CARLTON FIELDS

Cornerstone Report Describes Securities Class Action Litigation Shift Toward West Coast and Smaller Public Companies

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Recently, Cornerstone Research, an economic and financial consultancy, released its mid-year report on federal securities class action filings. Cornerstone reported that 85 of these lawsuits were filed in the first half of 2015, representing a nominal increase over the 78 filings during the first half of 2014, a slight decline from the 92 filed during the second half of 2014, and a drop of about 10 percent from the historical semiannual average of 94 filings reported between 1997 and 2014. While the decline in filings relative to the historical average may be good news for some companies, a closer examination of Cornerstone's report reveals important trends, particularly an increased risk for smaller public companies, international companies registered on U.S. exchanges, and companies in the technology sector. In a recent conversation, Carlton Fields securities litigator and former federal prosecutor Joseph W. Swanson discussed those trends and other key takeaways from the report. **Q:** *Aside from the findings regarding the number of filings, what else does the report tell us?* **Mr. Swanson:** For one thing, the report shows that the amounts in controversy in these cases have dropped. In particular, losses, as measured by the size of the stock-price drop following the revelation of alleged fraud at a company, are lower than historic averages. Similarly, there have been fewer "mega filings," a term Cornerstone uses to describe cases where the defendant company experiences especially large, negative stock movement due to the revelation of the alleged fraud. One reason for the decline is factual: the pipeline of accounting-related filings against major public companies appears to be drying up. A second reason relates to the economics of how these complaints are put together. That is, there appears to be something of a diminished appetite on the part of plaintiffs' firms to invest in long-term cases that are fought for years when smaller matters fought over shorter periods of time can have the same return on investment. The Supreme Court and the federal courts of appeals have also shown a willingness in the past few years to enforce tighter pleading standards for these sorts of cases, and these may finally be gaining some traction.

Q: *If the number of filings is down, and the losses at issue have decreased, why isn't that good news from a defense standpoint?* **Mr. Swanson:** For some companies and their management and boards, that is good news. In fact, Cornerstone reported that the number of filings against companies in the S&P 500 are at historic lows. But these types of lawsuits are not going away, especially given the recent market volatility here and abroad. Furthermore, for some companies, the Cornerstone report contains reasons for concern. It makes no difference if the average number of cases is going down if the trends show that the type of company you happen to run is still a high-value target for a securities fraud lawsuit. **Q:** *If S&P 500 companies are decreasingly being targeted, then who is at risk?* **Mr. Swanson:** If there are fewer filings against S&P 500 companies, that means that other, smaller companies are increasingly facing securities class actions. Historically, smaller public companies could take comfort in the notion that the plaintiffs' bar was primarily interested in massive cases that arose out of the accounting scandals of a decade or so ago. That's no longer true. The massive stock-drop cases have been replaced in many instances by smaller securities suits that are just as disruptive and stressful to the companies and individuals who find themselves mired in them. The plaintiffs' bar may be moving to an "aim small, miss small" strategy. Fewer filings generally and smaller losses at issue are of little consolation to public-company targets outside of the S&P 500. **Q:** *What types of companies are being particularly hard hit?* **Mr. Swanson:** Cornerstone describes a rise in the number of filings against companies operating in the technology and industrial sectors, and we expect that trend to continue. Additionally, filings are up in the Ninth Circuit, which covers California and much of the western United States. This makes sense given the strong presence of technology companies in the region. Second, about one-quarter of the filings thus far in 2015 involved companies with headquarters outside the United States, particularly in Asia. This is likely a function of the increased number of foreign-based companies listed on U.S. exchanges. We are monitoring what, if anything, this will mean for our many Latin American clients with securities traded in the U.S. **Q:** *What challenges do these lawsuits present for defendants?* **Mr. Swanson:** A securities fraud class action can be very costly, both in terms of ultimate exposure and in terms of defending the lawsuit—especially if the case proceeds to discovery. The good news is that there have been a number of developments, most notably the passage of the Private Securities Litigation Reform Act and cases interpreting the PSLRA, that have made it more difficult for plaintiffs to defeat a motion to dismiss and seek discovery. **Q:** *Beyond its importance for companies and their officers and directors, does the report have significance for defense firms that practice in this area?* **Mr. Swanson:** Yes, the fact that more of these lawsuits are being filed against a more diverse set of companies, with relatively smaller losses involved, means that firms with headquarters outside New York and Washington have an opportunity to be of substantial assistance to public companies. Such firms may be able to offer more competitive rates to their clients, while providing a deep bench of practitioners both experienced in this field and knowledgeable of the court in which the suit has been filed. Given the increase in filings in the Ninth Circuit and against foreign-based companies, firms with a West Coast presence—especially those familiar with the technology industry—may be particularly well-positioned.

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Securities Litigation and Enforcement

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