

Securities Class Action Filings

2008: A Year in Review

Research Sample

- The Stanford Law School Securities Class Action Clearinghouse, in cooperation with Cornerstone Research, has identified 2,867 federal securities class action filings between January 1, 1996 and December 15, 2008.
- These filings include 313 “IPO Allocation” filings, 69 “Analyst” filings, 47 “Mutual Fund” filings, 40 “Options Backdating” filings, and 136 “Subprime/Liquidity Crisis” filings; the latter category includes 21 filings related to auction rate securities.
- The sample used in this report excludes IPO Allocation, Analyst, and Mutual Fund filings.
- Multiple filings related to the same allegations against the same defendant are consolidated in the database through a unique record indexed to the first identified complaint.

Overview

Federal securities class action activity in 2008 was dominated by a wave of litigation against firms in the financial services sector. A total of 210 federal securities class actions (“filings” or “class actions”) were filed in 2008, a 19 percent increase over the 176 filings in 2007, and a 9 percent increase over the annual average of 192 filings observed between 1997 and 2007 (Figure 1).¹

Financial companies are defendants in 103 of these filings (49 percent), and 91 of those filings are related to the subprime/liquidity crisis. The maximum dollar loss attributable to all the 2008 class actions is \$856 billion, a 27 percent increase over 2007.² Financial firms represent 46 percent of the maximum dollar loss in 2008. Evidently, litigation against the firms closest to the on-going subprime/liquidity crisis was the dominant force in federal class action securities litigation in 2008.

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Figure 1

Class Action Filing Summary			
	Average (1997 – 2007)	2007	2008
Class Action Filings	192	176	210
Disclosure Dollar Loss (\$ Billions)	\$130	\$153	\$227
Disclosure Percent Loss (%)	1.1%	1.1%	1.6%
Maximum Dollar Loss (\$ Billions)	\$698	\$676	\$856
Maximum Percent Loss (%)	5.7%	5.0%	5.9%

This level of litigation activity against firms in a specific sector is unprecedented since the passage of the 1995 Reform Act. Our newly introduced Litigation Heat Maps™ portray the intensity of litigation activity within each industry over time and Figure 6 shows that nearly a third of all large financial firms were sued in a securities class action filed in 2008. The scope of litigation activity within the financial sector is even more pronounced when measured as a share of total sector market capitalization. The companies named as defendants in class actions filed in 2008 accounted for over half of the total market capitalization of the financial sector (Figure 7). Combining data for 2007 and 2008 indicates that firms representing approximately two thirds of the financial sector as measured by market capitalization were the subject of a federal securities class action filing in the last two years.

¹ 2008 filings include class actions identified as of 12/15/2008. Typically few class actions are filed during the last two weeks of the year. All other years include filings through 12/31. Our “filings” counts consolidate multiple filings related to the same allegations against the same defendant and are therefore counts of unique disputes.

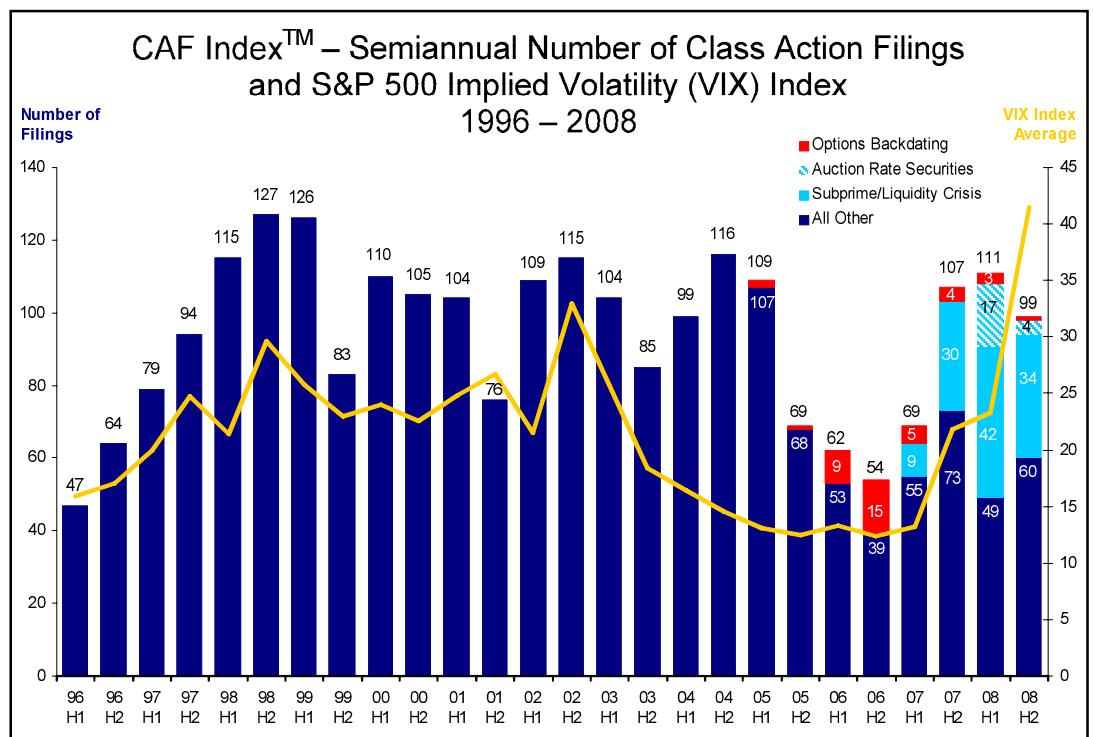
² Maximum Dollar Loss and Disclosure Dollar Loss are defined in the “Market Capitalization Losses” section of this report.

Overview continued

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Another interesting pattern in litigation in 2008 was the decline in activity observed during the second half of the year despite a dramatic drop in stock market value and an unprecedented spike in market volatility (Figures 2 and 4). High volatility has historically been correlated with an increased level of litigation activity. A break in this pattern in the second half of 2008 suggests that a new dynamic may be at work. One possible explanation is that the market volatility has been so large that plaintiffs found it difficult to isolate company-specific stock movements that could be alleged to be the result of fraudulent activity from the broader noise generated by a market that could swing 5 percent in a single day. If so, the market's volatility may have deterred some filings.

Figure 2



This report provides a full review of federal securities class action filings in 2008, characterizing the number of class actions both in terms of the number of filings and the associated market capitalization losses; the current status of filed class actions; and the distribution of filings across industries, stock exchanges, federal circuits, and the nature of the allegations.

Number of Filings

The Class Action Filings (CAF) Index™ reports 210 filings in 2008, the highest level of filing activity since 2004. The number of filings in 2008 constitutes a 19 percent increase over the 176 filings in 2007 and a 9 percent increase over the annual average of 192 filings for the 11 years ending December 2007 (Figure 3).³ In 2008, 97 filings, or almost half of all filings, were related to the subprime/liquidity crisis: 21 of these were filed on behalf of holders or purchasers of auction rate securities.

When the data are examined on a semiannual basis, it is evident that the number of filings began a marked increase in the second half of 2007 (Figure 2). There were 317 filings in the last 18 months, a 71 percent increase over the 185 filings in the prior 18-month period. These increases were largely attributable to filings related to the subprime/liquidity crisis that first emerged in 2007. There were 127 filings related to these crises in the last 18 months, 40 percent of the total filings over that period. Over the same period, filings unrelated to the subprime/liquidity crisis grew only 8 percent, from 176 to 190.

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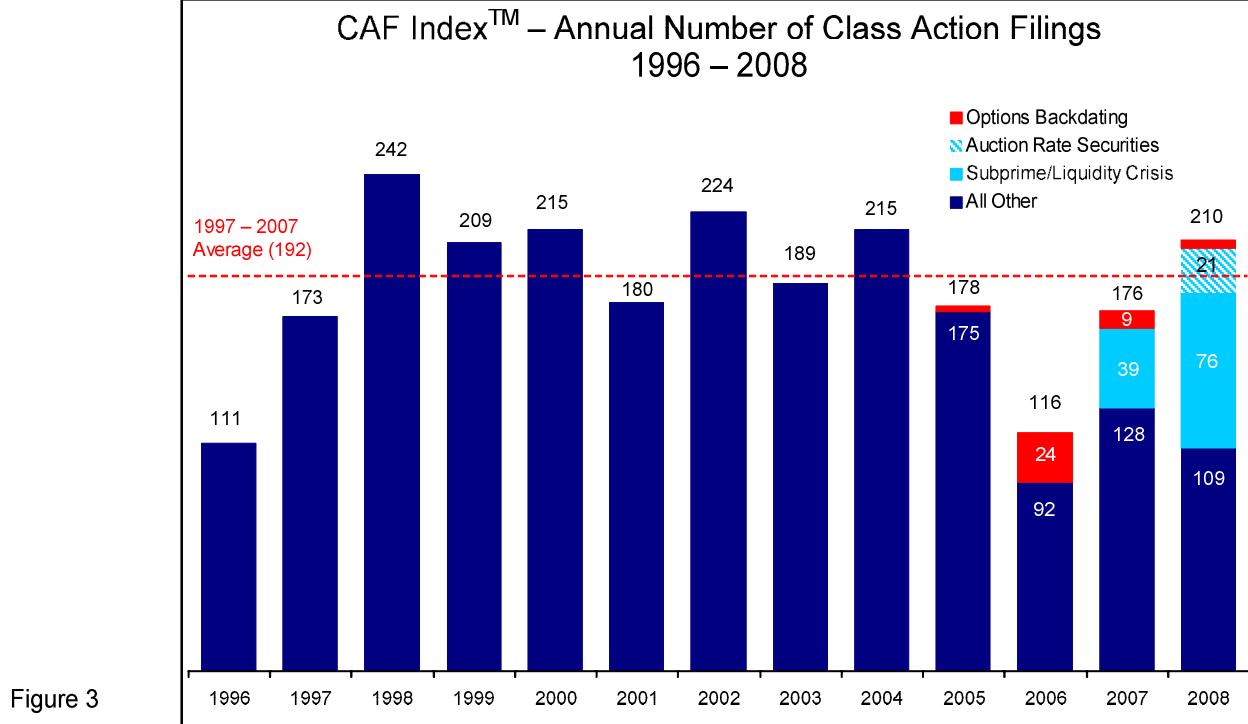


Figure 3

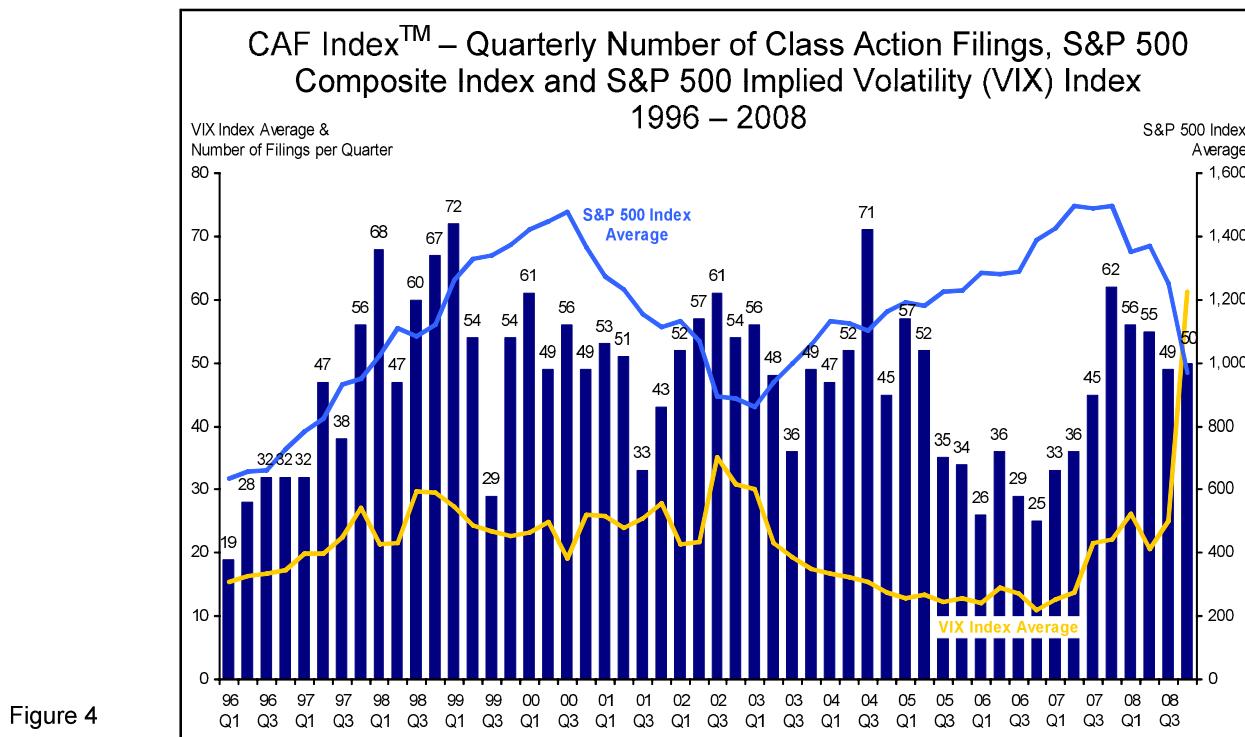
³ The indices and charts throughout exclude IPO Allocation, Analyst, and Mutual Fund filings.

Number of Filings continued

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Figure 4 shows that high filing activity tends to occur in periods of high stock market volatility as measured by the Chicago Board Options Exchange Volatility Index (VIX).⁴ This pattern, however, does not hold for the fourth quarter of 2008 in which there was a sharp increase in volatility without a resulting spike in the number of filings. Average stock market volatility in the fourth quarter was the highest since the inception of the VIX in 1990 and 74 percent higher than in the next most volatile quarter. The number of fourth quarter filings, however, was about the same as in the third quarter of 2008 and lower than in the three quarters prior to that.

This departure from the observed historical relationship between filing activity and stock market volatility raises a question about how this period might differ from others. One possibility is that the high market-wide volatility made it difficult for plaintiff law firms to isolate company-specific stock price changes that were allegedly the result of fraudulent activity. In a period in which the overall market can decline by as much as 5 percent in a single day of trading, it may be more difficult for a plaintiff law firm to make the case that even a large drop in a company's stock price is attributable to fraud rather than to market factors. If so, the market's volatility may have deterred some filings. Professor Joseph A. Grundfest of the Stanford Law School suggests a hypothesis that attributes the decline in total filings to the filing activity within the financial sector (see commentary on page 9).



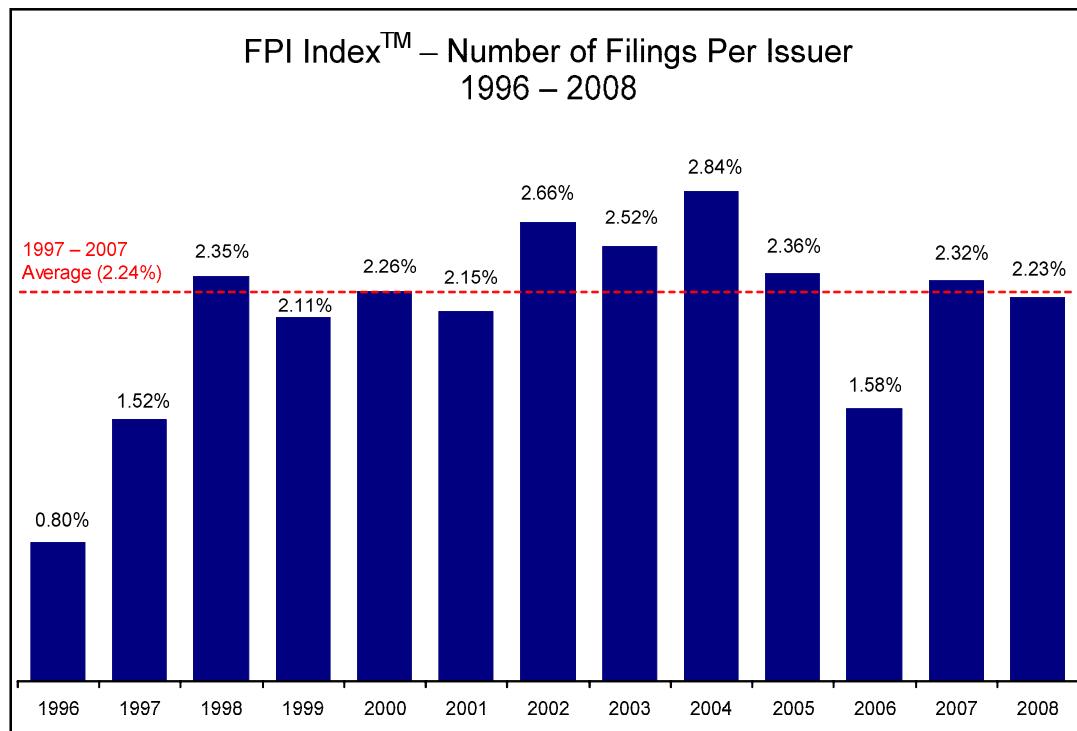
⁴ The VIX is a measure of market expectations of near-term volatility conveyed by S&P 500 stock index option prices. See <http://www.cboe.com/micro/vix/introduction.aspx>.

Number of Filings continued

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Although the number of filings increased in 2008, several companies were defendants in more than one class action. As a result, the Filings Per Issuer (FPI) Index™ shows a decline from 2007 to 2008 (Figure 5). Of all the companies listed on the NYSE, NASDAQ, and Amex at the start of the year, 2.23 percent were defendants in federal securities class actions filed in 2008, slightly down from the 2.32 percent in 2007 and in line with the 2.24 percent annual average for the 11 years ending December 2007.⁵

Figure 5



In this report, we introduce a new tool for analyzing securities class action activity by industry. We focus on companies in the S&P 500 index, which measures the aggregate stock market value of 500 large companies representing all major industries. We obtain the composition of the S&P 500 index at the start of each year and ask two questions for each industry.⁶ First, what share of the companies in the index at the beginning of the year was subject to securities class actions filings in federal courts during the year? Second, of the total market capitalization of the companies in the index at the beginning of the year, what share was accounted for by companies subject to securities class action filings? Our findings are presented in the S&P 500 Securities Litigation Heat Maps™.

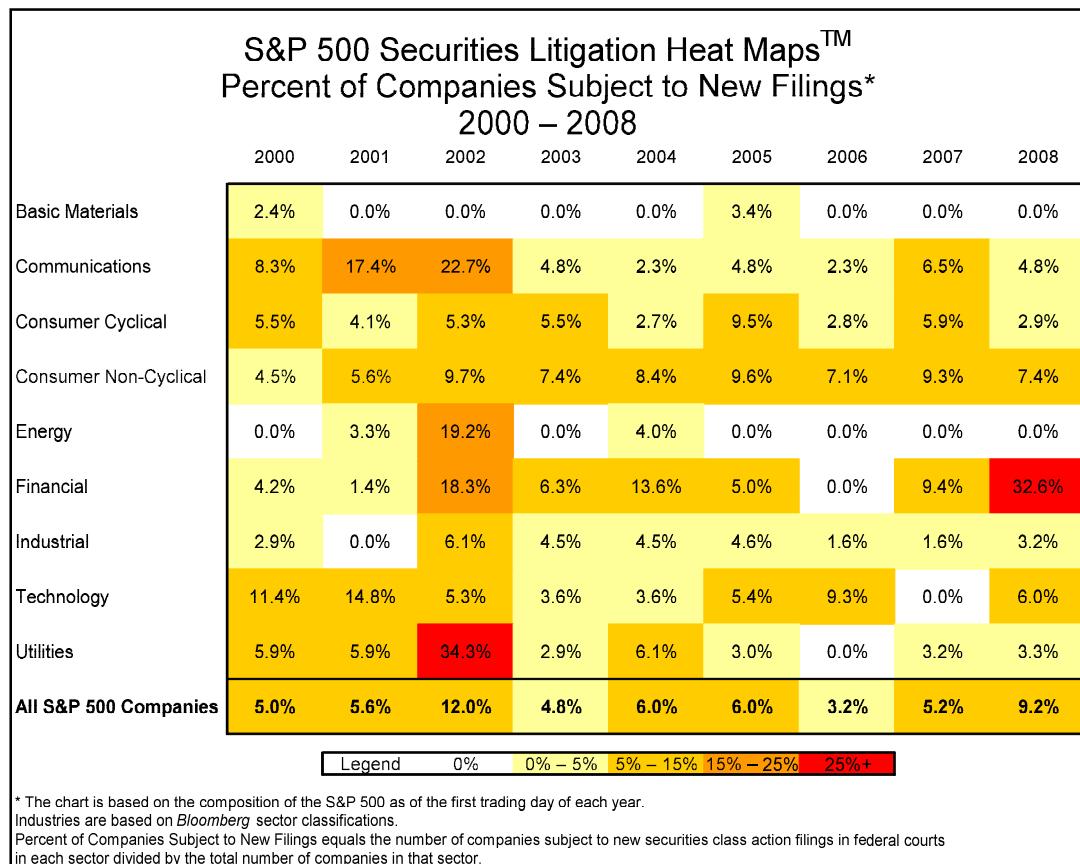
⁵ In Figures 5, 6, 7, 8 and 20 when we refer to the number of companies involved in litigation, we have consolidated all filings against the same company so that the count is a count of unique companies.

⁶ This analysis uses the sector classifications provided by Bloomberg. According to Bloomberg, "sector" is the broadest classification that represents the general economic activities of a company. Bloomberg divides companies into 10 sectors: basic materials, communications, consumer cyclical, consumer non-cyclical, diversified, energy, financial, industrial, technology, and utilities. The consumer cyclical sector includes airlines, apparel, auto manufacturers, auto parts and equipment, distribution/wholesale, entertainment, food service, home builders, home furnishings, housewares, leisure time, lodging, office furnishings, retail, and storage/warehousing. The consumer non-cyclical sector includes agriculture, beverages, biotechnology, commercial services, cosmetics/personal care, food, healthcare products, healthcare services, household products/wares, and pharmaceuticals.

Number of Filings
continued

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Figure 6



Overall, 9.2 percent of companies in the S&P 500 index at the start of 2008 were defendants in a federal securities class action filed in 2008 (Figure 6). As a comparison, Figure 5 shows that approximately 2.2 percent of all listed companies were defendants. The 9.2 percent of S&P 500 companies defending securities class action lawsuits in 2008 accounted for 17.1 percent of the market capitalization of the S&P 500 index (Figure 7). This means that these lawsuits were filed disproportionately against the larger companies within the S&P 500.

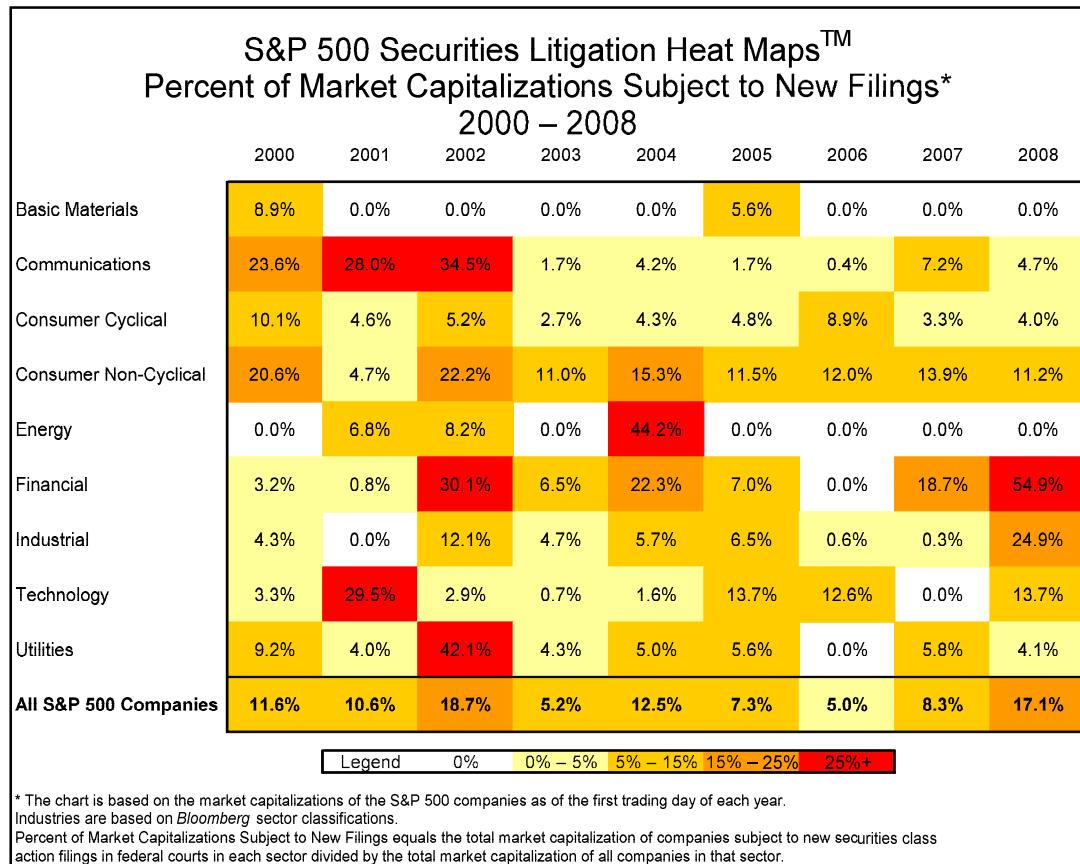
Turning to data by industry, the financial industry was the sector most heavily affected by new securities litigation in 2008. Of the companies in the S&P 500 index that *Bloomberg* classifies as financial, 32.6 percent were defendants in 2008 filings compared to 9.4 percent just a year earlier. These defendant companies accounted for 54.9 percent of the market capitalization of all financial companies in the S&P 500 index in 2008.

Going back in time, we see a high concentration of filings activity in the communications sector in 2001–02, reflecting securities lawsuits against growth companies in the aftermath of the market adjustment in this period. The high fraction of utilities companies subject to securities litigation in 2002 reflects both the relatively small number of utilities in the S&P 500 index (so that a few lawsuits translate into a high share of total companies in the sector) and allegations related to energy trading activity. Six of the 12 class actions that year against S&P 500 utilities companies include allegations of irregularities in revenue recognition from energy trades with various counterparties, including trades with Enron Corporation.

Number of Filings
continued

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Figure 7



Number of Filings *continued*

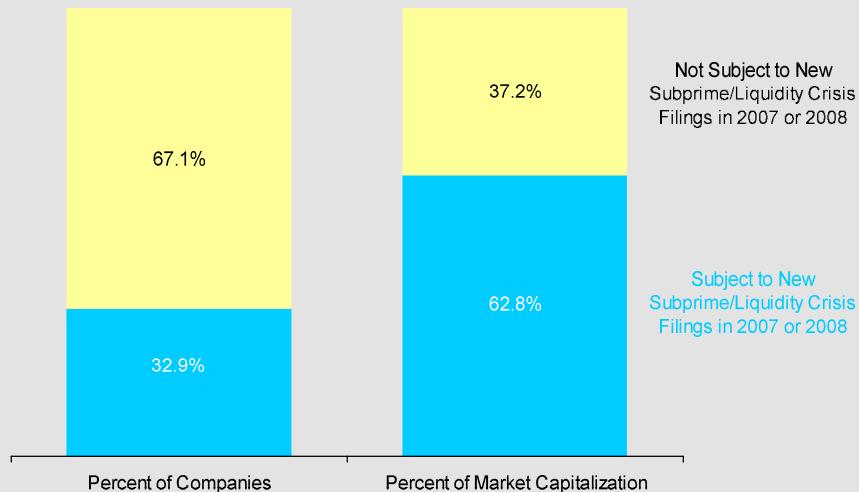
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Stanford Law School Professor Joseph Grundfest suggests that the high incidence of class action filings in the financial sector in 2008 provides a potential explanation for the slight decline in class action filings in the second half of 2008. Professor Grundfest explains that the flat profile in the levels of class action filings in the face of very high stock market volatility is consistent with the hypothesis that major financial players have already been sued:

As the subprime/liquidity crisis rocked the financial industry beginning in mid-2007, securities class actions related to the crises poured in. While the fallout from the crises seems likely to continue, the financial institutions with the deepest pockets have already been sued. If we examine the 85 companies in the S&P 500 that *Bloomberg* classified as being in the financial sector at the beginning of 2007 (prior to the start of the crisis), nearly one-third have been sued in subprime/liquidity crisis-related securities class actions. Furthermore, nine out of the largest 10 companies ranked by market capitalization and 12 out of the top 15 companies had been sued by the end of 2008. In the next set of top 25 companies, just nine were defendants in subprime/liquidity crisis-related lawsuits and the share of companies targeted by lawsuits thins out further down the list.

The fact that most of the lawsuits filed in 2008 were concentrated among the largest financial institutions may indicate a rational strategy by plaintiff law firms to initially focus on defendants with the deepest pockets. While an initial focus on the largest financial institutions may have kept the number of filings lower in the second half of 2008, it is unclear as to whether the wave of litigation will extend significantly beyond the largest financial firms in the near future.

Incidence of New Subprime/Liquidity Crisis Filings in 2007 and 2008 for Financial Companies in the 2007 S&P 500 Index



Note: The chart is based on the composition of the S&P 500 as of the first trading day of 2007 and *Bloomberg* financial sector classification. Percent of Companies Subject to New Subprime/Liquidity Crisis Filings equals the number of companies subject to new securities class action filings related to the subprime/liquidity crisis in federal courts in 2007 or 2008 divided by the total number of companies. Percent of Market Capitalization Subject to New Subprime/Liquidity Crisis Filings equals the total market capitalization of companies subject to new securities class actions related to the subprime/liquidity crisis in federal courts in 2007 or 2008 divided by the total market capitalization of all companies as of January 3, 2007.

Figure 8

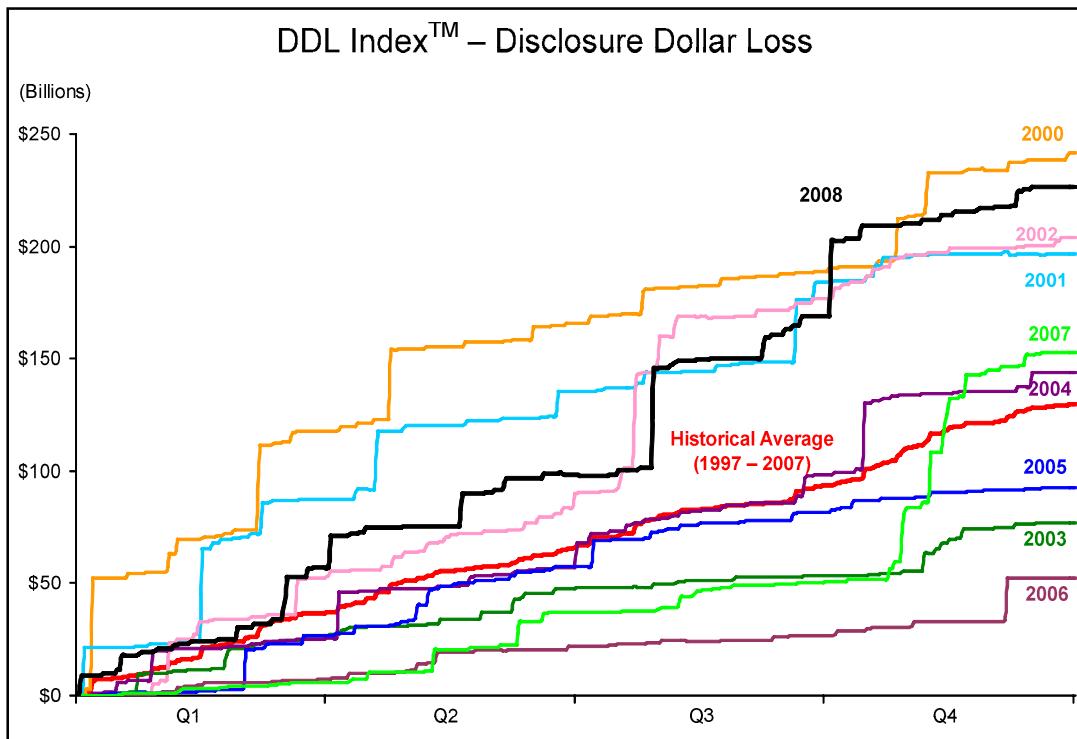
Market Capitalization Losses

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To measure changes in the size of class action filings, we track market capitalization losses for defendant firms during and at the end of class periods.⁷ Declines in market capitalization over extended periods may be driven by market, industry, and firm-specific factors. To the extent that the observed losses reflect factors unrelated to specific allegations in class action complaints, indices based on class period losses would not be representative of potential defendant exposure in class action litigation. This is especially relevant for the post-*Dura* securities litigation environment.⁸ This report tracks market capitalization losses at the *end* of each class period using Disclosure Dollar Loss (DDL) and market capitalization losses *during* each class period using Maximum Dollar Loss (MDL).

DDL is the dollar value change in the market capitalization of the defendant firm between the trading day immediately preceding the end of the class period and the trading day immediately following the end of the class period. MDL is calculated as the dollar value change in the market capitalization of the defendant firm from the trading day during the class period when its market capitalization was the highest to the trading day immediately following the end of the class period. DDL and MDL should not be considered indicators of liability or measures of potential damages. Instead, they estimate the impact of all the information revealed during or at the end of the class period, including information unrelated to the litigation.

The Disclosure Dollar Loss (DDL) Index™ tracks the running sum of DDL for all class actions filed in a given year. The DDL Index™ shows disclosure losses in 2008 are surpassed only by losses in 2000 (Figure 9). DDL for 2008 totaled \$227 billion: 48 percent more than in 2007 and 75 percent more than the annual average for the 11 years ending December 2007 (Figure 10). In 2008, subprime/liquidity crisis-related filings accounted for \$92 billion of DDL, or 41 percent.



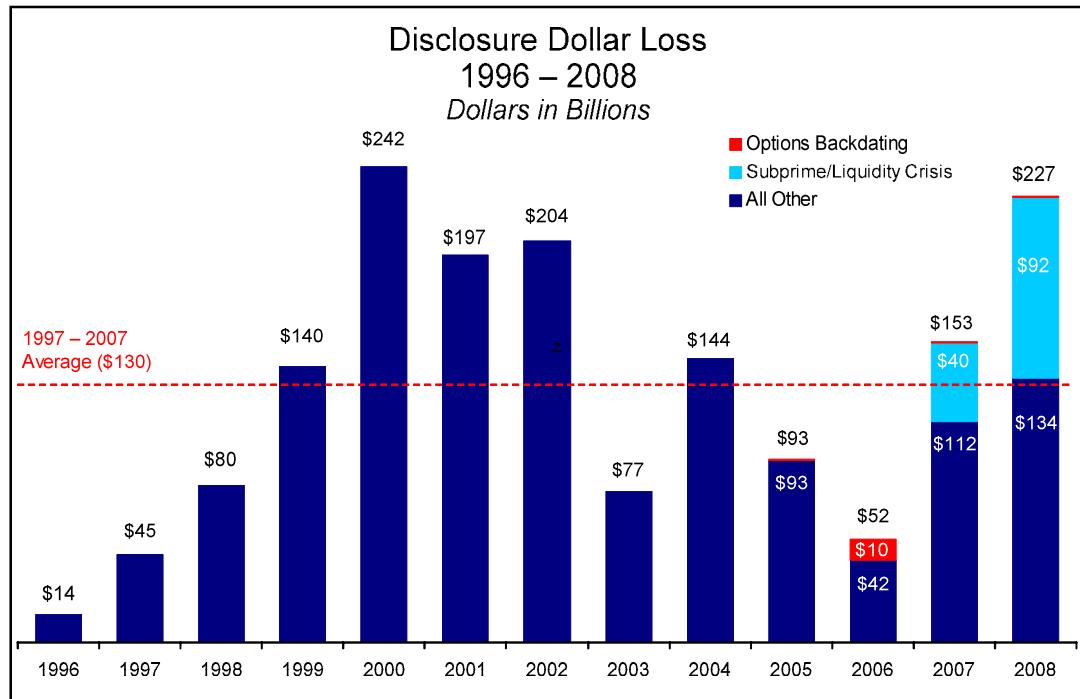
⁷ Market capitalization measures are calculated only for publicly traded equity securities.

⁸ In April 2005 the Supreme Court ruled that plaintiffs in a securities class action case are required to plead a causal connection between alleged wrongdoing and subsequent shareholder losses.

**Market
Capitalization
Losses
*continued***

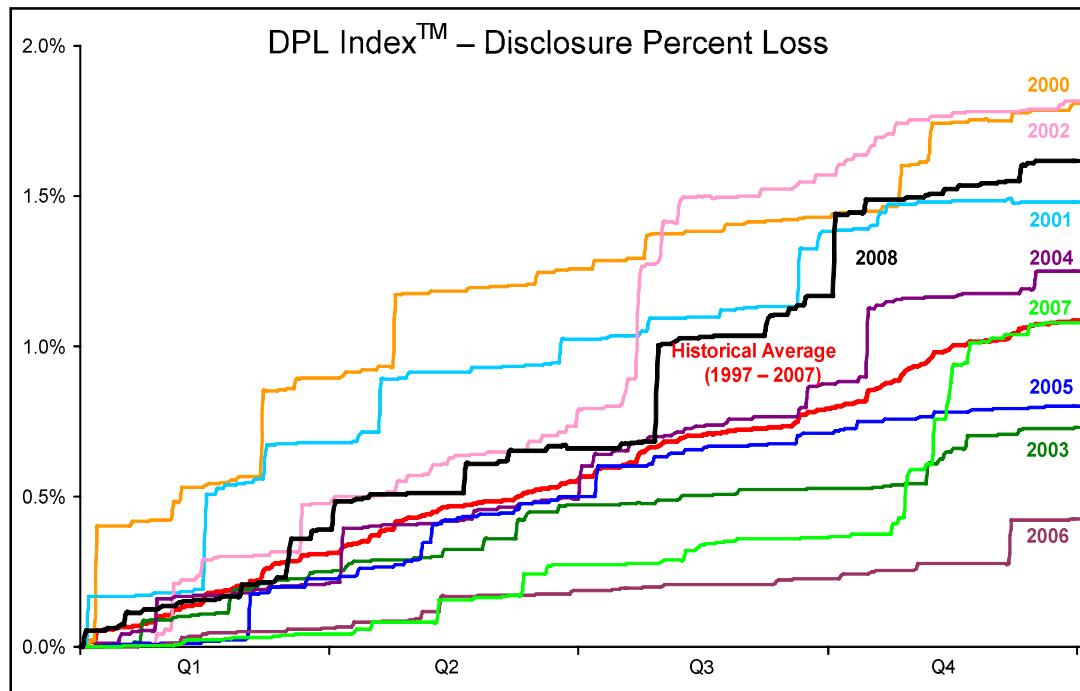
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Figure 10



The Disclosure Percent Loss (DPL) Index™ tracks the running sum of DDL as a percentage of the capitalization of the companies in the Wilshire 5000.⁹ The DPL Index™ also shows historically high levels in 2008, exceeded only in 2000 and 2002 (Figure 11). DDL in 2008 represented 1.6 percent of the Wilshire 5000 capitalization, compared to 1.1 percent in 2007 and the 1.1 percent annual average for the 11 years ending December 2007.

Figure 11



⁹ See <http://securities.cornerstone.com> for complete details on the DPL Index™ calculation.

**Market
Capitalization
Losses
*continued***

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Like the DDL Index™, the Maximum Dollar Loss (MDL) Index™ shows higher market value losses in 2008 than in recent years (Figures 12 and 13). MDL for 2008 was \$856 billion: 27 percent higher than in 2007, 23 percent higher than the annual average for the 11 years ending December 2007, and the highest level since 2002. MDL for subprime/liquidity crisis-related filings totaled \$456 billion in 2008, or 53 percent of MDL for the year.

Figure 12

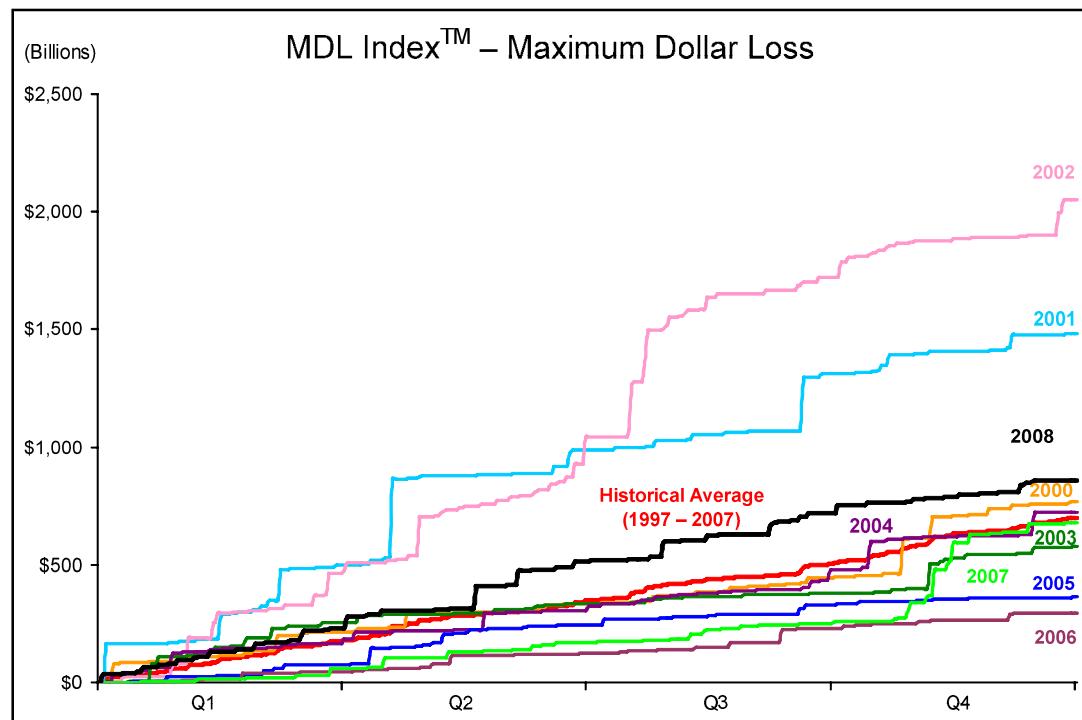
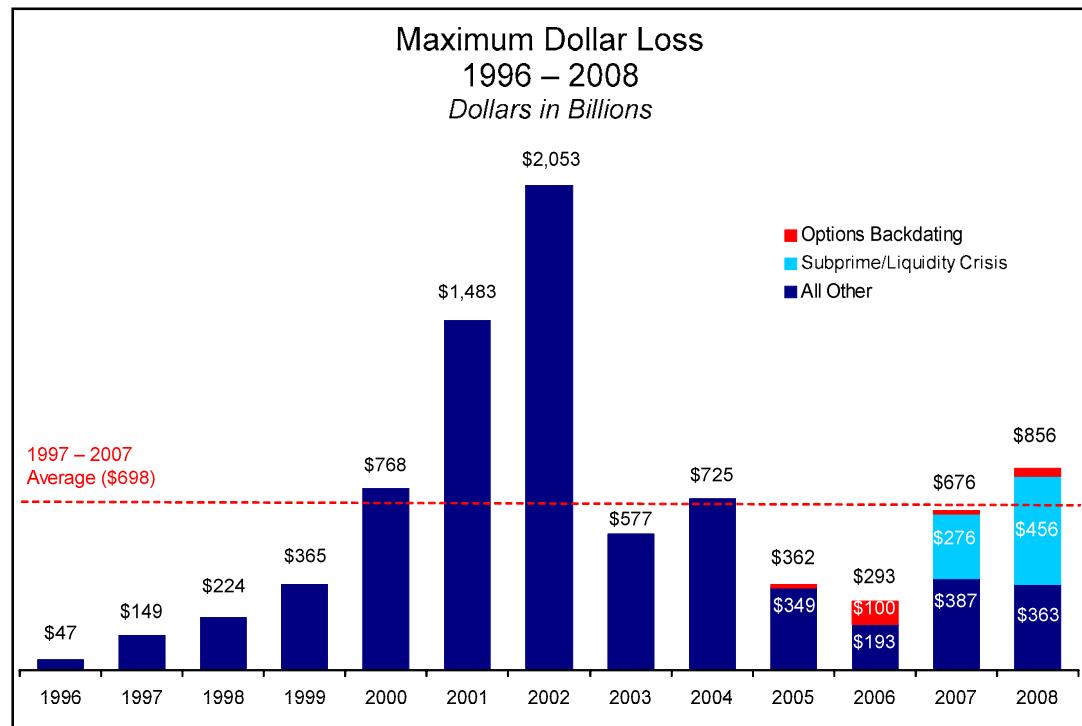


Figure 13

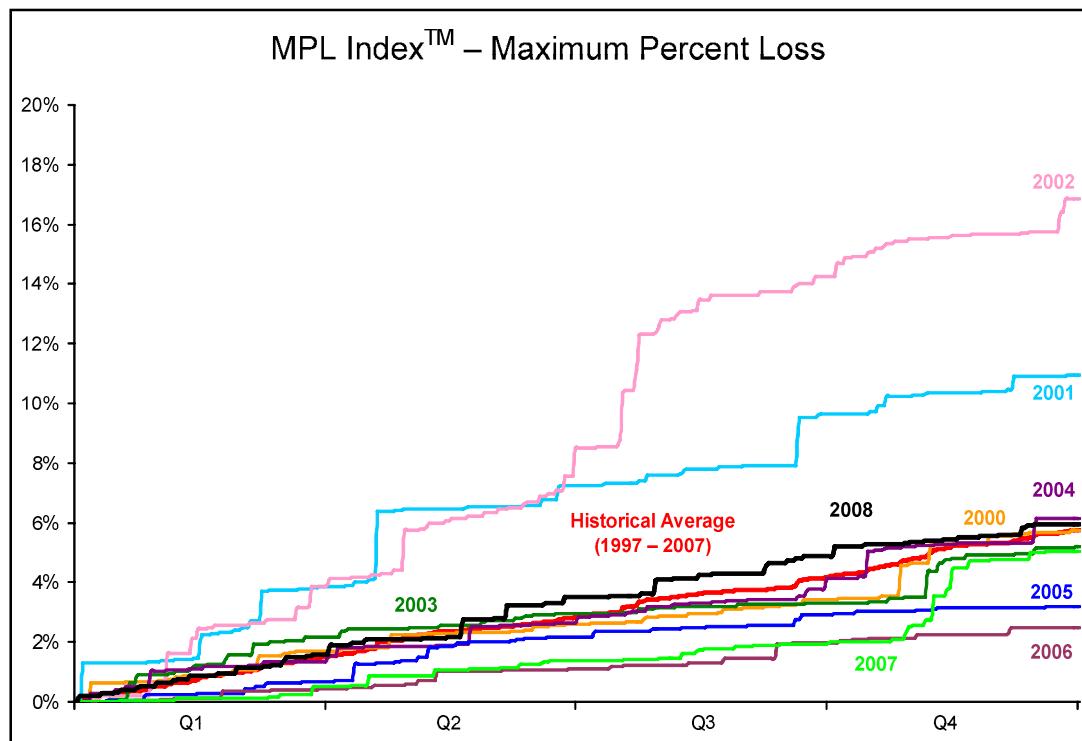


**Market
Capitalization
Losses
*continued***

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Figure 14

The Maximum Percent Loss (MPL) Index™ also increased in 2008 relative to recent years.¹⁰ The MDL for all filings in 2008 represented 5.9 percent of the capitalization of the Wilshire 5000 during the class periods, the fourth highest annual level in the database—behind 2002, 2001, and 2004 (Figure 14). This compares with 5.0 percent for filings in 2007 and 5.7 percent for class actions filed during the 11 years ending December 2007.



¹⁰ See <http://securities.cornerstone.com> for complete details on the MPL Index™ calculation.

**Market
Capitalization
Losses
*continued***

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Figure 15

Figure 15 provides summary statistics for 2008 filings compared to 2007 and the annual average over the 1997–2007 period. Both the 2008 median DDL of \$231 million and the average DDL of \$1.6 billion were higher than in any previous year. The 2008 median MDL of \$1.2 billion was the second highest after 2002, and the 2008 average MDL of \$6.1 billion was the third highest after 2002 and 2001. Figure 15 also shows that the median DDL percent decline for class actions filed in 2008 was 23.9 percent, higher than the 18.8 percent in 2007 and slightly higher than the 23.8 percent annual average for the 11 years ending December 2007.¹¹ Historically, there has been a statistical relationship between quarterly median percentage DDL declines and quarterly stock market volatility (Figure 16).

Filings Comparison			
	Average (1997 – 2007)	2007	2008
Class Action Filings	192	176	210
Disclosure Dollar Loss			
Total (\$ Millions)	\$129,611	\$152,835	\$226,553
Average (\$ Millions)	\$742	\$980	\$1,607
Median (\$ Millions)	\$112	\$154	\$231
Median DDL % Decline	23.8%	18.8%	23.9%
Maximum Dollar Loss			
Total (\$ Billions)	\$697.7	\$676.2	\$856.4
Average (\$ Billions)	\$4.0	\$4.3	\$6.1
Median (\$ Billions)	\$0.6	\$0.7	\$1.2

Figure 15

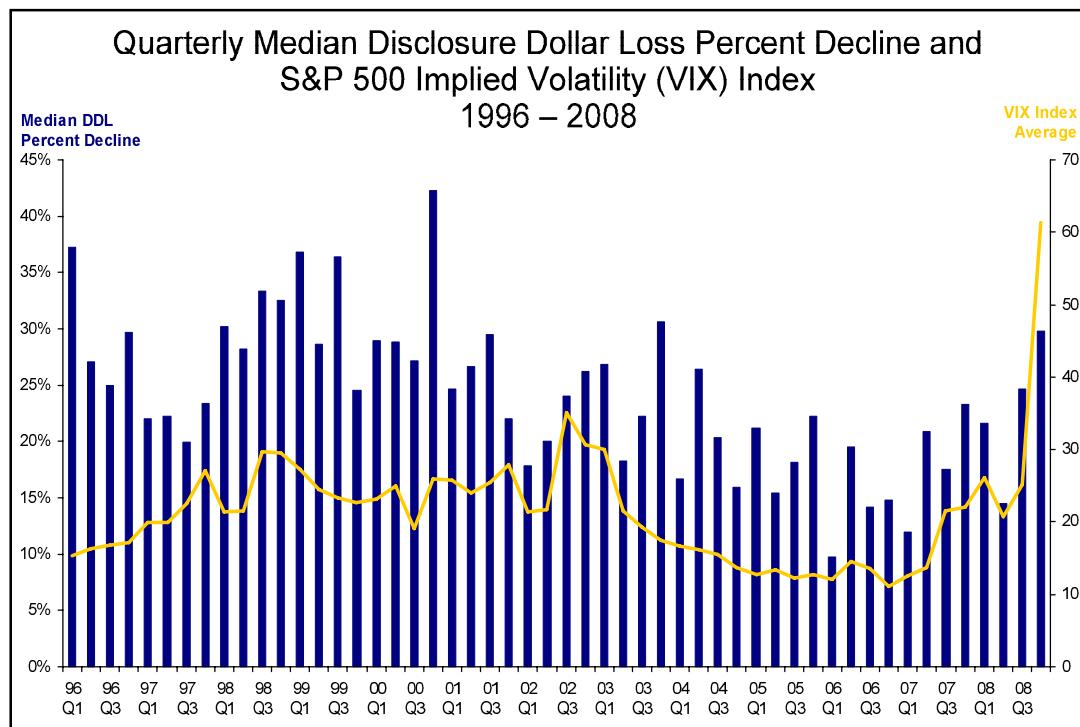


Figure 16

¹¹ Disclosure Dollar Loss percent decline equals the DDL divided by the market capitalization on the trading day immediately preceding the end of the class period.

Mega Filings

Analysis of “mega” filings shows that relatively few filings account for most of the total market capitalization losses associated with securities class action filings.

Disclosure Dollar Loss

In 2008 there were 12 mega DDL filings—filings with a DDL of \$5 billion or more. This is the largest number of mega DDL filings for any year in the database. These 12 filings accounted for a total of \$163 billion of DDL in 2008, the second highest mega filing total after 2000, and represent 72 percent of DDL for the year, the third highest share after 2000 and 2001. Four of the 12 mega DDL filings, including two of the largest three filings, were subprime/liquidity crisis-related.

The 12 mega DDL filings in 2008 represent an increase relative to 2007, when there were nine mega DDL filings which accounted for 58 percent of DDL in that year. Two of the nine filings in 2007 were subprime/liquidity crisis-related and one of those was among the largest three filings.

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Maximum Dollar Loss

In 2008 there were 26 mega MDL filings—filings with an MDL of \$10 billion or more. This is the second highest number of mega filings of any year in the database, behind only 2002, and the total MDL of \$682 billion represents the third highest by total MDL after 2002 and 2001. These 26 filings accounted for 80 percent of MDL in 2008, the third highest share after 2002 and 2001. Twelve of the 26 mega MDL filings, including four of the largest five filings, were subprime/liquidity crisis-related.

This is a large increase from the 16 mega MDL filings in 2007, which accounted for 74 percent of MDL that year. Six of the mega filings in 2007 were subprime/liquidity crisis-related, including three of the largest five filings. There were eight filings in 2008 and nine in 2007 with an MDL in excess of \$25 billion each.

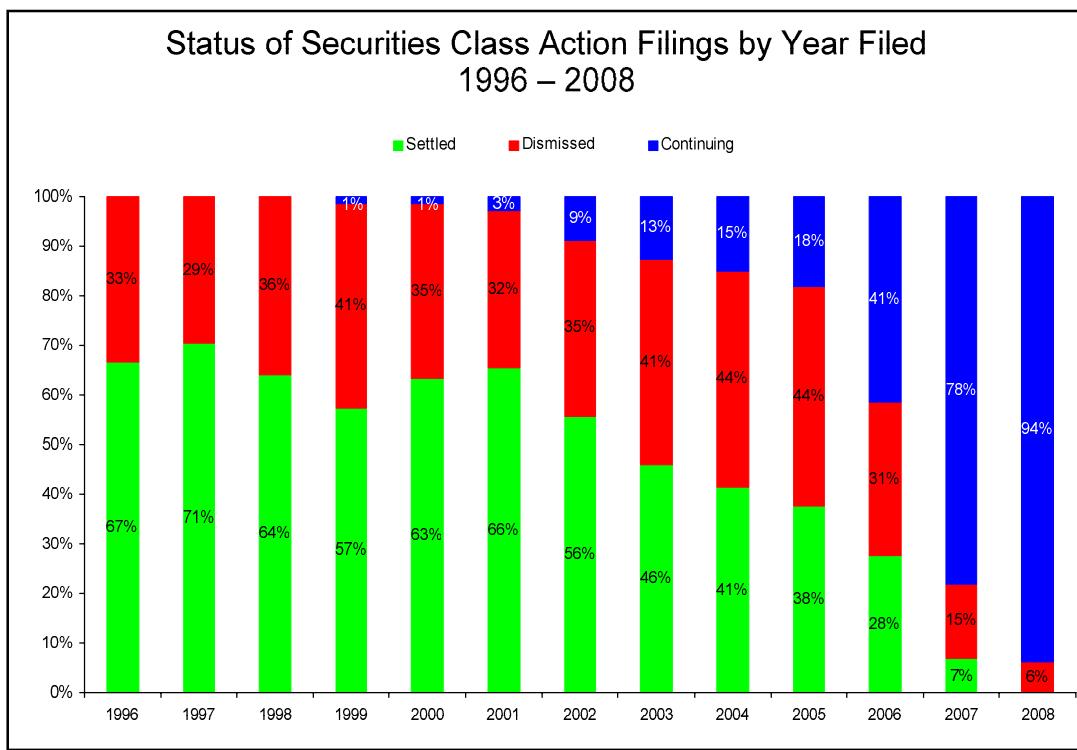
Case Status

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Figure 17 shows that most of the filings in the Stanford Law School Securities Class Action Clearinghouse database have been resolved, with only 20 percent of the filings continuing as of the end of 2008. As expected, the continuing class actions are concentrated among those filed in recent years: 76 percent of all continuing class actions were filed after 2005. Among the resolved class actions, 41 percent were dismissed and 59 percent settled. The majority of cases were resolved after the first ruling on the motion to dismiss but before a ruling on summary judgments, with 71 percent of dismissals and 59 percent of settlements occurring during this stage. For class actions filed from 1996 to 2002 and resolved by the end of 2008, the median time to resolution was 33 months, the median time to settlement was 37 months, and the median time to dismissal was 25 months.

The 2007 report examined the continuing class actions from the previous bear market (2000–02) and found that the average and median DDL for continuing class actions was higher than for settled or dismissed class actions. Although several large DDL class actions were resolved in 2008, that finding still holds; the average DDL of class actions settled or dismissed by the end of 2008 was \$1.1 billion while the average DDL of continuing class actions was \$1.7 billion. Similarly, the median DDL of class actions that were either settled or dismissed was \$114 million, while the median DDL of continuing class actions was \$169 million. These data suggest that class actions with higher shareholder losses take longer to resolve.

Figure 17

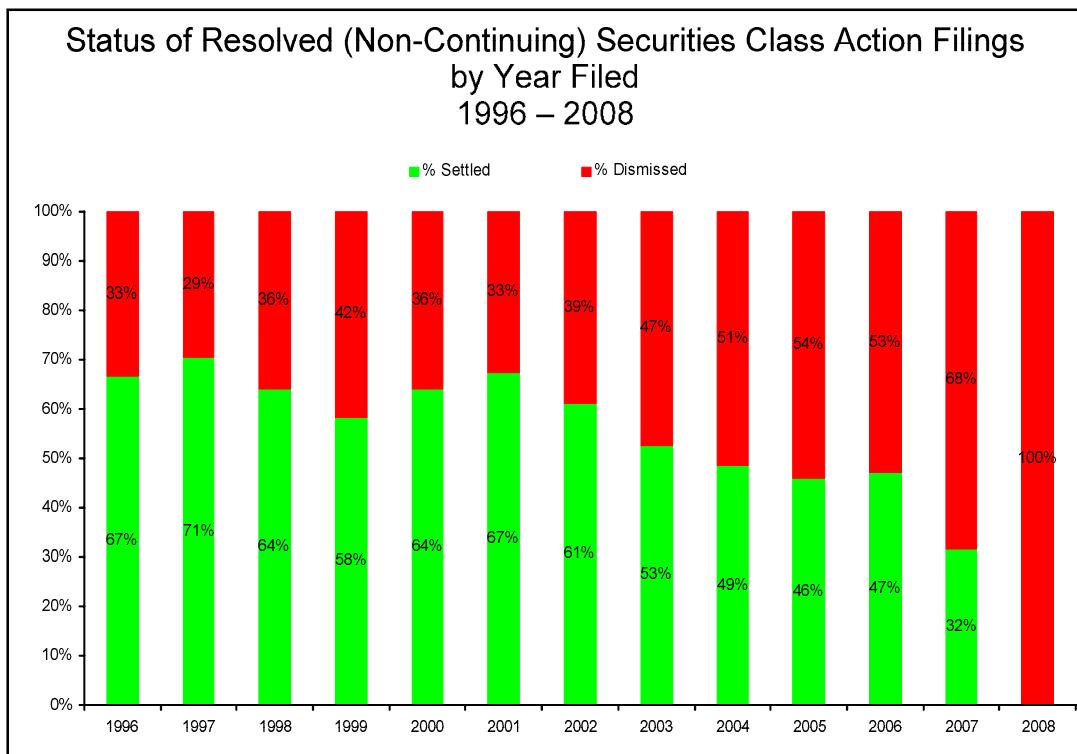


Case Status *continued*

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For class actions that have been resolved, Figure 18 shows the breakdown between settlements and dismissals. Because the typical time to dismissal is shorter than the typical time to settlement, there are more dismissals than settlements among resolved class actions in younger class action cohorts. The mix of settled and dismissed class actions evens out as cohorts age, though 2004 and 2005 both have slightly more dismissed class actions than settled class actions even though more than 80 percent of the class actions in each of these cohorts have been resolved. The uptick in dismissals in recent years may be related to increased pleading standards in the wake of the *Dura* decision by the Supreme Court.

Figure 18



Industry**18**

Figure 19 provides summary statistics on class actions by industry. As discussed in the “Overview” section and shown in the S&P 500 Securities Litigation Heat Maps™, the financial sector had the highest incidence of securities class action filings in 2008. While filings in the financial sector had the highest MDL in 2008, filings in both the industrial sector and the consumer non-cyclical sectors experienced higher DDL than filings in the financial sector.

Figure 19

Industry	Filings by Industry <i>Dollars in Billions</i>											
	Class Action Filings			Disclosure Dollar Loss			Maximum Dollar Loss					
	Average 1997 – 2007		2007	2008	Average 1997 – 2007		2007	2008	Average 1997 – 2007		2007	2008
Financial	26	52	103		\$18	\$39	\$49		\$90	\$259	\$391	
Consumer Non-Cyclical	45	35	37		\$41	\$58	\$57		\$145	\$190	\$155	
Industrial	18	12	17		\$9	\$2	\$82		\$34	\$13	\$121	
Technology	30	11	15		\$18	\$3	\$8		\$98	\$8	\$63	
Consumer Cyclical	24	23	12		\$8	\$7	\$6		\$56	\$38	\$25	
Communications	37	34	10		\$31	\$43	\$11		\$238	\$166	\$50	
Energy	4	5	7		\$3	\$0	\$6		\$18	\$2	\$26	
Basic Materials	3	3	5		\$1	\$0	\$4		\$5	\$0	\$11	
Utilities	4	1	4		\$2	\$0	\$4		\$13	\$0	\$14	
Total	192	176	210		\$130	\$153	\$227		\$698	\$676	\$856	

Exchange

For the first time since 2002, companies listed on NYSE or Amex had more securities class action filings than companies listed on NASDAQ (Figure 20). In 2008, 111 class actions were filed against firms listed on NYSE or Amex and 68 against firms listed on NASDAQ. In 2008, total and median DDL for firms listed on NYSE or Amex were the highest ever, and average DDL was second only to 2000. Total, average, and median MDL for firms listed on NYSE or Amex were higher than any year other than 2002. In contrast, several of the DDL and MDL metrics for NASDAQ firms declined between 2007 and 2008.

In contrast to previous years, there were 31 filings in 2008 against firms not listed on NYSE, Amex, or NASDAQ, and those filings led to the highest total and average DDL and MDL for firms not listed on the major exchanges since 2004.

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Figure 20

	Filings by Exchange Listing					
	Average (1997 – 2007)		2007		2008	
	NYSE/Amex	NASDAQ	NYSE/Amex	NASDAQ	NYSE/Amex	NASDAQ
Class Action Filings	74	97	79	80	111	68
Filings per Issuer	2.02%	2.45%	2.13%	2.53%	2.25%	2.22%
Disclosure Dollar Loss						
Total (\$ Millions)	\$92,084	\$36,221	\$110,751	\$41,951	\$200,924	\$24,114
Average (\$ Millions)	\$1,357	\$378	\$1,538	\$545	\$2,576	\$416
Median (\$ Millions)	\$247	\$80	\$292	\$89	\$515	\$127
Maximum Dollar Loss						
Total (\$ Billions)	\$425	\$258	\$538	\$135	\$714	\$129
Average (\$ Billions)	\$5.9	\$2.8	\$7.5	\$1.8	\$9.2	\$2.2
Median (\$ Billions)	\$1.2	\$0.4	\$1.3	\$0.4	\$2.5	\$0.6

Circuit¹²**20**

The three circuits with the highest number of filings in 2008 were the Second Circuit (New York) with 92 filings, the Ninth Circuit (California) with 28 filings, and the Eleventh Circuit (Florida/Georgia/Alabama) with 17 filings (Figure 21). The Second Circuit filings included 58 of the 97 subprime/liquidity crisis-related filings and 61 of the 103 financial filings. These three circuits have held the same ranks since 2006. The Second and Ninth Circuits have been the top two every year in the database, and the Eleventh Circuit has been in the top four every year other than 2005.

The circuits with the highest total DDL in 2008 were the Second Circuit with \$136 billion, the Third Circuit (Delaware/New Jersey/Pennsylvania) with \$30 billion, and the Ninth Circuit with \$17 billion. The Second Circuit accounted for six of the 12 mega DDL filings, while the Third Circuit contributed three and the Ninth Circuit contributed one. Historically, the Second, Third, and Ninth Circuits have had the highest DDL levels.

When ranked by MDL, the top three circuits in 2008 were the Second Circuit with \$400 billion, the Ninth Circuit with \$173 billion, and the Third Circuit with \$101 billion. Second Circuit filings in 2008 were dominated by 10 of the 26 mega MDL filings, while the Ninth Circuit contributed six mega MDL filings and the Third Circuit contributed three. Historically, the Second, Ninth, and Third Circuits have experienced the largest MDL.

Circuit	Filings by Court Circuit <i>Dollars in Billions</i>								
	Class Action Filings			Disclosure Dollar Loss			Maximum Dollar Loss		
	Average 1997 – 2007	2007	2008	Average 1997 – 2007	2007	2008	Average 1997 – 2007	2007	2008
1	10	2	15	\$6	\$0	\$4	\$23	\$1	\$15
2	42	58	92	\$36	\$93	\$136	\$220	\$443	\$400
3	17	10	11	\$22	\$12	\$30	\$79	\$39	\$101
4	7	5	7	\$3	\$0	\$2	\$17	\$2	\$13
5	14	8	4	\$11	\$1	\$1	\$57	\$6	\$3
6	10	6	13	\$9	\$1	\$8	\$37	\$3	\$39
7	10	9	10	\$6	\$5	\$16	\$28	\$28	\$61
8	8	3	8	\$4	\$7	\$11	\$14	\$9	\$39
9	49	45	28	\$22	\$21	\$17	\$176	\$109	\$173
10	6	7	4	\$3	\$4	\$0	\$13	\$6	\$0
11	19	18	17	\$7	\$6	\$3	\$31	\$17	\$13
12	1	5	1	\$1	\$2	\$0	\$4	\$12	\$0
Total	192	176	210	\$130	\$153	\$227	\$698	\$676	\$856

Figure 21

¹² Circuit information corresponds to the first identified complaint.

Classification of Complaints¹³

21

The Stanford Law School Securities Class Action Clearinghouse tracks allegations contained in class action complaints. A comparison of filings in 2008 with those from 2002 to 2007 reveals several interesting changes in the mix of allegations (Figure 22).

- The share of class actions alleging 10b-5 claims fell to its lowest level in 2008, dropping from 80 percent in 2007 to 75 percent. This contrasts with the previous five years, in which more than 85 percent of filings in every year included 10b-5 claims.
- The share of class actions alleging Section 11 and 12(2) claims increased to its highest level in 2008. Section 11 claims increased to 19 percent in 2007 and 23 percent in 2008; Section 12(2) claims increased to 11 percent in 2007 and 19 percent in 2008. In the previous five years, Section 11 claims peaked at 12 percent and Section 12(2) claims never reached 10 percent.
- In the *2007 Year in Review* we noted an increase in the share of class actions that named an underwriter as a defendant from 4 percent in 2006 to 11 percent in 2007. The trend continued in 2008 with 18 percent of filings naming an underwriter as a defendant.
- We also noted in the *2007 Year in Review* that the percentage of filings alleging misrepresentation in financial documents had remained stable over 2006 and 2007. This holds true for 2008 as well. Between 2002 and 2005, the share of filings alleging misrepresentations in financial documents was below 90 percent; the share increased to 92 percent in 2006, remained steady at 91 percent in 2007, and increased to 94 percent of filings in 2008. While the percentage of filings alleging false forward-looking statements decreased from 72 percent in 2006 to 63 percent in 2007, the share rebounded in 2008, with 70 percent of filings containing these allegations.
- The percentage of filings alleging insider trading continued to decline, from 27 percent of filings in 2007 to 23 percent in 2008. In contrast, filings alleging insider trading were above 30 percent in 2003 through 2006. This decline is consistent with a potential decline in allegations relating to scienter and an increase in the proportion of filings with Section 11 claims.
- To the extent that allegations of GAAP violations could be identified in complaints and/or press releases, the incidence of these allegations declined during 2008. The percentage of complaints alleging specific accounting irregularities decreased to 44 percent in 2008 from 48 percent in 2006. This decline may be an artifact of the tentative nature of initial class action complaints in the study.
- Consistent with the increase in filings related to the subprime/liquidity crisis, there was a shift in the emphasis in GAAP allegations from those related to the traditional income statement line items to allegations related to balance sheet components. The share of filings alleging GAAP violations that specified revenue recognition decreased from over 35 percent in 2002 through 2006 to 17 percent in 2007 and 26 percent in 2008. Also, filings alleging understatement of expenses decreased from 46 percent in 2006 to 19 percent in 2007 and 14 percent in 2008. Meanwhile, the percentage of GAAP-related filings alleging the overstatement of assets other than accounts receivable and problems with estimates both increased to new highs in 2007 and 2008. In contrast, the percentage of GAAP-related filings alleging understatement of liabilities increased from 2006 to 2007 and then decreased in 2008.

¹³ The classifications are based on the first identified complaint. Additional allegations and defendants may be added in subsequent complaints and are not captured in these analyses.

¹⁴ Some filings are included in multiple classifications.

Classification of Complaints continued

- “Other” accounting allegations remained below the high level in 2006, with 27 percent in 2008 and 30 percent in 2007 compared with 62 percent in 2006. Allegations related to accounting for option issuance declined in 2008; the share of “other” filings containing such allegations dropped to 16 percent in 2008 from 36 percent in 2007 and 44 percent in 2006.
- Seven of the 192 companies involved in class actions in 2008 (4 percent) subsequently claimed bankruptcy. In 2007, only two out of the 172 companies involved in class actions (1 percent) subsequently claimed bankruptcy in that year. Five additional companies that were involved in the 2007 filings subsequently claimed bankruptcy in 2008 (3 percent).

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Allegations Box Score							
	2002	2003	2004	2005	2006	2007	2008
	Percentage of Total Filings						
General Characteristics							
10b-5 claims	87%	91%	87%	91%	87%	80%	75%
Section 11 claims	11%	9%	7%	9%	12%	19%	23%
Section 12(2) claims	9%	4%	5%	5%	9%	11%	19%
Underwriter defendant	5%	2%	1%	5%	4%	11%	18%
Auditor defendant	6%	6%	4%	3%	3%	1%	2%
Allegations							
Misrepresentations in financial documents	82%	88%	79%	87%	92%	91%	94%
False forward-looking statements	69%	79%	68%	81%	72%	63%	70%
GAAP violations	58%	56%	48%	43%	67%	48%	44%
Insider trading	27%	31%	40%	45%	39%	27%	23%
Specifics of Accounting Allegations							
Revenue recognition	49%	44%	60%	53%	35%	17%	26%
Understatement of expenses	52%	14%	21%	26%	46%	19%	14%
Overstatement of accounts receivable	53%	53%	16%	21%	9%	12%	14%
Understatement of liabilities	12%	8%	13%	18%	10%	17%	9%
Overstatement of other assets [1]	23%	24%	13%	12%	12%	29%	32%
Non-recurring items	9%	8%	1%	5%	4%	1%	4%
Overstatement of inventory	11%	12%	5%	15%	5%	8%	7%
Acquisition accounting	8%	7%	5%	4%	5%	5%	3%
Estimates	6%	8%	3%	10%	1%	17%	18%
Derivatives/hedging	4%	3%	1%	6%	0%	2%	8%
Other	5%	11%	10%	37%	62%	30%	27%

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

Figure 22

New Developments

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Treasury Bailout

On October 3, President Bush signed the Emergency Economic Stabilization Act (EESA) of 2008, a \$700 billion financial bailout package to reduce the liquidity constraints facing financial institutions and promote the flow of credit.¹⁵ To the extent that the injection of government funds effectively reduces liquidity constraints, it may have the effect of spurring increased litigation activity by increasing the expected payoff to litigation.

Under EESA, the Troubled Asset Relief Program (TARP) was created with the stated goal of supplying government funds to purchase distressed “mortgages and any securities, obligations or other instruments that are based on or related to such mortgages” from financial institutions suffering from the consequences of the subprime/liquidity crisis.¹⁶ The first \$250 billion of the package was used, however, to inject capital into the financial markets by purchasing equity in struggling financial institutions.¹⁷ This was meant to increase the flow of credit and restore confidence in the banking system.¹⁸ In November, Treasury Secretary Henry Paulson announced that he intended to use some of the remaining TARP funds to prevent foreclosures and support the market for consumer debt such as credit cards and college loans.¹⁹

It is not yet clear whether the program has had the desired effect of thawing the credit markets. In December, the Government Accountability Office (GAO) stated that the Treasury needed to develop policies to ensure that TARP was achieving its goals and that banks receiving government funds were adhering to executive compensation and dividend payment restrictions.²⁰ Concerns have been raised that some banks intend to use bailout money to purchase healthy banks or to pay higher dividends rather than to provide loans.²¹

Bank Failures

In 2008, bank profitability suffered and failures increased due to the worsening subprime/liquidity crisis and the housing downturn.²² As of December 15, 2008, 25 U.S. banks had failed and been taken over by the Federal Deposit Insurance Corporation (FDIC). By comparison, just three banks failed in 2007, and none failed in 2006 or 2005.²³ Five of the 25 banks that failed in 2008 were named in federal securities class actions filed in 2008.²⁴

¹⁵ Dina Temple-Raston, “Bush Signs \$700 Billion Financial Bailout Bill,” *National Public Radio*, dated October 3, 2008; “Pelosi, Reid, Dodd, Frank Renew Call on Bush to Use TARP to Aid Auto Industry in Light of Risks to Financial System,” *Wall Street Journal MarketWatch*, dated December 4, 2008.

¹⁶ Joanna Chung, “Treasury Tackled over TARP Concerns,” *The Financial Times*, dated December 3, 2008; Dina Temple-Raston, “Bush Signs \$700 Billion Financial Bailout Bill,” *National Public Radio*, dated October 3, 2008; Alan S. Blinder, “Got \$700 Billion? Sweat the Details,” *The New York Times*, dated October 11, 2008.

¹⁷ Joanna Chung, “Treasury Tackled over TARP Concerns,” *The Financial Times*, dated December 3, 2008; Richard Cowan and Rachelle Youglai, “UPDATE 3-US GAO: Critical Issues Not Yet Addressed in TARP,” *Reuters*, dated December 2, 2008; Alan S. Blinder, “Got \$700 Billion? Sweat the Details,” *The New York Times*, dated October 11, 2008.

¹⁸ Richard Cowan and Rachelle Youglai, “UPDATE 3-US GAO: Critical Issues Not Yet Addressed in TARP,” *Reuters*, dated December 2, 2008.

¹⁹ Stephen Gandel, “Banks Left Out of TARP Bailout Could Face Extinction,” *Time, Inc.*, dated November 13, 2008.

²⁰ Joanna Chung, “Treasury Tackled over TARP Concerns,” *The Financial Times*, dated December 3, 2008.

²¹ Richard Cowan and Rachelle Youglai, “UPDATE 3-US GAO: Critical Issues Not Yet Addressed in TARP,” *Reuters*, dated December 2, 2008.

²² Karey Wutkowski, “FDIC Sees 117 Problem Banks; Most Since 2003,” *Reuters*, dated August 26, 2008.

²³ “Failed Bank List,” *Federal Deposit Insurance Corporation*, updated December 15, 2008.
<http://www.fdic.gov/bank/individual/failed/banklist.html>

²⁴ Only 11 of the 25 banks that failed were publicly traded.

**New Developments
continued**

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Not only did the number of bank failures rise in 2008, some of the failed banks were much larger than banks that failed in prior years. The largest of them was Washington Mutual, which was seized by federal regulators on September 25 and sold to JPMorgan Chase. With \$307 billion in assets, Washington Mutual was “by far the largest bank failure in American history.”²⁵

In the second quarter of 2008, the number of U.S. banks on the FDIC’s “watch list” rose 30 percent to 117, the highest level in five years. FDIC Chairman Sheila Bair warned that more banks might be added to this list of “institutions with financial, operational, or managerial weaknesses that threaten their financial viability.”²⁶ Despite the increase in the number of failing and troubled banks, Bair said that 98 percent of the 8,500 U.S. banks continue to be well-capitalized.

Market Volatility

Financial markets were extremely volatile in 2008. The S&P 500 index dropped by 40 percent from the start of the year through December 15, 2008. The Dow Jones Industrial Average experienced its largest one-day point loss (777 points or almost 7 percent) in September 2008 and four of its five largest one-day point losses were in the fourth quarter. The combined market capitalization of U.S. companies declined by over \$6 trillion in 2008. Volatility, as measured by the Chicago Board Options Exchange Volatility Index (VIX), climbed to 80.86 in November 2008, the highest level in the 18-year history of the index. According to a November 2008 Goldman Sachs research note, the S&P 500 three-month realized volatility reached 66 percent, exceeding the levels during the 1987 stock market crash and the Depression.²⁷ As discussed above, filings, however, did not rise sharply in the fourth quarter of 2008, possibly due to difficulty in isolating allegedly fraudulent company-specific stock movements from general market volatility.

²⁵ Eric Dash and Andrew Ross Sorkin, “Government Seizes WaMu and Sells Some Assets,” *The New York Times*, dated September 25, 2008.

²⁶ Kären Wutkowski, “FDIC Sees 117 Problem Banks; Most Since 2003,” *Reuters*, dated August 26, 2008.

²⁷ “US Stock Volatility is Expected to Stay High for Rest of Year,” *Economic Times*, dated November 22, 2008.

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