A Primer on Shareholder Litigation

Securities Class Actions, Derivative Actions, Merger & Acquisition Litigation, and Direct Actions (Opting-Out)

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Disclaimer:
This article is intended to provide a thorough background on shareholder class action litigation, serving as a lead plaintiff, and litigating an action. However, it is not intended as a substitute for legal advice with your chosen counsel and discussions as to the merits of each particular action you may consider.

- *All citations are omitted, but available upon request.*
- *All financial figures are in U.S. dollars unless otherwise indicated.*

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I. Introduction

Kessler Topaz Meltzer & Check, LLP ("Kessler Topaz") is pleased to provide this primer on shareholder litigation to institutional investors. The goal of this primer is to briefly explain litigation options available under federal and state securities laws of the United States. We believe these laws should be viewed as tools that allow investors, among other things, an opportunity to recover investment losses suffered as a result of fraud or other illegal conduct and/or to implement corporate governance changes. The information contained herein provides a general overview of various substantive and procedural issues that may arise in connection with pursuing some of the options we discuss and is intended to assist institutional investors in gaining a general understanding of the rights and remedies available under various laws, particularly the ability to serve as a plaintiff in a class action, pursuing a direct action, initiating a takeover or derivative action, as well as the benefits associated with these and other options. We hope this primer will assist the reader in becoming familiar with these areas of the law while providing an understanding as to how the institutional investor community may use these laws to recover losses and safeguard the value of investments.

II. Overview of the United States Federal Securities Laws

Congressional regulation of securities transactions followed the historic stock market crash of 1929. According to Congressional findings (published in 1933) in the decade following World War I, of the $50 billion in securities offered in the United States, approximately $25 billion were completely worthless. Deceptive business practices and rampant fraud in the sale of securities prior to the 1929 crash led the United States Congress to enact significant legislation to regulate securities markets and transactions. The two primary pieces of federal legislation enacted during this era are: (i) the Securities Act of 1933 (the "Securities Act"); and (ii) the Securities Exchange Act of 1934 (the "Exchange Act"). As stated by the United States Supreme Court, the "fundamental purpose" of both the Securities Act and the Exchange Act is "to substitute a philosophy of full disclosure for the philosophy of caveat emptor [or buyer beware] and thus to achieve a high standard of business ethics in the securities industry." Thus, both Acts seek to provide investors accurate material information about a security to permit investors to assess a company's risk exposure, properly value a security and factor in an appropriate rate of return for the risks of the investment. Inaccurate or misleading information precludes such an assessment and potentially violates both Acts.

A. The Securities Act

The Securities Act, the first major federal regulation of securities enacted by Congress following the 1929 crash, provides protections for investors purchasing securities in issuer transactions (initial or secondary offerings of securities). The Securities Act has two basic objectives: (i) to require that investors receive financial and other significant information concerning securities being offered for public sale; and (ii) to prohibit deceit, misrepresentations, and other fraud in the sale of securities. The Securities Act accomplishes its objectives by mandating that, before an offering of securities occurs, an issuer disclose all material facts about the company and the proposed security in a registration statement and a prospectus. Generally (unless specific exemption requirements are met), any securities sold in the United States must be registered. According to the Securities and Exchange Commission ("SEC"),[1] the information required under the Securities Act should enable "investors, not the government, to make informed judgments about whether

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[1] The SEC is an independent, nonpartisan, quasi-judicial regulatory agency created by the Exchange Act. The SEC has been granted "broad authority over all aspects of the securities industry" including the "power to register, regulate, and oversee brokerage firms, transfer agents, and clearing agencies as well as the nation's securities self regulatory organizations (SROs)." The SEC is also empowered to investigate and remedy violations of the federal securities laws through civil enforcement actions. Criminal prosecutions are conducted by the United States Department of Justice.

to purchase a company's securities. While the SEC requires that the information provided be accurate, it does not guarantee it. Investors who purchase securities and suffer losses have important recovery rights if they can prove that there was incomplete or inaccurate disclosure of important information."

The inclusion of false or materially misleading statements (even ones that may be technically correct) in offering materials violates the Securities Act and may allow the deceived investor to file suit to recover damages. Liability under the Securities Act can be imposed upon the issuer of a security, every person who signed the registration statement, every person who was a director of the issuer at the time the registration statement was filed, every underwriter of the security, and every accountant or other "expert" who consented to be named as having prepared or certifying any part of the registration statement. Entities engaged in the sale of registered securities (such as underwriters) are subject to liability for misleading statements in a prospectus or oral communication related to an offering. The Securities Act also imposes "control person" liability on any person who, by virtue of their position, holdings or relationship to the other persons, controls another person liable for having issued a false and misleading registration statement or prospectus.

The Securities Act provides investors with significant protections. When suing the issuer of a security (usually the corporation), the Securities Act provides strict liability, meaning that the plaintiff is not required to establish that the issuer defendant acted intentionally or even negligently when making false and misleading disclosures in a registration statement or prospectus, or that the plaintiff even relied on the misstatement. The plaintiff need only establish that it bought the security in (or traceable to) an offering that was conducted pursuant to a materially false and misleading registration statement or prospectus. All other potential defendants (other than the issuer) may be held liable for "mere negligence." With respect to non-issuer defendants, the Securities Act permits such defendants to assert various "affirmative defenses" to avoid liability. One such defense, the "due diligence" defense, provides that a non-issuer defendant can avoid liability under the Securities Act upon a showing that "he had, after reasonable investigation, reasonable ground to believe and did believe, at the time such part of the registration statement became effective, that the statements therein were true and that there was no omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading."

The Securities Act also sets forth the amount of damages that a plaintiff may recover. Generally, and subject to certain limitations, damages are determined by measuring the difference between the amount paid for the security (not exceeding the public offering price) and (i) the security's value when the suit was filed; (ii) the price at which the plaintiff disposed of the security before filing suit; or (iii) the price at which the plaintiff disposed of the security after filing suit but before judgment, if those damages are less than the security's value when the plaintiff filed suit. Defendants in such cases do have the ability to reduce plaintiff's claimed damages by proving some factor other than the false and misleading statement caused the loss, a concept known as a "negative causation" defense.

B. The Exchange Act

While the Securities Act governs public offering of securities, the Exchange Act governs aftermarket trading including purchases and sales of securities on securities exchanges.

The principal goal of the Exchange Act is to ensure that investors have access to accurate and truthful information concerning a security being traded, including any material facts about the issuer that may affect the value of a security. In cases of securities traded in an efficient market, courts presume that most publicly available information is reflected in the security's market price. Accordingly, misrepresenting a company's performance or omitting adverse information would tend to artificially manipulate the price of a security.

The Exchange Act accomplishes its goal by requiring, among other things, a series of continuing mandated disclosures by the issuer (via the annual report, the quarterly report and the current report). Also, any other statements — such as statements in press releases and conference calls — relating to a security or to an issuer of a security may be subject to liability under the Exchange Act. Thus, while the Securities Act covers statements made in connection with an issuance (registration statement and prospectus), the Exchange Act covers a much broader set of disclosures.[2]

The enforcement mechanism of the Exchange Act is found in Section 10(b). Section 10(b) prohibits acts or practices that constitute a "manipulative or deceptive device or contrivance in contravention of such rules and regulations as the [SEC] may prescribe." Pursuant to its rulemaking authority under Section 10(b), the SEC promulgated Rule 10b-5, which has become the primary antifraud provision under federal law. Rule 10b-5 states that "it shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange, (a) to employ any device, scheme, or artifice to defraud; (b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading; or (c) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person."

In private lawsuits, courts require plaintiffs to plead the following six elements in order to state a claim under Section 10(b) and Rule 10b-5:

1. **a material misrepresentation (or omission)** — a statement or omission of fact is deemed to be material "if a reasonable investor would consider it important in determining whether to buy or sell stock."

2. **scienter** — plaintiffs must allege that defendants acted with a wrongful state of mind. The scienter element is not met if a plaintiff merely alleges that defendants' actions were negligent or simply poor business decisions.

3. **in connection with the purchase or sale of a security** — this element requires a plaintiff to engage in some type of transaction involving a security. For example, plaintiffs cannot assert a claim under Section 10(b) by alleging that they were induced to hold a security by defendants' fraudulently optimistic statements. In order to meet the "in connection with" element, a plaintiff must have purchased or sold a security in reliance upon a misleading statement or material omission.

4. **reliance** — where securities are traded in an efficient market reliance is presumed. If reliance is presumed,[3] plaintiffs are not required to plead that they read and relied on defendants' material misrepresentations. Rather, the market's incorporation of publicly available information into the price of a security will satisfy the reliance element. If a security is not traded in an efficient market then the plaintiff will be required to plead actual reliance (i.e. they read a false statement issued by a defendant before purchasing a security).

5. **economic loss** — plaintiffs must allege that they sustained a loss from their investments.

6. **loss causation** — plaintiffs are required to plead a causal connection between the material misrepresentation and the loss.

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[2] Statements made in offering documents may be subject to liability under both the Securities Act and the Exchange Act.

[3] The legal name for this concept is the "fraud on the market doctrine."

Liability under the Exchange Act can be based on any false statement (whether or not the statement is filed with the SEC) issued by a corporation, its officers or third-parties whose statements are included with a corporation's filing (such as an auditor). Court decisions have, however, limited private litigants' (but not the SEC's) ability to bring suit against third parties who aid defendants' violations of federal securities laws.[4]

C. Private Remedies Under Federal Law

Violations of the Securities Act and/or the Exchange Act can be enforced by the federal government or by investors through private litigation. Private investor-led enforcement of the federal securities laws are a necessary component of the regulation of securities markets. To this end, the United States Supreme Court has noted the Court's long recognition "that meritorious private actions to enforce federal antifraud securities laws are an essential supplement to criminal prosecutions and civil enforcement actions brought, respectively, by the Department of Justice and the Securities and Exchange Commission (SEC)."

Congress enacted the securities laws intending that investors would enforce the laws through private actions. Specifically, the Securities Act provides investors an expressed private right of action allowing any person acquiring a security based on materially false offering documents to file suit under the Act. While the Exchange Act does not contain language expressly providing investors with a private right of action, since 1946, federal courts have consistently recognized the existence of an "implied" private right of action under Rule 10b-5. Congress has itself implicitly recognized the right of investors to sue under the Exchange Act and, as recently as 1995, enacted significant legislation to regulate private lawsuits under federal law. The 1995 amendments, known as the Private Securities Litigation Reform Act of 1995 ("PSLRA"), not only implicitly acknowledged investors' ability to seek private remedies for violations of the Exchange Act but fundamentally altered the manner in which federal securities lawsuits are litigated.

As explained in greater detail below, the PSLRA, for example, amended normal pleading rules for civil fraud suits to require heightened pleading standards for actions alleging violations under the Exchange Act. The heightened pleading standards require that a complaint filed by a private litigant specifically plead each statement alleged to have been misleading, the reasons why the statement is misleading, and, if an allegation is based upon "information and belief," the complaint must state with particularity all facts upon which the belief is based. In other words, the complaint must do much more than provide a defendant with general notice of the causes of action. Rather, courts have interpreted the pleading standard to mean that a complaint must identify the "who, what, when, and where" of the fraud.

Second, while "scienter" (or a culpable state of mind) has been a required element for imposing liability under Section 10(b), the PSLRA increased the pleading requirements by requiring plaintiffs to plead particular facts that give rise to a "strong inference" that the defendant possessed either motive and opportunity to commit fraud (such as unusual insider sales of securities before the fraud is revealed), or by setting forth facts and circumstances that constitute strong circumstantial evidence of either recklessness or conscious misbehavior. Case law requires courts to consider plausible non-culpable inferences flowing from plaintiffs' allegations when assessing whether scienter has been sufficiently pled.

The PSLRA requires plaintiffs to meet the heightened plead requirements without the benefit of demanding any information from defendants through the discovery process.[5] As a result, plaintiffs' claims are often supported by facts developed through private investigations conducted by counsel, government investigations and other public sources.

[4] The Exchange Act includes a provision for imposing liability on any person controlling a primary violator of the Exchange Act. The elements of control person liability are not uniform and vary from court to court.

[5] The PSLRA stays all formal discovery until defendants' motions to dismiss are denied.

III. Securities Class Action Litigation

The class action mechanism is a powerful procedural tool to hold wrongdoers accountable for widespread damages caused to a large number of victims, who individually may not have sufficient damages to support the cost of prosecuting individual claims. This scenario is especially true when it comes to securities violations where individual investor damages will likely be dwarfed by class-wide damages. The class action mechanism also allows a defendant to settle all applicable claims on a class-wide basis and, in the process, limit its exposure by obtaining a class-wide release. This procedural tool serves a useful social function because it provides remedies for all persons in a definable class who have suffered similar or identical damages from the same conduct. For these reasons, many countries recently have begun to explore implementing class or group action provisions in their own laws.

In the United States, class actions are governed by Rule 23 of the Federal Rules of Civil Procedure. This rule permits one party or a group of parties (the "Lead Plaintiff") to file a class action complaint on behalf of a "class" of similarly situated persons and institutions when certain requirements under Rule 23 are met.

The Lead Plaintiff is responsible for prosecuting the class' claims and has the power to settle and release claims of all class members. When a Lead Plaintiff files a lawsuit as a representative of a class of similarly situated victims, a federal court judge must, at an early practicable time, determine whether to certify the action as a class action. This procedure is commonly known as "class certification" and is a critical hurdle in a securities case.[6] Lead Plaintiff is also charged with selecting and supervising attorneys to represent the class ("Lead Counsel").

A. The PSLRA and Institutional Investors

As noted above, the PSLRA fundamentally changed the requirements for pleading violations under federal law. Just as important, however, is the impact of the law on the organization and leadership of federal class action lawsuits.[7]

1. Reasons for Reform

Congress enacted the PSLRA to curb what it had identified as "abusive litigation" in the process of class actions, and in securities class actions in particular. It was argued that often, when a stock price dropped dramatically and suddenly, plaintiffs sought to prove fraud by hindsight through extensive "fishing expedition" discovery, and lawyers would "race to the courthouse" to file such complaints in a jurisdiction that was expected to be most favorable to preside over the case. Whether or not the bleak picture being painted by critics was based upon reality, Congress overrode, as did the Senate, then-U.S. President Clinton's veto, to introduce reforms, both in procedure and substance, to securities class actions. (In his veto, President Clinton stated that the PSLRA would "have the effect of closing the courthouse door on investors who have legitimate claims.")

2. The PSLRA: Procedure and Substance

(a) Procedure

The perceived "race to the courthouse" by lawyers to file the first complaint, and trial lawyers' alleged use of "token plaintiffs," effectively ended with the enactment of the PSLRA. The PSLRA requires a court

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[6] Rule 23 and class certification are discussed in greater detail below. *See* Section III.F.3.

[7] The PSLRA applies to claims pled under the Securities Act and the Exchange Act.

overseeing federal securities fraud class action lawsuits to adopt a rebuttable presumption that the most adequate plaintiff to represent a class as Lead Plaintiff is the investor(s) who suffered the largest financial loss. Thus, there is no longer a meaningful advantage to filing the first action.

Before appointing the Lead Plaintiff, however, the plaintiff filing the first class action lawsuit must publish notice of the filing of an action via a wire service or widely circulated publication advising investors of the pendency of the action. The notice also informs investors that any class member may apply to the court to serve as the Lead Plaintiff. These applications must be made within sixty (60) days of the publication of the notice. The purpose of the initial notice, and the 60-day period that follows, is to alert potential class members to the commencement of the litigation and to provide investors with time to measure their losses and consider whether to move to be appointed Lead Plaintiff. A party does not need to file a complaint to be appointed Lead Plaintiff. Rather, any investor within the class may move the court by filing a motion for appointment as Lead Plaintiff. The motion must be accompanied by a PSLRA certification which provides: (i) that the plaintiff has reviewed the complaint and authorized its filing; (ii) that the plaintiff did not purchase the subject security at the direction of counsel in order to participate in the action; (iii) that the plaintiff is willing to serve as a representative party on behalf of a class; (iv) all transactions in the subject security; (v) identifies all other securities class actions in the past three (3) years in which the plaintiff is serving (or sought to serve) as a representative party; and (vi) that the plaintiff will not accept any payment for serving as a representative party beyond his or her pro rata share of any settlement or award.

After evaluating the Lead Plaintiff applications, including any arguments or briefs in support or in opposition, the judge will appoint a Lead Plaintiff — a role Congress clearly preferred for institutional investors to assume as evidenced by the language of the PSLRA and its published legislative history. The PSLRA requires courts to appoint as Lead Plaintiff the movant or movant group with the "largest financial interest" in the case (often measured as the largest loss) who are also adequate to lead the class. Congress (and the courts) prefers institutional Lead Plaintiffs because generally institutions (i) have the largest investments, and therefore often the largest losses and (ii) have the sophistication and experience to work most effectively and efficiently with lawyers.

(b) Institutional Investors as Lead Plaintiffs

One important goal of the PSLRA was to shift control of securities class actions from the lawyers to the plaintiffs. Indeed, the PSLRA "increased the likelihood that institutional investors will serve as Lead Plaintiffs" because, as Congress stated in published reports, institutional investors with large amounts at stake "will represent the interests of the plaintiff class more effectively than class members with small amounts at stake." Similarly, the Senate Report on the PSLRA states that "[t]he Committee believes that increasing the role of institutional investors in class actions will ultimately benefit the class and assist the courts." Senate Report No. 104-98 at 11.

Consistent with the goals of the PSLRA, since the passage of the Act, institutional investors have become much more active in prosecuting securities class actions. According to a PricewaterhouseCoopers study, institutional investors were lead plaintiffs in 56 securities class actions in 2002, up from 31 cases in 2001, 19 in 2000 and 18 in 1999. That figure rose dramatically by 2005, where institutional investors were lead plaintiffs in 101 securities class actions and reached a high of 104 actions in 2008. The percentage of institutional investors serving as lead plaintiff in securities class actions has averaged 52% per year since 2002. Some commentators have gone so far as to suggest that the managers of institutional investors may have a fiduciary duty to assume the role of Lead Plaintiff, or, at the very least, make an informed decision on why not to serve, when they sustain losses as a result of securities fraud. See Elliot J. Weiss & John S. Beckerman, Let the Money Do the Monitoring: How Institutional Investors Can Reduce Agency Costs in Securities Class Actions, 104 Yale L.J. 2053, 2098-2109 (1995) ("Consideration of their fiduciary obligations also may lead many institutional investors to decide that they should seek to serve as Lead Plaintiff whenever they are eligible to do so").

B. Non-U.S. Investors as Lead Plaintiff

Historically, institutional investors based outside the United States have refrained from seeking leadership roles in securities class actions brought in United States courts. The reasons for this reluctance vary, but it is clear that many non-U.S. institutional investors are not aware that they even have the ability to assert claims in the United States. More recently, however, courts in the United States have appointed foreign institutional investors as Lead Plaintiffs in securities class actions on behalf of both U.S. and non-U.S. investors.

Despite the fact that non-U.S. institutional investors (as well as U.S. institutional investors) lose many millions of dollars as a result of corporate fraud, frequently non-U.S. investors are not aware that they may pursue claims based on these losses in United States courts. In fact, some non-U.S. institutions are not even aware of pending litigation, which often prevents them from participating in any recoveries, not to mention from ever serving as lead plaintiffs. As such, there is an increased incentive for non-U.S. institutional investors to closely monitor securities class actions in the United States to: (i) evaluate their financial losses in these cases; (ii) consider stepping forward to lead cases under the correct circumstances; and (iii) utilize a portfolio monitoring service, like the free services offered by Kessler Topaz, to ensure that they are recovering all funds they are eligible to recover.

Indeed, several studies demonstrate that institutional investors are leaving billions of dollars in class action settlement monies unclaimed with over 70% not filling out claim forms. Kessler Topaz has extensive experience working with investors worldwide and represents a growing number of investors across Europe, Canada and Australia. The Firm offers professional services to all of its institutional clients, including those located outside the United States. Kessler Topaz currently represents various pension funds, mutual fund managers, insurance companies, and other institutional investors from around the world as Lead Plaintiffs in U.S. securities class actions. We will be happy to provide you with a sampling of securities class actions currently led by institutional investors located outside the United States.

C. What Is Being Accomplished (Important Trends in Securities Class Actions)

Securities class actions have been criticized by some who suggest that these lawsuits return little value to those harmed by the fraud. However, the past several years have seen several trends which are very favorable to investors and demonstrate that class actions are indeed a valuable vehicle not only for recovering lost monies, but also to implement meaningful corporate governance changes which produce long-term value for investors retaining positions in corporate defendants. These trends include significantly larger monetary settlements, potential corporate governance changes, lower attorney fees, payment from individual wrongdoers, creative settlements such as those involving equity as part of settlements and pre-packaged bankruptcies, to name a few. It is beyond debate that the main factor influencing these trends is the involvement of institutional investors as Lead Plaintiffs.

1. Increase in Monetary Value of Settlements

The increased size of settlements in securities class actions from 1995 through 2010 has been somewhat staggering. Even without the inclusion of several multi-billion dollar settlements including WorldCom, Enron, Cendant and Tyco, the increase in settlement dollars is still impressive. Prior to 1995 (the year the PSLRA was passed), class action settlements averaged approximately $5 million per settlement. By 2003, the average settlement had risen to approximately $25 million. That figure reached a peak of $42 million in 2010, and the average settlement value from 2003 to 2010 was $30.4 million. A closer examination of the underlying settlements which make up these averages demonstrates a further trend towards larger settlements per action. In 2003, twenty-three (23) settlements were valued at $20 million or greater, with six (6) settlements exceeding $100 million. In 2009, eleven (11) settlements reached values of $100 million or more. And from 2006 through 2010, between 8% and 11% of settled cases each year were valued at $100 million or more. Those, however, are dwarfed by the WorldCom settlement of $6.1 billion, the Enron settlement of more than $7 billion, and the Cendant and Tyco settlements both totaling over $3 billion. The explanations for these increased settlements are not hard to find. As the size and scope of the frauds have grown astronomically, so have investor losses per case. In 1996, the median loss for settled class actions was $64 million. That figure has risen steadily over the past fifteen (15) years, reaching $321 million in 2002 and a record $604 million in 2010. Also, an increasing number of institutional investors are stepping forward to become Lead Plaintiffs. Indeed, studies have shown that, in cases where institutional investors have served as the Lead Plaintiff, the average settlement was substantially higher than those led by individual investors. Of the 100 largest settlements in securities class actions from 1996-2010, totaling over $46.7 billion in settlement proceeds, 88% of those were led by institutional investors.

Of course, this has also meant a similar increase in the total settlement dollars available. In 2001, the value of all securities class action settlements for the year was approximately $1.9 billion; by 2004, the figure had risen to approximately $5.5 billion for the year; and from 2005 through 2010, more than $47 billion in settlement proceeds were made available for distribution.

2. Decreased Attorney Fees

As contemplated under the PSLRA, institutional investors are in a better position than individual investors to negotiate lower attorney fees, which increases the size of the recovery for the class without sacrificing the quality of counsel. Indeed, institutional investors are able to negotiate sophisticated fee arrangements, which may include provisions for sliding scales based on either the amount recovered for the plaintiff, the time it takes to litigate the case, or both. In addition, bonuses for certain types of recoveries (i.e., when individual defendants contribute to the settlement recovery) have become more common as motivators for counsel.

3. Individual Wrongdoers Being Held Accountable

The naming of executive and non-executive directors and officers as defendants in securities class actions is not new. However, forcing individual defendants to pay settlement dollars out of their own pockets is a recent development. Individual defendants have long been protected by Directors & Officers insurance and were not paying any portion of settlements from personal monies. In an effort to prevent these wrongdoers from walking away with the spoils of the fraud as well as to deter improper behavior, plaintiffs have begun to demand that these wrongdoers pay at least some portion of the settlements that are reached. Whereas in the past, being named as a defendant in a securities class action was merely a reputational risk, recent landmark settlements have begun to ensure that corporate officers suffer a financial penalty. In January 2005, eighteen (18) former non-executive directors of Enron agreed to settle one of the many cases brought by investors following the collapse of the company in 2001. As part of that settlement, ten (10) of those directors agreed to pay $13 million out of their own pockets. That came on top of the 2004 settlement where a dozen former Enron directors agreed to pay $1.5 million of their own money as part of the settlement of a case brought on behalf of former Enron employees.

In another important settlement, ten former directors of WorldCom agreed to pay $20 million of their own money to settle one of the many class actions filed after the communication company's collapse.

In fact, the Lead Plaintiff in the WorldCom securities class action, an institutional investor, demanded that executives of the company pay a portion of any settlement that was achieved. The fact that an institutional investor with significant losses took the lead role in this case gave the attorneys litigating the action substantial clout and leverage in negotiating such a successful settlement.

Other notable examples of individual wrongdoers being held accountable in securities class actions include Tenet Healthcare, in which the negotiated settlement included personal financial contributions from individual defendants as well as an additional $65 million recovery from Tenet's outside auditor KPMG, and Monster Worldwide, Inc., where the recipients of backdated stock options were required to disgorge more than $32 million in unlawful gains back to the company.

4. Corporate Governance Reforms

The serial nature of corporate scandals has brought corporate governance to the forefront of policy debate and action, whether government or market led. Each day seems to herald another government, industry, investor group, or firm-led voluntary corporate governance code, yet serious doubts remain as to their effectiveness given the focus on self-regulation and voluntary action. Indeed, even Sarbanes-Oxley, which was widely touted when enacted, has to date produced little in the way of deterrence and has been the victim of widespread criticism throughout the business community.[8]

Institutional investors have increasingly turned to litigation as a vehicle for implementing corporate governance reforms. Indeed, the role of litigation to secure such reforms has dramatically increased in the last few years, with some investors demanding significant governance changes alongside, and not in place of, substantial financial recoveries. Implementing corporate governance reforms through class action litigation is significant because, like all class action settlements, they must be approved by the court and are therefore judicially enforceable. The enforceability of these negotiated changes makes them all the more valuable to shareholders and an attractive way to secure the value of a long-term investment. It is important to remember though that it must not only be the Lead Plaintiff that is dedicated to seeking corporate governance changes. The Lead Plaintiff's chosen counsel must be seeking more than just a fee at the end of the day. Firms that focus on securing corporate governance reform have won notable changes. Corporate governance reforms that have been included in settlement agreements range anywhere from altering the audit committee's composition and control to revamping a corporation's overall structure. For example:

1. **Comverse Technology, Inc.** agreed to a host of corporate governance and internal control reforms in a 2010 derivative case settlement, including: the entire board of directors and senior executive corps that served at the time of the backdating scheme was replaced; the board split the positions of Chairman and CEO, with the Chairman being an independent director; the company enacted a proxy access provision for large shareholders; the board adopted a majority voting standard; and the company substantially reformed its stock option granting and administration processes as well as its internal auditing policies and procedures.

2. **Affiliated Computer Services** agreed to a settlement in an options backdating derivative case in 2009 which included numerous, substantial changes to the company's corporate governance and internal controls, including replacing the officers and directors who were most culpable in the backdating scheme, revamping the director nomination and removal process, and overhauling the stock option granting and administration policies and procedures.

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[8] Businesses from around the world have attacked the requirements of Sarbanes Oxley as onerous, and, as a result, were instrumental in the recent enactment of the Class Action Fairness Act, aimed to curtail the number of cases brought to limit businesses' exposure. By contrast, the investor community remains too fragmented to be an effective counterweight at the legislative level.

3. **Southwest Airlines Company** was sued derivatively in 2008. Plaintiffs alleged that between June 2006 and March 2008, Southwest flew 46 Boeing 737 airplanes on nearly 60,000 flights without complying with a 2004 Federal Aviation Administration ("FAA") Airworthiness Directive that required the Company to inspect the planes for fuselage fatigue cracks. As a result, Southwest was forced to temporarily ground forty-four (44) planes and the FAA levied a record $7.5 million civil penalty on the Company. In settling the suit against the Company's officers and directors for breach of fiduciary duties in connection with its violations of FAA safety and maintenance regulations, Southwest agreed to numerous reforms targeted at ensuring Southwest's Board is adequately apprised of any issues concerning Southwest's safety and operations and at implementing significant measures to strengthen Southwest's safety and maintenance processes and procedures.

4. **Sepracor, Inc.**, in settling a derivative suit against then current and former officers and directors in 2008, agreed to cancel or reprice more than 2.7 million unexercised stock options that were alleged to have been improperly granted in violation of shareholder-approved stock option plans. Sepracor agreed to adopt internal controls and granting procedures designed to ensure that all stock options are properly dated and accounted for, to not alter the exercise prices of stock options without shareholder approval, to hire an employee responsible for ensuring that the Company complies with its stock options plans, and to appoint a director of internal auditing.

5. **Tenet Healthcare Corporation** settled a securities class action in 2006, and agreed to sweeping governance reforms including the establishment of a special independent review committee focused on compliance with ethical, legal and regulatory issues specialized to the healthcare community with the power to investigate such issues. Additionally, Tenet agreed to revise its insider trading policy such that each employee covered by the policy would be required to undergo thorough training with respect to the policy. Lastly, Tenet agreed to require that two-thirds of its directors be independent, to separate the CEO and Chairman positions, and to establish a means for shareholders to communicate with the Board, among many other significant measures.

6. **Monster Worldwide, Inc.**, in settling a stock option derivative action against it relating to the options "backdating" scandal, agreed to a settlement which required the recipients of backdated stock options to disgorge more than $32 million in unlawful gains back to the Company, and also achieved significant corporate governance changes at the Company. These measures included: (a) requiring Monster's founder Andrew McKelvey to reduce his voting control over Monster from 31% to 7%, by exchanging super-voting stock for common stock; and (b) implementing new equity granting practices that require greater accountability and transparency in the granting of stock options moving forward. In approving the settlement, the court noted "the good results, mainly the amount of money for the shareholders and also the change in governance of the company itself, and really the hard work that had to go into that to achieve the results. . . ."

7. **Both Juniper, Inc. and McAfee, Inc.**, in settling high-profile options backdating cases against the respective companies, agreed to comprehensive corporate governance reforms in areas such as executive compensation policies and procedures, internal auditing practices, board of directors composition and committee responsibilities, and shareholder voting policies and procedures.

8. **Siebel Systems**, the maker of business software, settled a class action shareholder suit in 2003, and agreed, in part, to significant oversight reforms that included expanding the number of board members and requiring more disclosures about executive compensation.

9. **Enterasys Networks** settled a shareholder class action and, as part of the settlement, agreed to allow investors holding more than 5% of the company's stock to nominate alternative candidates to the board and to provide more information on executive compensation.

10. **Sprint Corp.** settled a shareholder suit and, as part of the settlement, agreed to substantially revise the composition of the Board, to ban insider selling during company stock buyback programs and to require independent directors to meet at least twice a year, outside the presence of management.

The governance reforms that were included in these settlements clearly advanced the interest of protecting all investors, particularly institutional investors. Again, in practice, the force behind these changes has been institutional investors and their selected counsel who understand the need for, under the correct circumstances, more than just a monetary recovery as part of a class action lawsuit.

5. Creative Settlements

In addition to corporate governance reforms, institutional investors have been at the forefront of reaching more creative settlements with defendants, particularly settlements that include payment in company stock in lieu of only cash. Including stock in the settlement is particularly useful when a company's long term viability is healthy, but its short term position leaves the company with limited ability to pay a large monetary judgment. This type of settlement structure seeks to maximize the recovery by aligning the interests of the class with the future performance of the defendant company. Other creative settlements have included the use of pre-packaged bankruptcies, downside protection for plaintiffs when taking equity as part of a settlement, and others.

6. The National Australia Bank Decision

In June 2010, the United States Supreme Court issued an opinion that affirmed all investors' rights (U.S. and non-U.S.) purchasing securities in the United States to assert claims in a U.S. court. See Morrison v. National Australia Bank, 130 S.Ct. 2869 (2010) ("NAB"). At the same time, however, the Court limited claims by investors who purchase securities on non-U.S. exchanges. In NAB, the Supreme Court decided Australian shareholders who had purchased securities in an Australian bank could not bring securities-fraud claims in a U.S. court. More specifically, the Supreme Court held that the Exchange Act does not apply extraterritorially, meaning only securities listed on an American stock exchange that are purchased or sold are subject to the Exchange Act. Whether or not the U.S. Congress will respond to the NAB decision by clarifying the extraterritorial reach of the Exchange Act remains to be seen. Likewise, it will be interesting to see whether and how other countries will seek to develop their own securities laws as well as mechanisms to pursue group actions.

D. The Benefits of Serving as the Lead Plaintiff

One of the leading misconceptions with regard to securities class actions is that there are no advantages to assuming the role of the Lead Plaintiff. While taking on the role of Lead Plaintiff requires careful consideration, it is important to note that the majority of investors do not understand what is entailed. Indeed, most believe that it is much more burdensome than it truly is and do not fully understand the benefits or the impact the Lead Plaintiff's decisions have on all investors. In addition, many non-U.S. investors believe that they are not eligible to serve in this role. This section will detail the responsibilities of a Lead Plaintiff and the advantages to serving as Lead Plaintiff when the circumstances are right for your particular fund.

1. Serving as Lead Plaintiff and Its Advantages

In order to have a representative of the plaintiff class overseeing the litigation, the court will appoint a single plaintiff or a small group of plaintiffs as the Lead Plaintiff. As noted above, this selection is based primarily on which plaintiff or plaintiff group has suffered the largest financial losses. While nearly all courts allow small groups of plaintiffs to come together to represent the class, the size of these groups generally does not exceed five members so that they are able to work together in an efficient manner. The court will then typically approve the Lead Plaintiff's selected attorneys as Lead Counsel. This organization is usually established by the court within the first several months after the lawsuit is initiated.

(a) Overseeing the Litigation

The Lead Plaintiff is responsible for managing the litigation primarily by overseeing and monitoring the progress of the action and the efforts of counsel. Specifically, a Lead Plaintiff will review and comment on important filings and other documents pertaining to the prosecution of the action. Lead Counsel is responsible for litigating the action and, at the same time, keeping the Lead Plaintiff well-informed so that the Lead Plaintiff can effectively monitor all progress and provide comments and suggestions. Kessler Topaz works with all of its clients to establish a reporting system that they determine to be effective, yet not overwhelming.

(b) Costs and Expenses

There is NO financial risk in serving as a Lead Plaintiff. Kessler Topaz advances all costs and expenses incurred in the prosecution of the case and will be reimbursed only if there is a successful settlement or judgment recovery on behalf of the class. This reimbursement comes from the money recovered on behalf of the class and, thus, there is never a time when the Lead Plaintiff would have to pay anything out of its own pocket. Furthermore, unlike many other countries, in U.S. class action cases, the Lead Plaintiff is not responsible for the legal costs or expenses of the defendants in the event that a case does not resolve favorably for the class. In addition, fees earned by Kessler Topaz are contingent upon a successful recovery and are ultimately determined by the court, based on the complexity of the lawsuit, the duration of the litigation and the quality of work performed. Institutional Lead Plaintiffs often will negotiate a competitive fee agreement with counsel, to limit the maximum percentage that their selected counsel will request from the court if there is a successful resolution of the case.

(c) Settlement Discussions

Once discussions aimed at resolving an action commence, the Lead Plaintiff will have an opportunity to be active in all negotiations relating to the size of the financial recovery, the makeup of the consideration (i.e., cash and stock, cash and options, etc.), the proposed plan of allocation for distribution of the recovery to the class, and corporate governance demands aimed to protect shareholders from similar future frauds. Generally, the Lead Plaintiff has a strong voice when negotiating settlements and the clout of a sophisticated institutional investor cannot be overstated in these situations. Moreover, the Lead Plaintiff must approve any settlement before it is presented to a court.

(d) Attorneys' Fees

A common complaint directed at class actions is that plaintiffs' attorneys are awarded too large a portion of the recoveries they achieve. The trend, however, is that attorneys' fees by percentage have been dramatically reduced in the last several years as institutional investors have begun stepping forward to serve as Lead Plaintiffs. Institutional investors are able to establish more competitive contingent fees with their counsel, well below the benchmark set by many courts. As a result, the class is benefited by a return of a larger portion of the settlement. While attorneys' fees are generally agreed to when an investor retains counsel, there are many different ways to structure agreements so that the fee properly reflects the amount and type of recovery achieved as well as the complexity and longevity of the litigation (i.e., sliding scales that encompass both the amount and timing of recoveries). It is important to note that even if counsel and the Lead Plaintiff agree on an appropriate fee, all fees must still be approved by the court as fair and reasonable.

2. Dispelling the Myths of Being a Lead Plaintiff

There are several myths about serving as a Lead Plaintiff. Below are several comments that we have encountered from both U.S. and non-U.S. investors, as well as the realities associated with the Lead Plaintiff role.

There is a large time and resource commitment in being a Lead Plaintiff.

Incorrect. Lead Counsel does all of the legal work and advances all of the costs and expenses associated with the litigation. The Lead Plaintiff monitors the progress of the litigation by reviewing important documents. While it is true that the Lead Plaintiff may need to produce documents and have a representative available for a deposition to answer certain questions, the time commitment generally is not significant and all expenses will be advanced by Kessler Topaz.

Lead Plaintiffs may be held financially or otherwise liable if the case is unsuccessful.

Incorrect. Unlike certain courts outside the United States, an unsuccessful plaintiff is not responsible for the defendants' fees, costs and expenses. Likewise, a plaintiff is not responsible for paying its own counsel fees, costs or expenses in a contingency matter, regardless of the outcome of the case.

The Lead Plaintiff will receive unwanted media publicity.

Incorrect. In response to questions of publicity, we typically ask investors to name the Lead Plaintiff in the Enron securities class action — arguably the most widely publicized class action ever. Most investors cannot answer this question. The truth is that most Lead Plaintiffs have as much or as little publicity as they seek. Indeed, in some instances institutional Lead Plaintiffs desire publicity to demonstrate that they are active, when necessary, to combat corporate fraud and that they are fulfilling their obligations to protect and preserve their funds' assets.

Lead Plaintiffs will have to make frequent trips to the United States.

Incorrect. The Lead Plaintiff is generally not required to attend most hearings. We do encourage our institutional clients, however, to consider attending the important hearings as the Lead Plaintiff's appearance often has a positive impact on the court. There is always the possibility that a Lead Plaintiff or other representative plaintiff will be required to sit for a deposition. These depositions typically are not burdensome and are scheduled at a convenient time and place. All costs and expenses for the litigation, including any travel related expenses, are advanced by Kessler Topaz, and are not the responsibility of the Lead Plaintiff.

There is no reason to be a Lead Plaintiff because institutions receive the same return when, and if, the case resolves in a recovery for the plaintiffs.

Incorrect. As discussed above, institutional Lead Plaintiffs frequently achieve larger recoveries than individual Lead Plaintiffs and are uniquely capable of implementing meaningful governance changes with the corporate defendant. As such, institutional Lead Plaintiffs offer material advantages for investor classes. Without question, a decline in the number of active institutional investors would lead to a decline in the quantity and quality of the recoveries and governance reforms accomplished by class actions.

There is no need to seek to be a Lead Plaintiff because another institution will step forward anyway.

Incorrect. The reality is that while there are a growing number of institutions that regularly seek to serve as Lead Plaintiffs, those same institutions are beginning to speak out against what they view as "free-riders" — institutional investors that rarely or ever serve as Lead Plaintiffs, yet always participate in class action recoveries. There is no risk in filing a Lead Plaintiff motion; indeed, one can always withdraw a motion once it is determined that another qualified institutional investor (with similar or greater financial losses) has stepped forward to protect the putative class. However, there exists a substantial risk when an institutional investor with substantial losses elects not to file a Lead Plaintiff motion and, instead, allows other smaller (perhaps individual) investors to assume the important role of Lead Plaintiff. Oftentimes, smaller investors have selected counsel with less experience and resources to prosecute these class actions which directly impact the quality and quantity of the recoveries and reforms.

Non-U.S. based investors cannot serve as a Lead Plaintiff.

Incorrect. We live in a global economy and courts in the U.S. have continually recognized that non-U.S.-based investors, many of which have very substantial holdings in U.S. securities, are adequate Lead Plaintiffs with just as much right to seek leadership positions in these cases as U.S.-based investors. While the NAB opinion described on page 11 did limit the ability for investors to bring claims for investments made on non-U.S. exchanges, investors domiciled anywhere can bring claims and serve as a lead plaintiff for claims brought on behalf of investments made on U.S. exchanges.

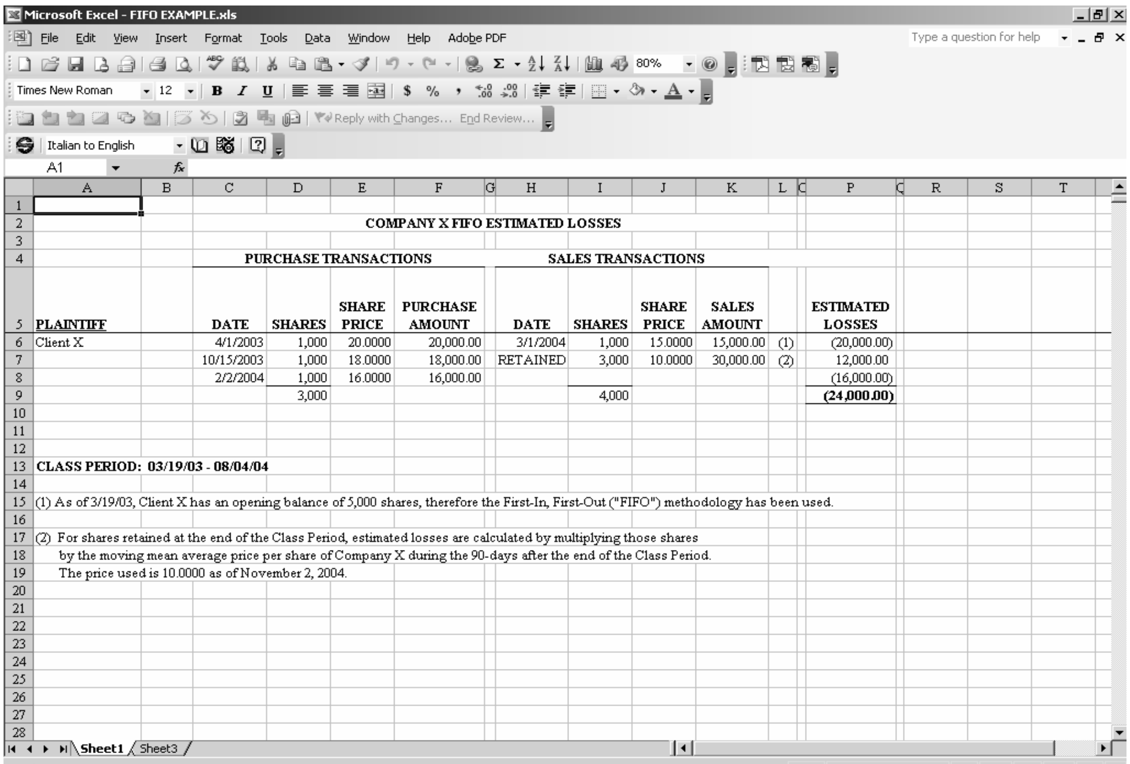
E. Calculating Your Losses

As discussed above, the PSLRA creates a rebuttable presumption that the plaintiff with the largest financial interest (of the movants seeking appointment) in the litigation should be appointed as Lead Plaintiff. Since institutional investors typically hold large positions in publicly-traded companies, Congress established this framework to encourage courts to appoint institutional investors as Lead Plaintiffs. However, the PSLRA does not define the term financial interest or otherwise guide courts on how to calculate a Lead Plaintiff candidate's financial interest. As a result, determining how to calculate a prospective Lead Plaintiff's financial interest, or financial loss, remains the subject of much debate among the courts.

At the outset, it is important to note that the Class Period — the time period during which the defendants' false and misleading statements inflated the price of the security — determines which purchases and sales of the security factor into a plaintiff's financial interest. Consequently, when an institutional investor elects to pursue a case as Lead Plaintiff, counsel will first request the client's transactions in the security during the Class Period, as well as any shares of the security the client held immediately prior to the beginning of the Class Period.

Using this information, counsel will calculate the client's financial interest in the litigation. Many courts equate financial interest with the out-of-pocket financial loss experienced (either as owner of the stock or on behalf of the actual owners) by the Lead Plaintiff candidate. Courts utilize one of two methodologies to determine financial loss — FIFO (first-in, first-out) and LIFO (last-in, first-out). A court's decision on which methodology to employ can have a dramatic impact on the institutional Lead Plaintiff candidate's financial loss.

Under FIFO, the first shares sold during the Class Period are matched or offset against the earliest purchases, even if they occurred before the Class Period. For example, if an institution owns 5000 shares of Company X stock at the start of the Class Period, and then purchases 3000 more shares during the Class Period before selling 1000 shares, those 1000 shares sold during the Class Period are offset against the 5000 share pre-Class Period balance. Accordingly, when counsel calculates the institution's financial loss, the 1000 shares sold during the Class Period are effectively zeroed out for loss calculation purposes because they relate to pre-Class Period purchases. Once counsel nets all Class Period transactions, the institution would have a net balance of 3000 shares purchased during the Class Period which were still held at the close of the Class Period.



COMPANY X FIFO ESTIMATED LOSSES

	PURCHASE TRANSACTIONS				SALES TRANSACTIONS					
PLAINTIFF	DATE	SHARES	SHARE PRICE	PURCHASE AMOUNT	DATE	SHARES	SHARE PRICE	SALES AMOUNT		ESTIMATED LOSSES
Client X	4/1/2003	1,000	20.0000	20,000.00	3/1/2004	1,000	15.0000	15,000.00	(1)	(20,000.00)
	10/15/2003	1,000	18.0000	18,000.00	RETAINED	3,000	10.0000	30,000.00	(2)	12,000.00
	2/2/2004	1,000	16.0000	16,000.00						(16,000.00)
		3,000				4,000				**(24,000.00)**

CLASS PERIOD: 03/19/03 - 08/04/04

(1) As of 3/19/03, Client X has an opening balance of 5,000 shares, therefore the First-In, First-Out ("FIFO") methodology has been used.

(2) For shares retained at the end of the Class Period, estimated losses are calculated by multiplying those shares by the moving mean average price per share of Company X during the 90-days after the end of the Class Period. The price used is 10.0000 as of November 2, 2004.

This methodology accounts for the reality that many institutions typically enter a Class Period with a pre-existing balance of company stock.

Conversely, under the LIFO methodology, the last shares purchased are considered the first shares sold. Under the above example, the 1000 shares sold during the Class Period would be offset against the 3000 shares purchased during the Class Period, thereby leaving a net balance of 2000 shares purchased during the class period. Currently, LIFO is the majority rule in many key jurisdictions in the United States.

After netting all Class Period transactions under either FIFO or LIFO, counsel determines a set-off value for the shares retained at the end of the Class Period to calculate the loss related to these shares. Under the PSLRA, the set-off value is equal to the mean trading price of the security during the 90-day period beginning immediately after the end of the Class Period ("hold price")[9]. The hold price is multiplied by

[9] Even if the institution sells the shares after the end of the Class Period but before the end of the 90-day period, the actual sale price is not always utilized. Instead, counsel must use the greater of the actual sale price or the mean trading price from the end of the Class Period to through the date of sale. Alternatively, if the institution sells after the 90-day period, the 90-day hold price is still used.

the corresponding number of shares retained at the end of the Class Period — in the above example, 3000 under FIFO and 2000 under LIFO. That product is then netted with the out-of-pocket cost of the shares held at the end of the Class Period.

COMPANY X LIFO ESTIMATED LOSSES

	PURCHASE TRANSACTIONS				SALES TRANSACTIONS					
PLAINTIFF	DATE	SHARES	SHARE PRICE	PURCHASE AMOUNT	DATE	SHARES	SHARE PRICE	SALES AMOUNT		ESTIMATED LOSSES
Client X	4/1/2003	1,000	20.0000	20,000.00	3/1/2004	1,000	15.0000	15,000.00		(5,000.00)
	10/15/2003	1,000	18.0000	18,000.00	RETAINED	2,000	10.0000	20,000.00	(1)	2,000.00
	2/2/2004	1,000	16.0000	16,000.00						(16,000.00)
		3,000				3,000				**(19,000.00)**

CLASS PERIOD: 03/19/03 - 08/04/04

(1) For shares retained at the end of the Class Period, estimated losses are calculated by multiplying those shares by the moving mean average price per share of Company X during the 90-days after the end of the Class Period. The price used is 10.0000 as of November 2, 2004.

F. Litigating Securities Class Actions

This section provides a general overview of the typical stages in prosecuting a securities class action after the Lead Plaintiff is appointment.

1. The Amended Complaint and Motion to Dismiss

As noted above, the PSLRA provides specific procedures for the appointment of a Lead Plaintiff in a securities class action. Following the Lead Plaintiff appointment, the Lead Plaintiff and defendants typically agree upon a schedule to file an amended complaint and for defendants to file responsive pleadings. The amended complaint is one of the more important steps in prosecuting a securities class action because it sets forth the relevant facts and pleads causes of action that the Lead Plaintiff intends to establish at trial.

Complaints typically assert claims against issuers and officers who issued materially false statements. The complaint may also name directors who signed documents, underwriters, and accountants who issued unqualified audit opinions as defendants.

Securities fraud complaints must be pled with particularity pursuant to Rule 9(b) of the Federal Rule of Civil Procedure and the PSLRA. The failure to comply with these stringent pleading standards may provide a basis for dismissal of the action. Accordingly, Lead Plaintiff's counsel will promptly undertake a thorough investigation of the factual circumstance that underlies the fraud, including researching all of the defendant's SEC filings, press releases, and other company statements, and analyzing any insider sales by officers and directors, or acquisitions that the issuer may have made with inflated stock which may expose the motive for the fraud.

Depending on the nature of the fraudulent statements, Lead Counsel may also engage investigators to identify and contact potential witnesses, such as customers, suppliers/vendors, former employees, non-defendant companies, or retaining industry experts who help better understand the industry and the fraud. Lead Counsel may also engage accounting experts to analyze the issuer's financial statements and identify violations of generally accepted accounting principles.

Once the Lead Plaintiff files the amended complaint, defendants will invariably move to dismiss the complaint on any number of grounds. Motions to dismiss typically argue that the alleged false statement was immaterial to investors, that the defendants did not know the statement was false when made, that the complaint fails to satisfy the heightened pleading requirements of Rule 9(b) and the PSLRA, and that the false statements did not cause the Lead Plaintiff's losses.

Lead Plaintiff's counsel will oppose the motion to dismiss and the court will issue an opinion and order that either grants or denies the motion to dismiss, or parts thereof.

2. Merits Discovery

Once the defendant has either answered the complaint, or the court has denied the defendant's motion to dismiss, the discovery stay, which is automatically in force under the PSLRA, is lifted and discovery begins.[10]

Under the Federal Rules of Civil Procedure, before the discovery process begins, the parties must confer to discuss, and ideally to agree upon, a comprehensive discovery plan. The plan may address (i) the scope and timing of discovery; (ii) the number of depositions and their length; (iii) the number of written questions (or interrogatories) each party may serve on another party; (iv) expert discovery including exchange of reports and scheduling of expert depositions; (v) issues concerning access to and retrieving documents; and (vi) obtaining document or deposition discovery from third parties. Following the meeting, the parties must provide the court with the proposed discovery plan for its approval, or if agreement is not reached, each party may submit their own proposed schedule. The court will often make modifications to the plans depending on its own schedule.

Within fourteen (14) days of the parties meeting, each party must provide the other parties to the action with their "initial disclosures." These disclosures include basic information concerning: (i) the parties' claims and defenses; (ii) identification of witnesses and contact information; (iii) identification of documents that support a party's claim or defense; and (iv) the identification of applicable insurance coverage. The Lead Plaintiff will generally be required to provide copies of its trading records to demonstrate its holdings in the defendant's company, as well as any other information the Lead Plaintiff possesses concerning the issuer of the securities or its decision to invest in the securities.

After the parties have provided initial disclosures, they may then serve discovery requests. These requests are made in the form of document requests and interrogatories (which are written questions), directed to parties in the action. The Lead Plaintiff will receive document requests and interrogatories relating to the claims asserted, and counsel will review the requests to ensure they are appropriate, and assist in the preparation of any responses.

The Lead Plaintiff may also be notified of the need for deposition testimony. The parties must give reasonable advance notice of any deposition and in general, the Lead Plaintiff need only sit for a few

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[10] "Discovery" is the formal process of gathering evidence to prove claims or establish defenses.

hours on a single day and counsel is generally able to schedule the deposition for a time convenient to all parties. Lead Counsel will generally prepare with the Lead Plaintiff prior to the deposition to assure that the Lead Plaintiff is familiar with the deposition process and is adequately prepared to respond to defendants' questions.

3. Class Certification

Rule 23 of the Federal Rules of Civil Procedure provides that "as soon as practicable after the commencement of an action brought as a class action, the court shall determine by order whether it is to be maintained." Class certification is an important procedural requirement that allows the Lead Plaintiff to maintain the action through trial on behalf of the Lead Plaintiff and all other similarly-harmed investors (the "Class"). Motions for class certification are typically filed several months after a court denies defendants' motions to dismiss.

A fundamental prerequisite to the maintenance of any class action is that there is an identifiable Class, that the Lead Plaintiff is a member of that Class, and that there are common issues of law or fact between Class members such that a Class action would be superior over any other available procedures for adjudicating the controversy.

Although class certification is a procedure distinct from the merits of the action, a court may nonetheless probe behind the pleadings before coming to rest on the certification issue. In making its class determination, the court will consider various prerequisites mandated by Rule 23, including: (i) numerosity of the parties; (ii) commonality of legal and factual issues; (iii) typicality of the claims and defenses of the class representative; and (iv) adequacy of representation. The party seeking certification bears the burden of establishing that all prerequisites are met.

Once the class is "certified," the court will direct that appropriate notice be made to the class members, generally through publication and individual notice to all members who can be identified through reasonable effort. The notice must concisely and clearly state in plain, easily understood language: (i) the nature of the action; (ii) the definition of the class certified; (iii) the class claims, issues, or defenses; and (iv) that a class member may enter an appearance through counsel if the member so desires. Importantly, class members have the right to affirmatively opt-out of the class and to pursue a separate (but likely coordinated) action on their own behalf.

If a Class is not certified, each plaintiff is responsible for litigating its own individual claim in its own action. As such, defendants are highly motivated to defeat Lead Plaintiff's efforts to certify a Class.

4. Trial

While securities class actions rarely go to trial, the possibility does exist. Since the passage of the PSLRA, only eight (8) cases have gone to trial and reached a verdict. The purpose of a trial is to adjudicate contested issues of fact. In this regard, before the trial commences, judges may require Lead Counsel to draft a series of statements of fact that they believe will be established at trial. Defendants then indicate which of the proposed facts are admitted, or will not be contested, and which are disputed, specifying the nature of the disagreement, as well as drafting narrative statements of additional facts that they believe can be established. This process helps to narrow the factual issues in dispute.

Judges sometime place certain limits to avoid trials of excessive length, but without hampering counsel's ability to present their case or jeopardizing the fairness of the trial. Limits may be imposed in a variety of ways, including limiting the number of witnesses or exhibits to be offered on a particular issue or in the aggregate, controlling the length of examination and cross-examination of particular witnesses, limiting the total time allowed to each side for all direct and cross-examination, and narrowing issues by order or stipulation.

The Lead Plaintiff is not required to attend a trial if one were to occur, but may be required to appear and present limited testimony related to the investment in the defendant issuer. Kessler Topaz is one of a handful of law firms in the United States that has tried a securities fraud class lawsuit.

IV. Shareholder Derivative Actions

Unlike a class action, which is brought on behalf of investors, a shareholder derivative action is a lawsuit brought by a shareholder of a public company on behalf of and for the benefit of the company against the directors and/or officers of that company. A company's board of directors is traditionally responsible for making decisions about whether or not the corporation will pursue litigation; however, in a derivative action, shareholders are permitted to "step into the shoes" of the directors and bring litigation that the board would be unwilling to pursue. Such unwillingness typically relates to the fact that the board members themselves are alleged to have participated in the misconduct and thus would be unlikely to "sue themselves." Shareholder derivative litigation can recover damages for financial harm caused by the conduct of its insiders, and also can be used to improve the governance of public companies in order to guard against such harms in the future. This section is intended to familiarize the reader with the nuances of shareholder derivative litigation, including the procedural requirements, underlying principles, and objectives of these actions, as well as to provide examples of successful derivative actions litigated by Kessler Topaz.

A. Plaintiffs in Shareholder Derivative Actions

Any shareholder of a company can serve as a plaintiff in a shareholder derivative action provided that the shareholder has held stock in the company continuously throughout the time period in which the wrongful conduct occurred and through the litigation. Strategically, it is beneficial for larger and more sophisticated shareholders to serve as derivative plaintiffs. First, allegations raised by such shareholders are traditionally treated more seriously by companies, defendants, and the courts, as compared to allegations raised by smaller shareholders. Thus, actions filed by larger and more sophisticated shareholders have an increased likelihood of effecting positive results for the company, be it monetary recovery or therapeutic corporate governance improvements. This is typically true whether or not the investor has a large position in the stock. Second, as in many shareholder actions, multiple plaintiffs often file substantially similar derivative actions on behalf of the same company. These situations often produce leadership disputes in order to determine which plaintiff will be the lead plaintiff in the litigation, and will thus be able to control the course of the litigation. Unlike federal class action lawsuits, derivative actions are not subject to the PSLRA and do not have a structured lead plaintiff appointment process. Although the PSLRA is not applicable, courts frequently give deference to shareholders with larger holdings in the subject company when selecting a Lead Plaintiff. In addition to the size of a shareholder's holdings and the shareholder's level of sophistication, courts will consider factors such as which plaintiff was the first to file a complaint, the quality of the plaintiff's pleadings, and the experience of plaintiff's counsel.

B. State Law Fiduciary Duties

Because shareholder derivative actions generally arise out of violations of state corporation laws, they are traditionally brought in state courts. However, shareholder derivative actions can be and are brought in federal court when certain claims arise and requirements are met. Under Delaware state law,[11] directors and officers of public companies owe a "triad" of fiduciary duties to the companies that they serve: (i) loyalty, which requires directors and officers to not use their positions of trust and confidence to further their private interests; (ii) care, which requires that directors use that amount of care which ordinarily careful and prudent people would use in similar circumstances; and (iii) good faith, which requires corporate fiduciaries to act with a genuine attempt to advance corporate welfare — to not act in a manner unrelated to a pursuit of the corporation's best interests. Breaches of the three (3) duties form the foundation of the claims underlying shareholder derivative actions.

C. Requirements to Bringing Shareholder Derivative Actions

In order to bring a shareholder derivative action, two general requirements must be met. First, the claims asserted by the shareholder must be derivative — i.e., the harm alleged by the plaintiff must be to the company itself, and not to the shareholder directly. Second, because company directors are traditionally charged with preserving the interests of the company, the shareholder must be able to demonstrate that a demand on the board to pursue the action was wrongfully refused, or that making a demand on the board to pursue the action would have been futile.

1. Direct or Derivative Harm

One of the prerequisites to bringing a shareholder derivative action is that the harm alleged by the plaintiff was suffered by the company (i.e., the claims are "derivative"), not the shareholder (i.e., the claims are "direct"). Delaware law provides a two-pronged test to determine whether claims are derivative or direct. The first question to be asked is: who suffered the alleged harm? If the company suffered the harm, then the claims are derivative; if the shareholder directly suffered the harm, then the claims are direct. The second question to be asked is: to whom would the benefit of litigation accrue? If the company would benefit from the litigation, the claims are derivative; if the plaintiff would benefit individually from the litigation, the claims are direct. If the shareholder suffered the alleged harm, or the benefit of the intended litigation would accrue to the shareholder, then the claims are direct and cannot be pursued derivatively by the shareholder on behalf of the company.

2. Demand and the Special Litigation Committee (SLC)

Because claims underlying derivative actions belong to the company, and because the company's board of directors is traditionally responsible for pursuing claims on behalf of the company they serve, shareholders are traditionally required to "demand" that the board pursue these claims. After a shareholder makes a demand on the board of directors, the board may either: (i) refuse the demand; or (ii) investigate the claims underlying the demand, after which the board may elect to refuse the demand or, alternatively, prosecute plaintiff's claims based upon the results of that investigation. An investigation into a shareholder's claims may be conducted by the entire board, by certain directors thereof, or by a specially designated Special Litigation Committee ("SLC") that has been constituted specifically to investigate and evaluate the merits of plaintiff's allegations. If the board refused plaintiff's demand with no investigation or following an investigation not conducted by a SLC, the shareholder may still pursue his or her claims, but must demonstrate that the board's refusal

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[11] A significant number of companies in the United States are incorporated in the State of Delaware, and those companies' directors' conduct is governed by Delaware law. Regardless of the jurisdiction in which shareholder derivative actions are filed, where the company in question is incorporated in Delaware, the court hearing the case will apply Delaware law to the claims asserted. In addition, because Delaware law governs such a large number of American companies, and because the corporate laws of Delaware are so thoroughly developed, many courts throughout the country use precedents established in Delaware to guide their own decisions on corporate matters. For these reasons, we use principles of Delaware law in this primer to illustrate the legal principles germane to the matters discussed herein.

of the demand was not protected by the business judgment rule. However, where a properly formed SLC refuses a shareholder's demand, that shareholder may only continue to pursue the claims if it is shown that the SLC lacked independence or good faith, or failed to conduct a reasonable investigation into plaintiff's allegations.

Making a demand, however, is not always a necessary prerequisite to bringing a shareholder derivative litigation. Where making a demand on the board to commence litigation would be "futile," a shareholder may commence a derivative action without making such a demand. "Demand futility" exists where the board members are conflicted and cannot be expected to properly investigate or pursue the claims. In order to demonstrate demand futility, the plaintiff must plead particularized facts in his complaint to create a reasonable doubt that either: (i) the directors are disinterested and independent; or (ii) the directors otherwise exercised business judgment in the conduct underlying plaintiff's allegations. The issue of demand futility is a fact-specific inquiry that must be decided on a case-by-case basis. Common factors that establish demand futility are a director's direct involvement in the unlawful conduct underlying plaintiff's claims, and close familial, social, or business relationships among directors that preclude those directors from acting independently of one another.

D. Objectives of Derivative Litigation

The objectives of these actions are primarily twofold: (i) to recover from wrongdoers monetary damages for the company; and (ii) to require the company to adopt corporate governance improvements designed to prevent the complained of harmful conduct from occurring again in the future. In the event that either one (or both) of these forms of relief is obtained, the company and its shareholders both benefit: the company because of the recovered financial contribution and/or improved corporate governance; the shareholders because of the company's improved corporate governance, which often results in an increase in stock price.

E. Examples of Derivative Cases Litigated by Kessler Topaz

1. Options Backdating

The "backdating" of stock options is a practice by which company directors, often with the assistance of company officers, manipulate the grant date of company stock options in order to give themselves more favorable, i.e., lower, option exercise prices. The practice of backdating stock options constitutes a breach of the fiduciary duties of good faith and loyalty by the directors and officers who engage in such backdating, as the granting of backdated options unduly benefits the recipients thereof to the detriment of the company and its shareholders. The backdating and subsequent exercise of manipulated stock options depletes substantial funds from public companies because the recipients of backdated stock options pay the company less money when they exercise those options than they otherwise would if the options were properly granted. Backdating stock options also violates company stock plans, federal tax laws, and federal securities laws. Furthermore, many companies have suffered harm as a result of stock option backdating by being forced to incur expenses associated with investigations of the underlying conduct and the massive financial restatements associated with the proper recognition of option grant dates and exercise prices.

The objective of litigating options backdating cases is to seek the repayment of money by those who were granted or received backdated options, as well as corporate governance reforms aimed at improving the manner in which directors determine and award compensation to corporate executives. From 2006 to 2008, Kessler Topaz filed more than 125 complaints on behalf of companies the directors and executives of which manipulated the exercise dates and prices of their stock options in order to enrich themselves and others at the company's expense. The majority of these cases have settled, and Kessler Topaz has recovered hundreds of millions of dollars in ill-gotten gains from backdated stock options and instituted groundbreaking corporate governance reforms not only with regard to options-granting, but also with regard to executive compensation generally, as well as accounting and record-keeping internal controls, and broader reforms regarding the composition, structure, and functioning of the board of directors and its committees. For example, in *In re Monster Worldwide, Inc. Derivative Litigation*, Index No. 06 108700 (N.Y. Sup. Ct.), Kessler Topaz attorneys negotiated a settlement that required the recipients of backdated stock options to disgorge more than $32 million in unlawful gains to the Company, plus significant corporate governance measures. These measures included (a) requiring Monster's founder Andrew McKelvey to reduce his voting control over Monster from 31% to 7%, by exchanging super-voting stock for common stock; and (b) implementing new equity granting practices that require greater accountability and transparency in the granting of stock options moving forward. In approving the settlement, the court noted "the good results, mainly the amount of money for the shareholders and also the change in governance of the company itself, and really the hard work that had to go into that to achieve the results…." Similarly, in *In re Comverse Technology, Inc. Derivative Litigation*, Index No. 601272/06 (N.Y. Sup. Ct.), Kessler Topaz attorneys negotiated a settlement that required the Company's founder, Chairman and CEO Kobi Alexander and other executives to disgorge more than $62 million to the Company and overhauled the Company's corporate governance and internal controls, including replacing a number of members on the board of directors and corporate executives, splitting the Chairman and CEO positions, and instituting majority voting for directors.

2. Corporate Waste and Executive Compensation

Derivative cases based upon corporate waste and executive compensation share similarities with options backdating cases. Corporate waste and executive compensation cases are filed because corporate executives breach their fiduciary duties of good faith and loyalty when they receive excessive compensation packages, and are intended to recover these sums from the unjustly enriched executives in order to those sums to the company. Examples of derivative cases based upon corporate waste and executive compensation that Kessler Topaz has successfully resolved include *In re Viacom Inc. Shareholder Derivative Litigation,* Index No. 602527/05 (N.Y. Sup. Ct.), in which Kessler Topaz attorneys negotiated a settlement that reduced Viacom Chairman and CEO Sumner Redstone's compensation by more than $30 million and significantly enhanced the alignment of his compensation with shareholder returns, and *Mercier v. Whittle*, Case No. 2008-CP-23-8395 (S.C. Comm. Pl.), in which Kessler Topaz attorneys negotiated a settlement that included significant corporate governance reforms and monetary payments, including requiring the CEO to leave the Company's board of directors and forgo $250,000 of his severance package; requiring the positions of Chairman and CEO be held by two separate people; mandating that the Company hold twice annual conference calls with their large shareholders so that investors will be able to speak directly with management; and requiring that the Board confer with its largest shareholders when considering new appointments to the Board.

3. Accounting Fraud and Financial Restatements

Derivative cases based on accounting fraud and financial restatements are filed because directors and executives of companies breach their fiduciary duties of good faith and care when they falsify corporate transactions or otherwise improperly recognize revenue. Often times this conduct requires the company to restate its historical financial results once the wrongdoers' conduct becomes public. The harm to the company in this category of cases includes the loss of revenue and/or net income upon the restatement, in addition to the costs incurred by the company in investigating the cause of and ultimately conducting the restatement. Examples of accounting fraud and financial restatement cases that Kessler Topaz has successfully resolved include *Graham v. Hutcheson, et al.*, Case No. 08-

cv-0246 MMA (NLS) (S.D. Cal.), in which Kessler Topaz attorneys negotiated a settlement that, among other things, required Leap Wireless International, Inc. to adopt a new billing system, enhanced compliance and accounting procedures, and greater oversight of accounting and internal controls by management, the Audit Committee, and the Company's independent auditors.

4. Self-Dealing Transactions

Not unlike corporate waste and excessive compensation cases, self-dealing cases involve directors and/or officers who breach their fiduciary duties of good faith and loyalty by usurping business transactions or opportunities that rightfully belong to the company, or otherwise act to benefit themselves to the detriment of the company. The harm to the company in these cases is usually the loss of potential revenue or the loss of other assets that rightfully belong to the company. These cases are filed with the purpose of recovering for the company the lost assets and/or opportunities that the wrongdoers usurped from the company. An example of a self-dealing transactions case that Kessler Topaz has litigated is *In re The Fairchild Corporation Shareholder Derivative Litigation*, Case No. 871-N (Del. Ch.) In *Fairchild*, it was alleged that Chief Executive Officer Jeffrey Steiner caused the company to make improper payments to him and his family, and to provide below-market loans to company officers and directors. As a result of this litigation, Steiner repaid approximately $3.76 million to the company, and the company reduced Steiner's compensation by 50%. In addition, the company added independent directors to the board, and substantially reformed the company's executive compensation practices.

5. Corporate Governance

Corporate governance cases are based upon allegations that directors have breached their fiduciary duty of care by failing to properly oversee the operations of the company. These "failure of oversight" actions often involve claims, harm to the company, and litigation objectives that are similar to those involved in corporate waste, self-dealing transactions, and accounting fraud derivative actions. Kessler Topaz has litigated numerous shareholder derivative actions focused on corporate governance and failure of oversight claims. One such action, *Klotz v. Parfet, et al.*, Case No. 03-06483-CK (Cir. Ct. Mich.) involved allegations that the directors of CMS Energy Corporation failed to properly monitor the business practices of CMS, thereby permitting CMS to engage in "round-trip" energy trades that had the effect of inflating the company's revenues and trading volume. As a result of the derivative action filed on behalf of CMS, a $12 million payment was paid to the Company by its insurance carriers, and numerous corporate governance improvements were enacted at the Company, including adding five new independent directors to the board and creating a position of Chief Compliance Officer.

6. Insider Trading

Insider-trading cases involve allegations that executives and/or directors violated their fiduciary duties of good faith and loyalty by engaging in stock purchases or sales based upon non-public information that they learned through their positions with the company. Derivative cases alleging insider trading are brought in order to recover the amount of profits that were unjustly received as a result of insider trading transactions. An example of insider trading cases that Kessler Topaz has litigated is *In re Oracle Corp. Derivative Litigation*, Consol. C.A. No. 18751 (Del. Ch.). *Oracle* alleged that Chief Executive Officer and Chairman of the Board Larry Ellison sold nearly $900 million of Oracle stock in the days immediately preceding the company's announcement that it missed its earnings estimates for the first time in five years. As a result of this litigation, Ellison disgorged $100 million worth of profit he received from his allegedly unlawful stock sales.

7. Conclusion on Derivative Actions

Shareholder derivative litigation is an important tool for shareholders concerned with the conduct of corporate directors and officers, and to rectify the harm caused by wayward corporate fiduciaries. It is of the utmost importance that concerned shareholders remain cognizant of the importance of strong corporate governance and faithful fiduciary conduct, and proactively seek to effect positive corporate changes. Companies with strong leaders and effective corporate governance measures are more profitable for their shareholders, and in the right circumstances a derivative action can ensure that the companies are as productive and profitable as possible.

V. Mergers & Acquisitions Litigation

Mergers and acquisitions ("M&A") litigation generally involves transactions where the ownership structure of a company will be materially altered, either through the receipt of stock in a new combined entity or — as is more typical — through the receipt of cash consideration in exchange for the stock held by the company's shareholders. Although Delaware law is extremely deferential to the business judgment of directors and officers in routine corporate decisions, Delaware courts closely scrutinize M&A transactions in which the public shareholders will lose ownership of their shares and the company. Courts will examine two elements of any M&A transaction: (i) the fairness of the price shareholders will be paid in exchange for their shares, and (ii) the fairness of the process resulting in the M&A transaction and the requisite shareholder approval for consummating the transaction.

A. Fair Price

M&A transactions typically offer shareholders premium consideration in return for their stock and control of the company. The short-term gains offered in M&A transactions, however, often cloud the significant risk of long-term losses created by ceding control in an otherwise healthy and growing company. The prospect that shareholders are not receiving the full value of their shares is particularly acute in going-private transactions where directors and officers will maintain their ownership in the company. In such transactions, management is essentially telling shareholders that they should sell their shares at the offered price even though they themselves are not willing to sell their own shares at that price. To protect shareholders in M&A transactions, Delaware law requires directors and officers to undertake a sales process that would be reasonably expected to maximize shareholder returns in any sale of the company. This generally entails some sort of auction, or at least a canvassing of the market, prior to agreeing to enter into such a transaction.

A prime example of a situation where shareholders were not receiving fair value for their shares was the case against Genentech, Inc. This shareholder litigation surrounded the July, 2008 attempt by Roche Holdings, Inc. to acquire Genentech for $89 per share. A shareholder action ensued to enforce provisions of an affiliation agreement between Roche and Genentech and to ensure that Roche fulfilled its fiduciary obligations to Genentech's shareholders through any buyout effort by Roche. The litigation resulted in the companies entering into an amended affiliation agreement, which allowed a negotiated transaction between Roche and Genentech to close, and enabled Roche to acquire Genentech for $95 per share, approximately $3.9 billion more than Roche offered in its hostile tender offer.

B. Fair Process

Related to the requirement that directors and officers maximize the price shareholders will receive in M&A transactions is the requirement that the sale process be fair to all bidders and potential bidders. Delaware law disfavors restrictions placed by buyers on a company's ability to provide other interested parties with the information necessary to make an offer that may lead to shareholders receiving higher consideration. The sales process of a company will be considered fair only if all the potential buyers were treated fairly and equally.

Delaware law also requires that M&A transactions be approved by a majority of the company's shareholders. To secure the requisite shareholder approval, directors and officers are required to provide shareholders with all material information that a shareholder would reasonably require to make an informed decision whether to approve the proposed transaction. Such information includes, for example, the reasons the board is recommending shareholders approve the transaction, the background and history of how the transaction came about, the company's financial projections and how they were used in assessing the financial fairness of the transaction, the personal financial benefits received by the company's directors and officers, and the payments received by the investment bankers who advised the company to enter into the transaction. Where directors and officers fail to fully and fairly disclose all material information, Delaware law empowers shareholders to enjoin the shareholder vote from proceeding until all the relevant information is made available.

VI. Direct Actions (Opting-Out)

As an alternative to participating in a class action, investors who seek to recover damages from violations of securities laws may instead file an individual direct action (also known as an "opt-out" action) and recover losses on their own behalf. By bringing an individual action, the investor is generally not bound to the outcome of the class litigation and has a right to prosecute its own case independent of the class action.

There are several advantages to bringing an individual direct action, including the ability to chart one's own litigation course and to determine the settlement terms. However, there are certain important risks in opting-out of class litigation, including a bar on participating in any class recovery and the inability to insist on corporate reforms. As such, every investor should have access to relevant information about their legal options to bring an individual claim and should seek competent legal advice before making the decision to opt-out of a class action.

A. Larger Recoveries

The size of the loss attributed to the alleged misconduct is often the most significant determinant of whether to file an individual direct action. Individual actions are usually not an option for investors with a nominal loss because of the time and expense involved in any litigation. Direct actions are usually reserved for investors with sizable losses who have the financial ability and structure to pursue their own claims.

For example, many public pension funds and large institutional investors opted-out of the WorldCom class action litigation and pursued individual actions on their own behalf, including five New York City funds that eventually reached a $78.9 million settlement, an amount reportedly three times larger than what the funds would have recovered under the class settlement. Likewise, a group of Alabama public funds opted out of the WorldCom class case and ultimately achieved a $111 million settlement, several times what it purportedly would have received had it remained in the class. According to a spokesperson for the Alabama funds, the settlement amounted to roughly ninety percent of their losses.

Similarly, many public pension funds and institutional investors that opted-out of the $2.65 billion dollar securities class action settlement with AOL Time Warner achieved recoveries that far exceeded what they would have recovered had they remained in the class case. For example, the State of Alaska reported that its settlement represented 50 times what it would have recovered in the class settlement and the California State Retirement System said its settlement represented 6.5 times what it would have recovered. State of Ohio public pension funds recovered $144 million in individual actions against AOL Time Warner, $135 million more than the $9 million they would have recovered under the class settlement, according to Ohio state officials. Thus, presuming the reports are accurate, in the right type of factual situation, a direct action could be advantageous.

B. Factors to Consider

The decision to file an individual action or remain a passive class member normally involves the consideration of many factors. The factors include, among others, the size of your loss and ability of defendant(s) to pay damages, the benefits of setting your own litigation strategy by pursuing an individual lawsuit, the advantage of being able to settle an individual claim without court approval and class notice, and the benefit of being able to select the forum in which to file the individual action subject to certain parameters regarding venue. Notwithstanding these factors, the decision to opt-out of class litigation and file an individual action is a critical one.

C. Size of Loss

By definition, the maximum recovery in an individual action is limited to the amount of damages suffered by the individual plaintiff. There is no minimum threshold loss required to bring an individual action, but an individual action to recover a relatively nominal loss may not be a practical option given the time and expense usually associated with prosecuting a securities action against one or more defendants.

D. Aggregating Claims

Although it may be economically impractical to bring an individual claim that involves a relatively small loss, it is sometimes possible to join or consolidate multiple individual actions, commonly referred to as a "mass action." By sharing the benefit of a coordinated investigation and prosecution, pooling claims of more than one investor may make economic sense with smaller individual claims, which, standing alone, would otherwise be impractical.

E. Availability of State Court Forum

A notable strategic advantage of litigating individual actions is that they are not subject to the Securities Litigation Uniform Standards Act ("SLUSA") that Congress passed in 1998. SLUSA gives exclusive jurisdiction of securities class actions to the federal courts. Because SLUSA applies to class actions, and not individual actions, state court forums may be available where there is no other basis for federal jurisdiction (such as arising under the federal bankruptcy code or diversity jurisdiction).

Whether there is an advantage to prosecuting the case in a state court forum varies from state to state, but state laws are generally more favorable to plaintiffs, and state courts normally provide a home court advantage to state and local pension funds, and other investors, located within the state.

Furthermore, class actions brought in federal court must satisfy heightened pleading requirements and are subject to automatic discovery stay of the PSLRA. On the other hand, individual actions brought in state court that allege violation of state securities and common law are normally not subject to such heightened pleading requirements, and in some cases, may not be subject to the automatic discovery stay of the PSLRA. Many states also provide for broader liability to "secondary actors" who either aid or abet the primary violation, thereby increasing the pool of possible defendants.

F. Settlement

Individual plaintiffs control the settlement negotiations and are able to settle their claim without having to obtain court approval or provide notice of the settlement terms to passive class members. Because the court does not have to approve the settlement and the parties do not have to give notice to the class, the process to settle an individual action is more streamlined and can result in a quicker recovery.

G. Avoidance of Class Certification Issues

As noted above, certification of a Class is a necessary component for litigating claims as a class action. Opt-out actions avoid this process and are able to litigate the merits of their claims without crossing this intermediate procedural hurdle.

H. Timing

The Federal Rules of Civil Procedure permit a court to refuse to approve a class settlement without extending the opportunity for class members to opt-out of the settlement. While the decision to file an individual action usually occurs at an earlier stage, it may be possible to wait and see the amount of the class settlement before electing to opt-out in order to pursue an individual action, and sometimes, this is the most prudent course of action. However, waiting may create discovery obstacles[12] and other inefficiencies.

I. Risks / Discovery / Unique Defenses

The decision to forego possible recovery as a passive class member in favor of pursuing an individual claim may yield a larger recovery but certainly involves risk. First and foremost, opting out of the class action serves as a bar to participation in any future class settlement or judgment, and it is generally an irreversible decision. Thus, it is always possible remaining in a Class would yield a better result.

In addition, direct actions require active participation in the litigation, including responding to discovery requests and the appearance at depositions. Defendants will invariably seek to find some infirmity that will prevent the individual action from moving forward, which may involve trying to discredit the individual claim.

The decision to file an individual action should also involve consideration of unique defenses that may exist in a direct action that do not exist in the context of class action litigation. For example, individual actions may be time barred while claims of passive class members are "tolled" under judicial doctrine; individual actions may involve unique issues of reliance that do not avail themselves to the "fraud on the market doctrine;" and, among other things, the individual plaintiffs may have had access to unique information about the investment opportunity that defeats any claim of reliance on public statements by the company.

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[12] For example, a court may not allow an opt-out plaintiff to re-depose witnesses deposed in the class case.

While there can be many advantages to pursuing a direct action or opting out of a class action, Kessler Topaz believes that actual opportunities to opt-out or file a direct action are not very common and are often limited to larger institutional investors. Careful consideration must be given to the added value one can hope to achieve in a direct action or opt-out before going forward with such an action.

VII. Conclusion

Kessler Topaz hopes this primer has helped to show that shareholder litigation can be a tool to recover losses and implement reforms. We also hope this information will assist institutional investors when assessing whether to come forward and serve as plaintiffs in the right circumstances. Considering what is at stake, it is crucial that a sophisticated investor with knowledge of the business world and the value that can be achieved through this type of litigation be the one overseeing counsel. Kessler Topaz is committed to serving the investment community and providing the best possible results for our clients and the classes they represent.

If you would like any further information with regard to class actions in general, serving as a plaintiff, or the services which Kessler Topaz can provide to you, please do not hesitate to contact Darren J. Check, Esquire at (610) 822-2235 or via e-mail at dcheck@ktmc.com.

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