

Securities Fraud Class Actions Must Be Curtailed, Attys Say

By **Dunstan Prial**

Law360 (June 11, 2018, 8:10 PM EDT) -- Class action securities fraud suits have proliferated in recent years, a trend that's harming U.S. businesses, investors and the economy, and it needs to be reversed, a panel of defense attorneys said at an event Monday in Lafayette Hills, Pennsylvania.

From 2014 to 2017, the number of federal securities class actions filed in the U.S. more than doubled from 168 to 412, according to statistics provided by insurer Chubb Ltd. during a discussion sponsored by the insurance company titled "From Nuisance to Menace: The Rising Tide of Securities Class Action Litigation."

Methods suggested for reversing that trend included forcing losing parties in securities fraud suits to pay all legal expenses, fostering a system in which "truly frivolous" cases are filtered out early in the process, and ensuring that cases are heard in federal court where stringent federal pleading standards apply.

"This proliferation is not only impacting businesses, but is also manifesting as a total tax on society," said Scott A. Meyer, a Chubb division president who moderated the panel.

As the number of securities fraud cases has risen, so have the costs for litigating them, according to Chubb's figures. Between 2012 and 2016, the average total cost for settling claims filed by shareholders who object to a proposed merger rose 63 percent to \$4.5 million in 2016, up from \$2.8 million in 2012, the insurer said. In merger objection cases that were ultimately dismissed, the average cost rose more than 162 percent during the same four-year period from \$880,000 in 2012 to \$2.3 million in 2016.

Bruce Vanyo of Katten Muchin Rosenman LLP said Congress may need to step in to fix a legal system in which many securities fraud cases are now filed in state courts, where pleading standards are more lenient, a factor that has contributed to the overall rising number of suits.

That practice was strengthened in March when the Supreme Court ruled in *Cyan v. Beaver County Employees Retirement Fund* that state courts can continue to hear certain securities class actions brought under federal law. The justices found that the Securities Litigation Uniform Standards Act of 1998, a reform of the 1933 Securities Act, allowed state courts to retain concurrent jurisdiction over securities claims that involve 50 or more plaintiffs.

But state court judges aren't as familiar with federal securities laws as federal judges, Vanyo said. "It's foreign territory for them. They're starting from scratch," he said.

“They’re not aware of how abusive these cases are, and as a result not as inclined to throw them out as unmerited and having no basis.”

Vanyo said Congress may need to pass “another reform act to reform the reform act,” or else, he predicted, every initial public offering that falls below the offering price will be met with a class action suit filed in state court.

Gerard G. Pecht of Norton Rose Fulbright said some new companies are addressing the issue by adding provisions to their charters requiring that shareholder cases be heard in federal court.

Older companies can and should draft similar provisions by amending their bylaws, said Daniel J. Tyukody of Greenberg Traurig LLP, adding that insurance companies like Chubb should be pressing companies they insure to include those provisions.

Pecht also warmed to a suggestion that the U.S. adopt a practice already in place in Canada and Australia under which the party that loses a securities fraud case is responsible for paying all the legal fees. “It does seem to curb some of the more frivolous lawsuits,” he said. “I think it does have the beneficial effect of making plaintiffs’ lawyers think twice about the lawsuits that they bring and the issues that they raise.”

Pecht said there are “no consequences” under the U.S. system for bringing “frivolous lawsuits,” and as a result virtually every merger and every stock price drop is followed by a shareholder suit. It “cannot be” that every merger and stock drop constitutes a securities fraud, he said.

Tyukody claimed 2017 statistics show that 8.3 percent of all U.S. companies are facing some form of class action, while strongly disputing the idea that “nearly one out of every 10” publicly traded U.S. company was committing securities fraud.

“Clearly the filtering mechanism is not working” for dismissing frivolous lawsuits, he said, while noting he’s uncertain what process might be implemented to weed out such lawsuits at the earliest stage.

Pecht said the threat of lawsuits is curbing the number of companies that want to take their shares public, and that the reduction in public companies has in turn hurt U.S. investors because they don’t have as many options in which to invest their money.

The rising number of suits filed by shareholders who oppose mergers acting as a “tax” on U.S. companies, Pecht added, one that foreign companies aren’t subject to, and as a result such so-called “merger objections suits” make the U.S. less competitive in the world market.

“It doesn’t stop deals but it’s offensive,” added Vanyo. “It’s very offensive that we have this and that we tolerate this.”

--Editing by Adam LoBelia.

