SECURITIES LAWSUIT FILINGS REACHED RECORD HIGHS IN 2016

The commentators and firms that track federal securities filings all agree that 2016 saw unprecedented litigation activity and that a public company has never had a greater likelihood of receiving a D&O claim.

Federal filings increased year over year by 44 percent

According to Cornerstone Research, 270 securities class actions were filed in 2016 compared to 188 the year before.1 The average number of federal class action lawsuits from 1997 to 2015 was also 188, so by all accounts 2016 was a standout year over both the short and long term.

Remarkably, 2017 may outpace it. The second half of 2016 saw 148 class actions filed—the most for any semiannual period since the PLSRA was passed in 1996—and the first two months of 2017 have set a furious pace with 66 additional filings.2 To put this in perspective, the last eight months have seen more securities litigation activity than did all of 2015.

Federal merger objection lawsuits more than quadrupled in 2016, but overall numbers remained flat

The judicial hostility to merger objection suits in Delaware state courts has not ended those matters, but has instead driven them to federal court. Eighty merger objection lawsuits were filed in federal court in 2016. By comparison, the yearly average for federal merger objection suits from 2009 to 2015 was 20.

The increase in merger objection suits in federal court does not appear to be an increase in merger objection litigation overall.3 For the increase in federal merger objection suits, there was a corresponding decrease in such filings in Delaware. In 2015, 91 merger objection suits were filed in Delaware, but that number plummeted in the first half of 2016 with only 10 Delaware filings. Federal courts probably are seeing the merger objection cases that would have previously been filed in Delaware.
The likelihood of a company facing a securities lawsuit has never been higher

In 2016, 5.6 percent of publicly listed companies were sued in federal court for a securities violation or for a merger objection, the greatest percentage in 20 years and the fifth straight year this measure has risen. Even excluding merger objection suits, 3.9 percent of listed companies—about 1 in 25—faced a traditional securities suit, again the highest percentage in 20 years and well above the 1997 to 2015 average of 2.8 percent.

Not surprisingly, bigger companies face an even larger risk. One in twelve of the S&P 500 companies faced a securities class action in 2016, or 8.4 percent. That was an extreme increase from 2015 (2.6 percent) and well above the average from 2001 to 2015 average (5.5 percent).

California state court saw a 260 percent increase in securities filings

In the five years preceding 2016, California saw a yearly average of five securities cases filed in its state courts. But 2016 saw 18 such cases filed in California courts. California state court may be a more plaintiff-friendly forum for Section 11 filings: From 2010 to 2015, California had a lower dismissal rate (33 percent) for such matters than did federal courts (54 percent).

Life sciences and financial sectors were the most targeted industries

Biotechnology, pharmaceuticals, and healthcare accounted for 80 filings, an 86 percent increase from 2015, with biotechnology more than quadrupling its average number of yearly filings from 1997 to 2015. The financial sector saw 34 filings in 2016, which is equal to its average from 1997 to 2015, but greater than the 17 filings in 2015.
Smaller market cap companies are increasingly being targeted by emerging law firms

According to Advisen, approximately 58 percent of federal securities filings were brought against companies with market caps under $2 billion, and 72 percent of matters were brought against companies with market caps under $10 billion. A disproportionate amount of these smaller cases have been brought by “emerging law firms” that are new to securities matters.4 It will be interesting to see if this trend continues throughout 2017.

Defense costs are rising for securities class actions

During a recent Advisen presentation, one insurer panelist stated that defense costs are rising between 8 percent and 9 percent per year. Even when excluding extremely large matters, the average defense costs for securities cases has risen from $4.2 million in 2011 to $7.6 million in 2016.5

Despite the increased frequency, cases were dismissed more quickly

2016 saw the fastest dismissal rate since the passage of the PSLRA—11 months—which is sharply lower than the trailing five-year average dismissal time of 17 months. Those numbers, however, were influenced by the many merger objection cases that typically have shorter lifespans.6

2016 saw a record number of settlements over $100 million and a rise in the average and median settlement values

There were ten settlements in 2016 for more than $100 million, including two over $1 billion, that accounted for 81 percent of all settlement dollars for the year ($6 billion) that nearly doubled 2015’s total. The median settlement value was $8.6 million, increasing from 2015’s $6.1 million. The average settlement value was $70.5, almost double last year’s total, but excluding the mega-settlements over $100 million drops the average to $16 million with 55 percent of cases settling for less than $10 million.7
**APPROXIMATELY ONE IN FOUR PRIVATE COMPANIES SUFFERED A D&O LOSS OVER LAST THREE YEARS**

The average D&O loss for private companies was nearly $390,000 with the majority of losses arising from customer disputes. Losses also arose from disputes with vendors/suppliers (37 percent), regulators (27 percent), competitors (27 percent), and shareholders/partners (23 percent).8

**SALLY YATES IS GONE, BUT HER LEGACY COULD REMAIN**

As most readers will know, in September 2015 US Department of Justice (DOJ) Deputy Attorney General Sally Yates issued a memo to prosecutors providing guidance to enable them to “identify culpable individuals at all levels in corporate cases” so that they can be held responsible for “corporate misdeeds.” The memo states that, going forward, for companies to receive any credit for cooperating with a federal investigation, they will have to give the DOJ “all relevant facts relating to the individuals responsible for the misconduct.”

Since the memo was issued, the DOJ has clarified what is required to receive cooperation credit. The DOJ has stated that:

› A prerequisite for cooperation credit is disclosing all facts relating to the individuals involved in the wrongdoing, no matter where they fall in the corporate hierarchy.

› Cooperation must be proactive. The DOJ expects certain disclosures even if not requested, like producing inculpatory documents, creating summaries of evidence to assist the DOJ’s investigation, and providing other materials and testimony that the DOJ might not know about or understand its significance.

› Timeliness of the cooperation is critical. The earlier, the better. Cooperation provided after the DOJ has invested significant time and energy will not be given credit.

Sally Yates recently gained notoriety outside the D&O world when she was fired by President Trump for failing to enforce his executive order concerning immigration. Whether the new Attorney General, Jeff Sessions, will continue to adhere to the Yates Memo remains to be seen, but considering the focus on individual liability remains politically attractive, the Yates Memo may not be discarded as quickly as its author was.
CHIEF COMPLIANCE OFFICERS IN THE CROSSHAIRS

Recent SEC enforcement actions have created anxiety among Chief Compliance Officers (CCOs) over whether they will be targeted for “passive conduct” and second-guessed for basic program design decisions. While D&O coverage depends on a claim’s specific causes of action and allegations, CCOs are typically insured under D&O policies, and the policies do respond to claims alleging omissions and passive wrongful conduct.

SHAREHOLDERS TRY AGAIN WITH A CYBER-BASED D&O CLAIM, THIS TIME AGAINST YAHOO

The emergence of cyber-related D&O claims has been a worrisome trend over the last 12 to 24 months, but initial high-profile, cyber-related D&O claims ended in defense rulings for Wyndham Worldwide, Target, and Home Depot. Undeterred, shareholders of Yahoo filed a securities class action based on two cyber incidents that allegedly made its disclosures misleading. The SEC is also investigating Yahoo based on the same cyber incidents. It remains to be seen whether the Yahoo situation will result in a different outcome than earlier attempts to create D&O liability out of a cyber event.

SEC ENFORCEMENT ACTIVITY CONTINUES AT A STRONG PACE

The SEC filed 868 total actions in FY2016, up from 807 in FY2015 and 755 in FY2014. Total recoveries were around $4 billion, about $190 million less than what was collected in each of the past two years.

The SEC has touted its enhanced use of data analytics to ferret out wrongdoing, particularly with respect to insider trading violations.

FY2016 saw new highs for cases brought against investment advisers and investment companies (accounting for 18 percent of all enforcement actions) and for FCPA enforcement actions. The nominee for SEC Chair, Jay Clayton, is a Wall Street lawyer who some expect to reduce the emphasis on enforcement and instead focus on other SEC missions, like promoting fair and efficient markets, but a large enforcement staff remains in place at the SEC so any changes may be many months away.
CONTINUED SUCCESS FOR THE SEC WHISTLE-BLOWER PROGRAM

The 2016 fiscal year ending on September 30, 2016, was tremendously successful for the SEC whistle-blower program. In FY2016, whistle-blower awards totaled $57 million, which is more than all of the awards issued in the years since the program began in 2011. Awards in FY2017 already total $24.4 million. By the SEC’s calculations, through the end of FY2016, the program allowed the SEC to recover nearly $1 billion in sanctions and disgorgement of ill-gotten gains. The whistle-blower program appears to have achieved what the SEC intended and has given the agency a deep pool of leads to bring enforcement actions concerning misconduct it otherwise would not have discovered.

TENTH CIRCUIT RULES THAT THE SEC’S USE OF IN-HOUSE COURTS IS UNCONSTITUTIONAL

Targets of SEC enforcement have complained that its administrative law courts are unfairly biased in favor of the SEC and that the agency has an unfairly favorable winning percentage there versus in federal court. The 10th Circuit Court of Appeals agreed, saying that the hiring of the judges violates the Constitution, the first appellate court to say so. The DC Circuit Court of Appeals, however, ruled the opposite way, and this issue may find its way to the US Supreme Court soon.

1 https://www.cornerstone.com/Publications/Reports/Securities-Class-Action-Filings-2016-YIR
2 http://securities.stanford.edu/filings.html?filter=2017
4 Id.
5 http://www.advisenltd.com/events/webinars/2016/01/23/quarterly-claims-trends-2016-wrap/
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