

When numbers count against you

THERE IS POWER IN NUMBERS. Winners receive the most votes in an election. The prize goes to the highest bidder. Therefore, when outnumbered, the odds may seem daunting and there is easy justification to “call it quits” or find the quickest way out of a situation. This is the power behind class action lawsuits.

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When numbers count, continued

In a class action lawsuit, a group of persons or entities having common characteristics or attributes band together to bring a single lawsuit and exhibit strength in numbers. There are many benefits. The cost of litigation is shared among the class members, rather than each individual having to bear the full cost. The court overseeing the litigation does not need to adjudicate numerous individual suits, and it avoids the possibility of conflicting rulings on the same cause of action. The defendant may also benefit as it is only litigating one case in one court versus numerous individual cases potentially in different court houses. For instance, there is currently a group of class action attorneys seeking individuals who purchased fabrics used for bed sheets and other linens which may have overstated thread counts. Consumers are being invited to join the action and seek appropriate compensation. They may also join a class action suit against their health and fitness center or dating service about their membership cancellation policies, or a suit involving trans fat in their fast food lunches.

IN CLASS ACTION SUITS, LARGE CORPORATIONS ARE OFTEN SADDLED WITH SIGNIFICANT LITIGATION AND SETTLEMENT COSTS...

Because class action suits involve numerous parties claiming the same injury, large corporations are often saddled with significant litigation and settlement costs — not to mention unwanted media attention. While the cases are very often settled out of court to avoid excessive defensive costs, they can still divert corporate time and attention and pose significant concerns about risks to revenue and reputation among employees, clients and shareholders.

CORPORATE CONUNDRUM

There are declines in some types of class action activity. A recent study, the *Stanford Law School's Securities Class Action Clearinghouse*, showed that securities fraud class action lawsuits slid to an all-time low in 2006, decreasing by 38% from the previous year. According to the report, in 2006 the total Disclosure Dollar Loss (DDL) decreased from \$93 billion in 2005 to \$52 billion in 2006. The study attributes lower losses related to securities

fraud class action filings to three main factors: a strong stock market, a strengthened federal enforcement environment created by legislation like Sarbanes-Oxley, and the fact that a majority of securities class action suits filed in the late 1990s and early 2000 are now settled.

For directors and officers of publicly traded corporations, class action suits related to options backdating appear to be on the rise, however. The Stanford Law School study reported that, as of January 2, 2007, there were 22 securities class actions filed to date. There are currently an estimated 80 ongoing backdating investigations involving high-profile companies that may result in future litigation. Many companies have launched stock option investigations and are looking at their risks associated with stock options, contemplating both defense and insurance strategies.

SUCCESS BREEDS MORE

Declines in securities suits may, in part, be attributable to a healthy economy, a well-performing stock market and attention to greater internal controls. A decline in the stock market or other market conditions that affect a company's performance may lead to greater exposure to shareholder lawsuits. Likewise, a successful outcome by the plaintiff in one class action suit can lead to other similar cases. The outcome of high-profile cases may result in class action attorneys seeking additional opportunities to start class actions against similar companies or circumstances.

Recent regulatory changes have altered the picture somewhat. In 2005, Congress passed the Class Action Fairness Act. Signed by President Bush in February 2005, the legislation, according to a White House press release, marked "a critical step toward ending the lawsuit culture in our country". It contains a number of provisions aimed at protecting the interests of the individual class members in any proposed settlement and curbing the enormous legal fees often charged by class action attorneys.

Additionally, attempts to curb legal abuses have also come from the judicial bench. In a class action suit involving silicosis, Judge Janis Graham Jack issued a weighty 249-page decision that put a halt to a class action suit against 250 companies. The plaintiffs claimed they were diagnosed with silicosis as a result of being exposed to silica dust, fine pieces of sand which are released into the air during certain activities, such as sandblasting. She observed in the suit that 9,000 plaintiffs were diagnosed by the same nine doctors retained by the law firms. When




deposed, the doctors admitted that they took their orders from the plaintiffs' attorneys. Another issue that the judge uncovered was that 65% of the plaintiffs in the case had previously been involved in an asbestos class action suit. Judge Jack's diligence uncovered the myriad abuses and possibilities of fraud that can occur in class actions, and she opened the door to further scrutiny of these cases.

GOOD JUDGMENT

Well-established practices for both internal and external communications, strong financial controls and good business judgment are among a company's best strategies to at least minimize risks associated with a class action lawsuit. In the case of securities lawsuits, internal controls designed to quickly identify issues within the company coupled with effective corporate communications should result in timely and accurate reporting of good news and bad news. Many times, securities allegations assert that a company knew of an internal problem but failed to advise the public of the potentially bad news in a timely manner. As a result, the company's stock

was artificially inflated because the company did not notify the investing public that the company had encountered some difficult times.

The failure of directors and officers of a corporation to act in good faith and use good business judgment may be grounds for a suit to be brought against the company. The company needs to ensure that when an officer or director of the company is speaking publicly the information that is conveyed accurately reflects the current status of the company. Overly positive or overly negative news can be problematic.

For many, especially large companies, avoiding class action suits altogether may seem impossible, but they would be wise to stay alert to situations that can pose class action risks. 

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