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In this issue... *Volatility, Securities Class Action lawsuits and SEC Enforcement.*

Volatility and Securities Class Action Frequency

The last time this newsletter discussed volatility was January 2008***** when the Chicago Board Options Exchange Volatility index, "the VIX," had risen to around 30. Those times now seem relatively tranquil; as of this writing, the VIX is well over 60, reflecting and, to a degree, encapsulating the worldwide crisis in lending and the widespread economic recession. It is generally believed — as we discussed in that newsletter — that increased volatility in the stock markets typically results in an increase in Securities Class Action (SCA) lawsuits. Recent experience appears to have again borne this out. Already the 2008 total of securities fraud-related class action lawsuits has surpassed the entire number in 2007, which itself represented an increase of around 48% over 2006.*

Moreover, the VIX in the current economic crisis is at levels not seen for a decade, and in October reached its historic high point. If the direct correlation between volatility and SCA lawsuits continues to hold true, it does not augur well for SCA filing frequency in the coming months — litigation will tend to lag a little behind the VIX — especially as there seems to be no immediate end to the financial crisis and stock market swings. And while the initial targets of SCA litigation were generally financial services companies, it is reasonable to assume that the longer the situation continues, the circle of potential defendants will expand beyond that relatively narrow industry sector.

The Securities and Exchange Commission (SEC) as Enforcer

If SCA lawsuits brought by investors are a form of private retribution for alleged wrongful acts, enforcement actions by the SEC could be seen as the government equivalent. In this area there has also been a significant increase in activity. According to a study by NERA Economic Consulting,***** enforcement action settlements are expected to reach a three-year high in 2008; the 2007 total was 702 and the 2006 total was 663.

In addition to increasing frequency, the severity of SEC settlements is setting new records. Prior to Sarbanes-Oxley (2002) the largest SEC-imposed penalty was $10,000,000 against Xerox. But since the enactment of Sarbanes-Oxley, the SEC has levied penalties of over $10,000,000 against 115 parties. Fourteen of those penalties were in excess of $100,000,000.

Wrongful acts alleged by the SEC tend to mirror the accusations made by class action plaintiffs: insider trading using non-public information, false public statements about company conditions and prospects, earnings misstatements and incorrect or misleading press releases. The SEC has also stepped up its allegations of companies violating the Foreign Corrupt Practices Act (FCPA): Since January 2006 the SEC has brought 38 FCPA enforcement actions, which is more than occurred during the preceding 29-year period since the FCPA became law in 1977.*****

The SEC Enforcement Manual

Along with increased policing and punishment, the SEC recently made public its in-house Enforcement Manual,***** the stated purpose of which is "... to be a reference for the staff in the U.S. Securities and Exchange Commission's ... Division of Enforcement ... in the investigation of potential violations of the Securities Laws ... and is intended to provide guidance only to the staff of the Division." [Section 1.1] The section on Complaints, Tips and Referrals is of particular interest; like most other law enforcement agencies, the SEC relies to some extent on informers. It is a sharp reminder that wrongful acts often have witnesses whose silence cannot be guaranteed.

One might wonder why the gamekeeper is sharing secrets with the poachers, but as pointed out in Section 1.3, the manual is United States Government property and so is subject to the Freedom of Information Act. In spite of this, not surprisingly, certain material is withheld from public view as permitted under the Code of Federal Regulations [Title 17 § 200.80], but the release of this 122-page manual still provides insights into the SEC's enforcement process. For attorneys with SEC defense practices, the manual is probably compulsory reading; for senior executives and in-house counsel at publicly traded companies, it may be worth leafing through.

Summary

With heightened and virtually unprecedented turmoil in the markets, the connection between volatility and SCA lawsuits appears to be continuing, and portends an increase in the frequency of filings and greater severity in settlements. Added to that we now see an increasingly aggressive SEC, flushed with success and determined to root out and punish transgressors. This muscular approach was summed up by the SEC's Director of Enforcement on October 22, 2008: "The dedicated…staff has been working around the clock to investigate and punish wrongdoing. The staff's commitment is unwavering year-in and year-out. We look forward to continuing our vital mission of investor protection in the coming year." *

* Sources

- CUG.COMments January 2008 *(http://www.cug.com/documents/newsletter/CUGCOMments-54.pdf)*
- Stanford Securities Class Action Clearing House *(http://securities.stanford.edu)*
- NERA Economic Consulting *(http://www.nera.com)*
- SEC Press Release, October 22, 2008 *(http://www/sec.gov/news/press.shtml)*
- SEC Enforcement Manual *(http://sec.gov/divisions/enforce.shtml)*
- SEC Press Release, October 22, 2008 *(http://www/sec.gov/news/press.shtml)*

Broker Alert!

January 2009 is near: Please forward your renewal and new business submissions as soon as possible so we can provide timely and intelligent solutions to help complete your programs before the year-end crush.

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