

New York Law Journal
Volume 231
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Thursday, August 26, 2004

News

OUTSIDE COUNSEL

Inherent Risk in Securities Cases in the Second Circuit

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Fee awards in securities class actions may be based on either the percentage of recovery method or the lodestar method, the U.S. Court of Appeals for the Second Circuit has ruled in [Goldberger v. Integrated Resources, Inc., 209 F.3d 43 \(2000\)](#).

Using either approach, the court may consider the risk to the attorneys in prosecuting the case in determining how much of the common fund created should be awarded to the plaintiffs' attorneys. Some courts have found that there is no inherent risk in a securities class action, while acknowledging that the nature of the case (novel or untested theories) could make a particular case risky.

This article addresses the contention of whether it is true there is no inherent risk in bringing and prosecuting a securities class action case.

In Goldberger, the Second Circuit stated, "At least one empirical study has concluded that 'there appears to be no appreciable risk of non-recovery' in securities class actions, because 'virtually all cases are settled'."

The circuit cited to a law review article by Stanford Professor Janet Cooper Alexander¹ in 1991 for this statement and later referenced "anecdotal evidence" supporting it. This statement has been repeated by district courts in the Second Circuit.²

Alexander Article

The article by Ms. Alexander states that in securities class actions "there appears to be no appreciable risk of non-recovery, for virtually all cases are settled." Unfortunately, there is no support in the article for this statement, either in the footnotes or the text; in fact, no footnote follows this statement at all.

The article does discuss nine cases brought in the Northern District of California, alleging strict liability claims under the Securities Act of 1933. This limited sampling of a subclass of cases that can be brought under the federal securities laws (for instance, none of the cases alleged fraud under the Securities Exchange Act of 1934) hardly comprises an "empirical study" warranting the conclusion there is no applicable risk of non-recovery in all securities class actions. Over any five year period, approximately 1,000 securities class actions are filed. Drawing conclusions from nine cases is fundamentally flawed.

The "anecdotal evidence" referred to in Goldberger are apparently two oral statements by Melvin Weiss and William Lerach, who were formerly partners in Weiss, Bershad, Hynes & Lerach until its recent split. Mr. Weiss apparently said losses in securities class actions were "few and far between" and Mr. Lerach said his firm achieved "a significant settlement although not always a big legal fee, in 90 percent of the cases we file."³

Such anecdotal statements hardly seem to be a basis for any serious policy decisions, as the quotes seem more like a boast or marketing statement than anything else.

Furthermore, Mr. Lerach's statement undermines the very proposition for which it is cited. If the law firm filing a securities class action received only a fraction of its lodestar, as Mr. Lerach implies happens at least some of the time in cases that settle, the case is a money-loser for the firm and the firm has taken a risk, and lost.

Risk of Non-Recovery

The authors have attempted to do what the Alexander article should have done. Using as a starting point the Web site of the Securities Class Action Clearing House (<http://securities.stanford.edu>), which is run by Stanford University, and supplementing it with online database searches and personal knowledge of other cases filed, the authors compiled a list of all securities class actions filed in the Second Circuit since the federal securities laws were amended by the passage of the Private Securities Litigation Reform Act (PSLRA) in 1995 to raise the pleading standards for cases alleging fraud. Included in the database are both strict liability cases brought under the Securities Act of 1933 and fraud cases brought under the Securities Exchange Act of 1934.

All told, 249 cases are included in the study to date.⁴ Of these, 34 were transferred out of the circuit and 17 were voluntarily dismissed, leaving 198 cases litigated. Of the 198 cases remaining, 22 were so recently filed that no answer or motion to dismiss has been filed. Of the 176 remaining cases, motions to dismiss were made in 142 cases (81 percent) and answers were filed in only 5 cases (3 percent). Twenty-eight cases settled prior to answer or motion to dismiss and one case is being stayed.

Of the 142 cases in which motions to dismiss were made, the motion is still pending in 25 cases, leaving 117 motions to dismiss decided. Of these 117 cases, the motion to dismiss was granted, at least in part, in 66 cases, or 56 percent of the time.⁵

Thus, rather than there being no appreciable risk of non-recovery, in 46 percent of all cases actively litigated and 56 percent of cases in which motions to dismiss are made, plaintiffs never get past the initial motion to dismiss on some or all claims in the Second Circuit.

Furthermore, even when plaintiffs get past the initial motion to dismiss, the path to glory is filled with danger. If the plaintiff class is not certified, it will likely spell the death knell of the litigation.⁶ The plaintiffs must also survive a motion for summary judgment and, of course, the case can always be lost at trial, or reversed by an appellate court after trial.⁷

Conclusion

The article by Ms. Alexander, stating there is no risk of non-payment in a securities class action, to the extent it was ever grounded in empirical evidence,⁸ does not stand up to scrutiny in this circuit,⁹ at least since the passage of the PSLRA.

The empirical evidence shows there is a large inherent risk of loss in securities class actions.

1. Janet Cooper Alexander, "Do the [Merits Matter? A Study of Settlements in Securities Class Actions](#)," 43 STAN. L. REV. 497 (1991).

2. See, e.g., [Baffa v. Donaldson, Lufkin & Jenrette Sec. Litig.](#), 2002 WL 1315603, at *1 n. 3 (S.D.N.Y. June 17, 2002); [In re Dreyfus Aggressive Growth Mut. Fund Litig.](#), 2001 WL 709262, at *4 (S.D.N.Y. June 22, 2001).

3. [Goldberger](#), 209 F.3d at 52.

4. In compiling the list, choices had to be made as to how to treat some cases. Although numerous cases were filed in the litigation now captioned *In re IPO Securities Litigation*, 21 MC 92 (S.D.N.Y.), pending before Judge Shira Scheindlin, they were consolidated and one decision was issued on a motion to dismiss relating to all consolidated cases. This is treated as one case. Numerous cases have also been filed against Merrill Lynch & Co. and Henry Blodgett arising out of Attorney General Eliot Spitzer's investigation into tainted research analyst reports. Although individual complaints were filed in each case, individual motions to dismiss were made, and individual decisions are being issued, these are also treated as one case, as the opinions mimic each other.

5. The motion to dismiss was granted in its entirety in 38 cases (32 percent) and granted in part (and denied in part) in 27 cases.

6. [*In re Nasdaq Market-Makers Antitrust Sec. Litig.*, 169 F.R.D. 493, 528 \(S.D.N.Y. 1996\)](#) (a negative determination on class certification may sound the death knell of case).

7. See, e.g., *In re N. Telecom, Ltd. Sec. Litig.*, 116 F. 2d 446, 468 (S.D.N.Y. 2000) (summary judgment entered for defendants after seven years of litigation.)

8. The Dreyfus Aggressive Growth Mutual Fund case cites to a Senate Report containing testimony that 93 percent of securities lawsuits settle. [*In re Dreyfus Aggressive Growth Mutual Fund Litig.*, 2001 WL 709262, at *4 n.10 \(S.D.N.Y. 2001\)](#), citing [*S. Rep. No. 104-98, at 9 \(1998\)*](#) (citing testimony of George S. Sollman on behalf of American Electronics Assoc). At least in the Second Circuit, such "empirical evidence" seems to be mistaking the facts.

9. The empirical evidence in other circuits would seem to be even more extreme. One defendant in a securities class action suit recently put out a press release stating its San Francisco-based counsel was successful in getting 41 out of 45 motions to dismiss granted in their entirety. *Novastar Retains Leading Law Firm for Securities Litigation*, *Business Wire*, April 16, 2004.

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8/26/2004 NYLJ 4, (col. 4)

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