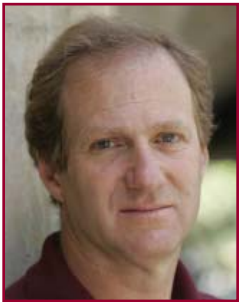


## WHEN ARE SECURITIES CLASS ACTIONS DISMISSED, WHEN DO THEY SETTLE, AND FOR HOW MUCH? – PART II

by Michael Klausner and Jason Hegland



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*As part of our education mission, the PLUS Foundation supports research important to professional liability at seven top insurance universities across the country. This article is a product of that funding.*

It is well known that approximately one-third of securities class action suits are dismissed, two-thirds settle, and hardly any go to trial. There is also abundant data on mean and median settlement amounts. But a lot remains unknown about the detail underlying these basic numbers. How many times do courts give plaintiffs an opportunity to amend a complaint before finally dismissing a case with prejudice?<sup>1</sup> How often do cases settle during the pleading stage—that is, before a final ruling on a motion to dismiss—and how often during discovery? How many cases settle before even an initial ruling on a motion to dismiss? For cases that go to discovery, how long do the parties continue litigating before settling? How is settlement size related to settlement timing? What factors

influence settlement timing and size? These questions, which we address below, are potentially important to lawyers, claims officers, monitoring counsel and others involved in the litigation and settlement process. They are important from a policy perspective as well because they can help us assess the total cost of this type of litigation.

This article follows an article we published in the 2010 February issue of the *PLUS Journal* on the extent to which D&O insurance protects companies and their officers and directors in securities class actions. Both articles are based on data we have collected on securities class actions dating back to 2000. The data for the statistics presented here are taken from securities class actions filed between 2000 and 2003 and settled between 2001 and 2009. We selected cases filed between 2000 and 2003 for this article so that we would have a sample of cases nearly all of which have been resolved.<sup>2</sup> Additional data is taken from SEC enforcement actions that ran parallel to some of those class actions. In total, there were 726 cases filed during this period, 443 of which settled, 249 of which were dismissed with prejudice or voluntarily dropped by plaintiffs, and 34 of which are still pending. Figure 1 presents some basic information about these cases.

### OVERVIEW OF SETTLEMENT AND DISMISSAL TIMING

A common view of securities class actions is that they entail a drawn-out pleading stage, with judges giving plaintiffs numerous attempts to plead a case in sufficient detail to go to discovery, and then lengthy discovery in which each side grinds down the other until settlement finally occurs on the eve of trial, after many millions of dollars have been spent on the litigation. While this description certainly fits some cases, approximately half of all securities class actions end before discovery and before even a second complaint is filed.

Figure 2 shows the outcome of all securities class actions as cases proceed through the litigation process. The upper pie chart shows the outcome at the time a case is consolidated or a lead plaintiff is appointed.<sup>3</sup> In 18% of all cases, the motion to dismiss (MTD) the first complaint is granted with prejudice and the case ends. An additional 5% of cases are voluntarily dropped before the motion to dismiss is ruled on, and another 6% are dropped after the motion to dismiss is granted without prejudice. Thus, in total, 29% of cases end relatively quickly and painlessly for the defendants.

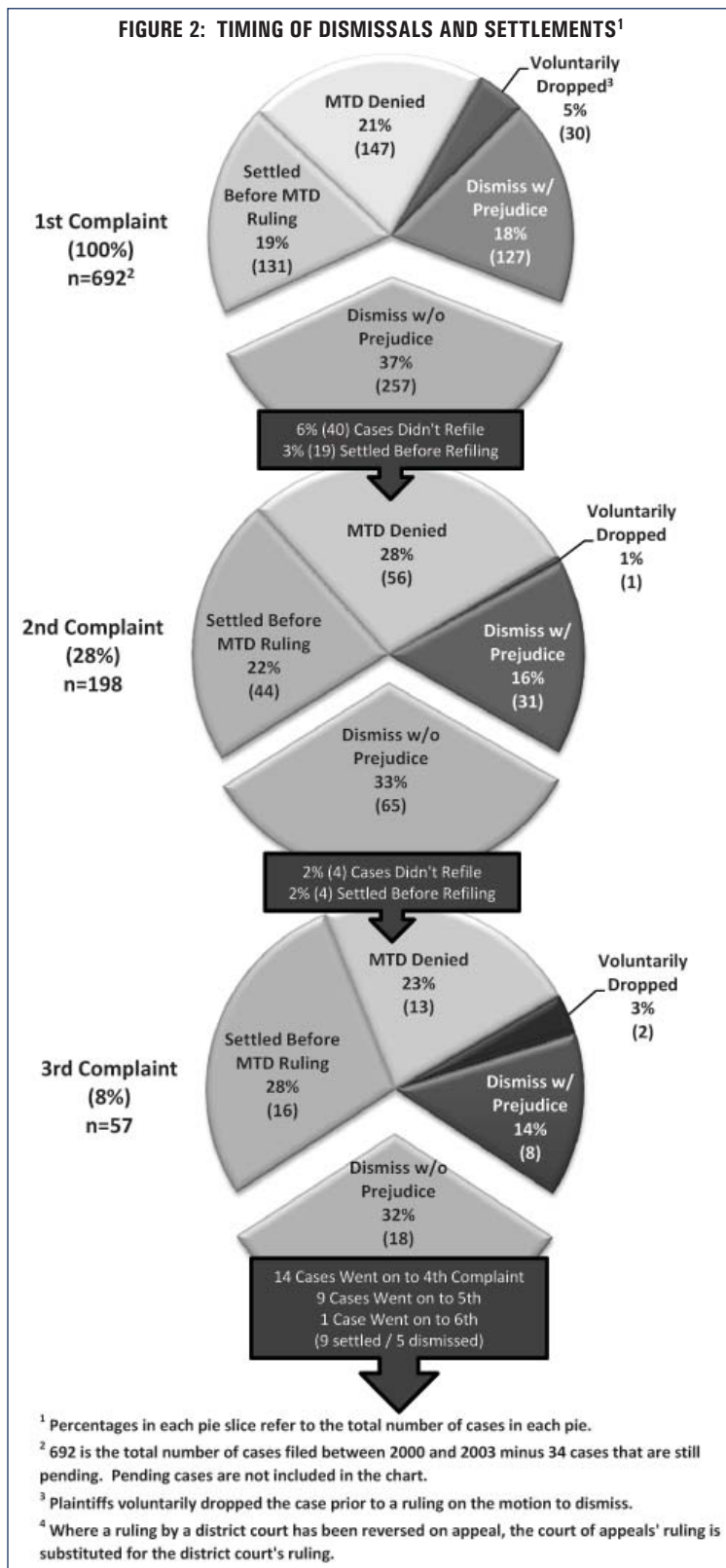
A substantial number of cases settle relatively quickly as well. Nineteen percent of cases settle before the court rules on the first motion to dismiss, and another 3% of cases settle after the court grants a motion to dismiss without

**FIGURE 1: BASIC CASE INFORMATION**

Cases Filed 2000 - 2003			
		Settlements*	
		Mean	Median
Settled	61% (443)	\$48 million	\$7 million
Dismissed / Dropped	34% (249)		
Ongoing	5% (34)		
Total	100% (726)		
Parallel SEC Action?			
		Yes	19% (139)
		No	81% (587)
*Excludes Third Party Payments			

prejudice but before the plaintiff files a second consolidated complaint. These cases—22% in all—are of course costly to defendants and their insurers, but they do not involve extended litigation.

In 21% of cases, the motion to dismiss is denied, and the case moves on toward discovery. Virtually all of these cases are ultimately settled rather than tried.



In 28% of cases filed—a total of 198 cases—the court grants the defendants' motion to dismiss without prejudice, and the plaintiff files a second consolidated complaint. The distribution of settlements and dismissals once a second consolidated complaint is filed is shown in the middle pie chart. The distribution roughly parallels the disposition of cases at the first-complaint stage, with the primary difference being a larger proportion of motions to dismiss denied (28% vs. 21% of cases). Out of the 198 cases in which a second consolidated complaint is filed, 22% settle before the court's ruling on the defendants' motion to dismiss the second complaint, 16% of cases are dismissed with prejudice, and 28% of cases move on toward discovery after the defendants' motion to dismiss is unsuccessful.

Only 8% of cases filed (57 cases) reach a point at which at least two complaints are dismissed without prejudice and a third complaint is filed. In a few of those cases, a total of four, five or six complaints will be filed. The distribution of dismissals, settlements and denials of motions to dismiss is similar at the third consolidated complaint stage as at the second.

### WHAT SORTS OF CASES ARE ULTIMATELY DISMISSED OR DROPPED, AND WHEN?

Thirty-four percent (249) of cases examined here were either dismissed with prejudice or voluntarily dropped. As shown in Figure 3, 79% (197) of these cases were finally dismissed or dropped after the first consolidated complaint was filed, 15% (37) were finally dismissed or dropped after the second consolidated complaint (sometimes referred to as the "second amended consolidated complaint") was filed, and 6% (15) were dismissed or dropped after the third or later consolidated complaint was filed.

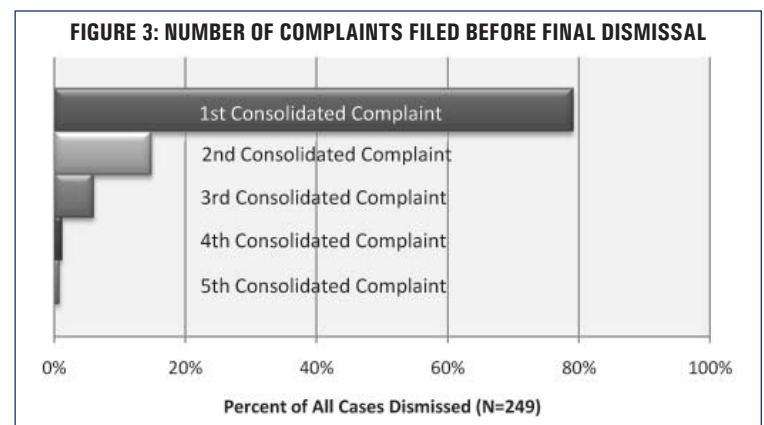
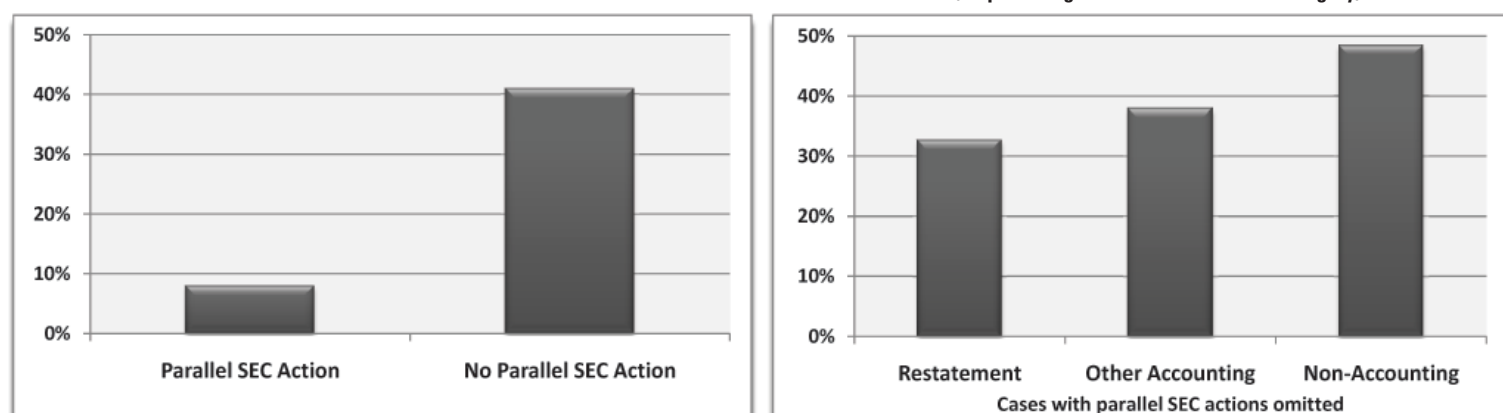


Figure 4 shows the frequency with which cases are ultimately dismissed or dropped, broken down by the nature of the allegations and whether there is a parallel SEC action. Where the SEC has filed a parallel enforcement action—based on the same allegations made in a class action complaint—the class action is dismissed in fewer than 10% of cases. Thus, over 90% of those cases settle. Leaving aside class actions with parallel SEC actions, cases that involve restatements are dismissed less frequently than cases that involve non-restatement accounting issues, which in turn are dismissed less frequently than are non-accounting cases. These differences are statistically significant.

**FIGURE 4: FREQUENCY OF DISMISSED OR DROPPED CASES BASED ON NATURE OF SUIT (As percentage of cases filed in each category)**



## HOW OFTEN DO CASES SETTLE DURING THE PLEADING STAGE AND HOW OFTEN DURING DISCOVERY?

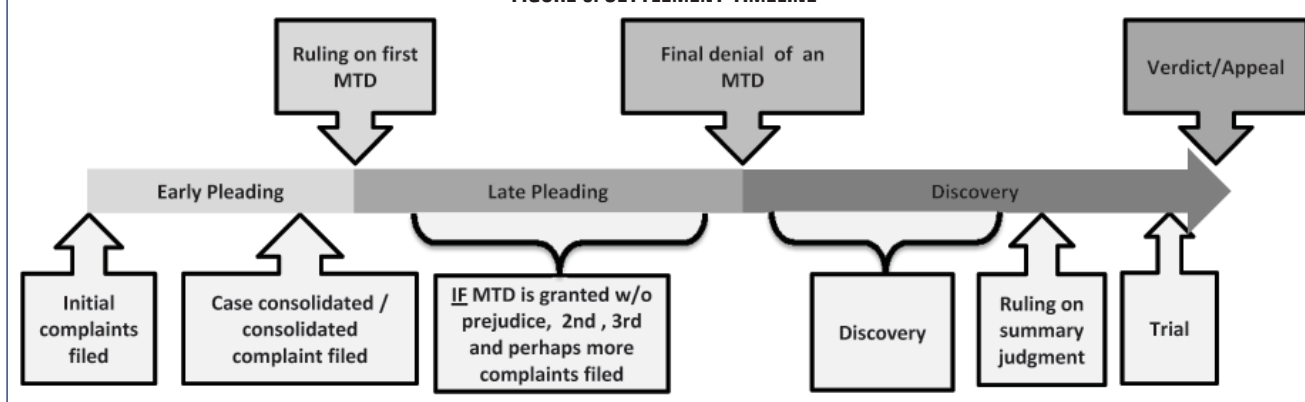
As shown in Figure 2, above, some cases settle before the ruling on the first motion to dismiss; some settle later in the pleading process, after an initial dismissal without prejudice; and some settle after a motion to dismiss has been denied and a case heads toward discovery and potentially to trial.

Figure 5 shows a timeline of a typical case with three phases of litigation delineated: Early Pleading, Late Pleading, and Discovery. We divide settled cases into three groups based on the phase in which they settled. Settlements in the Early Pleading Phase occur before a ruling on the first motion to dismiss. Settlements in the Late Pleading Phase occur after a case has been dismissed without prejudice but before a final ruling on a later motion to dismiss<sup>4</sup>—that is, while there is still a possibility that the case will be dismissed.

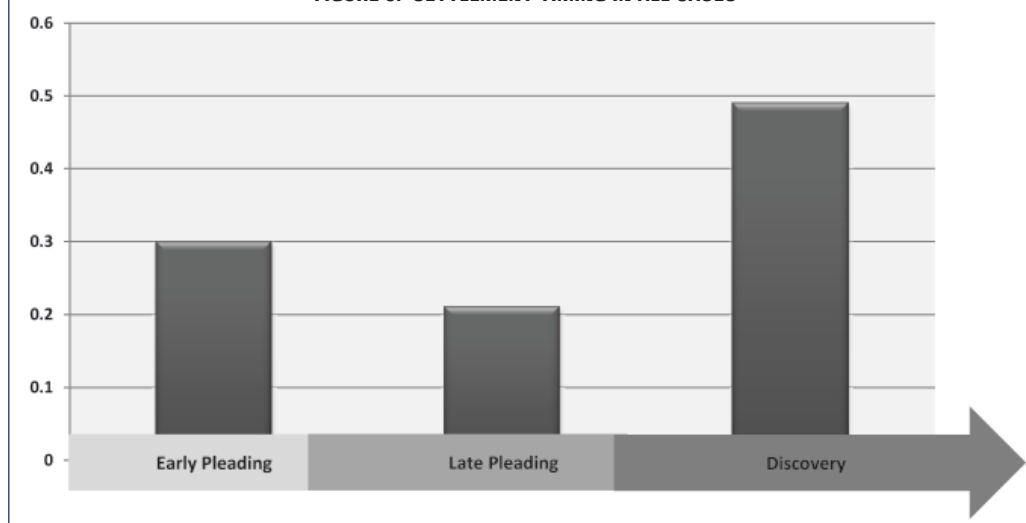
Settlements in the Discovery Phase occur after a motion to dismiss has been denied, at which point the stay of discovery is lifted. Discovery Phase settlements include cases that settle soon after the motion to dismiss has been denied, in which case actual discovery has not begun, and cases that settle on the eve of trial after full discovery. (We break these settlements down further below.)

Figure 6 shows the distribution of settlements across these three phases of litigation. Just over half of settlements occur in the Early

**FIGURE 5: SETTLEMENT TIMELINE**



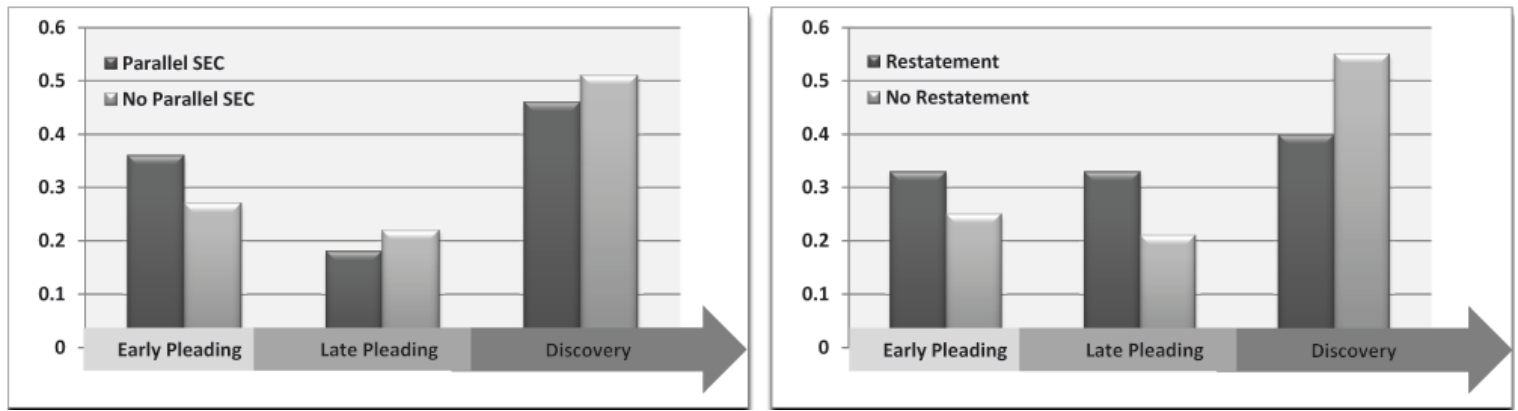
**FIGURE 6: SETTLEMENT TIMING IN ALL CASES**



or Late Pleading Phase—that is, while there is still a possibility of dismissal.

Figure 7 compares cases with and without parallel SEC actions, and cases with and without restatements. As shown there, class actions with parallel SEC actions tend to settle in the Early Pleading Phase more than do cases without parallel SEC actions. This difference is statistically significant. The other differences are not statistically significant. Cases involving restatements also tend to settle in earlier phases than do other cases. The difference between

**FIGURE 7: SETTLEMENT TIMING: CASES WITH PARALLEL SEC ACTIONS AND CASES WITH RESTATEMENTS**



restatement and non-restatement cases is statistically significant in a comparison across the Early and Late Pleading Phase, on the one hand, and the Discovery Phase on the other. Relatively early settlement in some cases with parallel SEC actions and some involving restatements may reflect an inclination on both sides of a case to save the expense of discovery when the occurrence of a legal violation is relatively clear.

### ONCE DISCOVERY BEGINS, HOW LONG IS IT UNTIL THE CASE SETTLES?

Roughly half of all settlements occur in the Discovery Phase—some shortly after the motion to dismiss is denied and others after lengthy discovery. The mean length of time before settlement once a motion to dismiss has been denied is 24 months. The full range of settlement timing for these cases runs from one month to over seven years after the motion to dismiss is denied.

Figure 8 shows the distribution of settlement timing for both the full set of cases and cases that have parallel SEC actions. A comparison of these distributions indicates that class actions with parallel SEC actions tend to settle earlier in discovery than those without parallel SEC actions. This is consistent with our finding that cases with parallel SEC actions tend to settle earlier in the

pleading stage than do other cases. Again, a potential explanation is that these are cases in which a violation can be relatively clear to both sides, and that when this is true the parties tend to settle relatively early. (We found no difference in Discovery Phase settlement timing between cases with and without restatements where no parallel SEC action was filed.)

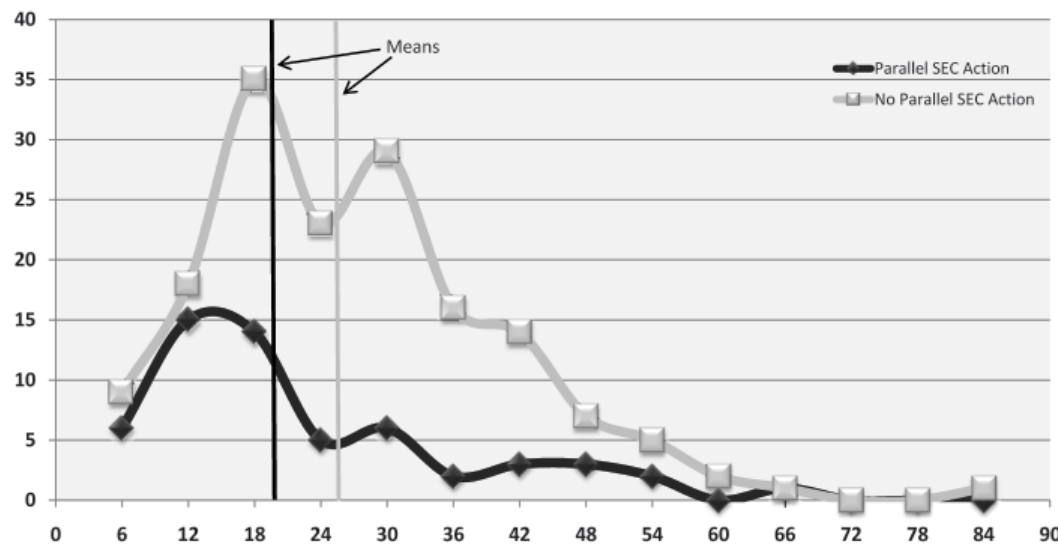
### IS SETTLEMENT SIZE RELATED TO SETTLEMENT TIMING?

Is there any relationship between settlement timing and the size of settlements? One can hypothesize a number of cross-cutting influences on this relationship. Untangling these factors is a task that lies beyond the scope of this article. Nonetheless, we briefly explore how settlement timing is related to settlement size.

Figure 9 shows two, apparently contradictory relationships. The bar graph shows mean settlement amounts<sup>5</sup> for cases that settle in each of the three phases of the litigation. Those amounts are measured on the left-hand vertical scale. A line graph is superimposed on the bar graph and is measured on the right-hand vertical scale. The line graph shows mean settlements as a percentage of shareholder losses (measured crudely by the difference of the maximum price of a company's shares during the class period minus its share price the day after the end of the class period.<sup>6</sup>) While settlement size increases as cases move from the Early Pleading to the Discovery Phase, settlement size as a fraction of shareholder losses decreases.

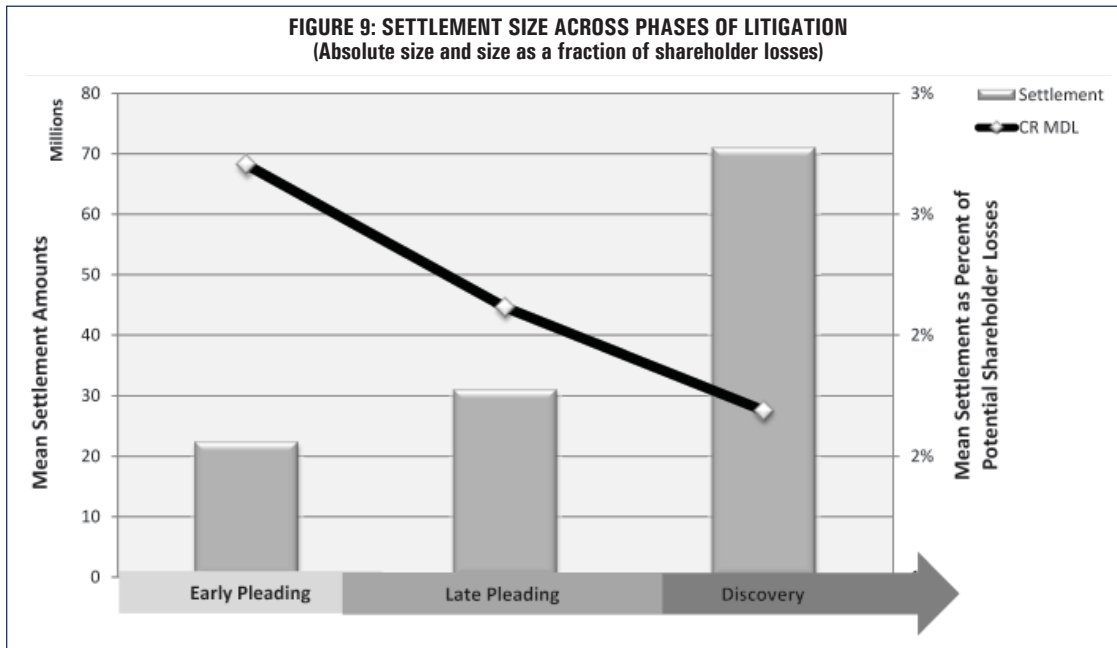
What explains this inverse relationship? As a matter of arithmetic, it must be that shareholder losses decline in settlements across the three phases. But why? Shareholder losses are a function of company size and the size of the stock drop, measured in percentage terms. We compared each of these factors across cases that settled in each phase and found that company size is the explanation. Large companies tend to settle later than smaller companies and, not surprisingly, large company

**FIGURE 8: SETTLEMENT TIMING: AFTER MOTION TO DISMISS IS DENIED**





**FIGURE 9: SETTLEMENT SIZE ACROSS PHASES OF LITIGATION**  
(Absolute size and size as a fraction of shareholder losses)



settlements tend to be larger in absolute terms than small company settlements. On the other hand, small companies tend to settle for a larger fraction of shareholder losses than do larger companies.

The relationship between company size and settlement timing appears as well when we look at settlement timing within the Discovery Phase. Large companies tend to settle later in discovery than do small companies.

## CONCLUSION

This analysis of settlements and dismissals of securities class actions reveals several facts of interest. First, over half of securities class actions end early in the pleading stage, either as a result of a quick dismissal or a quick settlement. Second, relatively few cases entail the filing of a second, third, or later consolidated complaint. Third, among cases that settle, roughly half settle during the pleading stage—before a final ruling on a motion to dismiss. Class actions with parallel SEC actions and those with restatements tend to settle during the pleading stage somewhat more often than do other cases. Fourth, among cases that settle during discovery, those with parallel SEC actions tend to settle somewhat earlier. And finally, cases that settle early in the litigation process tend to settle for less than do cases that settle later. This, however, is due to the fact that large companies tend to settle later. When measured as a fraction of shareholder losses, settlements that occur early are larger than settlements that occur later.

## FOOTNOTES

- 1 A dismissal with prejudice is a final dismissal, whereas a dismissal without prejudice allows the plaintiff to amend and refile the complaint to cure whatever shortcomings the judge initially found.
- 2 The dataset covers cases filed between 2000 and 2008 at this point.
- 3 The vast majority of cases are consolidated. In relatively few cases, there is only one complaint filed and therefore no need to consolidate. In those cases, the sole plaintiff that files a case is named lead plaintiff. In either case, we refer to the first complaint as the first consolidated complaint.
- 4 If there is a reversal on appeal, we substitute the appellate court's ruling for the district court's ruling.
- 5 Settlement amounts exclude payments by third parties such as accounting firms and investment banks.
- 6 Use of other measures of shareholder losses do not affect the relationship shown here.

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