31. Securities

31.1 Introduction

The goal of the Securities Act of 1933[1755] (1933 Act) and the Securities Exchange Act of 1934[1756] (1934 Exchange Act) is to ensure that issuers of public securities provide all necessary and accurate information to investors. The statutes prohibit the sale or purchase of securities through false or misleading statements. Most litigation in the securities area centers on these two statutes and is based on allegations of fraud or misstatements in the purchase, sale, or offering of securities and other alleged market or management abuses. Causes of action also exist under sections 77k, 77*l*(a), and 77o of the 1933 Act and section 78t(a) of the 1934 Exchange Act. Private rights of action, both express and implied, are available under the statutes,[1757] although the Supreme Court in recent years has narrowed the availability of implied remedies through cases

1755. 15 U.S.C. §§ 77a–77aa (2000).

1756. *Id*. §§ 78a–78mm.

1757. Most notably, there is the implied remedy under Securities and Exchange Commission (SEC) Rule 10b-5 for fraud in connection with the purchase or sale of securities and the remedy for fraud in connection with the solicitation of shareholder votes. These two remedies have been so firmly entrenched in the federal jurisprudence that they have survived the general cutback in the recognition of private remedies. Thomas Lee Hazen, The Law of Securities Regulation § 1.7, at 65 (3d ed. 1996). *See also* Herman & MacLean v. Huddleston, 459 U.S. 375 (1983).

such as *Central Bank of Denver v. First Interstate Bank of Denver*,[1758] which eliminated an implied private right of action against aiders and abettors.[1759]

Cases alleging securities fraud can present problems similar to those that arise in mass tort litigation. Many cases are brought as class actions, triggering the requirements of Federal Rule of Civil Procedure 23 as well as limitations imposed by the Private Securities Litigation Reform Act (PSLRA).[1760] This section discusses some of the issues and problems peculiar to securities litigation, and particularly securities fraud class actions.

31.2 Statutory Framework

The 1933 Act prohibits offering securities to the public for sale or purchase unless they have been registered with the Securities and Exchange Commission (SEC).[1761] Companies are required to file registration statements that fully disclose all of the information required by the statute and by SEC rules prior to such sale. These registration and disclosure provisions apply to the issuance or distribution of securities, and the statute's protection extends only to the purchaser.[1762] Civil liability can be imposed for misrepresentations and omissions in registration statements or where securities are sold in violation of the registration requirements, as well as under the general antifraud provisions of section 77q(a).[1763] The 1934 Exchange Act regulates the public trading of securities. The statute requires that any securities traded on a national exchange must be registered with the SEC, with full disclosure of relevant information about the company. Unlike the 1933 Act, the 1934 Exchange Act protects both sellers and purchasers.

1758. 511 U.S. 164 (1994).

1759. The Supreme Court had previously noted the absence of "aiding and abetting" language in section 10(b) of the Exchange Act and in 17 C.F.R. § 240.10b-5 (1995), but it was not until the decision in *Central Bank of Denver* that the Court held aiding and abetting liability in private actions could not be imposed. As a consequence, civil actions based on theories of aiding and abetting may only be brought by the SEC and then, only where the defendant acts knowingly. *See* Melissa Harrison, *The Assault on the Liability of Outside Professionals: Are Lawyers and Accountants Off the Hook?*, 65 U. Cin. L. Rev. 473, 505 (1997); *see also* Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737 (codified as amended at 15 U.S.C. §§ 77z-1, 78u-4 to -5 (2000)) (citations to the PSLRA hereafter will refer to the amendments to the 1934 Exchange Act, although parallel provisions were added to the 1933 Act except where noted).

1760. 15 U.S.C. § 78u-4 (2000).

1761. *Id.* § 77e.

1762. Express remedies are provided for in 15 U.S.C. §§ 77k, 77*l*(a), 77o (2000).

1763. *See* Hazen, *supra* note 1757, at 7.

Most securities actions under the 1934 Exchange Act allege either violations of section 10(b),[1764] which prohibits using any manipulative or deceptive device in connection with the purchase or sale of securities, or violations of SEC Rule 10b-5,[1765] which extends liability to include misstatements and omissions, or both. These actions typically take the form of securities fraud class actions. The 1934 Exchange Act also created the SEC to administer and enforce the securities statutes.[1766] Both the 1933 Act and the 1934 Exchange Act rely heavily on self-regulation by affected companies, with the SEC providing the necessary oversight. The SEC has the authority to promulgate rules and regulations, investigate potential violations, impose fines, and seek equitable or other relief.[1767] In addition to instituting enforcement actions and levying administrative sanctions,[1768] however, the SEC can refer conduct to the Department of Justice for criminal prosecution.

31.3 The Private Securities Litigation Reform Act

The Private Securities Litigation Reform Act of 1995 (PSLRA) sought to prevent frivolous and unmeritorious securities class actions through broad-based legislation reaching both substantive and procedural law, as well as by instituting other reforms in securities actions. The legislation was targeted towards certain perceived abuses of securities class actions arising out of lawsuits brought on behalf of "professional plaintiffs" or plaintiffs with at best a nominal interest in the securities at issue.[1769] The PSLRA directs the court to appoint

1764. 15 U.S.C. § 78j(b) (2000).

1765. 17 C.F.R. § 240.10b-5 (1995).

1766. The SEC is composed of five members, appointed by the President with the approval of the Senate, who function as a bipartisan, quasi-judicial agency. 15 U.S.C. § 78d(a) (2000); *see also* 1 Hazen, *supra* note 1757, §§ 1.3–1.3[3].

1767. The SEC also functions as an original and appellate tribunal in connection with licensing and disciplinary charges.

1768. The SEC can, among other things, issue civil fines in administrative proceedings, freeze assets, and seek forfeiture. *See, e.g.,* SEC v. Gonzales de Castilla, 170 F. Supp. 2d 427 (S.D.N.Y. 2001) (SEC issued freeze order on defendant's assets in insider trading case).

1769. "In place of that practice—a practice wherein the class lawyer selected the class plaintiff—Congress sought to substitute a new model . . . . Under the new model, the court would appoint the lead plaintiff who, in turn, would select and direct class counsel." *In re* Network Assocs., Inc. Sec. Litig., 76 F. Supp. 2d 1017, 1020 (N.D. Cal. 1999). *See also* Greebel v. FTP

as lead plaintiffs the "person or group of persons" with the greatest financial interest in order to encourage institutional investors, who are more likely to have significant financial holdings at stake as well as greater sophistication and experience in securities matters, to exercise control over the litigation and over counsel.[1770] The PSLRA changed the selection criteria for lead plaintiffs from the first to file to the adequacy of the proposed class representative. The PSLRA has had the greatest impact on class actions alleging corporate fraud under 15 U.S.C. § 78j(b) and SEC Rule 10b-5, and its provisions are found in 15 U.S.C. §§ 77z-1 and 77z-2 of the 1933 Act and 15 U.S.C. §§ 78u-4 and 78u-5 of the 1934 Exchange Act.

Efforts by plaintiffs to circumvent the statutory reforms of the PSLRA by filing securities fraud class actions in state court were rebuffed with the passage of the Securities Litigation Uniform Standards Act in 1998 (Uniform Standards Act).[1771] The Uniform Standards Act preempted state law securities fraud class

Software, Inc., 939 F. Supp. 57, 58 (D. Mass. 1996) (The PSLRA arose from a belief "that the plaintiff's bar had seized control of class action suits, bringing frivolous suits on behalf of only nominally interested plaintiffs in the hope of obtaining a quick settlement." (citing S. Rep. No. 104-98, at 8–11 (1995), *reprinted in* 1995 U.S.C.C.A.N. 679, 687–90)); *In re* Party City Sec. Litig., 189 F.R.D. 91, 103 (D.N.J. 1999) ("Prior to the enactment of the PSLRA, plaintiffs in securities fraud cases tended to profit irrespective of the culpability of the defendants, most of whom chose settlement over prolonged and expensive litigation." (citing H.R. Conf. Rep. No. 104-369, at 31–35 (1995), *reprinted in* 1995 U.S.C.C.A.N. 730, 730–34)).

1770. *In re* USEC Sec. Litig., 168 F. Supp. 2d 560, 560–64 (D. Md. 2001); *see In re* Donnkenny Inc. Sec. Litig., 171 F.R.D. 156, 157 (S.D.N.Y. 1997) (The PSLRA serves to "ensure that institutional plaintiffs with expertise in the securities market and real financial interests in the integrity of the market would control the litigation, not lawyers." (citing H.R. Conf. Rep. No. 104-369, at 31–35 (1995), *reprinted in* 1995 U.S.C.C.A.N. 730, 730–34)); Gluck v. CellStar Corp., 976 F. Supp. 542, 548 (N.D. Tex. 1997) (institutional investors likely to have largest financial interest, and Congress intended institutional investors to play greater role in directing securities fraud litigation); *Greebel*, 939 F. Supp. at 63 (PSLRA creates presumption in favor of institutional investors). *See also In re* Horizon/CMS Healthcare Corp. Sec. Litig., 3 F. Supp. 2d 1208, 1212 (D.N.M. 1998) (The PSLRA "appears to reflect a congressional intent to transfer power from counsel who win the race to the courthouse to those shareholders who possess a sufficient financial interest in the outcome to maintain some supervisory responsibility over both the litigation and their counsel." (citing Michael Y. Scudder, Comment, *The Implications of Market-Based Damages Caps in Securities Class Actions*, 92 Nw. U. L. Rev. 435, 437 (1997))).

1771. 15 U.S.C. §§ 77p, 78bb (2000). The statute exempts four categories of actions: (1) exclusively derivative actions; (2) actions pursuant to contractual agreements between issuers and indenture trustees; (3) actions by states or political subdivisions or pension plans; and (4) certain other actions brought under the corporate laws of the state of incorporation. *Id.* §§ 77p(f), 78bb(f). *See, e.g.,* Derdiger v. Tallman, 75 F. Supp. 2d 322, 324 (D. Del. 1999) (case involving claims under Delaware law by issuer to shareholders not subject to Uniform Standards Act provisions).

actions,[1772] granted federal courts the authority to stay discovery in private state-court actions[1773] and mandated removal to federal court of state-court securities class actions that fell within the purview of the statute, followed by their automatic dismissal.[1774] The enactment of the Uniform Standards Act effectively placed exclusive jurisdiction over fraud-based securities class actions in federal court.

The PSLRA has had a significant impact on case management of securities litigation, including procedures for the appointment of class representatives and counsel, heightened pleading requirements on claims alleging fraud, provisions for discovery stays, and a "safe harbor" for forward-looking statements. Other changes include the adoption of a "90-Day Look-Back Period" in calculating damages under 17 Code of Federal Regulations (C.F.R.) § 10b-5, limiting attorney fees in class actions to a reasonable percentage of the class recovery, and limiting defendants' liability in section 10(b) cases to their proportionate share (with certain exceptions where joint and several liability may still apply). Much of the case law interpreting the PSLRA obligations has focused on the lead plaintiff and pleading provisions.

31.31 Class Representatives and Lead Plaintiffs

The PSLRA does not establish specific procedures for courts in implementing the lead plaintiff provisions, nor does it identify selection criteria other than financial interest and the traditional adequacy and typicality requirements of Federal Rule of Civil Procedure 23. As a result, the courts have wrestled with the interpretation of the lead plaintiff provisions in light of the legislative goal to remedy lawyer-driven lawsuits. The statute imposes certain preliminary procedural requirements on plaintiffs at the time the complaint is filed. It requires a plaintiff seeking to represent a securities class to file, along with the complaint,[1775] a certification that (1) confirms the plaintiff did not purchase the securities at issue at the direction of counsel; (2) shows the plain-

1772. 15 U.S.C. §§ 77p(b), 78bb(f)(1) (2000).

1773. *Id.* § 77z-1(4).

1774. *Id.* § 78bb(f)(2). *See, e.g.,* Green v. Ameritrade, Inc., 279 F.3d 590 (8th Cir. 2002) (district court properly remanded case following removal under Uniform Standards Act where plaintiff filed amended complaint eliminating any securities causes of action, leaving only state-law claims). State-court jurisdiction was preserved over certain covered class actions, such as actions based on the statutory or common law of the state in which the issuer is incorporated and that involve purchases or sales by issuers to equity holders, 15 U.S.C. § 78bb(f)(3)(A) (2000), or actions by a state, political subdivision, or pension plan. *Id.* § 78bb(f)(3)(B).

1775. However, a movant need not file a complaint to seek lead plaintiff status. *See* Aronson v. McKesson HBOC, Inc., 79 F. Supp. 2d 1146, 1155 (N.D. Cal. 1999).

tiff is willing to serve as a representative party on behalf of the class; (3) identifies all transactions by the plaintiff in the security at issue during the relevant time period; (4) identifies all other actions filed during the preceding three years in which the plaintiff served or sought to serve as a representative party; and (5) certifies that the plaintiff's recovery will be limited to his or her pro rata share, except as ordered by the court.[1776] The PSLRA (or "the statute") creates a presumption precluding any plaintiff seeking to serve as lead plaintiff who has been a lead plaintiff in more than five securities class actions during any three-year period.[1777] There is a split of authority over whether and when the presumption should be rebutted if an institutional investor is seeking lead plaintiff status.[1778]

The PSLRA also directs the plaintiff, shortly after filing, to comply with detailed notice provisions informing potential class members of the existence of the securities class action.[1779] The PSLRA specifically provides, however, that notices required under the statute "shall be in addition to any notice required pursuant to the Federal Rules of Civil Procedure."[1780] The plaintiff must pub-

1776. 15 U.S.C. § 78u-4(a)(2)(A) (2000). The Northern District of California held in *Aronson* that the certification requirement only applied to plaintiffs filing the complaint, and its provisions did not attach to non-initiating movants for lead plaintiff status. *Aronson*, 79 F. Supp. 2d at 1155–56. *But see* Chill v. Green Tree Fin. Corp., 181 F.R.D. 398 (D. Minn. 1998) (imposing certification requirements on plaintiffs seeking lead plaintiff status, even though they did not file the complaint). The *Aronson* court noted, however, that the local rules for the Northern District of California provide that although not required to file a certification, a plaintiff seeking lead plaintiff status must at the time of its initial appearance state it has reviewed the complaint and adopted the complaint's allegations or identify additional allegations it intends to assert. *Aronson*, 79 F. Supp. 2d at 1155–56 (citing N.D. Cal. Civ. L.R. 3-7(c)).

1777. 15 U.S.C. § 78u-4(a)(3)(B)(vi) (2000).

1778. *Compare In re* Enron Corp. Sec. Litig., 206 F.R.D. 427 (S.D. Tex. 2002) (discussing whether it would be proper to appoint Florida State Board of Administration (FSBA) as lead plaintiff where it was serving as or seeking lead plaintiff status in nine cases), *and In re* Telxon Corp. Sec. Litig., 67 F. Supp. 2d 803 (N.D. Ohio 1999) (FSBA would be barred from serving as lead plaintiff where it had served or was serving as lead plaintiff in five other securities class actions in three years), *and* Aronson v. McKesson HBOC, Inc., 79 F. Supp. 2d 1146 (N.D. Cal. 1999) (FSBA disqualified as lead plaintiff where it was serving as lead plaintiff in six other securities class actions), *with* Piven v. Sykes Enters., Inc., 137 F. Supp. 2d 1295 (M.D. Fla. 2000) (finding presumptive bar against serving as lead plaintiff created by lead plaintiff status in five other cases could be overcome); *In re* Critical Path, Inc. Sec. Litig., 156 F. Supp. 2d 1102 (N.D. Cal. 2001); *In re* Network Assocs., Inc. Sec. Litig., 76 F. Supp. 2d 1017 (N.D. Cal. 1999). *See* Melanie M. Piech, *Was the Selection of Lead Plaintiff and Lead Counsel in Enron Correct?*, 13 Sec. Reform Act Litig. Rep. 6 (Apr. 2002).

1779. *See* Greebel v. FTP Software, Inc., 939 F. Supp. 57, 60 (D. Mass. 1996) (suggesting that failure to comply with the PSLRA notice provisions would be fatal to maintaining the action as a proposed class action).

1780. 15 U.S.C. §§ 77z-1(a)(3)(A)(iii), 78u-4(a)(3)(A)(iii) (2000).

lish notice of the action in "a widely circulated national business-oriented publication or wire service" within twenty days of the filing of the complaint, advising of the action, the claims asserted therein, and the class period.[1781] The notice must also state that any purported class member may move to serve as lead plaintiff within sixty days of the date of the notice.[1782] Several courts have held that the sixty-day notice requirement is mandatory and precludes consideration of untimely filed motions for lead plaintiff appointment.[1783]

Where multiple actions alleging substantially the same claims have been filed by more than one plaintiff, the statute imposes the obligation to provide early notification on the plaintiff who was the first to file. One of the effects of the notice provisions, however, has been to help some attorneys to continue to exert control over securities class actions, a result contrary to the goals of the PSLRA. One court observed that notices have been filed by attorneys on multiple occasions in related cases "over and again, all in an effort to compile the largest portfolio [of clients]" who are then presented by the firm as a "group" for purposes of appointment under the lead plaintiff provisions.[1784] The SEC has also cautioned that the notice provisions afford an opportunity to continue the very abuses the PSLRA sought to redress.[1785] Scrutiny of the early notices the plaintiff proposes to disseminate, with a critical eye towards any language that "extols" the virtue of the firm or otherwise solicits support for the lawyer-proposed lead plaintiff, may assist in reducing the incidence of these tactics. In

1781. *Id*. §§ 77z-1(a)(3)(A)(i), 78u-4(a)(3)(A)(i). *See* Yousefi v. Lockheed Martin Corp., 70 F. Supp. 2d 1061, 1067 (C.D. Cal. 1999) (finding that plaintiffs met notice requirements of PSLRA by announcing class action suit in national wire service); *Greebel*, 939 F. Supp. at 63 (*Business Wire* met requirements for widely circulated national business wire service).

1782. *But see* Chill v. Green Tree Fin. Corp., 181 F.R.D. 398, 404 (D. Minn. 1998) (where several notices were published, court would extend the sixty-day notice period beyond original publication date where to do otherwise "would deprive injured investors of any opportunity to seek to be selected as [l]ead [p]laintiff").

1783. *See* Skwortz v. Crayfish Co., No. 00 Civ. 6766, 2001 WL 1160745, at *5 (S.D.N.Y. Sept. 28, 2001) (finding motion for appointment as lead plaintiff filed beyond the sixty-day period was untimely, thereby eliminating movant as a candidate for lead plaintiff); *In re* MicroStrategy Inc. Sec. Litig., 110 F. Supp. 2d 427, 439–40 (E.D. Va. 2000) (rejecting party's application for lead plaintiff for procedural failure to file timely motion for appointment). *But see Chill*, 181 F.R.D. at 404.

1784. *See In re* Network Assocs., Inc. Sec. Litig., 76 F. Supp. 2d 1017, 1021 (N.D. Cal. 1999) (detailing method used by law firms to accumulate clients for the purpose of aggregating claims and claiming overwhelming support for the lawyer-created "group" as lead plaintiff and the firm as lead counsel). The court in *Network Associates* rejected a motion by 1,725 members collected by attorneys to appoint a subgroup of 10, also chosen by the attorneys, noting there was "no organized decisionmaking apparatus, no coherency, no common ground other than the lawyer. They [the subgroup] too are simply disparate, unlinked, and unrelated investors." *Id*. at 1023.

1785. *In re* Baan Co. Sec. Litig., 186 F.R.D. 214 (D.D.C. 1999).

addition, the judge should try to ensure that these early communications to class members encourage them to serve as lead plaintiffs and do not mislead them into believing that they are filling out claims forms. In many cases, however, plaintiffs will publish notice of the action concurrently with the filing of the complaint in order to comply with the twenty-day deadline for publication imposed by the PSLRA. To the extent the court requires judicial approval of the proposed notices prior to publication, perhaps through a standing order, the court will need to complete its review prior to the expiration of the twenty-day period.

The PSLRA contemplates that the court will appoint a lead plaintiff within ninety days of the date on which notice is published. In certain circumstances, such as when a defendant is facing possible bankruptcy, the court should make the lead plaintiff determination as quickly as possible. These time constraints are modified, however, where a motion to consolidate multiple actions has been filed. In such cases, the statute directs the court to appoint the lead plaintiff "as soon as practicable" after resolving the motion to consolidate. Indeed, 15 U.S.C. § 78u-4(a)(3)(B)(ii) directs the court to address and resolve the motion to consolidate prior to rendering a decision on the appointment of lead plaintiffs.[1786] The statute further creates a rebuttable presumption that the plaintiff most capable of adequately representing the class is the person or group of persons with the largest financial interest in the relief sought, who also satisfies the requirements of Federal Rule of Civil Procedure 23.[1787] The showing under Rule 23 is considered a preliminary inquiry into whether the plaintiff has made a prima facie showing that the adequacy and typicality requirements have been met.[1788] This presumption can be rebutted upon proof that the plaintiff either "will not fairly and adequately protect the interests of the class" or is subject to unique defenses that impair the plaintiff's ability to do so.[1789] In most cases, the plaintiff filing the action will also seek appointment

1786. *See* Vincelli v. Nat'l Home Health Care Corp., 112 F. Supp. 2d 1309 (M.D. Fla. 2000); *Chill*, 181 F.R.D. at 405–08 (considering motion to consolidate, followed by motion to appoint lead plaintiff).

1787. 15 U.S.C. § 78u-4(a)(3)(B)(iii)(I) (2000).

1788. *In re* Advanced Tissue Scis. Sec. Litig., 184 F.R.D. 346 (S.D. Cal. 1998).

1789. 15 U.S.C. § 78u-4(a)(3)(B)(iii)(II) (2000). The PSLRA only permits purported class members to challenge the adequacy of the presumptive lead plaintiff. *Id.* § 78u-4(a)(3(B)(i); Gluck v. CellStar Corp., 976 F. Supp. 542 (N.D. Tex. 1997). *See In re* Cendant Corp. Litig., 264 F.3d 201, 262 (3d Cir. 2001) ("The Reform Act establishes a two-step process for appointing a lead plaintiff: the court first identifies the presumptive lead plaintiff and then determines whether any member of the putative class has rebutted the presumption."). However, defendants may challenge whether the lead plaintiff meets Rule 23 requirements at the class certification stage. *See In re* Lucent Techs., Inc. Sec. Litig., 194 F.R.D. 137, 150 n.17 (D.N.J. 2000) ("The

as lead plaintiff, although once the statutory early notification is published, other investors may file competing motions.

The PSLRA does not require courts to hold a hearing on lead plaintiff motions. Courts have approached the decision-making process in various ways, ranging from requiring movants to respond to a written questionnaire prepared by the court, to conducting interviews of the candidates and their counsel at hearings on motions for appointment,[1790] to simply considering the parties' submissions and oral argument.[1791] Although some decisions have allowed discovery as part of the appointment process,[1792] the PSLRA severely restricts discovery into the adequacy of the representation by the proposed lead plaintiff.[1793] A member of the proposed plaintiff class can challenge the adequacy of lead plaintiff's representation only by demonstrating "a reasonable basis for a finding that the presumptively most adequate plaintiff is incapable of adequately representing the class."[1794] Absent such a showing, a class member objecting to the presumptive lead plaintiff will not be entitled to discovery.

Where the movant is a single investor or institution, the court's task is fairly straightforward. In identifying the plaintiff with the largest financial interest, courts have considered factors such as the number of shares purchased or sold during the class period,[1795] the net number of shares purchased, the net funds spent, and approximate losses suffered by the plaintiff.[1796] These factors courts have found helpful "because they look to relatively objective indicators . . . rather than to the ultimate question of damages."[1797] One option in assessing the merits of competing lead plaintiff petitions is to have those parties seeking lead plaintiff status file a joint submission setting forth their claimed financial interests and comparing their financial stakes in the litigation, preferably through an agreed on method. Such an approach allows the court to assess the merits of competing parties' positions without expending significant

determination, however, that . . . [l]ead [p]laintiffs meet the requirements of Rule 23 does not preclude revisiting the issue at the class certification stage.").

1790. *See In re* Network Assocs., Inc. Sec. Litig., 76 F. Supp. 2d 1017, 1027 (N.D. Cal. 1999).

1791. *In re* Cell Pathways, Inc. Sec. Litig. II, 203 F.R.D. 189 (E.D. Pa. 2001).

1792. *In re Network Assocs.*, 76 F. Supp. 2d at 1027 (permitting four-hour depositions of each of the main candidate representatives).

1793. 15 U.S.C. § 78u-4(a)(3)(B)(iv) (2000).

1794. *Gluck*, 976 F. Supp. at 547.

1795. *In re Network Assocs.*, 76 F. Supp. 2d at 1027 ("At least as a first approximation, the candidate with the most net shares purchased will normally have the largest potential damage recovery.").

1796. *See In re* Cendant Corp. Litig., 264 F.3d 201, 263 (3d Cir. 2001); *In re* Critical Path, Inc. Sec. Litig., 156 F. Supp. 2d 1102, 1107 (N.D. Cal. 2001).

1797. Aronson v. McKesson HBOC, Inc., 79 F. Supp. 2d 1146, 1158 (N.D. Cal. 1999).

judicial resources wading through or reconstructing underlying figures on which the calculations are based. In addition, the court may find it difficult to reconcile damage calculations based on differing methodologies.

Complications arise where a group seeks appointment as lead plaintiff. Although the PSLRA contemplates that more than one class member may be appointed as lead plaintiff, courts disagree as to whether and when a group will qualify as the presumptively most adequate plaintiff. One issue the courts have struggled with is whether the claims of unrelated investors can be aggregated to meet the financial interest requirement of the PSLRA.[1798] Several courts have held that aggregation of claims was proper,[1799] although some decisions have allowed groups to serve as lead plaintiff simply because there was no opposition by individual class members, or the only opposition presented was by a competing group.[1800] Other courts have concluded that aggregation of numerous unrelated plaintiffs defeats the purpose of the PSLRA's lead plaintiff provisions.[1801] Those courts permitting groups to be appointed have looked to whether the proposed group demonstrates the ability to control the litigation and the lawyers.[1802] The size of the group also has been a determinative fac-

1798. *See, e.g., In re Cendant Corp.*, 264 F.3d at 266 ("The [PSLRA] contains no requirement mandating that the members of a proper group be 'related' in some manner."); *Aronson*, 79 F. Supp. 2d at 1159.

1799. *See, e.g., In re* Rent-Way Sec. Litig., 209 F. Supp. 2d 493, 518 (W.D. Pa. 2002) ("We see no reason to find that group pled allegations *per se* cannot meet the heightened pleading standards of Rule 9(b) or the PSLRA, and rather will consider the allegations individually."); Weltz v. Lee, 199 F.R.D. 129, 132–33 (S.D.N.Y. 2001) (permitting aggregation); *In re* Advanced Tissue Scis. Sec. Litig., 184 F.R.D. 346, 352–53 (S.D. Cal. 1998) (rejecting proposal to appoint entire 250-member group as lead plaintiff and approving alternative proposal to appoint six designated group members).

1800. *See, e.g.,* Yousefi v. Lockheed Martin Corp., 70 F. Supp. 2d 1061, 1067–68 (C.D. Cal. 1999); *In re Advanced Tissue*, 184 F.R.D. at 352–53; *In re* Milestone Scientific Sec. Litig., 183 F.R.D. 404 (D.N.J. 1998); *In re* Oxford Health Plans, Inc. Sec. Litig., 182 F.R.D. 42 (S.D.N.Y. 1998); *In re* Horizon/CMS Healthcare Corp. Sec. Litig, 3 F. Supp. 2d 1208 (D.N.M. 1998); Greebel v. FTP Software, Inc., 939 F. Supp. 57, 64 (D. Mass. 1996) (no opposition to motion for group to serve as lead plaintiff).

1801. *See, e.g.,* Donnkenny Inc. Sec. Litig., 171 F.R.D. 156, 157–58 (S.D.N.Y. 1997) ("To allow lawyers to designate unrelated plaintiffs as a 'group' and aggregate their financial stakes would allow and encourage lawyers to direct the litigation."); *see also In re* Bank One S'holders Class Actions, 96 F. Supp. 2d 780, 783 (N.D. Ill. 2000); *In re* Network Assocs., Inc. Sec. Litig, 76 F. Supp. 2d 1017, 1023–24 (N.D. Cal. 1999) (cannot aggregate unrelated investors to satisfy lead plaintiff); *Aronson*, 79 F. Supp. 2d at 1153–54; *In re Advanced Tissue*, 184 F.R.D. at 352 (rejecting appointment of 250 unrelated individual investors).

1802. *See In re Network Assocs.*, 76 F. Supp. 2d at 1025–26 (citing SEC memoranda discussing meaning of "group of persons" under PSLRA and that the agency's interpretation was entitled to great deference).

tor.[1803] The SEC has suggested that groups of three to five plaintiffs are permissible.[1804] Additional relevant factors have included (1) the prior experience of group members; (2) the structure of the group; (3) communication mechanisms both within the group and with counsel; (4) how the group was formed;[1805] (5) the ability of the group to oversee the litigation; (6) the ability of the group to work together; and (7) the existence of a prelitigation relationship among group members.[1806] Courts also have been presented with motions for appointment of co-lead plaintiffs. These requests have raised similar, but less troublesome, issues regarding the number of proposed co-leads and whether appointment of a large group of co-lead plaintiffs would impede their ability to control the litigation and supervise counsel.[1807]

1803. The district court in *In re Baan Co. Securities Litigation*, for example, shared the SEC's view that a group should consist of "no more than three to five persons, a number that will facilitate joint decisionmaking and also help to assure that each group member has a sufficiently large stake in the litigation." *In re* Baan Co. Sec. Litig., 186 F.R.D. 214, 217 (D.D.C. 1999) (citing Memorandum of the Securities and Exchange Commission, Amicus Curiae, at 16–17). *See In re* Gemstar-TV Guide Int'l, Inc. Sec. Litig., 209 F.R.D. 447, 450 (C.D. Cal. 2002) (holding that a group of three institutional investors and four individual investors was too large and diverse to represent the class); *In re Network Assocs.*, 76 F. Supp. 2d at 1023, 1026–27 (refusing to consider group of 1,725 members and rejecting 10-member subgroup); Chill v. Green Tree Fin. Corp., 181 F.R.D. 398, 408 (D. Minn. 1998) (approval of proposed group comprised of 300 plaintiffs "would threaten the interests of the class, would subvert the intent of Congress, and would be too unwieldy to allow for the just, speedy and inexpensive determination of this action"); Gluck v. CellStar Corp., 976 F. Supp. 542 (N.D. Tex. 1997); *see also In re* Tyco Int'l, Ltd. Sec. Litig., MDL No. 1335, 2000 WL 1513772, at *4 (D.N.H. Aug. 17, 2000) (mem.) ("[A] group that consists of a small number of large shareholders should be capable of managing [the] litigation and providing direction to class counsel."); Aronson v. McKesson HBOC, Inc., 79 F. Supp. 2d 1146, 1152–54 (N.D. Cal. 1999) (defining group as "a small number of members that share such an identity of characteristics, distinct from those of almost all other class members, that they can almost be seen as being the same person").

1804. *In re Baan Co.*, 186 F.R.D. at 216–17. *See also In re* Cendant Corp. Litig., 264 F.3d 201, 267 (3d Cir. 2001) (noting that groups of "more than five members are too large to work effectively").

1805. The *Cendant* court included an additional factor where the presumptive lead plaintiff was a group: an inquiry into whether the way in which the group was formed "preclude[d] it from fulfilling the tasks assigned to a lead plaintiff." *In re Cendant Corp.*, 264 F.3d at 266.

1806. *In re* Waste Mgmt., Inc. Sec. Litig., 128 F. Supp. 2d 401, 413, 432 (S.D. Tex. 2000) (requiring, among other things, a prelitigation relationship other than the loss); *In re Network Assocs.*, 76 F. Supp. 2d at 1026.

1807. *See, e.g.,* D'Hondt v. Digi Int'l Inc., Civ. No. 97-5, 1997 WL 405668, at *5 (D. Minn. Apr. 3, 1997) (mem.) (appointing twenty-one plaintiffs as "co-lead" plaintiffs); *In re* Cephalon Sec. Litig., No. 96-CV-0633, 1996 WL 515203, at *1 (E.D. Pa. Aug. 27, 1996) (mem.) (finding that PSLRA "does not preclude appointing more than one lead plaintiff"); *but see In re*

The presumptive lead plaintiff must also make a *prima facie* showing that it satisfies the adequacy and typicality requirements of Rule 23.[1808] Drawing on the PSLRA, the Third Circuit in *In re Cendant Corp. Securities Litigation*[1809] expanded the traditional Rule 23 inquiry into "adequacy" and "typicality" to include whether the presumptive lead plaintiff "has demonstrated a willingness and ability to select competent class counsel and to negotiate a reasonable retainer agreement with that counsel."[1810] Information about the firm selected and its ability to conduct the litigation, as well as the manner in which the fee structure was derived, were found to be indicia of whether the lead plaintiff was capable of representing the class.

Thus, a court might conclude that the movant with the largest losses could not surmount the threshold adequacy inquiry if it lacked legal experience or sophistication, intended to select as lead counsel a firm that was plainly incapable of undertaking the representation, or had negotiated a clearly unreasonable fee agreement with its chosen counsel.[1811]

The PSLRA places the selection of lead counsel in the hands of the lead plaintiff, subject to the approval of the court,[1812] although some courts have held that lead counsel be selected through a competitive bidding process, sometimes referred to as an auction.[1813] When determining whether to approve lead counsel proffered by the lead plaintiff, courts focus on the selection process used by the lead plaintiff to choose counsel, the proposed fee structure, whether the firm has adequate resources, and the extent of the firm's (and lead attorney's) experience in class action securities cases. On some occasions, the appointment of more than one firm as lead counsel may be appropriate in order to protect the interests of the class.[1814] Courts that have approved the ap-

Donnkenny Inc. Sec. Litig., 171 F.R.D. 156, 157–58 (S.D.N.Y. 1997) (co-lead plaintiffs not permitted by PSLRA).

1808. *See In re Cendant Corp.*, 264 F.3d at 263.

1809. 264 F.3d 201 (3d Cir. 2001).

1810. *Id.* at 265.

1811. *Id.* at 265–66.

1812. 15 U.S.C. § 78u-4(a)(3)(B)(v) (2000). *See* Vincelli v. Nat'l Home Health Care Corp., 112 F. Supp. 2d 1309, 1315 (M.D. Fla. 2000) ("The decision to approve counsel selected by the lead plaintiff is a matter within the discretion of the district court.").

1813. *See, e.g., In re* Quintus Sec. Litig., 148 F. Supp. 2d 967, 969 (N.D. Cal. 2001); *In re* Bank One S'holders Class Actions, 96 F. Supp. 2d 780, 784 (N.D. Ill. 2000); *In re* Lucent Techs., Inc. Sec. Litig., 194 F.R.D. 137, 156–57 (D.N.J. 2000); Wenderhold v. Cylink Corp., 188 F.R.D. 577, 587 (N.D. Cal. 1999); In *re* Cendant Corp. Litig., 182 F.R.D. 144, 150–51 (D.N.J. 1998).

1814. *In re* Lernout & Hauspie Sec. Litig., 138 F. Supp. 2d 39, 46–47 (D. Mass. 2001) (appointing three law firms as co-lead counsel and noting factors warranting appointment of more than one firm including the large amount of monies at stake and pending bankruptcy proceeding of defendant corporation). *But see In re* Wells Fargo Sec. Litig., 156 F.R.D. 223, 226 (N.D.

pointment of co-lead plaintiffs often have been willing to approve the appointment of more than one counsel to serve as co-lead counsel.[1815] The sharing of resources and expertise in costly cases may favor the appointment of multiple counsel.[1816]

Factors disfavoring more than one firm include the potential for duplicative services, absence of coordination, the risk of increased litigation time and expense, and the potential for the attorneys to take over or control the litigation—a particular concern of the PSLRA.[1817] The court in *In re Milestone Scientific Securities Litigation*[1818] required that before multiple counsel would be appointed, there must be a showing that "the lead plaintiff will be able to withstand any limitation on, or usurpation of, control, and effectively supervise the several law firms acting as lead counsel."[1819] Review of the proposed organizational structure of lead counsel may reveal potential conflicts among firms, as well as whether the independence and ability of the lead plaintiff to manage the litigation will be impaired.[1820] In cases where the court has determined that the appointment of multiple law firms as lead counsel is ill-advised, the court can still encourage lead counsel to seek the assistance of other firms where appropriate.[1821]

Cal. 1994) (finding joint appointment of co-class counsel unwarranted and posing a "'dangerous probability' of lessened competition" where the firms seeking joint appointment were large and dominant players).

1815. Sakhrani v. Brightpoint, Inc., 78 F. Supp. 2d 845, 854 (S.D. Ind. 1999) (approving selection of two law firms as co-lead counsel and a third firm as local counsel); *In re* Oxford Health Plans, Inc. Sec. Litig., 182 F.R.D. 42, 50 (S.D.N.Y. 1998) (appointing three law firms as co-lead counsel); *In re* Advanced Tissue Scis. Sec. Litig., 184 F.R.D. 346, 353 (S.D. Cal. 1998) (granting plaintiff's motion to approve selection of two firms as co-lead counsel).

1816. *See, e.g., Vincelli*, 112 F. Supp. 2d at 1315; *In re* Milestone Scientific Sec. Litig., 187 F.R.D. 165, 176 (D.N.J. 1999); *In re Oxford Health Plans*, 182 F.R.D. at 49–50.

1817. *See Vincelli*, 112 F. Supp. 2d at 1315–16; *In re Advanced Tissue*, 184 F.R.D. at 351.

1818. 187 F.R.D. 165 (D.N.J. 1999).

1819. *Id.* at 177. *See also In re* Sprint Corp. Sec. Litig., 164 F. Supp. 2d 1240, 1246 (D. Kan. 2001) (approving co-lead counsel but warning that "the court will not approve any possible award of fees and expenses that reflects duplication, inefficiency, or the costs of coordinating the efforts of the two firms . . . [and] will not tolerate co-lead counsel speaking with a divided voice").

1820. *See In re Milestone Scientific*, 187 F.R.D. at 179.

1821. *See, e.g., id.* at 181 & n.10; *In re* Horizons/CMS Healthcare Corp. Sec. Litig., 3 F. Supp. 2d 1208, 1211 (D.N.M. 1998) (appointing firm as lead counsel and two local attorneys as liaison counsel).

31.32 Pleading Requirements

Fraud claims, including allegations of securities fraud, must meet the requirements of Federal Rule of Civil Procedure 9(b), which requires that fraud be pleaded with particularity.[1822] The PSLRA reinforced the pleading requirements for securities fraud claims[1823] by specifically mandating that where these pleading requirements are not met, the district court "shall, on the motion of any defendant, dismiss the complaint."[1824] Under the PSLRA, the complaint now must include each allegedly misleading statement together with reasons why it is misleading. Any allegations regarding statements or omissions that are made on information and belief must be supported by a particularized statement of facts supporting such belief.[1825] The courts have disagreed as to whether the group pleading doctrine survives the PSLRA. Some have interpreted the PSLRA to preclude plaintiffs from grouping all defendants together in order to survive a motion to dismiss, requiring instead identification of the specific misrepresentations made by each.[1826] Others have adhered to a narrow interpretation of the doctrine, holding that in appropriate circumstances it may still apply.[1827] Some courts have required the plaintiff to plead with par-

1822. Fed. R. Civ. P. 9(b) provides: "In all averments of fraud or mistake, the circumstances constituting fraud or mistake shall be stated with particularity. Malice, intent, knowledge and other condition of mind of a person may be averred generally."

1823. The enhanced pleading requirements were not included in the PSLRA provisions of the 1933 Act.

1824. 15 U.S.C. § 78u-4(b)(3)(A) (2000). *See* San Leandro Emergency Med. Group Profit Sharing Plan v. Philip Morris Cos., 75 F.3d 801, 812–13, 815 (2d Cir. 1996) (affirming lower court's ruling that plaintiffs did not allege fraud with sufficient particularity). *But cf.* Novak v. Kasaks, 216 F.3d 300, 315 (2d Cir. 2000) (vacating and remanding lower court's dismissal of the case for failure to allege fraud with particularity).

1825. 15 U.S.C. § 78u-4(b)(1) (2000). *See* Liberty Ridge LLC v. Realtech Sys. Corp., 173 F. Supp. 2d 129 (S.D.N.Y. 2001).

1826. *See, e.g., In re* U.S. Interactive, Inc., No. 01-CV-522, 2002 WL 1971252, at *4 (E.D. Pa. Aug. 23, 2002) (finding group pleading doctrine could be applied to corporate officers where it was clear, given their high level positions and the nature of writing at issue, that the officer would have been involved directly with its writing, approval of its contents, or privy to information concerning its accuracy); Allison v. Brooktree Corp., 999 F. Supp. 1342, 1350 (S.D. Cal. 1998) ("[T]he continued vitality of the judicially created group-published doctrine is suspect since the PSLRA specifically requires that the untrue statements or omissions be set forth with particularity as to 'the defendant' . . . .").

1827. *See e.g., In re* Raytheon Securities Litig., 157 F. Supp. 2d 131, 152–53 (D. Mass. 2001) ("this Court agrees with the majority of courts that have held that the rationale behind the group pleading doctrine remains sound in the wake of the passage of the PSLRA"); *In re* Stratosphere Corp. Sec. Litig., 1 F. Supp. 2d 1096, 1108 (D. Nev. 1998) (declining to adopt defendant's proposition that "group pleading has been sub silentio abolished by the PSLRA").

ticularity each defendant's specific statements supporting the plaintiff's claim against that defendant.[1828]

The degree of specificity required has varied.[1829] Courts have required the plaintiff to identify how the plaintiff learned of the conduct for the basis for its allegations, including confidential sources underlying allegations on information and belief.[1830] To the extent such sources are documentary, courts also have required plaintiffs to identify the document, its author, its date, and its recipient, and to describe the document's contents.[1831] Other courts have held the PSLRA's heightened pleading standard does not "require that plaintiffs plead with particularity every single fact upon which their beliefs concerning false or misleading statements are based."[1832] One option is to require plaintiffs (in all cases subject to the provisions of the PSLRA) to file, along with a complaint alleging securities fraud, a "case statement" modeled after those often utilized in Racketeer Influenced and Corrupt Organizations Act (RICO) litigation.[1833] For example, a judge ordered plaintiffs filing an amended complaint to include, with respect to each false or misleading statement, the following information:[1834]

- whether the statements were written or oral;
- the title, author, date of preparation, and persons reviewing any written statements;
- when, where, and the circumstances under which oral statements were made;

1828. *See, e.g.,* Coates v. Heartland Wireless Communications, Inc., 26 F. Supp. 2d 910, 915–16 (N.D. Tex. 1998) (holding group pleading banned by PSLRA); *Allison*, 999 F. Supp. at 1350 (questioning continued vitality of group pleading doctrine); Zuckerman v. Foxmeyer Health Corp., 4 F. Supp. 2d 618, 626–27 & n.4 (N.D. Tex. 1998).

1829. *See, e.g., In re* Silicon Graphics, Inc. Sec. Litig., 183 F.3d 970 (9th Cir. 1999); *In re* McKesson HBOC, Inc. Sec. Litig., 126 F. Supp. 2d 1248 (N.D. Cal. 2000); *In re* Eng'g Animation Sec. Litig., 110 F. Supp. 2d 1183 (S.D. Iowa 2000).

1830. *In re* Green Tree Fin. Corp. Stock. Litig., 61 F. Supp. 2d 860 (D. Minn. 1999); *In re* Silicon Graphics, Inc. Sec. Litig., 970 F. Supp. 746 (N.D. Cal. 1997), *aff'd*, 183 F.3d 970 (9th Cir. 1999).

1831. *In re* Guess?, Inc. Sec. Litig., 174 F. Supp. 2d 1067 (C.D. Cal. 2001). *Compare In re* Silicon Graphics, Inc. Sec. Litig., 970 F. Supp. 746 (N.D. Cal. 1997), *aff'd*, 183 F.3d 970 (9th Cir. 1999), *and In re* Green Tree Fin. Corp. Stock Litig., 61 F. Supp. 2d 860 (D. Minn. 1999), *with* Novak v. Kasaks, 216 F.3d 300 (2d Cir. 2000); *see also In re* Digi Int'l Inc. Sec. Litig., 6 F. Supp. 2d 1089 (D. Minn. 1998).

1832. *Novak*, 216 F.3d at 313.

1833. *See infra* § 35.

1834. *In re Guess?*, 174 F. Supp. 2d at 1079–80.

- all facts supporting the claim that the statement was false or misleading when made;
- details regarding any reports or other sources that plaintiffs allege support or demonstrate the falsity of the statements; and
- all facts giving rise to a strong inference of recklessness, and detailed information regarding any documents or other sources supporting such an inference.

Such statements can be designed to detail both the factual and legal basis for the plaintiff's claim. These statements may prove helpful in assisting a plaintiff with a meritorious case to comply with the PSLRA pleading requirements as interpreted within the jurisdiction, and they may assist the court when ruling on motions brought pursuant to Federal Rule of Civil Procedure 12. The PSLRA requires a plaintiff to have a detailed factual basis for the allegations at the time suit is filed. This suggests that the normal liberality of amendment provided by the Federal Rules may be inappropriate in shareholder class actions. Where it is apparent that repeated amendment of the complaint cannot correct the deficiencies, dismissal with prejudice may be appropriate.

The PSLRA also imposes a uniform standard for pleading scienter in order to survive a motion to dismiss.[1835] Prior to the PSLRA, the Second Circuit, for example, had held that a plaintiff must plead a strong inference of scienter either by (1) alleging facts establishing a motive and opportunity to commit fraud, or (2) presenting circumstantial evidence of recklessness or conscious misbehavior.[1836] Other circuits held that compliance with Federal Rule of Civil Procedure 9(b), permitting general averments of scienter, was sufficient.[1837] Although the PSLRA incorporated language from Second Circuit jurisprudence requiring the plaintiff to allege with particularity all "facts giving rise to a strong inference that the defendant acted with the required state of mind,"[1838] Congress declined to expressly codify the Second Circuit standard.[1839] Nor did

1835. "[T]he PSLRA did not change the scienter that a plaintiff must prove to prevail in a securities fraud case but instead changed what a plaintiff must plead in his complaint in order to survive a motion to dismiss." *In re* Comshare, Inc. Sec. Litig., 183 F.3d 542, 548–49 (6th Cir. 1999).

1836. *In re* Time Warner Inc. Sec. Litig., 9 F.3d 259, 268–69 (2d Cir. 1993).

1837. *See In re* GlenFed, Inc. Sec. Litig., 42 F.3d 1541, 1545 (9th Cir. 1994) (en banc).

1838. S. Rep. No. 104-98, at 26 (1995), *reprinted in* 1995 U.S.C.C.A.N. 679, 705; *see also id.* at 15, *reprinted in* 1995 U.S.C.C.A.N at 694 (choosing "a uniform standard modeled upon the pleading standard of the Second Circuit"); H.R. Conf. Rep. No. 104-369, at 41 (1995), *reprinted in* 1995 U.S.C.C.A.N. 730, 740 ("The Conference Committee language is based in part on the pleading standard of the Second Circuit.").

1839. *See* Bryant v. Avado Brands, Inc., 187 F.3d 1271, 1282 (11th Cir. 1999) (questioning whether Congress "merely borrow[ed] the Second Circuit's 'strong inference' language without

Congress define the "required state of mind" or change the scienter plaintiffs must prove.[1840] The courts construing the PSLRA, however, have split on whether a "strong inference" of scienter can be shown by motive and opportunity alone or whether the statute heightens the Second Circuit standard and more is required.[1841]

31.33 Safe Harbor

The PSLRA's statutory "safe-harbor" provision protects statements defined as "forward looking" in section 78u-5(i)(1). However, the Act specifically excludes certain statements from the definition of forward-looking and also withdraws the safe-harbor protections from any person convicted of securities violations within the previous three years.[1842] Under this provision, liability will not attach to forward-looking statements that are accompanied by appropriate

adopting its motive and opportunity test"); *In re* Boeing Sec. Litig., 40 F. Supp. 2d 1160, 1173 (W.D. Wash. 1998) (Although modeled after the Second Circuit standard, "'[t]he Committee does not intend to codify the Second Circuit's caselaw interpreting this pleading standard, although courts may find this body of law instructive.'" (emphasis omitted) (quoting S. Rep. No. 104-98, at 15 (1995), *reprinted in* 1995 U.S.C.C.A.N. 679, 694 (citations omitted))).

1840. *In re* SmarTalk Teleservices, Inc. Sec. Litig., 124 F. Supp. 2d 505, 512 (S.D. Ohio 2000); *In re* Glenayre Techs., Inc. Sec. Litig., 982 F. Supp. 294, 298 (S.D.N.Y. 1997).

1841. 15 U.S.C. § 78u-4(b)(2) (2000). *See, e.g.,* Novak v. Kasaks, 216 F.3d 300 (2d Cir. 2000) (adhering to traditional test of motive and opportunity and strong inference); *Bryant*, 187 F.3d at 1283, 1285 (holding that "[PSLRA] does not codify the 'motive and opportunity' test formulated by the Second Circuit" and that allegations of motive and opportunity alone are insufficient); *In re* Comshare, Inc. Sec. Litig., 183 F.3d 542, 551 (6th Cir. 1999) (rejecting motive and opportunity alone as sufficient evidence of scienter); *In re* Silicon Graphics Inc. Sec. Litig., 183 F.3d 970, 974 (9th Cir. 1999) ("In order to show a strong inference of deliberate recklessness, plaintiffs must state facts that come closer to demonstrating intent, as opposed to mere motive and opportunity."); *In re* Advanta Corp. Sec. Litig., 180 F.3d 525, 535 (3d Cir. 1999) (following Second Circuit test but barring "catch-all" allegations and adhering to heightened pleading); Williams v. WMX Techs., Inc., 112 F.3d 175, 177–78 (5th Cir. 1997) (Second Circuit test still viable after PSLRA); *In re Boeing*, 40 F. Supp. 2d at 1174 (finding motive and opportunity alone, while usually insufficient, may be sufficient to plead scienter "if the totality of the circumstances creates a strong inference of fraud"); *In re* Stratosphere Corp. Sec. Litig., 1 F. Supp. 2d 1096, 1107–08 (D. Nev. 1998) (finding motive and opportunity alone not presumed to be sufficient); *In re Glenayre*, 982 F. Supp. at 297–98 (motive and opportunity relevant, but insufficient on own); *In re* Health Mgmt., Inc. Sec. Litig., 970 F. Supp. 192, 201 (E.D.N.Y. 1997) (Second Circuit test still viable); Friedberg v. Discreet Logic Inc., 959 F. Supp. 42, 48 (D. Mass. 1997) (Reform Act heightened Second Circuit pleading standard); Marksman Partners L.P. v. Chantal Pharm. Corp., 927 F. Supp. 1297, 1308–11 (C.D. Cal. 1996) (Second Circuit test still viable). *See also* Greebel v. FTP Software, Inc., 194 F.3d 185 (1st Cir. 1999).

1842. 15 U.S.C. § 78u-5(b) (2000).

cautionary statements[1843] tailored to the particular risks.[1844] The provision, however, does not apply to statements included in financial or registration statements.[1845] Also, it will not protect statements that are knowingly false when made, even if such statements otherwise would fall within the scope of section 78u-5(i)(1).[1846] Early review of the complaint may disclose that the statements complained of fall within the safe-harbor provisions and that the claims consequently are subject to dismissal under Federal Rule of Civil Procedure 12 or 56.

31.34 Discovery Stays

The PSLRA provides that all discovery and other proceedings "shall be stayed during the pendency of any motion to dismiss" absent a showing of "undue prejudice"[1847] or a showing that "particularized discovery is necessary to preserve evidence."[1848] The safe harbor provisions exempting forward-looking statements from liability also permit a stay of discovery pending resolution of summary judgment motions,[1849] although limited discovery targeted towards the applicability of the safe-harbor provisions may be permitted. The discovery stay provisions were designed to protect defendants from fishing expeditions and unnecessary costs of discovery where the legal sufficiency of the

1843. The statute protects individuals making forward-looking statements if accompanied by "meaningful cautionary statements identifying important factors that could cause actual results to differ materially . . . ." *Id.* § 78u-5(c)(1)(A)(i).

1844. *See* EP Medsystems, Inc. v. Echocath, Inc., 30 F. Supp. 2d 726 (D.N.J. 1998) (representations effectively "bespeak caution").

1845. 15 U.S.C. § 78u-5(b)(2)(A)–(B) (2000).

1846. Fugman v. Aprogenex, Inc., 961 F. Supp. 1190, 1196–97 (N.D. Ill. 1997).

1847. *See* SG Cowen Sec. Corp. v. United States Dist. Court, 189 F.3d 909, 913 (9th Cir. 1999) ("[F]ailure to muster facts sufficient to meet the Act's pleading requirements cannot constitute the requisite 'under prejudice' to the plaintiff . . . ."); Anderson v. First Sec. Corp., 157 F. Supp. 2d 1230, 1242 (D. Utah 2001) (existence of confidentiality agreement between defendant and third-party merger candidate precluded plaintiffs from obtaining specific information and therefore plaintiffs would be unduly prejudiced unless afforded limited discovery); *In re* Carnegie Int'l Corp. Sec. Litig., 107 F. Supp. 2d 676, 684 (D. Md. 2000) (defendants failed to show undue prejudice); Med. Imaging Ctrs. of Am., Inc. v. Lichtenstein, 917 F. Supp. 717, 720–22 (S.D. Cal. 1996) (failing to show undue prejudice standard).

1848. 15 U.S.C. § 78u-4(b)(3)(B) (2000). *See also* Berckeley Inv. Group, Ltd. v. Colkitt, 984 F. Supp. 827, 828 (M.D. Pa. 1997) (stay applies where motion to dismiss is directed towards counterclaim asserting claims under the securities laws). "Congress clearly intended that complaints in these securities actions should stand or fall based on the actual knowledge of the plaintiffs rather than information produced by the defendants after the action has been filed." Medhekar v. United States Dist. Court, 99 F.3d 325, 328 (9th Cir. 1996) (per curiam).

1849. 15 U.S.C. §§ 77z-2(f), 78u-5(f) (2000).

complaint had not been determined.[1850] The provisions apply to both party and nonparty discovery[1851] and preempt the mandatory disclosure provisions of Rule 26.[1852]

The courts have disagreed on whether the discovery stay provisions apply even though a motion to dismiss has not yet been filed. Several courts have held that the stay provisions are triggered once the defendant indicates an intent to file a motion to dismiss.[1853] The court, in *In re Carnegie International Corp. Securities Litigation,* commented that the defendant had to be given an *opportunity* to challenge the complaint and "[a]ny other interpretation would encourage unseemly gamesmanship, i.e., a race to serve subpoenas for discovery before a defendant had the opportunity to test the sufficiency of the complaint."[1854] Other courts have required an actual motion to be filed before imposing a stay.[1855] Application of the discovery stay provisions does not, however, automatically apply to all claims asserted in the complaint. Where the complaint contains separate state law claims that are distinct from the securities claims, some courts have allowed discovery to proceed on those claims; staying the entire case, however, generally is more efficient.[1856]

31.4 Initial Pretrial Conference

Securities claims can arise under both federal and state statutes, as well as the common law, and can involve numerous parties. Complaints typically assert numerous claims against various defendants, ranging from companies and securities professionals to accountants and lawyers, with the latter defendants

1850. *See, e.g.,* Angell Invs., L.L.C. v. Purizer Corp., No. 01-C-6359, 2001 WL 1345996, at *2 (N.D. Ill. Oct. 30, 2001).

1851. *In re Carnegie*, 107 F. Supp. 2d at 679–81 (quashing subpoena duces tecum issued to third parties).

1852. *Medhekar*, 99 F.3d at 327–28 (holding that "initial disclosures are a subset of discovery, and that, as such, they are included in the Act's stay provision").

1853. *See, e.g., In re Carnegie*, 107 F. Supp. 2d at 683.

1854. *Id. See also In re* Trump Hotel S'holder Derivative Litig., No. 96-CIV-7820, 1997 WL 442135, at *2 (S.D.N.Y. Aug. 5, 1997) (staying discovery even though motion to dismiss had not been filed where lack of dismissal motion was result of agreed on schedule).

1855. *See, e.g.*, Novak v. Kasaks, No. 96-CIV-3073, 1996 WL 467534, at *1 (S.D.N.Y. Aug. 16, 1996).

1856. *See* Tobias Holdings, Inc. v. Bank United Corp., 177 F. Supp. 2d 162, 167 (S.D.N.Y. 2001) (allowing discovery to proceed on plaintiff's state law claims, where "separate and distinct" from federal securities claims "would not represent an impermissible 'end run' around the PSLRA's automatic stay provisions"); Angell Invs., L.L.C. v. Purizer Corp., No. 01-C-6359, 2001 WL 1345996, at *2 (N.D. Ill. Oct. 30, 2001). *But see In re Trump Hotel*, 1997 WL 442135, at *2 (staying discovery).

implicating issues of privilege and confidentiality.[1857] Complaints also may be lengthy, in part as a result of the requirements of Federal Rule of Civil Procedure 9(b) and the PSLRA that fraud be pleaded with particularity.[1858] Failure to comply with Rule 9(b) and the more stringent pleading standards of the PSLRA provide a basis for dismissal of securities actions.[1859] Defendants frequently seek substantial time to respond to the complaint and to decide whether to file counterclaims, cross-claims, and third-party complaints. Immediately after assignment of the litigation, the judge should consider entering an order suspending the time for all defendants to respond to the complaint in cases where a motion to consolidate is pending or a lead plaintiff has not been selected, as the initial complaint is likely to be amended. The initial conference offers an opportunity to learn about the potential size and complexity of the litigation; set a schedule for amendments, motions, and responsive pleadings; and schedule discovery accordingly.

Early institution of an initial case-management order will help to organize the case and preliminarily identify key legal and factual issues. Of particular significance in assessing securities litigation is early determination of the following issues:

- *The likely size and scope of the case.* Complaints will often name as defendants the company whose securities are involved, its officers, directors, independent accountants, attorneys, and brokerage firms. Standards for both pleading and liability may differ depending on the type of defendant. In addition, many securities cases are brought as class actions, raising issues under Federal Rule of Civil Procedure 23 and the PSLRA.
- *Pending or expected related litigation.* In addition to private actions, the SEC or other administrative agencies may institute proceedings. In some instances, related criminal proceedings may also be pending, which may lead the government to request staying the litigation.[1860] A

1857. In addition to claims under the 1933 Act and the 1934 Exchange Act, plaintiffs may include claims under the RICO Act, 18 U.S.C. §§ 1961–1968 (2000), as well as claims for common-law fraud, negligent misrepresentation, and breach of fiduciary duty, among others.

1858. *See, e.g.,* Greenstone v. Cambex Corp., 975 F.2d 22, 25 (1st Cir. 1992); Whalen v. Carter, 954 F.2d 1087, 1097–98 (5th Cir. 1992).

1859. *See, e.g.,* Parnes v. Gateway 2000, Inc., 122 F.3d 539, 549–50 (8th Cir. 1997) (holding that lower court properly dismissed claims for failing to meet particularity requirements); Lovelace v. Software Spectrum Inc., 78 F.3d 1015, 1021 (5th Cir. 1996) (holding lower court properly dismissed claims based on failing to adequately plead scienter under Rule 9(b)).

1860. *See, e.g., In re* Aid Auto Stores, Inc. Sec. Litig., No. CV-98-7395, 2001 WL 1478803, at *1 (E.D.N.Y. July 13, 2001) (order granting government's motion to intervene and staying discovery pending resolution of criminal proceeding).

party may also be a debtor in bankruptcy, which may result in automatic stays with respect to that party, removal of cases, related adversary proceedings, and objections to the discharge of debts. In addition, separate actions may have been filed regarding fidelity bonds and other insurance coverage issues, or to prevent foreclosure of security interests. All related litigation in the same court, including pertinent aspects of bankruptcy proceedings, ordinarily should be assigned or transferred to one judge for initial supervision and planning.[1861] The extent to which these cases should be formally consolidated for further pretrial proceedings and trial will depend on the circumstances[1862] and, after a period of centralized management, some cases may be appropriately reassigned to other judges. In class actions, the PSLRA provides that the court should consolidate multiple actions where appropriate.[1863] Related cases may also have been filed in different jurisdictions, as the conduct alleged in securities fraud litigation often affects persons in many states. Centralized pretrial management of the federal litigation may be possible through motions to transfer, or through transfer by the Judicial Panel on Multidistrict Litigation under 28 U.S.C. § 1407.[1864] In general, the optimal venue for a shareholder class action is the district in which the defendant company is headquartered. To the extent that cases remain in different courts, each court should consider whether formal or informal coordination is possible to minimize the risk of conflict.[1865]

- *Takeover litigation.* Takeover litigation—actions brought in connection with the attempted acquisition or transfer of control of a corporation by obtaining securities, assets, or stockholder support—often will involve several actions filed almost simultaneously in different

1861. *See, e.g.,* Aronson v. McKesson HBOC, Inc., 79 F. Supp. 2d 1146, 1150 (N.D. Cal. 1999) (fifty-four related class actions assigned to the court by the District Reassignment Committee).

1862. *See* Fed. R. Civ. P. 42(a).

1863. *See Aronson*, 79 F. Supp. 2d at 1152 (consolidating all cases except shareholder derivative suit, which was deferred for full briefing); Chill v. Green Tree Fin. Corp., 181 F.R.D. 398, 405–07 (D. Minn. 1998) (granting motion to consolidate and consolidating actions into two class actions).

1864. *See, e.g., In re* Enron Corp. Sec., Derivative & "ERISA" Litig., 196 F. Supp. 2d 1375, 1376 (J.P.M.L. 2002) (transferring all related cases outside the Southern District of Texas to that forum "for centralized pretrial proceedings" pursuant to 28 U.S.C. § 1407); *In re* Wash. Pub. Power Supply Sys. Sec. Litig., 568 F. Supp. 1250 (J.P.M.L. 1983) (section 1407 transfer order).

1865. For example, coordination may be possible on decisions regarding lead plaintiffs or class notification.

courts seeking a preliminary injunction against violation of the federal antitrust and securities laws. Takeover litigation can be extremely time sensitive, requiring the court's attention to the need for quick resolution of many issues and the impact on the market of even the timing of rulings and hearings. See section 31.7 regarding special problems in takeover litigation.

- *Parties seeking protective orders.* Discovery in securities actions can result in the disclosure of sensitive information, the dissemination of which is potentially detrimental, particularly to corporate defendants.[1866] Securities claims can also implicate attorney–client privileges.
- *Referral to a special master.* Securities cases can present complex factual disputes over matters of accounting, corporate finance, market analyses, or the negotiation or implementation of complex settlements.
- *Potential for settlement.* The parties may be amenable to settlement before substantial time and expense is wasted in litigation, and the court may want to explore the possibilities of early settlement.[1867]

Several foundational issues may preclude the action altogether, and thereby render it subject to early resolution under Federal Rule of Civil Procedure 12(b) or 56. Examples of such issues include

- whether an instrument constitutes a security subject to registration for purposes of liability under the securities laws;[1868]
- whether the alleged misstatements are material;[1869]
- whether the conduct falls within the PSLRA's statutory safe-harbor provisions, or the "bespeaks caution" doctrine;[1870]
- whether a claim is barred by the statute of limitations;[1871]

1866. *See, e.g.,* SEC v. TheStreet.com, 273 F.3d 222, 230–31 (2d Cir. 2001) (discussing circumstances under which modification of protective order was appropriate); *In re* Cephalon Sec. Litig., No. 96-0633, 1998 WL 744067 (E.D. Pa. Oct. 22, 1998) (mem.).

1867. *See, e.g., In re* Horizon/CMS Healthcare Corp. Sec. Litig., 3 F. Supp. 2d 1208, 1211 (D.N.M. 1998) (settlement reached where litigation stood in the way of acquisition of the defendant by major healthcare provider).

1868. *See, e.g.,* Assocs. in Adolescent Psychiatry v. Home Life Ins. Co., 941 F.2d 561, 564–66 (7th Cir. 1991).

1869. *See* Parnes v. Gateway 2000, Inc., 122 F.3d 539, 546 (8th Cir. 1997).

1870. *See* Bryant v. Avado Brands, Inc., 187 F.3d 1271, 1276 n.7 (11th Cir. 1999) (describing the safe-harbor provision and the bespeaks caution doctrine). The bespeaks caution doctrine appears to remain viable after the PSLRA. *See In re* Boeing Sec. Litig., 40 F. Supp. 2d 1160, 1170 (W.D. Wash. 1998) ("The PSLRA's safe harbor provisions do not supplant the 'bespeaks caution' doctrine.").

- whether a demand must be made on a corporation's directors;[1872]
- whether the "business judgment" rule allows the directors, or a committee they have established, to dismiss or settle the action;[1873]
- whether the defendant is a "controlling person" on whom liability may be imposed;[1874]
- whether and when a "sale" or "purchase" occurred;[1875]
- whether public availability of material information excuses nondisclosure in an action relying on the "fraud-on-the-market" theory;[1876]
- whether loss causation can be established—the PSLRA places the burden of proving loss causation on the plaintiff;[1877]
- whether scienter has been properly alleged and can be established;[1878] and

1871. Litigation pursuant to section 10(b) and Rule 10b-5 must be commenced within one year from the discovery of a violation and no more than three years from the date the violation occurred. 15 U.S.C. §§ 77m, 78i(e) (2000); Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson, 501 U.S. 350, 364 (1991). The one-year period begins to run when plaintiffs are on inquiry or constructive notice of the facts giving rise to the claims. Berry v. Valence Tech., Inc., 175 F.3d 699, 703–04 (9th Cir. 1999); Liberty Ridge LLC v. Realtech Sys. Corp., 173 F. Supp. 2d 129, 135 (S.D.N.Y. 2001); Reisman v. KPMG Peat Marwick LLP, 965 F. Supp. 165, 170 (D. Mass. 1997). The Supreme Court in *Lampf* established a uniform federal statute of limitations for such claims and further held the doctrine of equitable tolling would not apply. 501 U.S. at 361–62, 363. In some cases, plaintiffs must affirmatively plead compliance with the statute of limitations, with supporting facts. *See, e.g., In re* Chaus Sec. Litig., 801 F. Supp. 1257, 1265 (S.D.N.Y. 1992).

1872. *See, e.g.,* Daily Income Fund, Inc. v. Fox, 464 U.S. 523 (1984).

1873. *See* Burks v. Lasker, 441 U.S. 471, 486 (1979) (state law controls issue of board's power to discontinue derivative action on federal claim); *see also* RCM Sec. Fund, Inc. v. Stanton, 928 F.2d 1318 (2d Cir. 1991); Joy v. North, 692 F.2d 880 (2d Cir. 1982); Clark v. Lomas & Nettleton Fin. Corp., 625 F.2d 49 (5th Cir. 1980).

1874. *See, e.g.,* Martin v. Shearson Lehman Hutton, Inc., 986 F.2d 242, 244 (8th Cir. 1993); Hollinger v. Tital Capital Corp., 914 F.2d 1564, 1572–76 (9th Cir. 1990) (en banc); *In re* Indep. Energy Holdings PLC Sec. Litig., 154 F. Supp. 2d 741, 772 (S.D.N.Y. 2001); *In re* Xerox Corp. Sec. Litig., 165 F. Supp. 2d 208, 220 (D. Conn. 2001); *In re* Sirrom Capital Corp. Sec. Litig., 84 F. Supp. 2d 933, 940 (M.D. Tenn. 1999) (denying motion to dismiss).

1875. *See, e.g.,* Frankel v. Slotkin, 984 F.2d 1328, 1333 & n.3, 1337–38 (2d Cir. 1993); Colan v. Mesa Petroleum Co., 951 F.2d 1512, 1522–25 (9th Cir. 1991); Freeman v. Decio, 584 F.2d 186, 200 (7th Cir. 1978).

1876. *See In re* Apple Computer Sec. Litig., 886 F.2d 1109, 1115 (9th Cir. 1989).

1877. 15 U.S.C. § 78u-4(b)(4) (2000). *See* EP MedSystems, Inc. v. EchoCath, Inc., 235 F.3d 865, 883–85 (3d Cir. 2000); McGonigle v. Combs, 968 F.2d 810, 819–20 (9th Cir. 1991); Norwood Venture Corp. v. Converse Inc., 959 F. Supp. 205, 209–10 (S.D.N.Y. 1997). Loss causation requires plaintiffs to do more than allege that "they would not have bought . . . stock had they known the truth; they must allege that they would not have suffered the loss" but for defendant's actions. Miller v. New Am. High Income Fund, 755 F. Supp. 1099, 1108 (D. Mass. 1991).

- whether the defendant may be held liable as a "seller."[1879]

In addition, the resolution of various issues—for example, whether the plaintiffs may proceed on a fraud-on-the-market theory[1880]—will be relevant to whether individual cases may be consolidated for joint trial or should proceed as a class action.[1881]

31.5 Class Actions and Derivative Actions

Where appropriate, the court can use the initial pretrial conference to set a schedule for determining whether one or more of the cases should proceed as a class action under Federal Rule of Civil Procedure 23, or a derivative action under Rule 23.1. In addition to ensuring that the notice and pleading requirements of the PSLRA have been met, the following can be assessed as an initial matter:

- whether there has been more than one class action filed, and the parties' intent to seek consolidation or transfer;
- if the action has been removed pursuant to the Uniform Standards Act, whether removal was appropriate;[1882]
- whether there have been or will be challenges to lead plaintiff certification;
- whether there has been a demonstrable need for limited discovery regarding lead plaintiff certification—in addition to showing a significant financial interest in the relief sought by the class, the plaintiff must also satisfy the typicality and adequacy requirements of Rule 23(a);
- whether appropriate discovery stays pending resolution of any motions to dismiss have been instituted;
- whether lead plaintiff has been selected;
- whether lead counsel has been identified and approved by the court; and

1878. *See* Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976). *See also Hollinger*, 914 F.2d at 1568–72.

1879. *See* Pinter v. Dahl, 486 U.S. 622, 641–47 (1988).

1880. *See* Basic Inc. v. Levinson, 485 U.S. 224, 241–49 (1988).

1881. *See, e.g., In re* LTV Sec. Litig., 88 F.R.D. 134 (N.D. Tex. 1980); Mirkin v. Wasserman, 858 P.2d 568 (Cal. 1993).

1882. Derdiger v. Tallman, 75 F. Supp. 2d 322, 325 (D. Del. 1999) (finding remand required where claims fell within savings clause of 15 U.S.C. § 78bb(f)(3)(A)(ii)).

- whether the complaint alleges claims that are not susceptible to class treatment.

Other matters must be resolved before a class can be defined. The initial complaint occasionally will include some claims (e.g., reliance on oral misrepresentations or the breach of a "suitability" standard) that rarely would be susceptible to class action treatment, along with other claims (e.g., an omission of a material fact from a proxy statement) that may well be presented on behalf of a class. The dates when plaintiffs bought or sold the securities, and what information they possessed on those dates, may not be clear from the complaint, yet may be critical to a decision regarding the class of persons they might properly represent. Whether the plaintiffs may proceed on a fraud-on-the-market theory may depend both on matters developed during discovery and on what claims will be pursued in the case. The court may need to determine whether a particular claim is made derivatively or individually[1883] and whether the same plaintiff may assert both derivative and class claims.[1884] In deciding whether a class should be certified, consider what class the plaintiffs may represent, and whether multiple classes or subclasses should be formed. It is advisable to consider sources of potential conflict and their effect, such as

- whether the class members are holders of different types of securities;[1885]
- whether some class members took certain key actions while others did not;[1886]
- whether some class members bought or sold before the alleged misconduct and others did so afterwards (or continued to hold the security);[1887]
- whether some class members had inside information;[1888]

1883. *See* Daily Income Fund, Inc. v. Fox, 464 U.S. 523, 527–34 (1984).

1884. *Compare* Hawk Indus., Inc. v. Bausch & Lomb, Inc., 59 F.R.D. 619, 623–24 (S.D.N.Y. 1973), *and* Ruggiero v. Am. Bioculture, Inc., 56 F.R.D. 93, 95 (S.D.N.Y. 1972), *with* Keyser v. Commonwealth Nat'l Fin. Corp., 120 F.R.D. 489, 492–93 (M.D. Pa. 1988), *and In re* Dayco Corp. Derivative Sec. Litig., 102 F.R.D. 624, 629–31 (S.D. Ohio 1984). The court may choose to address any actual conflict arising between the claims at the remedy stage. *Keyser*, 120 F.R.D. at 492 n.8 (citing Bertozzi v. King Louie Int'l, Inc., 420 F. Supp. 1166 (D.R.I. 1976)).

1885. *See, e.g.,* Margolis v. Caterpillar, Inc., 815 F. Supp. 1150, 1157 (C.D. Ill. 1991) (buyers of call options and sellers of put options); Deutschman v. Beneficial Corp., 761 F. Supp. 1080, 1082–83 (D. Del. 1991) (common stock and call options).

1886. *See, e.g., In re* Bally Mfg. Sec. Corp. Litig., 141 F.R.D. 262, 270 (N.D. Ill. 1992) (those who sold during the class period and those who did not).

1887. *See, e.g.,* Kovaleff v. Piano, 142 F.R.D. 406, 408 (S.D.N.Y. 1992); Deutschman v. Beneficial Corp., 132 F.R.D. 359, 382–83 (D. Del. 1990); *In re* LTV Sec. Litig., 88 F.R.D. 134, 149 (N.D. Tex. 1980).

- whether class members purchased or sold securities at different times based on different information;[1889] and
- whether class members are seeking damages or rescission.[1890]

These differences in the various groups of plaintiffs and proposed class members require the court's early attention. Defendants may raise these differences when opposing class treatment, and in some cases opposing positions may justify denial of class certification. In many instances, however, differences may be resolved by limiting the definition of the class or classes that the plaintiffs may represent, by creating additional classes or subclasses, or by tailoring the relief afforded to different plaintiffs. For example, the court may define a class to exclude (or treat as a subclass) those who, as often occurs in complex securities litigation, are also defendants in the class action or in related litigation. If a subclass should be formed and no representative of that subclass is a party, the court may direct notice to the unrepresented class members, to afford them time to have a representative intervene.[1891] Although, as discussed in section 21.23, unnecessary classes generally should be avoided, in some securities cases multiple classes or subclasses may be needed to ensure that the interests of all class members are fairly and adequately protected, particularly during settlement negotiations. Occasionally a mandatory class under Federal Rule of Civil Procedure 23(b)(1) or (b)(2) may be proper, but generally classes in securities litigation will be certified under Rule 23(b)(3), with members enjoying the right to notice and an opportunity to opt out. Class members' opting out of a 23(b)(3) class, if adequately disclosed, may cure some conflicts.

Although the PSLRA provides for early notice to class members by the plaintiff who first files a securities class action, class representatives must also comply with Rule 23(c)(2)'s notice provisions. Absent special circumstances, the class representatives must bear not only the cost of providing Rule 23(c)(2) notice, but also the expense of obtaining class members' names and addresses, which frequently are in the possession of the defendants or a transfer agent.[1892] When securities are registered in "street" names with brokerage houses or fi-

1888. *See, e.g.,* Dubin v. Miller, 132 F.R.D. 269, 274–75 (D. Colo. 1990).

1889. *See, e.g.,* Hoexter v. Simmons, 140 F.R.D. 416, 421–22 (D. Ariz. 1991); Alfus v. Pyramid Tech. Corp., 764 F. Supp. 598, 605–06 (N.D. Cal. 1991).

1890. *See, e.g.,* Larson v. Dumke, 900 F.2d 1363, 1366–68 (9th Cir. 1990); Davis v. Comed, Inc., 619 F.2d 588, 592–98 (6th Cir. 1980).

1891. *See* Fed. R. Civ. P. 23(d)(2).

1892. Oppenheimer Fund, Inc. v. Sanders, 437 U.S. 340 (1978).

nancial institutions, these nominees' assistance will be needed.[1893] Class representatives should make arrangements with nominees to provide the necessary names and addresses or to forward notices where appropriate, or, where necessary, issue a *subpoena duces tecum*.[1894] Sometimes—for example, in a class action on behalf of holders of bearer bonds—the identity of class members may not be ascertainable. In such a case, the plaintiffs' attorneys should give notice by publication in media likely to be seen by the class members.

31.6 Discovery

The principles and procedures discussed in section 11.4 for controlling discovery are generally applicable to securities litigation, subject to the discovery stay provisions of the PSLRA where class action litigation is involved. As an initial matter, the judge should consider what information will be needed from the parties to determine whether the litigation should proceed as a derivative action or class action. In cases that do not raise class issues, the parties are subject to Rule 26 disclosures and the court should further ascertain at the initial pretrial conference the scope of discovery likely to be sought by the parties and tailor a discovery schedule accordingly. Additional reciprocal prediscovery disclosures may expedite and reduce the amount of discovery needed. Similarly, deferral of depositions until the completion of document discovery may help facilitate and expedite the depositions, reducing the burden and cost on the parties. In class actions, the discovery process can begin once the court has resolved any outstanding motions to dismiss; therefore, it is helpful to set a discovery schedule that includes dates for Rule 26 disclosures (which would have been preempted by any stay of discovery) prior to permitting the parties to begin the formal discovery process. Staged discovery may be appropriate, such as where there are certain factual issues that may be key to summary judgment or settlement. Discovery into these areas first may facilitate early resolution or, at minimum, identify areas that remain in dispute.

To avoid duplicative discovery in multiple litigation, it is best to require plaintiffs in related cases to prepare a single set of interrogatories to be propounded to each defendant, and require the parties to coordinate discovery plans. Consider also establishing a common document depository, perhaps online, cross-noticing depositions of common witnesses for use in all cases. Whether claims of attorney–client privilege or other requests for protective

1893. *See* Silber v. Mabon, 18 F.3d 1449, 1453–55 (9th Cir. 1994) (no due process violation where notice mailed to broker holding stock in street name was not sent to class member until after opt-out period, but court should have considered allowing late opt out).

1894. *See, e.g., In re* Penn Cent. Sec. Litig., 560 F.2d 1138 (3d Cir. 1977).

orders are likely to arise during the course of discovery can be ascertained at the initial conference, and efforts can be made to resolve such issues before they can disrupt the discovery schedule. The court can also establish a schedule for exchanging expert reports and taking depositions early in the litigation and can adopt procedures to facilitate discovery and use at trial of summaries and computerized data. As in other cases, counsel should be expected to stipulate to facts not genuinely in controversy and directed to develop a joint statement of agreed-on (or uncontroverted) facts.

31.7 Takeover Litigation

Takeover litigation presents special problems. Several actions and counteractions may be filed almost simultaneously in different courts to enjoin or remedy alleged violations of federal antitrust laws, federal securities laws, and state statutes. Major decisions must often be made rapidly about complex factual, legal, and economic issues that involve large amounts of money and would ordinarily take months or even years to resolve. Fortunately, such litigation typically involves only a few parties, represented by experienced attorneys accustomed to working under severe time constraints and other pressures. The existence of state statutes and corporate defenses, such as shareholders' rights plans ("poison pills"), may render time constraints less severe than suggested by the Williams Act.[1895]

31.71 Initial Conference

It is wise to hold a preliminary conference with counsel as soon as possible after the commencement of takeover litigation—preferably within a day or two after the complaint is filed. Plaintiff's counsel usually will know or be able to ascertain the identity of counsel for the defendants. The judge should consider whether attorneys for other companies with an interest in the litigation, either as potential intervenors or parties in related cases, should participate. Consider also inviting counsel for government enforcement agencies, such as the Securities and Exchange Commission or the Antitrust Division of the Department

1895. Pub. L. No. 90-439, 82 Stat. 454 (1968) (codified as amended at 15 U.S.C. §§ 78m(d)–(e), 78n(d)–(f) (2000)).

of Justice. Telephone conferences can accommodate attorneys who are not available on short notice for a conference in chambers.

Procedures can be established—such as telephone conference calls or setting aside a period before or after normal office hours for an in-person conference—for emergency or other matters that may arise and require an immediate ruling. The parties should be cautioned, however, that unnecessary "emergency" motions, whose primary purpose may be to influence the market, may subject offending counsel or their clients to appropriate sanctions. All orders in takeover litigation involving entities with publicly traded securities should, to the extent feasible, be announced after the stock market closes. These rulings may have a substantial impact on the stock market for both plaintiffs' and defendants' stock and are sometimes monitored by securities professionals in an attempt to take immediate action in response to the court's actions, often to the disadvantage of less sophisticated market participants. In unusual situations involving important confidential information, consider holding certain proceedings in camera or receiving some evidence under seal. Although the court may order counsel to defer disclosing the results of a court conference, the court will need to examine whether such an order could conflict with the disclosure requirements of the federal securities laws. Because of the limited time within which rulings must be made, the need for the judge to be personally involved in management and supervision is greater here than in other complex litigation. For this reason, some judges avoid referral to a magistrate judge or special master, which may result in critical delays while rulings are reviewed.

A schedule should be established at the initial conference for filing responsive pleadings and motions, defining and narrowing issues, conducting necessary discovery, and holding the next conference. The schedule usually will be substantially compressed compared with those typical of other litigation. For example, the court may require that the answer be combined with any motions and filed well before the twenty-day period prescribed by Federal Rule of Civil Procedure 12(a), and parties may also be required to serve papers by personal delivery rather than through the mail. In setting the schedule, the suggestions and requests of counsel should be considered. Although the schedule should be regarded as firm, unforeseen events may dictate revisions. The attorneys should confer in advance of each conference, seeking through discussion and compromise to narrow, if not eliminate, disagreements as to matters to be considered by the court. If counsel has not done so, the court might consider adjourning the conference for a day or two to permit counsel to develop more detailed proposals for management of the case.

Additional agenda items that may be appropriate for consideration at this initial conference, whether the conference is held in person or by telephone, include whether the parties anticipate filing threshold motions and the exis-

tence and status of any related cases. The parties may contemplate challenging standing, personal jurisdiction, venue, or other threshold matters that, if resolved promptly, might reduce or eliminate the need for discovery. If so, the judge should establish a schedule for expedited resolution of these issues. This is also an appropriate time to ascertain, or direct counsel to ascertain, the status of other related cases, including times set for hearings, and make plans to coordinate the proceedings to the extent possible. If jurisdiction and venue will not be contested, consider requiring the parties to include any related claims that may arise and enjoining them from instituting new litigation in other courts. Because of time constraints, multidistrict transfer under 28 U.S.C. § 1407 is rarely feasible. Transfer of cases to a single district under 28 U.S.C. § 1404 or 1406 may, however, be appropriate; if so, such transfers should be ordered as expeditiously as possible. If the cases remain in separate courts, the judges should confer and attempt to avoid conflicts in schedules.

31.72 Injunctive Relief

The most significant hearing in takeover litigation usually is that on the preliminary injunction. The court's ruling may moot or resolve other issues. Although the complaint typically will include a request for a temporary restraining order (TRO) and an application for a preliminary injunction, a TRO—or any order in takeover litigation—should almost never be granted ex parte, particularly given the opportunity for a telephone conference. Ordinarily, any pending request for a TRO should be resolved at the initial conference, and a date should be set for hearing the motion for injunctive relief. Depending on the date of the hearing, the court may, under Federal Rule of Civil Procedure 65(a)(2), order the trial on the merits to be advanced and consolidated with the hearing. In some cases, it is advisable to refuse hearing a motion for preliminary injunction if a hearing on a permanent injunction can be held expeditiously. Before deciding when or whether to hear the application for a preliminary injunction, the court should determine whether a ruling on the application must be rendered by an identifiable date. It is also wise to ascertain from counsel all dates important to the litigation, including those on which any statutory waiting periods expire or significant events (such as a stockholders meeting, or the commencement of acquisition of shares by a competing offeror) are scheduled to occur. The federal statutory waiting period may not be controlling, because of the prevalence of state statutes, such as control share acquisition acts and business combination statutes, as well as shareholders' rights plans (poison pills). Counsel should be questioned about the interplay of such laws and corporate defenses and the effect they will have on the date to be set for the hearing. If the deadline for a ruling cannot be met because of requirements of the litigation, such as criminal proceedings subject to the Speedy

Trial Act, consider reassigning the case to another judge. Counsel's views about the minimum time needed to conduct essential discovery and to conduct the hearing itself should be considered. The court may make a tentative determination on the form of the hearing—for example, whether the motion will be decided on affidavits, depositions, and documents alone, or whether witnesses will be heard in person and, if so, whether their direct testimony will be presented by prepared statements and reports.

One or two additional case-management conferences usually will be needed before the hearing. A meeting (or conference call) among counsel should precede each conference. The primary purposes of these case-management conferences are to ensure that schedules are being met, to narrow or revise the issues based on intervening circumstances (such as an offer being made by another company for the target company's stock, or other defensive measures adopted or proposed to be adopted by the "target" company), and to make final preparations for any scheduled hearing.

Complaints in takeover litigation frequently include a number of claims that the plaintiffs may be willing to eliminate, after further exploration, at least for purposes of the preliminary injunction. Similarly, defenses and counterclaims may be abandoned as the hearing date approaches. The judge can encourage the parties to narrow the scope of the case to the most important issues, setting a date by which they are to specify those allegations the parties will press at the hearing.

Various steps may be taken to expedite and streamline the hearing, including the following:

- holding the hearing on only the affidavits, where no substantial factual disputes exist;
- directing the parties to submit statements of undisputed facts or requests for admission to narrow the scope of the hearing;
- directing counsel to identify any witnesses in advance along with the substance of their testimony and the exhibits they will sponsor;
- requiring that direct testimony be offered in the form of adopted narrative statements, exchanged in advance and subject to motions to strike, to cross-examination, and to redirect at the hearing if issues of credibility are presented;
- directing counsel to exchange proposed exhibits in advance of the hearing, and giving notice that objections may be treated as waived if not made in writing in advance of the hearing;
- resolving objections to foundation before the hearing;
- directing counsel to present stipulated summaries or extracts of any deposition testimony to be used in lieu of lengthy readings of transcripts;

- directing counsel to submit briefs in advance of the hearing, along with proposed findings of fact and conclusions of law; and
- where time is of the essence, ruling from the bench at the conclusion of the hearing, dictating findings and conclusions into the record, and requiring counsel to state immediately, at the hearing, any motions for modified or additional findings and conclusions based on the record.

31.73 Discovery

The court should encourage counsel to submit a jointly agreed on discovery plan for approval. The potential scope of disputed issues in takeover litigation can lead to excessive discovery demands, both for documents and depositions, creating unreasonable burdens on the parties in view of the brief time usually available for compliance. The need to identify and narrow the disputed issues and tailor the discovery plan narrowly in light of those issues should be stressed.

Discovery should begin with an expedited procedure for the production of relevant files, records, and documents necessary for the resolution of the issues. Where the initial conference is held within days of the filing of the complaint, the parties will have been unable to comply with early disclosure mandates of Federal Rule of Civil Procedure 26. The judge should discuss with the parties how to effectuate the goals of Rule 26 within the time pressures imposed by takeover litigation and take steps to avoid excessively voluminous production that will burden rather than assist the parties. The following may be helpful:

- limiting the relevant periods of time for discovery requests;
- requiring the parties to minimize objections and to redact documents and files to eliminate extraneous matter;
- encouraging counsel and the parties to consider alternative means of obtaining testimony in the limited time available, such as through statements from interviews of witnesses or discovery in related litigation; and
- encouraging and approving stipulated protective orders.

31.8 Trial and Settlement

The court should always be prepared for the possibility of trial, even though complex securities cases seldom proceed that far. Procedures similar to

those used for trial and settlement of mass tort litigation[1896] may be appropriate for securities litigation. For example, consider consolidating related cases for a joint trial on specified issues, such as the defendants' respective liabilities for alleged misrepresentations and omissions, while leaving for subsequent separate trials other issues, such as damages and individual defenses. In cases subject to the PSLRA, the defendant is entitled, upon request, to have a written interrogatory submitted to the jury on the "defendant's state of mind at the time the alleged violation occurred."[1897] The PSLRA further requires that special interrogatories be submitted in jury cases (or findings of fact in bench trials) as to each covered person or each person alleged to have caused or contributed to the plaintiff's loss, regarding (1) whether such person violated the securities laws; (2) the person's percentage of responsibility; and (3) whether the securities violation was committed knowingly.[1898] In selected cases, the court may direct the parties to confer with the court about the precise text of appropriate special questions to a jury.

Securities cases typically involve experienced and sophisticated lawyers, as well as large sums of money. It is best to refer settlements to another judge, a special master, or a court-appointed expert with comparable experience and skills. Counsel need court approval to settle class or derivative actions, and when such approval is sought, the court should apply the principles and procedures governing settlements of class actions in general. The PSLRA contains specific provisions relating to settlement of covered class actions, including statements that must be included in proposed or final settlement agreements disseminated to the class[1899] and restrictions on settlements under seal.[1900] The PSLRA also provides for the discharge of all contribution claims against a covered person who settles before final judgment.[1901] In derivative actions, nonmonetary benefits—such as a change in corporate management or policies—may play a significant role.[1902]

The PSLRA provides for the court's mandatory review of the parties' conduct and that of their counsel during the course of the action, and upon final adjudication it requires the court to "include in the record specific findings regarding compliance by each party and each attorney representing any party

1896. *See supra* section 22.9.

1897. 15 U.S.C. § 78u-4(d) (2000).

1898. *Id.* § 78u-4(f)(3)(A). The statute sets out factors to be considered by the trier of fact in determining the percentage of responsibility. *Id.* § 78u-4(f)(3)(C).

1899. *Id.* § 78u-4(a)(7).

1900. *Id.* § 78u-4(a)(5).

1901. *Id.* § 78u-4(f)(7).

1902. *See* Bell Atlantic Corp. v. Bolger, 2 F.3d 1304, 1310–12 (3d Cir. 1993), and cases cited therein.

with each requirement of Rule 11(b) . . . as to any complaint, responsive pleading, or dispositive motion."[1903] The parties should be afforded an opportunity to be heard on the issue before any such finding is made. Sanctions are mandatory, however, once a finding of noncompliance has been made.

1903. 15 U.S.C. § 78u-4(c)(1) (2000).