

ALASKA

ARIZONA

CALIFORNIA

HAWAII

IDAHO

MONTANA

NEVADA

OREGON

WASHINGTON

WEST COAST SECURITIES LITIGATION & SEC ENFORCEMENT REPORT 2007 > 2008

WILMERHALE® 



2007 was a dangerous year for the roughly 1,600 public companies and the many corporate officers and directors and other securities market participants in the western United States—Alaska, Arizona, California, Hawaii, Idaho, Montana, Nevada, Oregon and Washington. The **US Securities and Exchange Commission continued its vigorous scrutiny** of corporate malfeasance (real or perceived), often in conjunction with federal criminal prosecutors. The past year also saw **a sharp increase in securities class actions**, once again making public companies in the Ninth Circuit—and in California, in particular—the **most vulnerable in the nation**. We looked back to understand why regulatory and private litigation risks were so great last year, and in the process found **some cause for optimism in 2008**.

SECURITIES LITIGATION

Marked Increase in Class Actions

Investors sued 44 public companies in the West in 2007, a striking 56 percent increase over 2006, reversing what some had hoped was a permanent post-Enron decline in securities class actions. More cases were brought against US issuers in the Ninth Circuit than anywhere else, accounting for nearly one quarter of all class actions brought nationwide. Last year, a California-based issuer was sued about every 10 days and was 63 percent more likely to be sued than the average domestic issuer.

A California public company was

63%
more likely to be sued than the average domestic issuer.

Why the surge in filings? The subprime crisis precipitated lawsuits against a number of financial services firms and others involved with mortgage loans,

collateralized debt obligations, and other structured products. Plaintiffs' lawyers exploited the broad market downturn during the fourth quarter, filing lawsuits that attributed industry-wide investment losses to "fraud." The upswing in filings was also likely driven by increased capacity at the dozen-plus law firms that bring most of these class actions. Having concluded the analyst research and market timing cases brought years earlier, the plaintiffs' lawyers sought to replenish their case inventory in 2007 by casting a wider net.

Many Dismissals, Rare Trials

Last year more class actions were dismissed (29) than settled (18) in the Ninth Circuit. We expect the favorable dismissal/settlement ratio to continue throughout 2008, in part because a number of the recently filed complaints appear primed for early dismissal. The continued willingness of West Coast courts to toss out these cases confirms our view that last year's spike in filings was the product of opportunistic lawyers in a falling stock market, and not an indication that corporate malfeasance is on the rise.

The only two securities class actions tried last year were in the Ninth Circuit. An Oakland jury handed the defendants a victory in *JDS Uniphase Corp. Sec. Litig.*, while a Phoenix jury did the opposite by awarding \$280 million to the plaintiffs in *Apollo Group Inc. Sec. Litig.* In addition, the Court of Appeals reversed a defense verdict in *Miller v. Thane Int'l*, sending it back to a California district court for a new trial. These rare class action trials mean little in the big picture. Not only do last year's wins and losses cancel each other out, it is unlikely that filing rates or settlement prices will change in 2008 because a small number of lawsuits went to trial.

Favorable Settlement Trend

The 18 class actions that settled in 2007 provide cause for optimism. At the same time that settlement costs are skyrocketing

The median West Coast settlement dropped to \$6 million—nearly

40%
below the national median.

nationwide, it is becoming cheaper to settle in the Ninth Circuit. Last year the median West Coast settlement (\$6 million) fell to its lowest point since 2004, and was 40 percent lower than the national median (\$9.6 million, the highest since 2004). In our view, the comparatively lower cost of West Coast class actions is not surprising. Taken as a group, the recent wave of California cases appears weaker than those filed in New York and elsewhere, and—as in the past—negotiated settlements reflect the financial condition of the defendant issuer and/or the magnitude of the market loss.

Favorable dismissal rates may have—indeed, should have—encouraged plaintiffs’ lawyers to scale back their expectations by settling earlier and for less than in years past. (Plaintiffs’ lawyers do not, however, seem to be discounting their own compensation—fee awards are still running around 25 percent of the recovery achieved for the investor clients, a payday roughly on a par with nationwide averages.)

Stock Option Litigation

The plaintiffs’ bar aggressively moved to leverage restatements and government enforcement actions relating to stock options issues into class and derivative litigation—with mixed results. Ninth Circuit courts have been far less receptive to these cases than have courts in other regions. Since September, class actions against Amkor Technologies (Arizona), Apple and Hansen Natural (California) have been thrown out, while courts in New York and New England have allowed similar cases to go forward.

West Coast issuers successfully defended a larger number of shareholder derivative actions; by year end, courts had dismissed 14 such cases and allowed only two to proceed. A handful of technology issuers opted to settle eight derivative or class actions, including those filed by shareholders of McAfee, Rambus and Vitesse. We expect this trend to continue as the SEC and Department of Justice’s investigations begin to wind down.

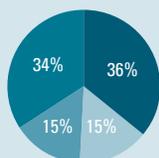
SEC ENFORCEMENT

Active SEC Enforcement Presence

With well over 100 attorneys, accountants and investigators in Los Angeles and San Francisco, the SEC’s enforcement staff remained aggressive throughout 2007, bringing enforcement actions that alleged misconduct at 72 public companies and 39 broker-dealers and investment advisers.

Litigation Snapshot

- Dramatic 56% jump in class actions in the West—representing roughly one quarter of all securities class actions nationwide.
- Investors sued 44 public companies in the Ninth Circuit: 35 in California, 6 in Washington, 2 in Nevada, and 1 in Arizona.
- California issuers were at higher risk than those nationwide, and technology companies saw significantly more litigation activity than any other sector.



- **Industries affected by securities litigation**
Technology 36%
Financial Services 15%
Life Sciences 15%
Other 34%
- Median settlement cost fell to \$6 million in the western United States—the lowest since 2004, and 40% below national median (\$9.6 million).
- Most cases settled between 3 and 4 years after filing (median 3.7 years).
- Plaintiffs’ attorneys again were well paid—fees ranged from \$280,000 to \$4 million, with an average fee award of \$1.7 million and a median award of \$980,000.

Enforcement Snapshot

- SEC enforcement on the West Coast remained active in 2007.
- The SEC brought enforcement actions against 136 individuals. Cases involved misconduct at 72 public companies, 39 broker-dealers and investment advisers, and 7 accounting firms.



- **Industries affected by securities enforcement (federal court actions)**
Technology 31%
Financial Services 38%
Life Sciences 10%
Other 21%
- Federal court judgments entered against 6 companies, with civil penalties ranging from \$75,000 to \$28 million.
- Federal court judgments entered against 37 individuals, with civil penalties ranging from \$15,000 to \$540,000 (median of \$75,000).
- 13 individuals received orders barring them from serving as public company directors or officers. Several individuals agreed to “disgorge” amounts well into the seven figures.

All told, cases were brought against 136 individuals and involved 118 businesses on the West Coast.

The financial services industry attracted the most scrutiny, not surprising in light of the SEC’s role as primary regulator for broker-dealers and mutual fund advisers. Many of these cases arose from inspections by the SEC’s field examiners, who conduct compliance reviews of regulated financial services firms. The technology and life sciences industries once again saw

substantial enforcement activity, reflecting the high concentration of such issuers in California and other western states.

Stock Option Investigations

By the end of 2007, California issuers accounted for slightly more than half of all stock options-related restatements, including four of the five largest ones.

California saw 4 of 5 largest restatements in options cases nationwide.

The SEC and the US Department of Justice brought a number of highly publicized cases, both civil and criminal, and moved to focus their efforts after initially casting a wide net. Although numerous investigations are still pending, the SEC has placed a high priority on concluding the bulk of these options-related matters in 2008.

One of the most noteworthy trends in this area was the aggressiveness with which corporate boards moved to conduct independent investigations and to terminate executives based on some purported evidence of misconduct, long before any government enforcement action occurred. Never before have we seen so many casualties, so quickly. We estimate that more than 50 C-level and other senior executives (and several outside directors) have parted ways from West Coast issuers for reasons related to stock options.

What Else besides Stock Options?

Although options-related investigations dominated the headlines for much of last year, the SEC pursued a number of other enforcement priorities in 2007, which we expect to remain largely unchanged in 2008. These include cases arising from the subprime crisis, insider trading violations, the Foreign Corrupt Practices Act, and the municipal securities market. In addition, public company disclosure and accounting cases, misconduct by

financial services firms, investment fraud schemes and microcap fraud have always been—and remain—at the core of the SEC's enforcement program.

The Future is Subprime

As the subprime market collapsed, the SEC launched a number of investigations, concentrating in particular on Southern California and, of course, Wall Street. These investigations encompass every link in the chain of the subprime market, from mortgage lenders to investment banks, with a focus on valuation, disclosure and sales practices. By the end of 2007, federal criminal prosecutors and state and local authorities had also joined the fray. Many of these matters will prove to be massive in scope and extraordinarily complex—meaning we expect that subprime-related investigative activity will continue intensively (if not accelerate) throughout 2008.

Settlement Trends

The vast majority of SEC cases are resolved through settlement. Although the SEC continues to seek stiff sanctions in its settlements, the eye-popping amounts of several years ago are now much less common. The SEC's demands have been tempered to some degree, reflecting both

2007 saw 13 orders barring individuals from serving as public company directors or officers.

a philosophical shift and the growing realization that its settlement expectations may exceed the sanctions it could obtain in a litigated proceeding. But the SEC still wields considerable leverage, and this fact—plus the high economic and other costs of litigation—means that settlement remains the best option for most defendants. Last year, companies based on the West Coast paid civil penalties ranging from \$75,000 to \$28 million to resolve SEC charges, while almost 40 corporate officers, directors and other market participants found closure by consenting to federal court injunctions

In 2007, the SEC began sending formal letters notifying companies that they are no longer under investigation.

against future securities violations. These individuals paid penalties ranging from \$15,000 to \$540,000 (median of \$75,000), with several also agreeing to “disgorge” amounts well into the seven figures. About one third of those settlements resulted in bars on an individual's ability to serve as a public company director or officer.

Challenges in Resolving Cases

SEC investigations are typically long and expensive, and resolving them in a timely manner has always been a challenge. In 2007, there appeared to be a significant bottleneck at the SEC for those seeking to settle or otherwise resolve investigations. We expect this trend to continue in 2008, further complicating negotiations with the SEC. In a welcome development, last year the SEC formalized a policy of notifying those under investigation when it had closed the file (as opposed to simply going silent). A number of West Coast issuers received closing letters, which lifted the cloud of uncertainty that hangs over companies and individuals under investigation. ■

Looking Ahead in 2008

As the year continues, we expect to see the following:

- Accelerated resolution of stock options-related SEC investigations and shareholder cases
- Increased pace and expanded scope of subprime market investigations
- Greater SEC focus on Foreign Corrupt Practices Act and insider trading cases
- Moderate increase in class action filings, including challenges to cost accounting, reserves, and MD&A

Experience Matters

WilmerHale brings unparalleled experience to matters involving the securities markets. With more than 225 lawyers, our securities practice includes numerous former SEC officials, including former Directors of the Divisions of Enforcement, Market Regulation and Investment Management, as well as a former Regional Director of the Pacific Regional Office and a Deputy Director of the Division of Corporation Finance. Our team also includes former officials from the Commodity Futures Trading Commission, Federal Reserve Board, US Department of Justice, FBI and US Attorneys' Offices.

Our approach is collaborative. Combining our diverse expertise into pragmatic solutions, together we have:

- Counseled clients in hundreds of matters before the DOJ, SEC, FINRA, NYSE, AMEX, state regulators and Congress, in the past five years alone
- Defended more than 300 securities and market conduct class actions in the last decade
- Defended enforcement actions alleging financial reporting and disclosure violations, market manipulation, insider trading, and broker-dealer and investment management misconduct
- Conducted some of the most complicated and high-stakes internal investigations in corporate history, including those on behalf of directors of Enron, Qwest, WorldCom and UnitedHealth
- Assisted financial services industry participants—including leading mutual fund groups, investment banks, broker-dealers, investment advisers and hedge funds—in navigating a range of sophisticated corporate compliance and regulatory issues

The results described herein are for informational purposes only and are not intended as predictors or guarantees of similar results in other matters.



WilmerHale recognizes its corporate responsibility to environmental stewardship.

WILMERHALE ON THE WEST COAST

350 South Grand Avenue, Suite 2100, Los Angeles, California 90071 +1 213 443 5300 (t)
1117 California Avenue, Palo Alto, California 94304 +1 650 858 6000 (t)

wilmerhale.com • Beijing • Berlin • Boston • Brussels • London • Los Angeles • New York • Oxford • Palo Alto • Waltham • Washington

Wilmer Cutler Pickering Hale and Dorr LLP is a Delaware limited liability partnership. Our United Kingdom offices are operated under a separate Delaware limited liability partnership of solicitors and registered foreign lawyers regulated by the Solicitors' Regulation Authority. In Beijing, we are registered to operate as a Foreign Law Firm Representative Office. WilmerHale principal law offices: 60 State Street, Boston, Massachusetts 02109, +1 617 526 6000; 1875 Pennsylvania Avenue, NW, Washington, DC 20006, +1 202 663 6000. This material is for general informational purposes only and does not represent our legal advice as to any particular set of facts; nor does it represent any undertaking to keep recipients advised of all relevant legal developments. Prior results do not guarantee a similar outcome. © 2008 Wilmer Cutler Pickering Hale and Dorr LLP