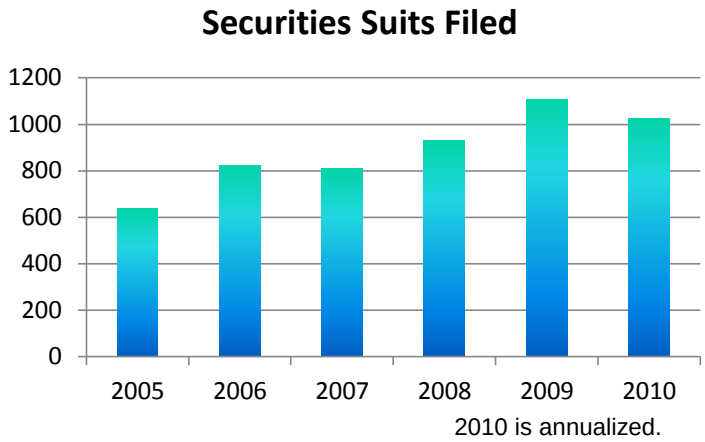
Securities Litigation Remains Escalated

An Advisen Quarterly Report – Q3 2010

Executive summary

In a quarter marked by the signing of the Dodd-Frank financial reform, establishing future governance burdens, plaintiffs' attorneys and regulators had no problem finding current complaints to file. The number of securities lawsuits filed in the quarter, including derivative actions, regulatory suits, and securities class action suits, among others, remained at inflated levels. At 284 securities suits filed, Q3 2010 was a bit higher than the robust second quarter at 278, and, on an annualized basis, above the 1,105-level of the credit crisis frantic-2009. The annualized count of 1,136 suits was significantly higher than 2008, at 928, a year also embroiled in credit crisis-related suits, and much higher than previous years.



As litigators moved beyond credit crisis-related suits, 2010 was expected to be a winding-down period, a respite between scandals and legal flashpoints. The first quarter cooperated with filings around the 2007 level. The past two quarters, however, came in at crisis-like levels. The second quarter contended with the BP oil spill and its resultant lawsuits, but the third quarter had no crisis to speak of, yet filings remain high. Credit crisis- and Madoff-related new filings have indeed dwindled to almost nil, leading to securities class action suits to slide to 20 percent of all suits filed in the third quarter, and securities fraud cases were at pre-crisis levels.

The raging bull of the year thus far has been breach of fiduciary duty suits, with approximately a third of all new security suit filings in Q3 2010. These suits are usually brought by shareholders of an acquired company claiming that directors and officers accepted a "low-ball" bid. Although somewhat resurging M&A activities in the U.S. have contributed to this phenomenon, it appears the most significant driver is plaintiffs' attorneys seeking new revenue streams as securities class action suits decline, all the while seeking out friendly state courts where most of these suits reside. Low company valuations in a tough business environment, coupled with frugal buyers demanding value, has added fuel to the fire for shareholders feeling cheated.

Financial firms continue to represent a smaller share of total filings in the quarter. The financial sector is still a leader in new filings, but gone are the days during the credit crisis and recession when it represented nearly half of all filings. New lawsuits were more evenly dispersed among other sectors such as information technology and healthcare. Despite the demise of credit crisis-related new filings, the aftermath lives on in settlements and awards, as the two largest settlements of the quarter revealed. Bank of America Home Loans (formerly Countrywide Financial) tentatively settled a securities class action suit for $600 million related to the management and disclosure of its mortgage portfolio. Goldman Sachs settled with the SEC for $550 million for the much-publicized synthetic collateralized debt obligation (CDO) incident involving hedge fund Paulson & Company.

Looking ahead, the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act) almost certainly will have a significant, though at this point unquantifiable, impact on securities litigation. The Dodd-Frank Act contains a number of governance-related and whistleblower provisions that will affect all U.S. public companies, and in many ways is an extension of Sarbanes-Oxley. It will, however, place more stress on financial firms and their directors and officers. Its "clawback" provision is a highlight, as well as its expansion of federal court jurisdiction over certain non-U.S. issuers for actions brought by the SEC and Department of Justice (DOJ), certainly a response to a recent Supreme Court ruling.

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

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

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

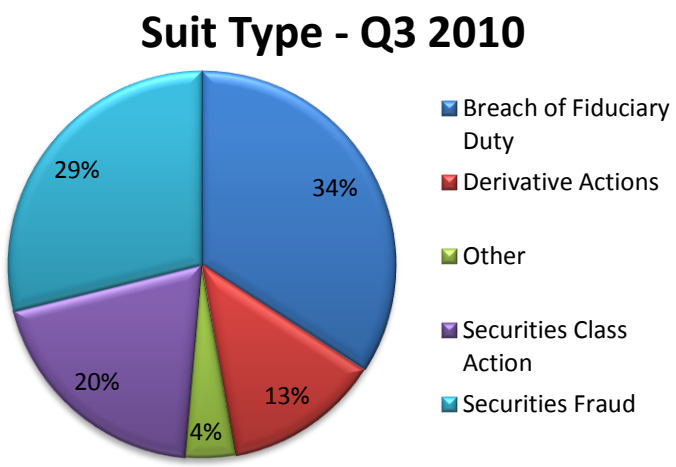
- **Securities Class Action:** suits alleging violations of federal securities laws, principally the Securities Act of 1933 and the Securities Exchange Act of 1934, filed by a private party on behalf of a class of persons injured by alleged violations.
- **Securities Fraud:** suits charging violations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

Master Significant Case and Action Database (MSCAd).[1] MSCAd is the most complete and accurate database of such cases, consisting of over 50,000 events and over $3.9 trillion in aggregate losses. Advisen's MSCAd covers a full range of securities cases, categorized by type. Information about suits and filing details are available for purchase at Advisen's online store, Advisen Corner, at http://corner.advisen.com/analytics_mscad.html and available at no extra charge to Advisen members through their advisen.com logins. For more information please call +1.212.897.4800 or email corner@advisen.com.

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

Suits filed

Securities suit filings in the third quarter were mostly in line with the second quarter: 284 versus 278. This compares to 276 suits filed in the third quarter of 2009, which was a very active year for securities litigation. Annualized, 2010 is on track for 1,024 suits, which compares to 1105 suits filed in 2009 and 928 in 2008. Before the credit crisis, new filings were about 800 per year in 2007 and 2006, and lower in prior years.



The number of new securities class action suits filed was flat – 56 in the third quarter versus 52 in the second – though this type of suit continued to represent a smaller percentage of all securities suits filed than in years past. Securities class action suits comprised over a third of all securities lawsuits before 2006, but have been steadily trending downward as a percentage of securities suits filed. The percentage dropped to 21 percent of all securities suits in 2009 and 19 percent of the total through the first three quarters of 2010, including 20 percent for the third quarter. Over 60 percent of securities class action suits in Q3 named companies from three sectors, and their directors and officers, as defendants. The three sectors were: financial, consumer discretionary, and healthcare.

The number of new securities fraud suits, a category defined by Advisen to be comprised principally of suits by regulators and law enforcement agencies, was flat in the quarter: 82 versus 81 in the second quarter. As a percentage of total securities suits filed, securities fraud suits accounted for 29 percent of the total in the third quarter, equaling the second quarter, and down from 40 percent in 2009 when regulators became more active in the wake of the credit crisis. Financial firms and their directors and officers were most often named as defendants in this category as well, accounting for about a third of the total. This level for financial firms is down, as they comprised the majority as recently as the second quarter. Information technology firms and their directors and officers accounted for over 20 percent of securities fraud suit filings in the quarter.

The largest number of suits occurred in the breach of fiduciary duty category, which accounted for 34 percent of all securities suits filed during the quarter. Over 60 percent of these suits were filed in state courts. Breach of fiduciary duty suits have grown rapidly as a percentage of all securities suits filed, from 8 percent in 2004 to 24 percent in 2009 to 33 percent of securities suits filed through the first three quarters of 2010.

Breach of fiduciary duty suits typically allege that directors, officers or other company representatives failed to fulfill fiduciary duties owed under federal or state securities laws (as well as other corporate governance laws), or as concerns securities and products covered by securities laws. They often are filed in the wake of a merger or an acquisition by shareholders of the acquired company who believe the directors did not obtain an adequate price. Breach of fiduciary duty suits were broadly distributed among industry groups in the third quarter, with information technology companies, at nearly 30 percent, representing the highest concentration of suits.

The quarter saw steady activity in derivative actions: 38 suits were filed in the third quarter as compared to 36 in the second quarter. The recent volume of derivative actions was significantly higher than the 20 in the first quarter, and on an annualized basis at the highest level since 2006. The increase in Q2 was due largely to suits filed against companies in the energy industry and their directors and officers, and primarily were triggered by the Deepwater Horizon oil spill, many filed by BP shareholders. In Q3 2010, the numbers were more distributed, with the financial, healthcare and information technology sectors representing about two-thirds of all new suits filed. Three derivative actions were brought by shareholders of Hewlett-Packard disputing the $40-million severance packages for former CEO Mark Hurd, who allegedly falsified expense reports to cover a relationship with a female marketing consultant.

Jurisdiction. By jurisdiction, 30 percent of securities suits were filed in state courts. About 8 percent were filed in the traditional stronghold of federal securities litigation, the United States District Court, Southern District, New York. This district saw less activity compared to the past two years due to the falloff in credit crisis- and Madoff-related suits, as fewer suits were filed against financial companies with headquarters in the district. Three percent were filed in courts outside the U.S.

Court	% Total
State	30%
California Federal Districts	11%
U.S. District Court, Southern District, New York	8%
U.S. District Court, District of Columbia	8%
Illinois Federal Districts	7%
Texas Federal Districts	4%
Pennsylvania Federal Districts	3%
Non-U.S. Courts	3%

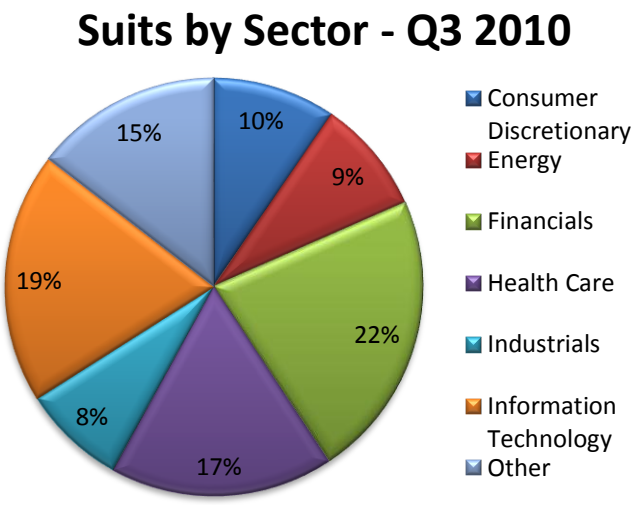
Suits alleging breach of fiduciary duty, by a wide margin, were the type of suit most likely to be filed in state courts. None of the securities class action suits filed in the third quarter were filed in state courts. The Class Action Fairness Act of 2005 (CAFA) requires most large multi-state class actions to be removed to federal courts. Securities class action suits filed in state courts typically rely on the non-removal provision in Section 22 of the Securities Act of 1933, which permits cases alleging violations of the '33 Act to be tried in state courts. Whether the non-removal provisions of the '33 Act or CAFA govern these cases is still being debated in the courts.

Defendant companies and their directors and officers

Financial firms accounted for about 40 percent of securities suits filed in 2008 and 2009 due substantially to lawsuits sparked by the meltdown of the subprime mortgage market and the ensuing credit crisis, and by the Bernard Madoff Ponzi scheme. That number fell to 29 percent in the first quarter of 2010, but saw an uptick in the second quarter as financial firms and their directors and officers were named in 36 percent of securities suits filed. The third quarter brought about the continued decline of securities suits filed against financial firms and their directors and officers, down to 22 percent. The number of suits filed were much more broadly dispersed than in the recent

past, with information technology (19 percent) and healthcare companies (17 percent) coming in a close second and third.

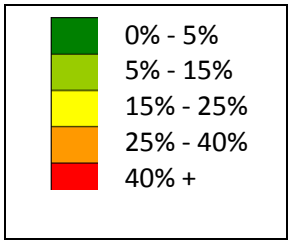
Financial firms have historically seen an abundance of securities fraud cases, as a large portion of these cases involve regulatory actions such as suits brought by the SEC. The third quarter was no exception: 43 percent of all cases filed against financial firms and their directors and officers were securities fraud cases. Securities class actions suits are also common for these firms, with 23 percent of these suits filed in the quarter naming financial firms. Breach of fiduciary duties was third at 17 percent, which brought some suits to state courts for these firms. Derivative actions represented 11 percent.



Lawsuits filed against information technology firms and their directors and officers had a much greater presence in state courts, as breach of fiduciary duties cases dominated at 47 percent. The remainder for these firms was securities fraud suits at 29 percent, securities class actions at 12 percent, and derivative actions at 10 percent. Healthcare firms and their directors and officers saw a similar mix of filings, with breach of fiduciary duties at 38 percent, securities class actions and derivative actions both at 22 percent, and securities fraud at 13 percent. Healthcare providers, pharmaceutical companies and biotechnology companies were hit hardest within this sector.

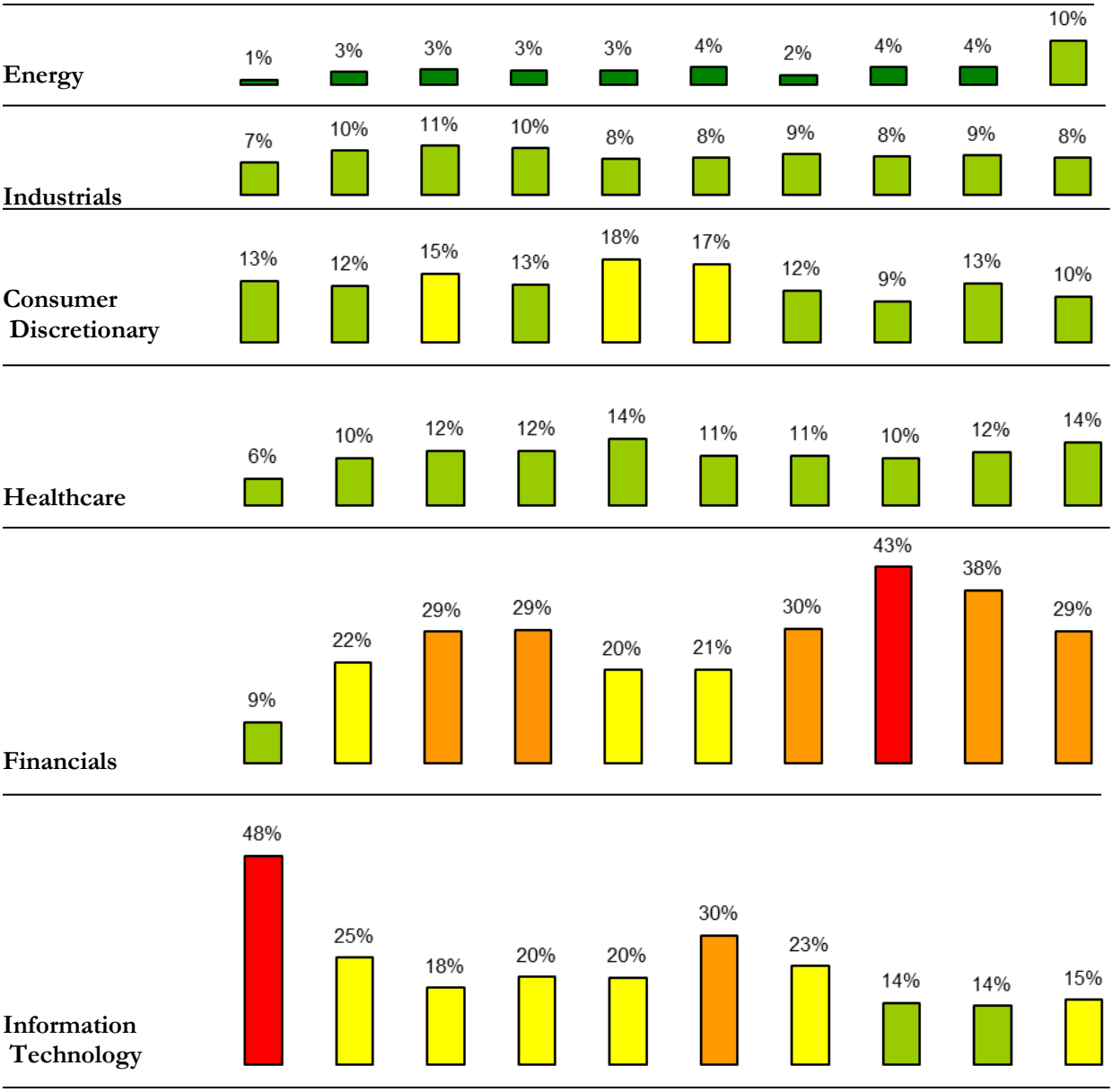
Another active sector for the quarter was consumer discretionary, where for-profit educational services reside. Five of its industry leaders were struck with securities class action lawsuits, alleging improper recruiting practices, which included suits filed against American Public Education, Apollo Group, Corinthian Colleges, Education Management Corporation, and Lincoln Educational Services.

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



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

SI Metric™



Note: The totals for each year do not add to 100 percent because only the sectors with significant lawsuit activity are shown. Other sectors include: materials, consumer staples, telecommunications and utilities.

Settlements and awards

The average settlement value (including proposed and tentative settlements) of securities suits during the third quarter fell to $24 million from $47 million in the second quarter, and from $30 million in 2009. Awarded amounts are included in these averages, though the vast majority of securities lawsuits are settled before going to trial. Securities class action suits represented the highest average settlement amount at $66 million. Despite the falloff in average settlement values, certain eye-popping settlements occurred in the quarter. In the largest, Bank of America Home Loans (formerly Countrywide Financial) tentatively settled a securities class action suit for $600 million. The settlement with shareholders addresses claims of false and misleading statements regarding the quality of its mortgage portfolio during the waning days of the credit bubble.

Goldman Sachs settled with the SEC for $550 million, in a securities fraud case, with $250 million returned to harmed investors and the remainder going to Uncle Sam. Goldman Sachs set up a synthetic CDO, investing in subprime residential mortgage-backed securities (RMBS) in early 2007. Paulson & Company, a hedge fund, was then allowed to select particular pieces of the investment vehicle portfolio, and then effectively shorted the vehicle by entering into credit-default swaps (CDS). This conflict of interest was unknown to the investors, and when the mortgage market dropped, Paulson & Co. made a handsome sum. Goldman Sachs benefited from fees paid by all parties.

An investment group that took pipeline operator Kinder Morgan private in 2006 tentatively settled with shareholders for $200 million in a breach of fiduciary duty suit. Three major back-dated option-related cases settled in the third quarter, and six settlements in total. Maxim Integrated Products, Juniper Networks, and Broadcom brought back memories of a pre-credit crisis scandal. The total settlement for the three cases was over half a billion dollars.

In the past, derivative actions principally demanded changes in corporate governance or strategy with monetary awards beyond the plaintiffs' legal costs being rare. In recent years, large monetary settlements have become increasingly common. The third quarter saw a $150 million proposed settlement from AIG's directors and officers, $60 million of which will be paid to former CEO Hank Greenberg and former CFO Howard Smith. This case reinforces the trend of significant cash settlements of derivative actions.

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

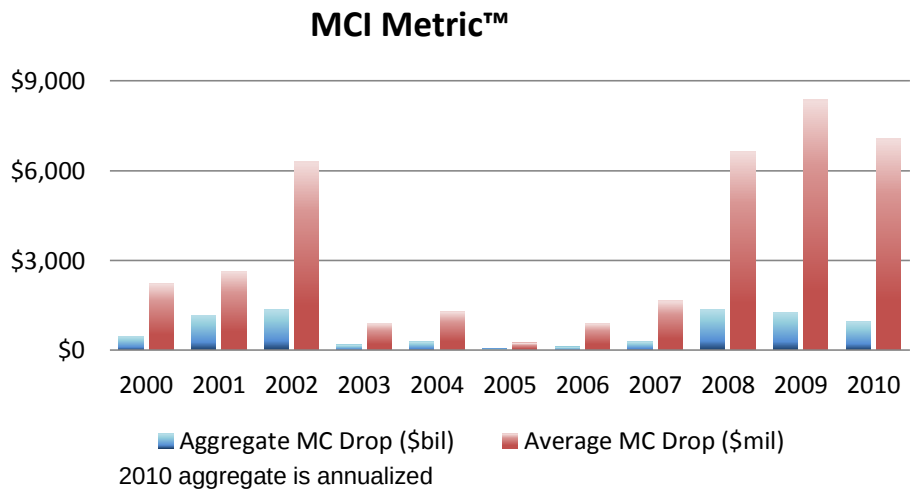
Company	Suit Type	Amount	Status
Bank of America Home Loans	Sec. Class Action	$600 million	Tentative
Goldman Sachs	Securities Fraud	$550 million	Settled
Kinder Morgan	Breach of Fid. Duty	$200 million	Tentative
WellCare Health Plans	Sec. Class Action	$194 million	Proposed
Maxim Integrated Products	Sec. Class Action	$173 million	Tentative
Juniper Networks	Sec. Class Action	$170 million	Settled
Broadcom Corporation	Sec. Class Action	$161 million	Settled
American International Group	Derivative Action	$150 million	Proposed
Dell, Inc.	Securities Fraud	$100 million	Settled

Market Cap Impact Metric™ (MCI Metric™)

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

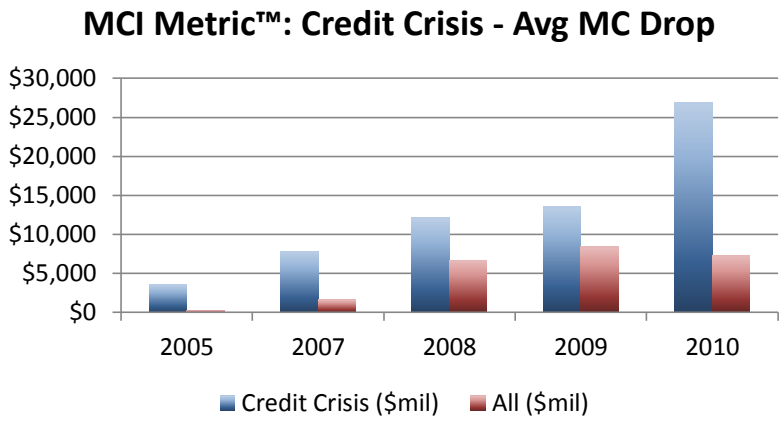
This market capitalization loss is calculated for most companies with a securities class action suit filed against them during each year of the past decade, with certain securities class action cases eliminated. Securities class action suits eliminated from the calculations are those whose alleged losses are not tied to defendants' stock price losses, thus their potential damages are not tied to market capitalization losses. For example, Madoff-related securities class action cases with investors that experienced losses due to feeder-fund investments in the Ponzi scheme claim losses that are not tied to the defendants' stock price. Other examples include losses experienced by auction rate securities investors, which are tied to the underlying security as opposed to the stock price of investment banks named in many of these securities class action cases.

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



The aggregate and average market capitalization losses shot up in 2008 and 2009, and remained high in 2010. Aggregate losses were $1.4 trillion in 2008 and $1.3 trillion in 2009. Through the first three quarters of 2010, the annualized aggregate losses remained elevated at $944 billion. The losses in 2008 and many in 2009 reflect that most of the class periods occurred during the large stock market losses of the past couple of years. Since the beginning of Q2 2009, however, stock markets have generally risen, yet the aggregate losses have

remained high, affirming that market cap losses for companies named in securities class action suits are far in excess of market cap loss attributable to overall market fluctuations.



The surge in average market capitalization losses in 2008, 2009 and 2010 was driven largely by credit crisis cases. These cases, on average, have seen much greater destruction of market capitalization, implying that credit crisis suits will ultimately settle for far larger amounts than other types of suits. Although the aggregate drop in market capitalization for credit crisis-related suits has fallen off considerably in 2010, the average drop per case has continued to climb. The average market capitalization drop for these suits rose from $8 billion in 2008, to $12 billion in 2009, and reached $27 billion in 2010.

Dodd-Frank Act goes beyond financial services

In July, the Dodd-Frank Act was signed into law, which represents the largest overhaul of the U.S. financial regulatory structure since Depression-era regulations went into effect. It mostly deals with the financial services industry, such as banning any institution that could be bailed out by the Federal Reserve from operating trading accounts. It also regulates many previously unregulated derivative markets, and provides the Federal Reserve with the tools to unwind financial firms that are failing. The Act creates a Bureau of Consumer Financial Protection within the Federal Reserve, and the SEC will have an office of Investor Advocate, both of which will undoubtedly create more obstacles for financial firms to trip over and potentially lead to lawsuits.

Non-financial firms, however, can get drawn into these regulations, as the new Financial Stability Oversight Council will have the ability to grant the Federal Reserve regulatory authority over any company that it considers a potentially significant threat to the financial system should it fail. The Dodd-Frank Act goes beyond these measures, as its governance requirements apply to public companies across all industries. Many of the requirements will increase the influence of shareholders in corporate governance matters, such as a non-binding "say-on-pay" vote. This vote is on the compensation packages of executive officers to be held at the first shareholders meeting in 2011. It is likely to increase shareholder scrutiny of compensation-committee decisions and their independence.

Executive compensation issues loom large in the Act. In addition to the "say-on-pay" vote, the Act requires that the SEC prohibit securities exchanges from listing any company that does not disclose incentive-based compensation. The Act's incentive-based "clawback" provision, a provision that requires that compensation based on false financial data must be returned, expands beyond the remedy available in the Sarbanes-Oxley Act. The new "clawback" provision extends to all executive officers, and applies to all incentive-based compensation received for three years following filing erroneous financial information. It applies regardless if the executive officer had knowledge of the conduct that led to restatement of financial statements. The "clawback" provision under Sarbanes-

Oxley included just the CEO and CFO, covered just one year of compensation, and "intent" needed to be proven.

Other governance changes include: new proxy access rules that the SEC now has the authority to adopt, heightened independence requirements for compensation committees, enhanced protections and incentives for corporate whistleblowers, new SEC authority to adopt rules increasing transparency of securities ownership, and disclosure requirements of certain corporate policies. The Act also beefed up funding for the SEC, and the SEC now plans to add another 800 employees, which likely will result in more rigorous investigations against public companies and their directors and officers. These new rules and an enhanced SEC might possibly lead to more suits from shareholders, regulatory bodies, and others, but they also might provide a clearer roadmap for companies to follow. Prudent and well-managed companies might find a solace in these rules, and fewer suits might follow.

Senators Dodd and Frank, as well as other contributors to the Act, were certainly also reacting to a recent Supreme Court decision. In *Morrison v. National Australia Bank*, the Supreme Court held that plaintiffs cannot pursue fraud claims under U.S. securities laws for securities purchased on foreign exchanges. The decision effectively put an end to so-called f-cubed cases – suits filed in the U.S. by foreign investors against foreign companies concerning shares bought on foreign exchanges. The Dodd-Frank Act provides federal court jurisdiction in certain actions brought by the SEC and DOJ relating to fraud sections of the Securities Act of 1933 and 1934, as well as the Investment Companies Act of 1940. The alleged fraud can involve conduct within the U.S. that constitutes "significant steps" in a violation, even if the securities transaction occurred outside of the U.S. and involves only foreign investors. Federal court jurisdiction is also established if the alleged fraudulent conduct occurred outside of the U.S. but has a foreseeable substantial effect within the U.S.

Other securities litigation trends and developments

Changing landscape for securities class action suits. Securities class action suits as a percent of all securities suits have been declining since 2004, but they nonetheless remain a vital watermark for securities litigation trends. In addition to remaining one of the most commonly filed types of securities suits, securities class action suits typically produce most of the largest settlements. The average securities class action settlement in the third quarter was $66 million, and securities class action suits accounted for five of the top seven settlements of the quarter.

Through three quarters, 144 securities class action suits have been filed for an annualized 192 cases. This compares to 234 suits filed in 2009 and 240 in 2008. The average for 2004-2009 is 226. The decline in 2010 is due substantially to a sharp drop in credit crisis suits.

A high percentage of credit crisis suits were filed against financial firms. Although the number of new credit crisis suits has fallen dramatically, financial firms remain a top target of choice for securities class action suits: 23 percent of securities class actions filed in the third quarter named financial companies and their directors and officers. However, this percentage is down from the majority of these suits in early-2009 and 35 percent from just the previous quarter. One suit was filed by Bank of America's shareholders against the bank and certain current and former officers involving the acquisition of Merrill Lynch. Two cases were filed against Morgan Stanley by investors in certain mortgage-backed securities.

As was true with overall securities suit filings, securities class action filings were much more broadly dispersed than in previous quarters. In a close second place for new securities class action suits filed

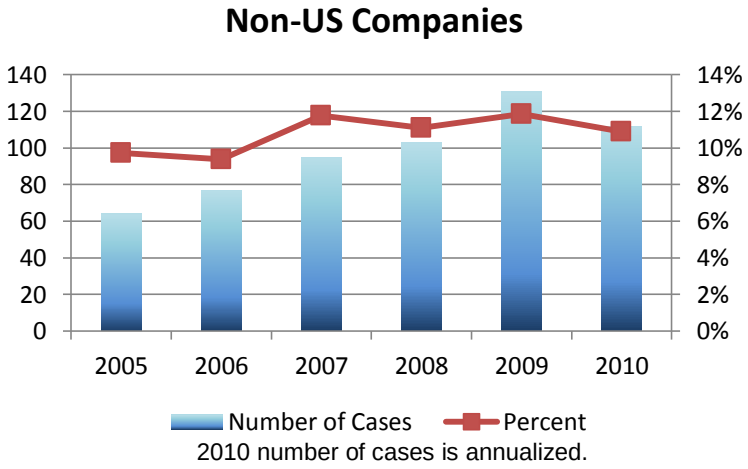
in the quarter were consumer discretionary companies, which accounted for 21 percent of the total. In one consumer discretionary case, shareholders of American Apparel accused its directors and officers of illegal hiring practices following an investigation by U.S. Immigration and Customs Enforcement. Healthcare companies accounted for 19 percent of new securities class action suits filed.

The average time between the end of the class period and the date the suit is filed for securities class action suits increased substantially during credit crisis-filing years, from 157 days in 2006 to 229 in 2007, 240 in 2008 and 234 in 2009. Potentially large credit crisis suits had commanded the attention of plaintiffs' attorneys during this period, so they likely searched as far back as possible for these types of cases, seeking other litigation opportunities. As the number of new credit crisis suits dwindled in 2009, attorneys turned their attention to the backlog of other types of securities class action suits. This phenomenon continued into 2010, with the average time between the end of the class period and the filing date increasing to 255 days by Q2 2010. The age of new suits could be on the decline, as the third quarter saw a return closer to historically normal levels with 160 days.

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

As compared to the U.S., securities litigation in Europe, Asia and Latin America is less frequently a matter of public record, making it difficult to get as complete a picture of litigation activity. Typically only the largest cases attract media attention, and non-U.S. companies are far less likely to provide details of litigation in their public disclosures. In spite of these limitations on data collection, it is nonetheless clear that securities litigation activity has been on the rise in recent years in courts outside the U.S. Through the three quarters of 2010, Advisen recorded 24 securities suits filed in courts outside the U.S., for an annualized total in line with 2006-2008 totals. The Madoff Ponzi scheme, which drew in a number of non-U.S. investors and banks, led to a spike in non-U.S. securities cases in 2009.

Securities suits against non-U.S. companies – both in the U.S. and elsewhere – have accounted for more than 10 percent of total securities suits tracked by Advisen for most years since 2005. For the first three quarters of 2010, 11 percent of securities suits were filed against non-U.S. companies. Credit crisis-related suits and Madoff-related suits were global in nature, but the falloff in these suit-types did not lead to a decline in the percentage of securities suits filed



against non-U.S. companies.

The number of suits filed against non-US companies is likely to dip in the short-term, however, as a result of the U.S. Supreme Court decision in *Morrison v. National Australia Bank,* which ends the practice of filing lawsuits in U.S. federal courts as concerns securities purchased on non-U.S. exchanges. The U.S. federal court system has been the venue of choice for securities litigation for shareholders across the globe. The number of securities suits against non-U.S. firms almost certainly will continue to grow in the long-term, but in the aftermath of *Morrison*, and as shareholders gain greater access to legal systems elsewhere to litigate securities claims, it is likely that fewer suits against non-U.S. firms will be filed in the U.S.

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

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

As the economy recovers, M&A activity will likely increase, and has increased somewhat in the U.S. this year, leading to more securities suits, especially breach of fiduciary duty suits. Breach of fiduciary duty suits often are filed by disgruntled shareholders of an acquired company, alleging the company's directors and officers sold the firm too cheaply. Historically, M&A activity falls sharply during a recession, and the current economic downturn is no exception. However, as recovery accelerates and credit markets are revitalized, M&A activity will increase, driven in part by fire sales of companies damaged by the recession and divestitures to raise sorely needed cash.

Despite just a modest rise in U.S. M&A activity, and a lull in these activities the previous two years, breach of fiduciary duty suits have been increasing in number during recent years. As M&A activity accelerates, the volume of breach of fiduciary duty suits is likely to grow at an even faster pace. A trend observed over the past year has been an increase in the number of these suit types filed against the same company for the same triggering event. For example, Aon's acquisition of Hewitt Associates, a human resources outsourcing services firm, attracted four breach of fiduciary duty lawsuits in the third quarter, three of which were filed in state courts. These suits surfaced despite that the price accepted was a 41-percent premium over Hewitt's closing price before the announcement. A revival of public offering activities, such as IPOs, could lead to significant potential liability for corporations and their directors and officers.

A resurgent SEC. Since the credit crisis, and the ensuing political storm, regulatory authorities have stepped up enforcement efforts, beefed up enforcement teams, and began coordinating efforts. The SEC, DOJ and state enforcement officers like attorneys general are more likely than ever to coordinate prosecutions, sharing evidence and information, making successful prosecution at all levels more likely. U.S. regulators and enforcement agencies have also coordinated their efforts with regulatory entities in the EU and elsewhere, and most notably with the UK's Financial Services Authority. These parallel proceedings have contributed to spiraling defense costs, even in cases with no wrongdoing.

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

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

The fiscal 2011 budget (began October 2010) calls for 400 additional full-time equivalent employees. The Dodd-Frank Act provides funding for an additional 800 employees and much enhanced SEC authority.

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

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

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

Cooperation initiatives could help to lower defense costs and lower insurance policy payments if most officers agree to cooperate. It also could increase overall defense costs depending on the dynamics of the case for a given company. A change in disclosure policies would make it less likely for officers to cooperate for fear that embarrassing and incriminating evidence would be released. It would at least delay cooperation to ensure that the increased number of facts is reasonably stated, prolonging negotiations with the SEC.

Any agreement that admits to liability very possibly void coverage of defense costs for most D&O insurance policies. Furthermore, depending on the terms of the policy, if one director does something to void coverage, it creates the danger of voiding coverage for all directors and officers,

placing the company and all officers at risk. Looking at the specific restrictive provisions in policies becomes essential when agreeing to cooperation – a review that is best done well before there is any threat of a claim.

More information

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

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