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SECURITIES LAW

Shift in Litigation Strategy Sends More Securities Cases to Trial

BY JEFFREY A. BARRACK
Special to the Legal

It used to be common for defendants accused of securities fraud to discount the threat of a jury trial. After all, as reported in the *Sacramento Business Journal*, back in 1962, most federal civil trials were tort cases. By 2002, less than 25 percent reached a jury, and nowadays, less than 1 in 50 reach trial. In securities fraud litigation, only half a dozen cases have made it to a jury since the passage of the Private Securities Litigation Reform Act of 1995. According to a December 2005 study by Duke University law professor James Cox and Vanderbilt University law professor Randall Thomas, "even though several hundred securities class actions are settled annually, fewer than one or two securities class action suits are tried in any year." Explaining the infrequency of securities trials, Cox and Randall point to what they describe as historically "weak incentives for all the participants in class actions" to take a case through to trial.

As a result, a sense developed that securities cases would never make it to trial, too often resulting in litigation strategies designed more to address dispositive motion practice than trial. As Judge Leonard B. Sand commented in open court when appointing the lead plaintiff and lead counsel in the Merrill Lynch securities litigation pending in the Southern District of New York that alleges a subprime debt scandal at the bank: "I always have a sense of Never-Neverland when I talk about trial in large class actions, but nevertheless."

There are recent indicators suggesting a litigation strategy shift toward trying securities fraud cases, however. This column identifies certain indicators generally arising from the securities litigation field and specific indicators from both the defense and plaintiff bars. Ultimately, it is too soon to tell whether there is a lasting overall trend toward litigating securities cases to juries.

One thing is certain: Institutional investors, like the Policeman's Annuity and Benefit Fund of Chicago, which in January secured a unanimous jury verdict on behalf of a class in the Apollo Group securities litigation, are heeding the call of the PSLRA that institutional investors step up to lead these cases. In a public statement, its executive director, John Gallagher, thanked the jurors for their service, noting that "their verdict will help all of us as investors to incrementally increase the accuracy, reliability and ... timeliness of reporting critical information to the market so that individual or institutional investors can fairly evaluate the risks involved in investing in public companies."

RECENT UP-TICK IN SECURITIES TRIALS

According to the Risk-Metrics Group Securities Litigation Watch, 19 securities cases have gone to trial since 1996. Of these, Risk-Metrics reports, six involving post-PSLRA conduct have reached a jury verdict, including the Apollo Group case, with three verdicts going in favor of the plaintiffs and three going in favor of the defendants. One of the three reported verdicts for plaintiffs was in the 2005 case against Clarent Corporation. But according to docket entries and a review of the executed verdict forms, the Clarent case, in which two limited partnerships served as lead plaintiffs, actually resulted in a defense verdict against the bankrupt company's auditor, Ernst & Young, and a settlement with the company's chief executive officer after a jury returned a liability-only partial verdict against him. Thus the tally may be more clearly described as four for the defense and two for the plaintiff related to post-PSLRA conduct.

JEFFREY A. BARRACK *is a partner at Barrack Rodos & Bacine, where he litigates cases on behalf of institutional investors in securities fraud class actions and has served on the trial teams in the WorldCom Litigation and the Apollo Group Litigation. He can be reached at 215-963-0600 or at jbarrack@barrack.com.*

Among the six reported jury verdicts are the back-to-back Nov. 27, 2007, defense verdict in the JDS Uniphase trial and Jan. 16, 2008, plaintiff class verdict in the Apollo Group trial. The JDS Uniphase trial, in which the class was represented by the Connecticut Retirement Plans and Trust Funds as the lead plaintiff, lasted a month and resulted in a verdict in favor of all defendants on all claims. The Apollo Group verdict, which came after two months of trial, is valued in post-verdict papers at approximately $200 million; it is reportedly the single largest securities verdict since passage of the PSLRA. The only other post-PSLRA plaintiff verdict occurred in 2002 and dealt with the purchase and sale of limited partnership interests, not common stock. According to Kevin LaCroix of OakBridge Insurance Services, all these trials, especially the recent JDS Uniphase and Apollo Group trials, have been "closely watched because trials in securities cases are so rare."

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WHY ARE CASES GOING TO TRIAL?

There are a few fundamental dynamics in the securities industry and on both the plaintiff and defense bars that are operating to usher in what some are describing as a new chapter in the history of securities litigation involving more jury trials. While the dynamics are somewhat new, they have their roots in common sense business decision-making, and all involve careful cost vs. benefit analyses.

To begin with, the PSLRA worked a sea change in the industry by deeming the investor seeking to lead a case who has the largest amount at stake as presumptively the person most adequate to do so. Thus, the statute itself places at the helm the person who has the most at risk and the most to win, and it places that investor in a supervisory role over the plaintiffs' lawyers. As LaCroix explained, "The institutional investor lead plaintiff is clearly calling the shots and is clearly willing to run the risk of trial."

In addition, many of the precedents guiding courts as to what is required to establish the elements of securities fraud claims were handed down in pleading cases, like *Dura Pharmaceuticals v. Broudo*, which clarified the loss causation element of the securities fraud claim; *Tellabs v. Makor Issues & Rights*, which clarified the standard of review on a motion to dismiss; and *Stoneridge Investment Partners v. Scientific-Atlantic*, which affirmed the principles of pleading a primary violation of the securities laws. While these cases specifically addressed pleading a cause of action, litigants must turn to the trier of fact when their case gets beyond the motion to dismiss. District courts are generally inclined to let the sieve of the jury system resolve those cases where there is a genuine issue of fact in dispute.

Dynamics on the defense and plaintiff bars are equally powerful forces prompting cases to be litigated through to trial. Defense firms are seeking more and more to distinguish themselves to issuers and other securities fraud defendants as "unlike any other firm." For example, Gibson Dunn & Crutcher, defense counsel in the Apollo Group case, used the marketing slogan: "When your back is against the wall, there is always a way out." Skadden Arps Slate Meagher & Flom was recently noted for fighting class actions, based on interviews with partners, client references and litigation achievements in trial. Morrison & Foerster, which defended the JDS Uniphase trial, has received wide recognition for its victory. These firms appear to be choosing tactics that emphasize the benefits of the jury trial and post-trial procedures over the risks of large monetary verdicts, especially in cases like JDS Uniphase with alleged damages of $50 billion. Moreover, defendants appear to be less inclined to credit the risk that a jury would adjudicate them as having committed a knowing fraud, which would trigger the fraud exclusion in a typical director and officer liability insurance policy, and appear to be designing tactics for adjudications of a lesser state of mind, either that of innocence, good faith or, at worst, negligence, none of which would trigger that typical D&O insurance exclusion.

Plaintiff firms are likewise holding their trial lawyers out as key firm assets. Stephen R. Basser, a Temple Law School graduate who was the lead trial attorney in the Apollo Group trial, has the distinction of being the trial lawyer who, among other trial tasks, delivered the opening statement and closing argument that secured the largest securities verdict for plaintiffs in recent history. Plaintiffs firms covet human assets like Basser, who, together with his trial team, which included the undersigned Temple Law graduate as well as Samuel M. Ward, have become the new hallmark of distinction in the eyes of many institutional investors seeking to lead securities fraud cases.

Plaintiffs lawyers who have tried any securities fraud case are rare enough, but those who can bring the experience of multiple securities fraud trials to a retention are viewed by institutional investors as adding unique value. "We are quite confident in our securities litigation counsel; their successes in the WorldCom case and the Apollo case are substantial," says Lt. James P. Maloney, the commanding officer of the Chicago Police Department's financial crimes investigations and trustee of the department's retirement system. "We are willing to take securities cases to trial, even where there may be costs and risks, because we are obligated as fiduciaries to fight for truth on behalf of victims of fraud."

In an environment that favors trial once a complaint is sustained and with litigants holding their attorneys out as highly competent trial lawyers supported by track records, litigating to a settlement has fallen out of favor. Indeed, when asked about why the JDS Uniphase case was going to trial, the general counsel for the Connecticut treasurer told the Associated Press that the defendants did not take "pretrial settlement talks seriously." Similarly, while there was reportedly a failed mediation in the Apollo Group litigation, Basser told *Condé Nast Portfolio* after the trial that the defendants "made it abundantly clear to us that they had every intention of trying this case to verdict. We had no intention of caving, we would never cave, and we made it abundantly clear that we try cases to verdict."

With all these circumstances converging in the field and on each bar, it is no wonder there has been an uptick in securities fraud trials. The JDS Uniphase verdict has emboldened defendants; the Apollo Group verdict has emboldened investors. Thus, investors as well as issuers, officers and directors are recognizing the value of their constitutional "right to a speedy and public trial by an impartial jury." In so doing, the adjudication process further enhances and protects the integrity of our capital markets and ensures that the transparency of disclosure required of public companies by federal law is fairly kept in check and balance. •