affect settlement amounts (e.g., defendant asset size); when these other factors are controlled for, industry variables are not significant in explaining settlement values.

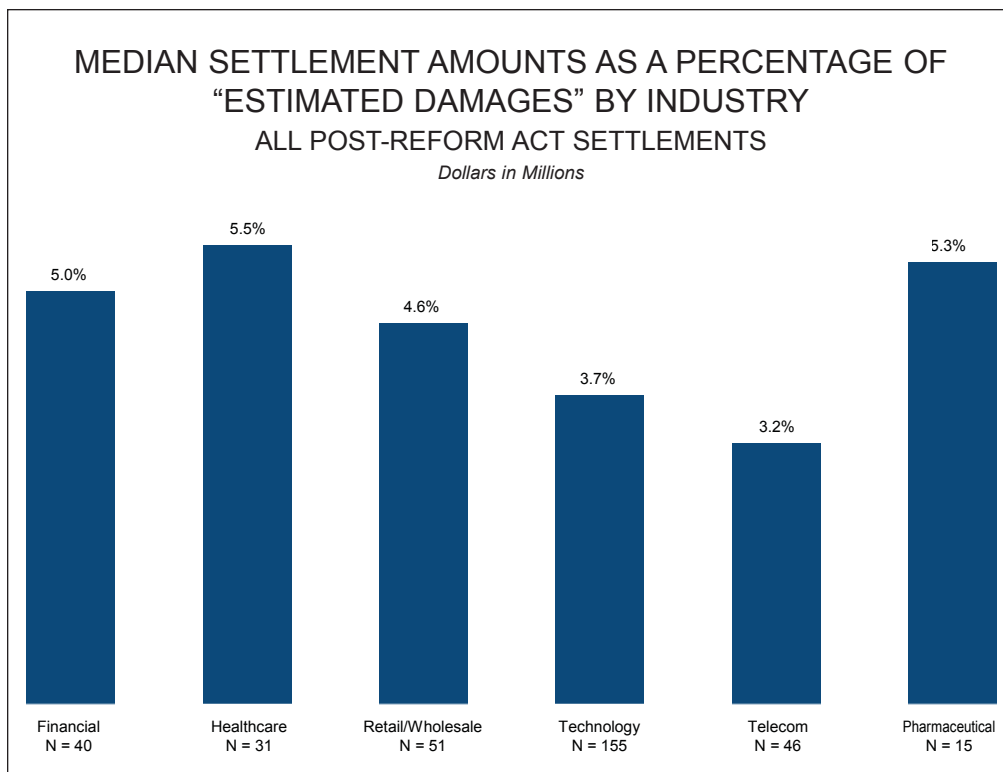


Figure 15



16

Settlements continue to occur most frequently in the ninth circuit, although proportionately the ninth circuit represented less of a concentration in 2003 than in prior years.

SETTLEMENTS BY COURT CIRCUIT				
<i>Dollars in Millions</i>				
Court Circuit	No. of Cases		Median Settlement	
	2003	Through Year-End 2002	2003	Through Year-End 2002
1	6	27	\$6.8	\$4.5
2	16	54	\$5.0	\$5.5
3	14	37	\$7.7	\$5.8
4	1	16	\$17.8	\$5.1
5	8	30	\$6.2	\$4.6
6	6	17	\$11.8	\$10.3
7	4	22	\$4.3	\$10.5
8	3	9	\$8.0	\$7.5
9	18	113	\$7.0	\$5.8
10	4	14	\$2.4	\$8.5
11	12	38	\$2.5	\$4.8
DC	1	0	\$32.5	-
State	3	30	\$3.5	\$4.5
Total	96	407		

Figure 16

Case jurisdiction is often correlated with other factors such as industry sector (e.g., the concentration of the technology sector in the Ninth Circuit). When controlling for the effects of “estimated damages” and other factors, two circuits are associated with a statistically significant effect on settlement amounts, based on settlements reported through 2003. These two circuits are the fourth and seventh circuits, and both are associated with lower settlements.

Consistent with prior years, almost 95% of all cases have involved Rule 10b-5 allegations, though in almost 15% of all cases such claims were combined with Section 11 and/or 12(a)(2) allegations.

SETTLEMENTS BY NATURE OF ALLEGATIONS			
ALL POST-REFORM ACT SETTLEMENTS			
<i>Dollars in Millions</i>			
	No. of Cases	Median Settlement	Median Settlement as a % of "Estimated Damages"
Rule 10b-5	403	\$5.8	3.9%
Section 11 and/or 12(a)(2)	25	\$3.1	5.5%
Both 10b-5 and 11 or 12(a)(2)	68	\$8.1	4.2%
All Post-Reform Act Settlements	496	\$5.8	4.0%

Figure 17



CORNERSTONE RESEARCH SETTLEMENT PREDICTION MODEL

Our research on settled cases allows us to study the factors that significantly affect settlement values. Characteristics of securities cases that may affect settlement outcomes are often correlated with each other, and the use of regression analysis allows for the examination of these factors simultaneously. Accordingly, as part of our ongoing research on securities case settlements, we have applied regression analysis to study the determinants of settlement outcomes. Our analysis performed on a sample of 496 post-Reform Act cases settled through December 2003 reveals that variables that are important determinants of settlement amounts include the following:^{13, 14}

- Estimated simplified plaintiff-style “damages”
- Most recently reported total assets of the defendant firm
- The number of docket entries for the case
- Indicator for whether there is a restatement of the financial statements involved in the class-action (or, alternatively, whether GAAP violations are alleged)
- Indicator for whether there is a corresponding SEC action against the issuer or other defendants involved
- Indicator for whether an accountant is a named co-defendant
- Indicator for whether an underwriter is a named co-defendant
- Indicator for whether a corresponding derivative action is filed
- Indicator for whether there is a non-cash component to the settlement
- Indicator for whether the settlement occurred in 2002
- Indicator for whether the settlement occurred in 2003
- Indicator for whether the case was filed in the seventh circuit
- Indicator for whether the case was filed in the fourth circuit
- Indicator for whether an institution was involved as lead or co-lead plaintiff
- Indicator for whether the firm filed for bankruptcy prior to settlement

Settlements are higher when estimated plaintiff-style “damages,” defendant asset size or the number of docket entries are higher, or when there is a restatement or other accounting allegations, a corresponding SEC action, an accountant named as co-defendant, an underwriter named as co-defendant, a corresponding derivative action, a non-cash component to the settlement, or an institution involved as lead plaintiff. Settlement amounts are lower for settlements occurring in 2002 or 2003, for cases filed in either the fourth or seventh circuits, or for cases in which the issuer defendant has filed for bankruptcy prior to the settlement.

Over 65% of the variation in post-Reform Act settlements can be explained by these variables.

Our clients are often interested in obtaining estimates of expected settlement amounts in securities cases. Accordingly, from the regression analysis described above, we have developed a prediction model that can be used to estimate expected settlement amounts for post-Reform Act cases. Settlement estimates based on this model are available to Cornerstone Research clients.

CONCLUDING REMARKS

This monograph reports descriptive statistics for a sample of post-Reform Act cases settled through December 2003. While settlement dollar amounts increased slightly in 2003 compared to prior post-Reform Act years, settlements as a percent of “estimated damages” decreased for the third year in a row. This finding is consistent with our regression analysis results, which indicate that, compared to prior post-Reform Act years, settlement amounts were significantly lower in 2002 and 2003, when other factors such as “estimated damages” and the nature of the allegations are considered. This result contrasts with the popular expectation that settlements might increase following the attention surrounding recent allegations of accounting improprieties.¹⁵

Statistics on settlements in the post-Reform Act period are significantly affected by a small number of exceptionally large cases, including settlements in excess of \$100 million. Nevertheless, the majority of securities cases continue to settle for less than \$10 million.

SAMPLE AND DATA SOURCES

The sample of cases discussed in this monograph was identified from issues of the *Securities Class Action Alert (SCAA)*. Our database is limited to cases alleging fraudulent inflation in the price of a corporation’s common stock (i.e., excluding cases filed only by bondholders, preferred stockholders, etc. and excluding cases alleging fraudulent stock price depression). Inclusion in our sample is also limited to cases alleging Rule 10b-5, Section 11 and/or Section 12 claims brought by purchasers of a corporation’s common stock. These criteria were imposed to ensure data availability and to provide a relatively homogeneous set of cases with respect to the nature of the allegations.

In addition to the *SCAA*, data sources include Dow Jones Interactive, the Center for Research in Security Prices at the University of Chicago, Standard & Poor’s Compustat, court filings and dockets, SEC registrant filings, SEC litigation releases and administrative proceedings, LEXIS-NEXIS, and the public press.



FOOTNOTES

- 1 Seven settlements are excluded from all figures involving damages due to a lack of available stock price data.
- 2 The small number of settlements in the early years following passage of the Reform Act reflects the fact that overall, securities cases typically settle more than two years after they are filed (and our sample is limited to cases filed after December 22, 1995).
- 3 In previous research publications, the year designation for a settlement was based on publication dates of the SCAA. For purposes of the current study, settlements have been re-classified by the year in which the settlement hearing occurred.
- 4 The decrease in the number of cases filed in 2001 refers to traditional securities class actions (i.e., cases other than those with allegations related to the allocation of shares in initial public offerings).
- 5 Original settlement of \$3.186 billion adjusted to \$3.132 billion to reflect a \$54 million payment, reported in December 2002, to settle related shareholder derivative suits against the company's officers and directors.
- 6 DaimlerChrysler also settled a securities class action for \$300 million during 2003. This settlement is excluded from our sample because more than 95% of the settlement fund was designated for shareholders who received DaimlerChrysler shares in exchange for their Chrysler shares in connection with the merger of Daimler and Chrysler in 1998, rather than for purchasers of the company's common stock.
- 7 Our simplified plaintiff-style model is applied to common stock only. For all cases involving Rule 10b-5 claims, damages are determined from a market-adjusted backward value line. For cases involving only Section 11 and/or 12(a)(2) claims, damages are determined from a model that caps per-share damages at the offering price. A volume reduction of 50 percent for shares traded on Nasdaq and 20 percent for shares listed on NYSE or AMEX is used. Finally, no adjustments for institutions, insiders, or short sellers are made to the float.
- 8 Medians represent the point at which half the data points are greater and half are smaller (i.e., the midpoint), and thus, unlike averages, medians are not distorted by the presence of extreme observations.
- 9 We present MDL information in Figure 6 to provide a benchmark for the convenience of our readers since the measure is simple to compute and does not require application of a trading model.
- 10 Accompanying derivative actions are identified primarily through a search of the public press and review of court dockets and SEC filings.
- 11 Determination of involvement as lead or co-lead counsel is based upon reporting by the *SCAA*.
- 12 Industry categories were defined by SIC codes, following classifications established by Hoover's, Inc. and the American Electronics Association. The Telecom classification represents a subset of the general technology sector, composed of firms belonging to SIC Industry Group code 366 [Communications Equipment] or Major Group code 48 [Communications]. The chart excludes cases for which there were insufficient industry concentrations to report separately.
- 13 Due to the presence of extreme observations in the data, logarithmic transformations are applied to settlement amounts, "estimated damages," the defendant's total assets and the number of docket entries.
- 14 The settlement model does not capture the effect of non-public or non-measurable factors that influence final settlements. These factors include the relative merits of the case, as well as limits of available insurance.
- 15 Note that it is considered too early to assess any potential impact of the Sarbanes-Oxley Act of 2002 on settlement outcomes.

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Laura Simmons is a principal in the Washington, DC office and has over twelve years of experience in accounting practice and economics consulting. She is a certified public accountant and specializes in accounting issues arising in complex commercial litigation, including securities, breach of contract and intellectual property matters. Her experience in securities litigation has involved analysis of damage and liability issues for both equity and fixed income securities. She has served as a testifying expert in cases involving accounting analyses and research on securities lawsuits.

Dr. Simmons' research on pre-and post-Reform Act securities litigation settlements has been published in a number of reports and is frequently cited in the public press. She has been an invited speaker at various conferences addressing the topic of securities case settlements. From 1986–1991, she was employed as an accountant with Price Waterhouse.

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