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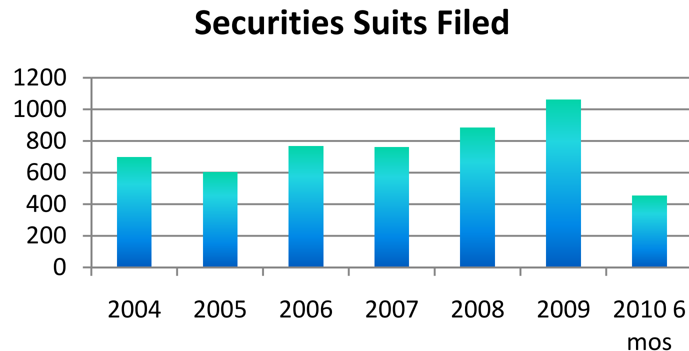
Securities Litigation Surges Following a Quiet First Quarter

An Advisen Quarterly Report – Q2 2010

Executive Summary



A surge in securities litigation in the second quarter of 2010 was driven by short term reactions to headline-grabbing events as well as what are shaping up to be longer term shifts in litigation trends. The number of securities lawsuits filed in the quarter, including derivative actions, regulatory suits, and other suits with securities-related allegations, as well as securities class action suits, was up sharply – nearly 30 percent higher than the first quarter, and 19 percent above the very active second quarter of 2009. New securities class action filings were 36 percent above the first quarter pace and 14 percent higher than the same quarter last year.

The heightened activity was due in large measure to suits sparked by highly visible events such as the government investigation of Goldman Sachs and the Deepwater Horizon oil spill. Deepwater Horizon-related cases drove an 82 percent increase in new filings against energy companies compared to the prior quarter. The focus on Goldman Sachs was in part responsible for several new subprime/credit crisis suits, though other factors suggest that these events will not drive a material number of new suits in the future. While subprime/credit crisis suits are on the wane, financial firms continued to be targeted frequently.

The average settlement through the first half of 2010 – for all categories of securities suits, and including proposed and tentative settlements – fell as compared to 2009, from $29.6 million to $18.9 million. Although the overall average fell, the average securities class action settlement increased materially, from $10.4 million to $49.6 million.

The US Supreme Court handed down several decisions at the end of the second quarter that will influence pending and future securities litigation to varying degrees. In a case challenging the Sarbanes-Oxley Act, the Court upheld all substantive provisions of the law. In a case involving Jeffrey Skilling, the Court ruled that the former Enron CEO should not have been convicted of violating the federal "honest services" fraud law. Perhaps the most significant decision as concerns securities litigation effectively put an end to so-called f-cubed cases – lawsuits brought in the US by foreign shareholders of foreign companies with shares traded on foreign exchanges. In *Morrison v. National Australia Bank*, the Court held that plaintiffs cannot pursue fraud claims in US courts for securities purchased on foreign exchanges.

The key trends and developments of the quarter include:

- Breach of fiduciary duty suits, most of which were filed in state courts, led a surge in new securities suit filings.
- Subprime and credit crisis cases were far below 2007-2009 levels.
- Although new subprime/credit crisis suits have almost disappeared, financial firms continued to be sued more frequently than companies in any other industry group.
- An increase in suits against companies and their directors and officers in the energy industry was sparked by the Deepwater Horizon oil spill and the Upper Big Branch mine explosion.
- The US Supreme Court decision in *Morrison v. National Australia Bank* may impact pending securities class action suits against Vivendi, BP and other foreign companies, and effectively wipes out so-called f-cubed suits.

Securities suits defined. The purpose of this report is to examine all sources of securities-related suits that impact management liability insurance policies other than ERISA liability suits. In addition to SCAS, this report encompasses a much broader set of suits, such as securities fraud, breach of fiduciary duties, derivative actions, collective actions and Ponzi scheme cases, among others.

Several analytic firms publish tallies of securities class action suits filed, but rarely do these tallies agree. In addition to the broad array of securities suits other than securities class actions that Advisen covers, another issue is the way events are counted. In some cases, multiple companies (and their respective directors and officers) are named in the same complaint. Advisen counts each company for which securities violations are alleged in a single complaint as a separate suit. Advisen also includes securities class action suits filed in state courts in its securities class action tally.

The specific definition of each type of suit can vary as well, resulting in different lawsuit tallies. Advisen defines the major types of suits in this report as follows:

- **Securities Class Action:** suits alleging violations of federal securities laws, principally the Securities Act of 1933 and the Securities Exchange Act of 1934, filed by a private party on behalf of a class of persons injured by alleged violations.
- **Securities Fraud:** suits charging violations of securities fraud laws filed by regulators or law enforcement agencies. They also include cases brought by private parties alleging violations of securities laws that are not styled as class actions, and where more specific securities law violations are not made. More than 80 percent of securities fraud cases in the second quarter were filed by regulators or law enforcement agencies.
- **Collective Action:** similar to Securities Class Action; used in jurisdictions, outside of the US, where class action laws do not exist.
- **Breach of Fiduciary Duty:** suits alleging breach of fiduciary duty owed under the federal securities laws, primarily 15 USC Sec. 80a-35, or direct claims of breach related to securities and products whose sale or transfer is covered by securities laws. This includes merger, privatization or other transactions that involve public companies.

Master Significant Case and Action Database (MSCAd).[1] MSCAd is the most complete and accurate database of such cases, consisting of over 50,000 events and over $3.9 trillion in aggregate

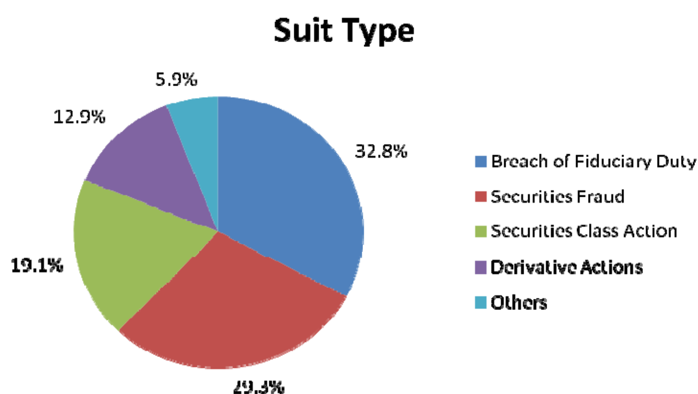
[1] On Advisen.com, MSCAd cases can be found under the "Losses & Exposures" tab, then click on "MSCAd".

losses. Securities cases in MSCAd represent over 10,000 cases and over $120 billion in aggregate losses.

Advisen's MSCAd covers a full range of securities cases, categorized by type. Information about suits and filing details are available for purchase at Advisen's online store, Advisen Corner, at http://corner.advisen.com/reports_topical_sec_normal_home.html and available at no extra charge to Advisen members through their advisen.com logins. For more information please call +1.212.897.4800 or e-mail corner@advisen.com.

Suits filed

Securities suit filings were up 30 percent in the second quarter as compared to the first quarter: 256 versus 197. This compares to 216 suits filed in the second quarter of 2009, which overall was a very active year for securities litigation. Annualized, 2010 is on track for 906 suits, which compares to 1062 suits filed in 2009 and 884 in 2008.



The number of new securities class action suits filed was up – 49 in the second quarter versus 36 in the first – though this type of suit continued to represent an increasingly smaller percentage of all securities suits filed. Securities class action suits comprised almost half of all securities lawsuits before 2006, but have been steadily trending downwards as a percentage of securities suits filed, falling to 23 percent of all securities suits in 2009 and 19 percent of the total through the first half of 2010. They accounted for 19 percent of all securities suits filed in the second quarter. About 35 percent of securities class action suits named financial firms and/or their directors and officers as defendants.

The number of new securities fraud suits, a category defined by Advisen to be comprised principally of suits by regulators and law enforcement agencies, was up slightly in the quarter: 74 versus 71 in the first quarter. As a percentage of total securities suits filed, securities fraud suits accounted for 29 percent of the total in the second quarter as compared to 36 percent in the first quarter and 38 percent in the second quarter of 2009. Financial firms and/or their directors and officers were most often named as defendants in this category as well, accounting for slightly more than half of the total.

The largest number of suits occurred in the breach of fiduciary duty category, which accounted for 33 percent of all securities suits filed during the quarter. More than two-thirds of these suits were filed in state courts. Breach of fiduciary duty suits have grown rapidly as a percentage of all securities suits filed, from 8 percent in 2004 to 25 percent in 2009 to 32 percent of securities suits filed through the first half of 2009.

Breach of fiduciary duty suits typically allege that directors, officers or other company representatives failed to fulfill fiduciary duties owed under federal or state securities laws, or as concerns securities and products covered by securities laws. They often are filed in the wake of a merger or an acquisition by shareholders of the acquired company who believe the directors did not

obtain an adequate price. Breach of fiduciary duty suits were broadly distributed among industry groups in the first quarter, with financial and healthcare companies, both at 19 percent, representing the highest concentration of suits.

The quarter saw an uptick in derivative actions: 33 suits were filed in the second quarter as compared to 18 in the first quarter and 17 in the second quarter of 2009. The increase was due largely to suits filed against companies in the energy industry and their directors and officers, and primarily were triggered by the Deepwater Horizon oil spill. A number of the Deepwater Horizon-related derivative actions were filed by a BP shareholder on behalf of BP and some of its subsidiaries against various other companies associated with the Deepwater Horizon project.

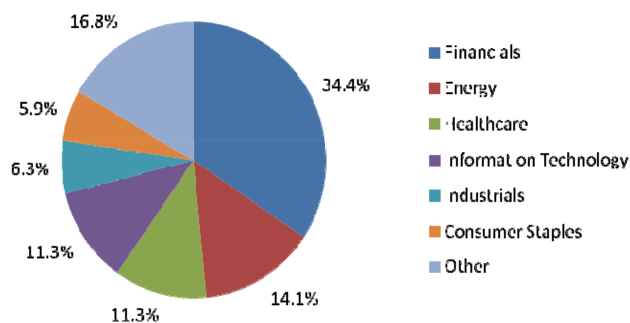
Jurisdiction. By jurisdiction, 28 percent of securities suits were filed in state courts. About 11 percent were filed in the traditional stronghold of federal securities litigation, the United States District Court, Southern District, New York. Three percent were filed in courts outside the US.

Court	% Total
State	27.7%
US District Court, Southern District, New York	11.3%
US District Court, Northern District of California	2.7%
US District Court, Southern District of Florida	2.7%
US District Court for the District of Columbia	2.3%
US District Court for District of Massachusetts	2.3%
US District Court, Northern District of Illinois	2.3%
US District Court, District of Delaware	2.0%
Foreign Courts	2.7%

Suits alleging breach of fiduciary duty, by a wide margin, were the type of suit most likely to be filed in state courts. Only 4 of 49 securities class action suits filed in the second quarter were filed in state courts. The Class Action Fairness Act of 2005 (CAFA) requires most large multi-state class actions to be removed to federal courts. Securities class action suits filed in state courts typically rely on the non-removal provision in Section 22 of the Securities Act of 1933, which permits cases alleging violations of the '33 Act to be tried in state courts. Whether the non-removal provisions of the '33 Act or CAFA govern these cases is still being debated in the courts.

Defendant companies and their directors and officers. Financial firms accounted for about 40 percent of securities suits filed in 2008 and 2009 due substantially to lawsuits sparked by the meltdown of the subprime mortgage market and the ensuing credit crisis, and by the Bernard Madoff Ponzi scheme. That number fell to 31 percent in the first quarter of 2010, and financial firms and their directors and officers were named in about 34 percent of securities suits filed in the second quarter. While fewer than in recent years, suits against companies in the financial sector were nonetheless far more common than suits against companies in any other industry group. Energy companies came in a distant second at 14 percent of securities suits filed in the quarter. Healthcare and information technology companies each came in at about 11 percent of the total.

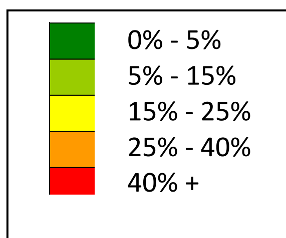
Goldman Sachs and/or its directors and officers were named in 5 of the 7 credit crisis suits filed during the quarter, including securities class action suits, shareholder derivative suits and a securities fraud suit filed by the SEC. Other second quarter suits naming financial companies were not directly attributable to the meltdown of the subprime market or the credit crisis, but nonetheless were sparked by the consequences of the credit crisis. These include a number of securities class action suits alleging that banks and their directors and officers failed to disclose seriously impaired loan portfolios. Two securities class action suits were filed against exchange traded funds.



The surge in suits naming energy companies was largely triggered by the Deepwater Horizon oil spill. BP Plc, Anadarko Petroleum Corp. and Transocean Ltd all were named in securities class action suits. As previously noted, many of the companies involved in the Deepwater Horizon project were sued by a BP shareholder derivatively on behalf of BP for their alleged contribution to BP's losses. Other energy-related suits were sparked by the explosion at the Upper Big Branch mine near Montcoal, West Virginia on April 5, 2010. The explosion caused the highest death toll in a US mining accident in 26 years. Massey Energy Co., the owner of the mine, and certain of its directors and officers have been named in a putative securities class action, and certain of the company's directors and officers were named in two derivative actions.

Securities litigation is typically regarded as a public company phenomenon, but 22 percent of the suits filed in the second quarter named private companies and/or their directors and officers. Many of these suits were securities fraud suits brought by regulators.

Sector Impact Metric™. Advisen's Sector Impact Metric™ (SI Metric™) measures the distribution of securities lawsuits across industry sectors over the past decade. The Metric provides a visual compass tracking the changing seas of securities litigation. The industries consistently with the greatest number of new suits are financial, information technology, consumer discretionary and healthcare, though the relative percentage each represents of the total shifts over time. Financial and information technology have tended to be the mirror image of one another – securities suits against financial companies wane as suits against IT companies increase, and vice versa. If the pattern holds true, a new round of suits against IT companies is looming on the horizon as suits against financial companies begin to fall off.

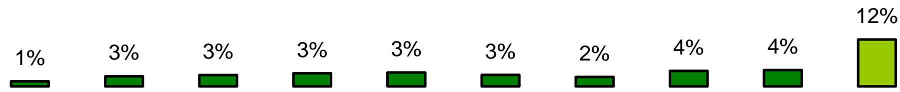


The SI Metric™ gives two visual indicators of securities lawsuits in each sector, providing a way to track trends by industry sector. The height of the bars indicates the percentage of securities suits that fell in each sector per year. The bars are color-coordinated to also reflect the frequency of suits per year for each sector: green (0%-5%); light green (5%-15%); yellow (15%-25%); orange (25%-40%); and red (40% and over).

Sector Impact Metric

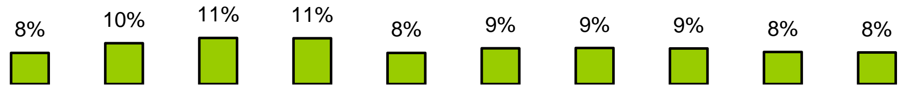
2001 2002 2003 2004 2005 2006 2007 2008 2009 2010

Energy

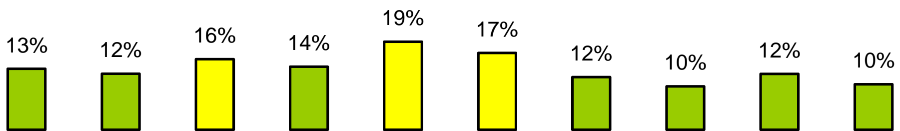


Materials

Industrials

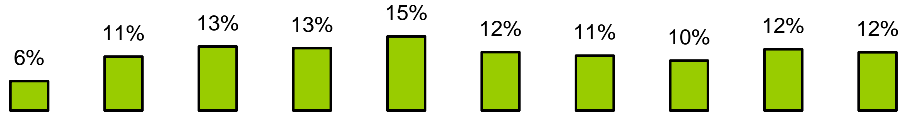


Consumer Discretionary

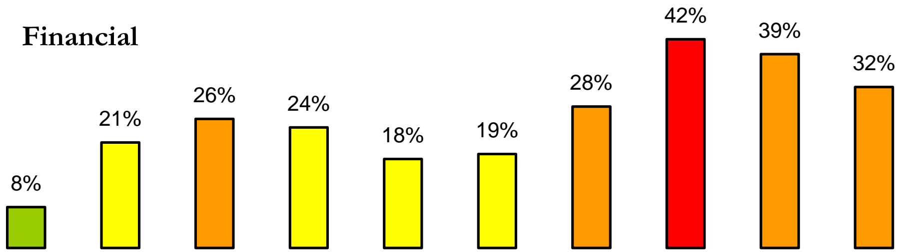


Consumer Staples

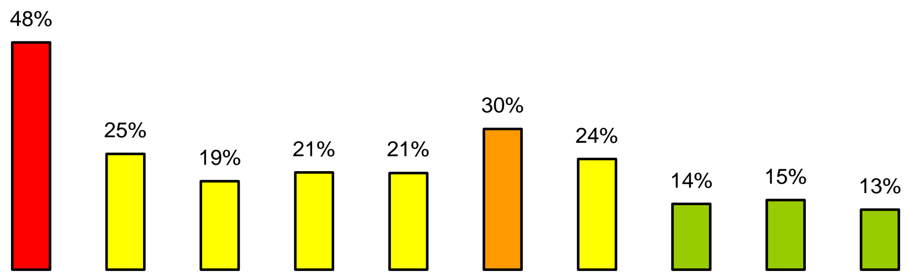
Healthcare



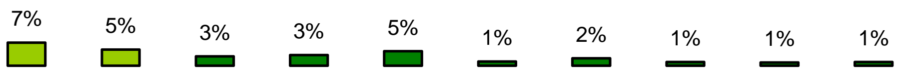
Financial



IT



Telecom



Utilities

Settlements and awards. The average settlement value (including proposed and tentative settlements) of a securities suit during the first half of 2010 fell as compared to full year 2009: $18.9 million versus $29.6 million. Securities class action settlements, however, were up sharply: $49.6 million as compared to $10.4 million. The average securities class action settlement value was not influenced by a single large case, but rather by a higher than average number of settlements greater than $100 million, including a $600 million proposed settlement for Countrywide Financial Corp. Other large securities class action settlements include a $235 million proposed settlement with the Charles Schwab Corp and a $225 million tentative settlement with Comverse Technology Corp. The two largest settlements, Countrywide Financial and Charles Schwab, are subprime/credit crisis cases.

Suits that settled for more than $100 million during the quarter include:

Company	Suit Type	Amount	Status
Countrywide Financial Corp.	SCAS	$600 million	Proposed
Charles Schwab Corp.	SCAS	$235 million	Proposed
Comverse Technology Corp.	SCAS	$225 million	Proposed
Daimler AG	Securities Fraud	$185 million	Settled
Maxim Integrated Products Inc.	SCAS	$173 million	Proposed
Juniper Networks, Inc.	SCAS	$169.5 million	Proposed
Broadcom Corp	SCAS	$160.5 million	Tentative
Refco Inc	SCAS	$140 million	Proposed

In the past, derivative actions principally demanded changes in corporate governance or strategy with monetary awards beyond the plaintiffs' legal costs rare. In recent years, large monetary settlements have become increasingly common. The second quarter saw no blockbuster derivative action settlements, but a tentative settlement of $14 million by directors and officers of Sequenom Inc, a proposed settlement of $9.35 million by directors and officers of Comverse Technology Inc. and a $9.15 million by Icahn Enterprises LP, an investor in National Energy Group. reinforce the trend of significant cash settlements of derivative actions.

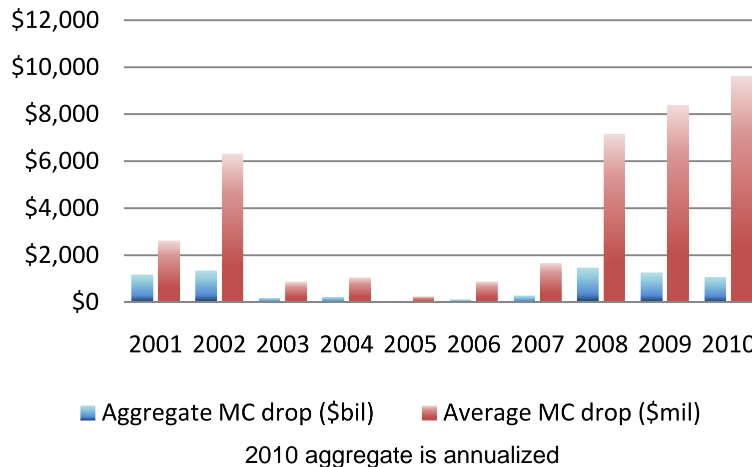
Market Cap Impact Metric™ (MCI Metric™)

The MCI Metric™ measures potential damages under securities class action lawsuits. This Metric measures the aggregate and average market capitalization drop around the class period. For cases initiated by shareholders, courts will typically award shareholders who purchased shares in a company during the class period an amount based on their estimated losses due to the alleged wrongful act. The MCI Metric™ calculates the market capitalization loss considering the typical starting and ending points for calculating damages to shareholders. Since claimants in any one case could have purchased shares on any date during the class period, Advisen considers the average market capitalization during the class period as the starting point. Advisen also uses the market capitalization 30 days after the class period end-date as the ending point for considering the company's market capitalization loss.

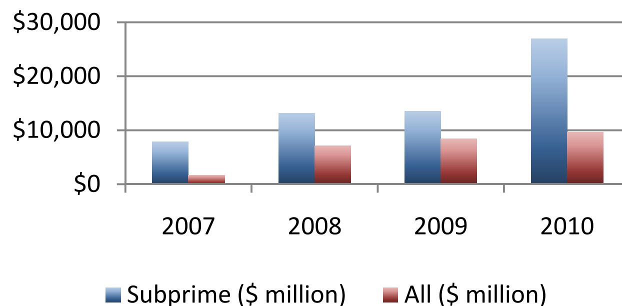
This market capitalization loss is calculated for most companies with a securities class action suit filed against them during each year of the past decade, with certain securities class action cases

eliminated. Securities class action suits eliminated from the calculations are those whose alleged losses are not tied to defendants' stock price losses, thus their potential damages are not tied to market capitalization losses. For example, Madoff-related securities class action cases with investors that experienced losses due to feeder funds investments in the Ponzi scheme claim losses that are not tied to the defendants' stock price. Other examples include losses experienced by auction rate securities investors, which are tied to the underlying security as opposed to the stock price of investment banks named in many of these securities class action cases.

Aggregate losses and average losses are presented within the MCI Metric™. The aggregate loss measures the total fall-off in market capitalization, using the method described, for companies with securities class action suits filed against them for each year. This number is a starting point for calculating damages, and is a useful benchmark for comparing the impact across years. The average loss measures the average fall-off in market capitalization per company and lawsuit. It provides an important new insight into the impact the average SCAS lawsuit could potentially have on the average company for each period.



The aggregate and average market capitalization losses shot up in 2008, 2009 and 2010. Aggregate losses were $1.4 trillion in 2009 and 2008 saw $1.5 trillion in losses. Through the first half of 2010, the annualized aggregate losses were $1.1 trillion. The losses in 2008 and many in 2009 reflect that most of the class periods occurred during the large stock market losses of the past couple of years. Since the beginning of Q2 2009, however, stock markets have generally risen, yet the aggregate losses have remained high, affirming that market cap losses for companies named in securities class action suits are far in excess of market cap loss attributable to overall market fluctuations.



The surge in average market capitalization losses in 2008, 2009 and 2010 was driven largely by subprime/credit crisis cases. These cases, on average, have seen much greater destruction of market capitalization, implying that subprime/credit crisis suits will ultimately settle for far larger amounts than other types of suits.

Supreme Court decisions

A trio of rulings from the U.S. Supreme Court in the second quarter, to varying degrees, will impact pending and future securities litigation.

In a 5-4 decision in *Free Enterprise Fund v. Public Company Accounting Oversight Board*, the Supreme Court found that the Public Company Accounting Oversight Board (PCAOB), created under the Sarbanes-Oxley Act to regulate the accounting industry, violates the Constitution's separation of powers mandate by limiting the president's power to oust its members. The Court, however, kept its decision narrow, saying the board could remain in place as long as the rules governing the appointment and removal of its members were changed. The petitioners, the accounting firm Beckstead and Watts and the Free Enterprise Fund, wanted the justices to invalidate the PCAOB entirely, which would have had the effect of setting aside the entire Sarbanes-Oxley Act. The Court ruled, however, that the Act itself "remains fully operative as a law with these tenure restrictions excised."

The Court ruled unanimously that former Enron CEO Jeffrey Skilling should not have been convicted of violating the federal "honest services" fraud law. The law covers fraud schemes to "deprive another of the intangible right to honest services." The justices ruled that the statute's use should be limited to cases where prosecutors put forward evidence that defendants accepted bribes or kickbacks, allegations that were not part of the case against Skilling. The case was sent back to the federal appellate court for further proceedings. In a related ruling, the court set aside the conviction under the "honest services" fraud law of former Hollinger International Inc. Chairman Conrad Black.

The Court's decision in *Skilling v. U.S.* has significant implications for white collar criminal prosecutions. The decision curtails the more aggressive honest-services theories that have emerged over the years. *Skilling's* effects will be felt far less in private-sector cases, in which honest-services fraud usually is employed as one of a number of prosecution theories.

In *Morrison v. National Australia Bank*, the Court held that plaintiffs cannot pursue fraud claims under US securities laws for securities purchased on foreign exchanges. The decision could have a material impact on several high-profile pending cases. French entertainment company, Vivendi, which in January had a plaintiffs' verdict entered against it in a securities class action suit filed in the US, said in a press release it is "very satisfied with this decision." Many Vivendi shareholders purchased their shares on exchanges outside the US. Securities class action litigation filed under US securities law against BP and certain of its directors and officers also may be affected by this decision. About 28 percent of BP's equity is in American Depositary Receipts, but most shareholders probably bought their shares in the UK. The decision effectively puts an end to so-called f-cubed cases – suits filed in the US by foreign investors against foreign companies concerning shares bought on foreign exchanges.

Other securities litigation trends and developments

Changing landscape for securities class action suits. Securities class action suits as a percent of all securities suits have been declining since 2004, but they nonetheless remain a vital watermark for securities litigation trends. In addition to remaining one of the most commonly filed types of securities suits, securities class action suits typically produce most of the largest settlements. The average securities class action settlement in the second quarter was $47.6 million, and securities class action suits accounted for 4 of the top 5 settlements of the quarter.

Through six months, 85 securities class action suits have been filed for an annualized 170 cases. This compares to 236 suits filed in 2009 and 240 in 2008. The average for 2005-2009 is 213. The decline in 2010 is due substantially to a sharp drop in subprime/credit crisis suits.

A high percentage of subprime/credit crisis suits were filed against financial firms. Although the number of new subprime/credit crisis suits has fallen dramatically, financial firms remain the target of choice for securities class action suits: 35 percent of securities class actions filed in the second quarter named financial companies and/or their directors and officers. Largely in response to government investigations into it role in the meltdown of the subprime mortgage market, Goldman Sachs was named in nearly one quarter of the financial institution securities class action suits filed. Exchange traded funds were named in two suits.

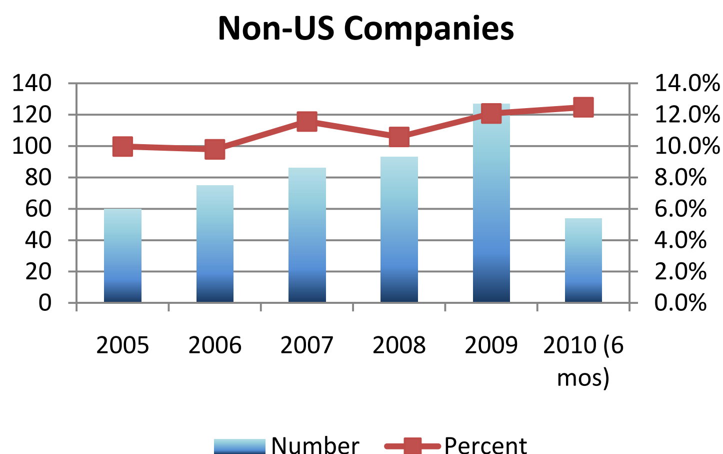
At a distant second place for new securities class action suits filed in the quarter were health care companies, which accounted for 16 percent of the total. Energy and IT companies each were responsible for 14 percent of new securities class action suits filed. Suits against energy companies were in response to two high profile disasters, the Deepwater Horizon oil spill and the explosion at the Upper Big Branch mine in West Virginia.

The average time between the end of the class period and the date the suit is filed increased substantially in 2009, from 126 days in 2008 to 214 in 2009. This most likely is an artifact of the drop in the number of subprime and credit crisis suits in 2009. The high volume of potentially large subprime and credit crisis suits had commanded the attention of plaintiffs' attorneys during 2007 and 2008. As the number of new suits dwindled in 2009, attorneys turned their attention to the backlog of other types of securities class action suits. This phenomenon continues in 2010, with the average time between the end of the class period and the filing date increasing to 228 days.

The globalization of securities litigation. The increasing number of non-US companies agreeing to securities litigation settlements in excess of $100 million makes it clear that securities litigation has become a reality of doing business for companies around the world. Any company with shares trading on US exchanges is subject to securities litigation (and other management liability-related litigation) in US courts. Furthermore, many countries around the world, especially in Europe, are "modernizing" their civil legal systems by providing greater access to court remedies through various collective action mechanisms. The end results are systems closer to the US class action system, and ultimately more suits with greater payouts from courts outside of the US. In addition, financial regulators around the world have stepped up enforcement efforts in the wake of the credit crisis, and increasingly work in consort with US authorities.

As compared to the US, securities litigation in Europe, Asia and Latin America is less frequently a matter of public record, making it difficult to get as complete a picture of litigation activity. Typically only the largest cases attract media attention, and non-US companies are far less likely to provide details of litigation in their public disclosures. Given these limitations on data collection, it is nonetheless clear that securities litigation activity has been on the rise in recent years in courts outside the US. For the first half of 2010, Advisen recorded 11 securities suits filed in courts outside the US, for an annualized total in line with 2006-2008 totals. The Madoff Ponzi scheme, which drew in a number of non-US investors and banks, led to a spike in non-US securities cases in 2009.

Securities suits against non-US companies – both in the US and elsewhere – have accounted for more than 10 percent of total securities suits tracked by Advisen since 2005. For the first half of 2010, 13 percent of securities suits were filed against non-US companies. However, that number is likely to dip in the short term as a result of the US Supreme Court decision in *Morrison v. National Australia Bank,* which ends the practice of filing lawsuits in US federal courts as concerns securities purchased on non-US exchanges. The US federal court system has been the venue of choice for securities litigation for shareholders across the globe. The number of securities suits against non-US firms almost certainly will continue to grow in the long term, but in the aftermath of *Morrison*, and as shareholders gain greater access to legal systems elsewhere to litigate securities claims, fewer suits against foreign firms will be filed in the US.



Bankruptcies, M&A and securities litigation. As a consequence of the global recession, corporate bankruptcies are skyrocketing. According to federal bankruptcy court records, 21,453 companies filed for bankruptcy in the first quarter of 2010 – almost 1,000 more than the highly elevated first quarter of 2009. Although there has not been the surge in bankruptcy-related securities lawsuits predicted by some analysts, that type of suit has been on the increase.

Advisen research has shown that the conditions that lead to a bankruptcy can be the catalyst for a securities class action suit long before the company files for bankruptcy. For that reason, bankruptcy has been a factor in more cases than the numbers suggest. Viewed another way, companies that have been named in securities class action suits during the past 18 months have a much higher than average probability of filing for bankruptcy in 2010 and 2011.

As the economy recovers merger & acquisition activity will likely increase, leading to more securities suits, especially breach of fiduciary duty suits. Breach of fiduciary duty suits often are filed by disgruntled shareholders of an acquired company, alleging the company's directors and officers sold the firm too cheaply. Historically, M&A activity falls sharply during a recession, and the current economic downturn is no exception. However, as recovery accelerates and credit markets are revitalized, M&A activity will increase, driven in part by fire sales of companies damaged by the recession and divestitures to raise sorely needed cash. Despite a lull in M&A activity, breach of fiduciary duty suits have been increasing in number during recent years. As M&A activity accelerates, the volume breach of fiduciary duty suits is likely to grow at an even faster pace.

A resurgent SEC. Since the credit crisis, and the ensuing political storm, regulatory authorities have stepped up enforcement efforts, beefed up enforcement teams, and began coordinating efforts. The SEC, DOJ and state enforcement officers like attorneys general are more likely than ever to coordinate prosecutions, sharing evidence and information, making successful prosecution at all levels more likely. US regulators and enforcement agencies have also coordinated their efforts with regulatory entities in the EU and elsewhere, and most notably with the UK's Financial Services

Authority. These parallel proceedings have contributed to spiraling defense costs, even in cases with no wrongdoing.

The SEC is becoming more proactive and more aggressive in light of recent not-so-stellar events that exposed an image of the SEC as asleep at the wheel. The agency has realigned staff and divisions and moved more authority to the field. The impact already is being felt. Between 2008 and 2009:

- Formal investigations were up 113 percent
- Temporary restraining orders were up 82 percent
- Disgorgement of profits was up 170 percent
- Penalties were up 35 percent

The fiscal 2011 budget (beginning October 2010) calls for 400 additional full-time equivalent employees, and the Obama Administration's proposed regulatory overhaul plan envisions much enhanced SEC authority.

In January 2010, the SEC threw a curveball at corporate executives and their insurers. The Commission announced a set of tools as part of its new cooperation initiative. These tools, used by the DOJ in criminal proceeding for years, authorize the SEC Enforcement Division to provide limited immunity to many cooperating parties. The three tools include: cooperation agreements; deferred prosecution agreements; and non-prosecution agreements. Cooperation agreements are written agreements that the Enforcement Division could offer to cooperators who provide substantial assistance and agree to cooperate fully. The cooperator must waive statutes of limitation, but does not need to admit or deny any violations. The Division would then recommend to the SEC that the cooperator receive credit for assisting in the investigation, but it is not binding on the SEC.

Deferred prosecution agreements are also written agreements to cooperate fully. The cooperator would agree to either admit or not contest relevant facts underlying the alleged offenses, and to pay disgorgement and penalties. The SEC would agree to forego prosecution during a period of time, not to exceed five years. After the deferred period, the SEC could authorize enforcement, and any admission of facts could be used against the cooperator. Non-prosecution agreements are written agreements with those cooperating fully, where the SEC agrees not to pursue enforcement action against the cooperator. This agreement will be used under "limited and appropriate circumstances," and the cooperator would agree to pay disgorgements and penalties.

Most assume that more cooperation will result from this initiative, but the degree of cooperation will depend on the details of the agreements. In March, the SEC announced a possible policy change that would work against the tide of cooperation. The SEC might end its long-standing practice not disclosing many details of evidence from cases where companies and individuals cooperated. These details could reveal facts that would prevent indemnification from insurance policies, and possibly open the floodgates to SCAS and other lawsuits using these facts as a basis for their cases.

Cooperation initiatives could help to lower defense costs and lower insurance policy payments if most officers agree to cooperate. It also could increase overall defense costs depending on the dynamics of the case for a given company. A change in disclosure policies would make it less likely for officers to cooperate for fear that embarrassing and incriminating evidence would be released. It

would at least delay cooperation to ensure that the increased number of facts is reasonably stated, prolonging negotiations with the SEC.

Any agreement that admits to liability would likely void coverage of defense costs for most D&O insurance policies. Furthermore, depending on the terms of the policy, if one director does something to void coverage, it may void coverage for all directors and officers, placing the company and all officers at risk. Looking at the specific restrictive provisions in policies becomes vital when agreeing to cooperation.

More information

More information about suits and filing details is available for purchase at Advisen's online store, Advisen Corner, at http://corner.advisen.com/reports_topical_sec_normal_home.html and available at no extra charge to Advisen subscription members through their advisen.com logins. For more information please call +1.212.897.4800 or e-mail corner@advisen.com.

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