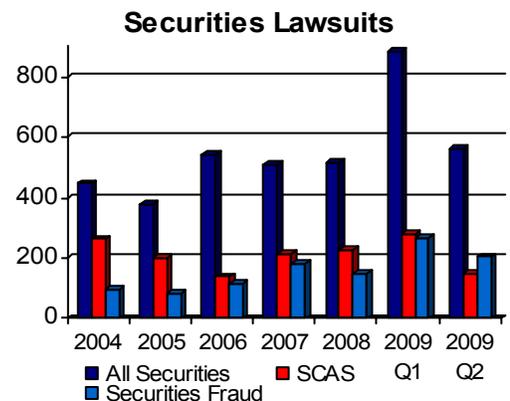


Securities Litigation Drops in Q2 2009

An Advisen Quarterly Report – Q2 2009

Essence: *Securities lawsuit filings fell off in the second quarter from frantic first quarter levels, with 140 suits down substantially from 221 in the first quarter, but the average settlements and awards spiked. Filings were down across all securities case types, as securities class action, securities fraud and breach of fiduciary duties represented the lion's share of cases. Cases filed against non-US companies continue a higher proportionate trend relative to historical levels. Suits filed against financial firms dominated, although new Madoff-related suits appear in decline.*

After a record-setting 221-suit first quarter driven by the credit crisis and the Bernard Madoff scandal, litigators seem to have taken a bit of a breather in the second quarter. Securities cases tracked in Advisen's Master Significant Case and Action Database (MSCAd) in Q2 2009 fell to 140 filings, down significantly from the first quarter but well within historical averages. On an annualized basis, securities suits filed in Q2 2009 were at 560 cases, representing a 37 percent drop from an annualized Q1 of 884 cases, but an increase of 8 percent from 518 cases filed in 2008. Securities class action suits (SCAS) no longer led the pack, with 37 cases filed in Q2 2009, down from 70 cases the quarter before and 57 cases a year earlier. This translates to an annualized Q2 2009 figure of 148 SCAS cases filed, just a hair higher than the recent low of 139 SCAS filed in 2006. The top billing in Q2 went to securities fraud suits with 51 cases filed. SCAS shared the No. 2 spot with breach of fiduciary duties cases in Q2, which also posted 37 suits filed.



Securities suits defined

The purpose of this report is to examine all sources of securities-related suits that impact management liability insurance policies. In addition to SCAS cases, this report encompasses a much broader set of suits, such as securities fraud, breach of fiduciary duties, derivative actions, collective actions and Ponzi schemes, among others.

Madoff-related cases remained significant, but have trended downward. Madoff suits accounted for 11 percent of all securities cases in the second quarter at 15 suits, down from 24 percent the quarter before (52 suits). The sub-prime/credit crisis had a strong proportionate showing, directly resulting in 16 percent of securities cases, but the total number dwindled to 23 cases compared to 45 in the first quarter.

Looking at the full first half of 2009, the annualized suits filed, at a robust 722 cases, remained a recent high. SCAS filings for the first half were at an annualized 214 cases, in line with most recent years. Annualizing quarterly numbers is useful for comparing 2009 with prior years, but can easily result in misleading numbers, as is seen in the widely disparate first quarter and second quarter numbers in 2009. A heavy front-end loaded 2009 is likely due to a flurry of Madoff-related cases that

rolled in during the first quarter. Additionally, evidence of a heavy front-end load might be inferred from the falloff in cases filed in the second quarter, down to a rate in line with the previous years. However, aside from Madoff-related suits, the second quarter could represent a lull in litigation activity while law firms worked on the flood of suits from the first quarter. Interestingly, the first few weeks of the third quarter have seen a surge in securities suits once again.

Master Significant Case and Action Database (MSCAd):¹ Advisen tracks significant lawsuits filed against companies and their directors and officers in MSCAd. MSCAd is the most complete and accurate database of such lawsuits, consisting of more than 30,000 events and over \$900 billion in aggregate losses. Securities cases in MSCAd represent more than 5,800 events and over \$70 billion in aggregate losses.

Advisen's MSCAd covers a full range of securities cases, categorized by type. Lists of suits and filing details are available at Advisen's online store, Advisen Corner, at http://corner.advisen.com/reports_topical_securitys_quarter2_home.html and available at no extra charge to Advisen members through their advisen.com logins. For more information please call +1.212.897.4800 or e-mail corner@advisen.com.

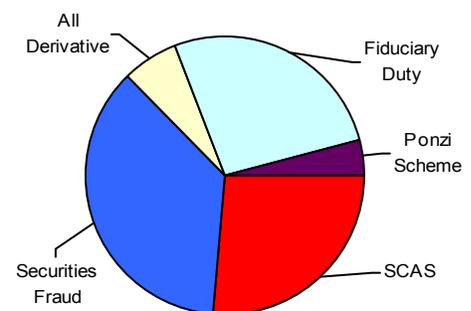
Case breakdown

Of the 140 securities cases filed in Q2 2009, the 37 SCAS cases formed a significant category, but were merely tied for second place. Securities fraud represented the largest category, accounting for 51 suits filed, down from 67 in Q1 2009, but increased in percentage to 36 percent from 30 percent of cases. On an annualized basis, securities fraud cases filed in Q2 2009 represented 204 cases, up from 148 in 2008 and 182 in 2007, and were significantly higher than 2006, 2005 and 2004, coming in at 116, 82 and 98, respectively. Securities fraud cases largely are the result of actions by regulatory and law enforcement agencies such as lawsuits or proceedings by the US Securities and Exchange Commission (SEC). States' Attorneys General and regulators are increasingly important actors in this arena. Tied for second place was breach of fiduciary duties at 37 suits. Other types of cases filed in Q2 2009 were derivative shareholder actions and other derivative cases (9) and Ponzi scheme and other cases (6).

SCAS cases have comprised the majority of securities lawsuits in most prior years. Continuing a trend that began in 2008, they continue to fall off proportionately, with Q2 2009 at 26 percent and Q1 at 32 percent.

Interestingly, collective actions in non-US courts were significant in Q1 2009 (20, or 9 percent), but non-existent in the second quarter. Collective actions are lawsuits outside the US that are similar to class-action lawsuits in the US, but often with much more stringent filing requirements, as well as limits on the types of plaintiffs allowed to file. However, a significant number of other types of securities suits (23, or 16 percent) were filed against non-US companies, with seven suits filed in courts outside of the US.

Types of Securities Lawsuits - Q2 2009



¹ On Advisen.com, MSCAd cases can be found under the "Losses & Exposures" tab, then click on "MSCAd".

The major jurisdictions of securities suit filings during Q2 2009 include:

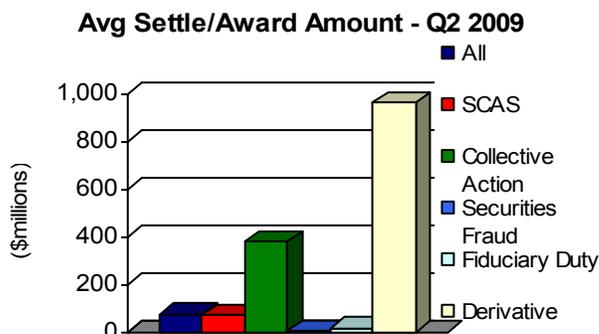
- 43 suits in state courts;
- 26 suits in US District Court, Southern District of New York (mostly New York City);
- 11 suits in US District Court, Northern, Central and Southern Districts of California; and
- Nine suits in US District Court, Middle and Southern Districts of Florida.

As concerns securities litigation against non-US companies, 23 suits (16 percent) were filed, with seven filed in non-US courts (down from 29 in the first quarter).

Settlements and awards

In Q2 2009, 57 cases were settled/awarded, meaning that either a judgment came down awarding damages or a settlement was reached. Of the 57 suits, three cases were in non-US courts and eight were cases with non-US companies as defendants. The average settled/awarded amount for the quarter spiked to \$75.1 million, substantially up from the \$33.4 million average of the first quarter. The Q2 2009 results were significantly higher than full year 2008, which had an average settled/awarded amount of \$22.2 million. However, Q2 2009 was disproportionately influenced by one derivative action suit, awarding almost \$2.9 billion to shareholders derivatively on behalf of HealthSouth Corporation, against its former CEO Richard M. Scrushy. Without this one suit, the average settled/awarded amount for the second quarter would have been \$25.1 million. The average amount for Q2 2009, with the HealthSouth case removed, is within historical fluctuations, with 2007 at \$33.1 million, \$48.7 million in 2006, \$23.1 million in 2005, and \$34.8 million in 2004.

By type of suit, in addition to the derivative action suit against Scrushy that made a splash, two other derivative actions suits averaged out this category at \$959.9 million. One collective action suit was also a heavyweight. This suit, filed against Royal Dutch Shell in a Netherlands court by its shareholders for overstating its oil reserves, settled for \$381 million. SCAS cases settled/awarded came in quite high with an average amount of \$74.5 million. Three of the top-five settled/awarded cases in the second quarter were SCAS cases, including a sub-prime/credit crisis-related case against Merrill Lynch with a proposed settlement of \$475 million. Breach of fiduciary duties suits saw a comparatively high quarter for settled/awarded amounts, averaging \$16.8 million. After an elevated first quarter, securities fraud cases came down closer to their historical average at \$5.7 million, but remained higher than their usual average of under \$5 million per case settled/awarded.



Trends

Non-SCAS gaining in importance, but don't count SCAS out. The number of SCAS suits, 37 cases, filed fell from the leading type of suit in Q2 2009, to second place, tied with breach of fiduciary duties and behind securities fraud. SCAS suits filed as a percentage of total securities suits remained at a historically low level in the second quarter at 26 percent, as the percentage has been on a long-term downward trend. Historically, SCAS suits comprise the majority of securities suits. However, in the first quarter, SCAS represented a mere 32 percent of all securities filings and, as noted, only 26 percent of total securities suits tracked by MSCAd in the second quarter.

In an effort to distinguish themselves in the competitive securities litigation marketplace, plaintiffs' attorneys increasingly have filed securities lawsuits alleging common law torts, contract law violations, and breach of fiduciary duties. This often results in two advantageous outcomes for plaintiffs and their attorneys: (1) it may avoid having the suit consolidated with others in a large class action suit by alleging unique claims; and (2) the suit may qualify to be tried in state court, as opposed to federal, allowing plaintiffs' attorneys to seek out states with more plaintiff-favorable laws and lower pleading standards.

Complaints that allege breach of fiduciary duties in Q2 2009 rose significantly to 26 percent of securities cases filed, up from 17 percent in Q1 2009 and 10 percent in 2008, and much higher than the 5 percent level in 2007. In 2008, 54 such cases were filed, but 30 were in the fourth quarter, indicating that this trend started in Q4 2008 and continued into 2009. These suits are often connected with M&A activities, alleging that the directors of the defendant company didn't negotiate a high enough price. With the economic crisis exposing weaker companies, M&A activities are likely to pick up as stronger companies seek strategic acquisition opportunities. More suits that allege breach of fiduciary duties will certainly follow, and the cost of settling such suits is considered by most when acquiring targets. These suits are often tried in state courts, with 31 of the 37 cases in the second quarter filed in state courts.

Securities fraud has become a growing case type since 2006. In Q2 2009, 51 securities fraud suits were filed – a number that is down from the first quarter as with all types of suits, but increased to 36 percent of all securities suits, from 30 percent. In 2008, securities fraud cases were at 29 percent, and in 2007 the percentage was at 36 percent. This level is significantly higher than the approximately 20-percent-level of prior years. Although the settled/awarded average for this type of case is down for Q2 2009, at \$5.7 million compared to \$24.2 million in the first quarter, it remains higher than the sub-\$5 million average of past years.

More importantly, concerning securities fraud cases, the SEC plans to become more proactive in light of recent not-so-stellar events, exposing an image of the SEC as sleeping at the wheel. According to Reuters, SEC Chairperson Mary Shapiro told reporters "I like to tell the staff we are going to act like our hair is on fire." The fiscal 2011 budget (beginning October 2010) calls for 400 additional full-time equivalent employees, and the Obama Administration's proposed regulatory overhaul plan envisions much enhanced SEC authority. Securities fraud settlements often contain fines and penalties not typically covered under directors & officers (D&O) policies, although defense costs are often covered. Furthermore, SEC actions often have a carryover effect on other types of securities suits, such as SCAS and derivative actions.

While falling as a percentage of total securities suits filed, SCAS cases remain a vital watermark for securities litigation trends. In addition to remaining one of the top case types filed, the settled/awarded amounts increased as well. The average settled/awarded amount increased from \$34.4 million to a substantially higher \$74.5 million. Three of the top-five settlements/awards for

the quarter were SCAS suits, totaling \$628 million for the three suits. The one major collective action suit settled, against Royal Dutch Shell, had all of the trappings of a SCAS case except for its non-US locale. If this suit was included as a SCAS, the average settled/awarded amount for the quarter would have been \$102.3 million.

More suits in state courts? A tactic explored by plaintiffs' attorneys in 2008 was filing securities-related class action suits in state courts. The advantages of state class action claims over federal include forum-shopping for a more sympathetic state court, as well as avoiding the higher pleading standards for class-action status in federal courts. These suits take advantage of a non-removal provision in Section 22 of the Securities Act of 1933 that permits cases alleging violations of the '33 Act to be tried in state courts. However, the Class Action Fairness Act of 2005 (CAFA), requiring larger multi-state class actions to be removed to federal courts, is considered a potential impediment to this movement.

In July 2008, the U.S. Ninth Circuit Court ruled that no securities claims alleging violation of the '33 Act could be removed to federal courts in what was seen as a precedent-setting case, *Luther v. Countrywide*, a sub-prime mortgage-related suit originally filed in California Superior Court for Los Angeles County. Claiming that the provisions in the '33 Act trump CAFA, the court relied on a canon of statutory construction, which states that the specific should control the general. This case potentially opened the floodgates to securities-related cases filed in state courts.

However, in January 2009, the Seventh Circuit Court in *Katz v. Gerardi* reached exactly the opposite conclusion: the provisions of CAFA trump Section 22 of the '33 Act. The court noted that the '33 Act's non-removal provision is incompatible with CAFA's jurisdiction and removal provisions. But the court claimed that it was unnecessary to consult canons of statutory construction, dismissing such canons as mere "doubt resolvers." The court points out that CAFA specifically addresses its applicability to securities cases, as it specifically lists exceptions to removal of securities cases.

How this issue plays out in other federal circuits and appeals courts is yet to be seen. In Q2 2009, 43 securities suits (31 percent) were filed in state jurisdictions, up from 24 suits (11 percent) in the first quarter. Of the 43 suits in the second quarter: 31 involved breaches of fiduciary duties; eight derivative actions; two securities fraud, one SCAS, and one a state-level regulatory action. Since most were brought by shareholders, a number could have conceivably been filed in federal courts as SCAS cases. However, all but one case filed in state courts avoided potential federal SCAS-status by alleging charges such as breach of fiduciary duties, steering clear of the non-removal issue.

E&O and fiduciary liability policies could take a hit. Although securities cases have traditionally triggered coverage under D&O policies, recent securities cases may also trigger coverage under errors & omissions (E&O) and fiduciary liability policies. In a trend that started in 2008 and continued into 2009, the bulk of cases have dealt with sub-prime/credit crisis issues and with Madoff and other Ponzi scheme issues. These suits, dealing with professional judgment and fiduciary duties may be excluded under D&O policies and covered under E&O policies. Fiduciary liability suits alleging violations of the Employee Retirement Income Security Act of 1974 (ERISA), the claim in many Ponzi scheme cases, may trigger fiduciary liability policy coverage.

In some cases, the same underlying cause of loss will trigger losses under D&O, E&O and fiduciary liability policies, resulting in aggregations across lines of business. Some allegations found in a securities suit that triggers E&O coverage may resurface in shareholder derivative suits, which can trigger coverage under Side A of a D&O policy. A recent trend for some Side A DIC D&O policies is wording that clearly covers ERISA liability, sparking D&O policy liability for ERISA suits.

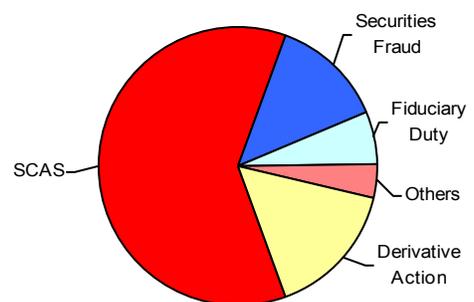
Financial firms still dominate. Financial services firms were much more likely to have a securities lawsuit filed against them in Q2 2009 than firms from any other sector. Out of the 140 securities suits filed in the second quarter, 53 of them named financial services firms, or 38 percent of all securities suits filed. If insurance companies are included, then the number of suits filed against financial services firms rises to 55 suits or 39 percent. These numbers are down from 2008 when approximately half of the securities cases were filed against financial services firms. Although the percentage has slid from 58 percent in the first quarter, it is substantially higher than previous years.

The reason for the preponderance of suits filed against financial services firms is due to three types of related cases, in total resulting in 43 suits filed in Q2 2009: sub-prime/credit crisis (23); Madoff Ponzi scheme (15); and auction rate securities (5). In the first quarter, as well as in 2008, the sub-prime/credit crisis and Madoff Ponzi scheme were large contributors to this trend. Other types of related cases that resulted in cases filed against financial services firms in the first quarter, but did not impact the second quarter, were specialist improper trading and the Stanford alleged Ponzi scheme.

The subprime/credit crisis and Madoff categories need no introductions. Auction rate securities related cases are suits filed against organizers of auctions for the purposes of creating a marketplace for municipal bonds and certain asset-backed securities, such as securities backed by student loans. The organizers, mostly investment banks, are charged with abandoning these auctions when credit markets began to fall off, leaving investors with un-tradable securities. The specialist improper trading cases refer to a claim that Goldman Sachs, ETrade, and Bodel, among others, inserted option trades for their own accounts before and between customer trades. R. Allen Stanford, a Texas billionaire who ran his activities from offshore locales of the Caribbean, has been charged with an alleged \$8-billion fraud of operating a Ponzi-scheme similar to Madoff's. A flood of other alleged pyramid schemes have been unveiled by an uptick in investor redemptions in the current recessionary economy.

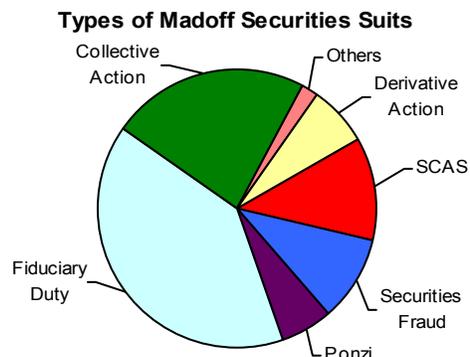
Lawsuits filed in response to the sub-prime/credit crisis hail back as far as 2005, but started growing in number beginning in February 2007. The number of all types of suits filed related to this issue through the end of Q2 2009 was 897. Of this total, 318 were securities suits. In Q2 2009, 23 securities suits were filed related to the sub-prime/credit crisis issue, which is at an annualized rate of 92 cases. This level of filing was down from 45 in Q1 2009 (180 annualized) and 176 in 2008, but still higher than the 72 filed in 2007. The 318 all-time securities suits filed related to this issue consisted of: SCAS (194); derivative suits (50); securities fraud (42); breach of fiduciary duties (19); and others (13).

Types of Credit Crisis Securities Suits



It remains to be seen if sub-prime/credit crisis suits will be dismissed at a higher rate than most types of suits. Judges and juries might be reluctant to blame the results of an economic crisis on a company's management, particularly for non-financial companies. Of the 318 sub-prime/credit crisis related securities cases filed, 18 have been settled/awarded as of the end of Q2 2009. Just two cases have been settled/awarded for over \$100 million, including a \$475 million proposed settlement against Merrill Lynch in a SCAS case in Q2 2009, and a \$406.5 million award against Credit Suisse in a securities fraud case in Q1 2009.

Madoff-related cases filed since the fraud was disclosed on December 11, 2008 consisted of 189 lawsuits in total through the end of Q2 2009, with 32 filed in Q2 2009. Securities-only filings totaled 100 suits since December 11, with 15 in Q2 2009 down from 52 in the first quarter. The 100 securities suits consisted of: breach of fiduciary duties (40); collective actions (23); SCAS (12); securities fraud (10); derivative actions (7); Ponzi scheme (6); and others (2).



It appears that the wave of sub-prime- and Madoff-related suits, and in particular suits filed against financial services companies, hit a crest in Q1 2009. With sub-prime-related case filings remaining at a high level, however, this related case type might have more life in it. As bankruptcies rise through the economy, hitting all sectors, and securities suits are filed as a consequence, suits filed will become more dispersed and broadly affecting all sectors. A wider spread of suits was observed in the second quarter, as the percentage of securities suits filed against financial services firms fell off a from 58 percent to just under 40 percent.

International exposure remains significant. The number of suits filed against non-US companies in US courts has been on a long-term upward trend, and so have been the number of suits filed against both US and non-US companies in courts outside the US. The second quarter, however, saw the international component of the equation drop a bit. Of the 140 securities cases filed in Q2 2009, 23 were filed against non-US companies, for a significant 16 percent of cases. Seven securities suits were filed in courts outside of the US, all against non-US companies. These numbers are down from the first quarter, which saw 51 securities suits, or 23 percent, filed against non-US companies, and 29 securities suits filed outside of the US court system, including five against US companies.

The largest settled/awarded cases for the quarter had a distinct international flavor, as two of the four largest amounts were against non-US companies (totaling \$462 million), both in non-US courts, and three of the top nine amounts (totaling \$505 million) against non-US companies. The third largest amount for Q2 2009 was a collective action settlement against Royal Dutch Shell for \$381 million in the Dutch courts. A rare SCAS suit for the Japanese court system resulted in an \$81 million award against Livedoor, Inc.'s founder Takafumi Horie, a fallen dot-com celebrity in Japan.

Sub-prime/credit crisis related suits are more global than most types of suits. Of the 318 all-time securities suits related to this issue, 50 were filed against non-US companies, and nine of the total suits were filed in courts outside of the US. Of the 23 filed in Q2 2009, four were filed against non-US companies. Considering the full first half of 2009, of the 68 securities suits filed, 14 were against non-US companies.

The true global lawsuit phenomenon is Madoff. Of the 189 all-time Madoff-related lawsuits, for all types of lawsuits, 86 were filed against non-US companies, and 42 were filed in courts outside of the US. Of the 100 all-time Madoff-related securities cases, 37 were filed against non-US companies, and 26 were filed outside of the US. For Q2 2009, of the 15 securities Madoff-related cases, six were filed against non-US companies. Considering the full first half of 2009, of the 67 securities cases, 34 were filed against non-US companies and 23 in courts outside of the US. This translates to the majority of Madoff-related securities suits filed in the first half of 2009 being against non-US companies, and over one-third were filed in courts outside of the US.

Critical cases

Nine events made up most of the settled/awarded amounts for Q2 2009, totaling \$4.1 billion with one derivative action suit at \$2.9 billion. The breakdown by type includes: four SCAS cases, two securities fraud cases, one breach of fiduciary duties case, one derivative action case, and one collective action case. Two of the nine suits were in courts outside of the US, and three involved non-US companies as defendants.

Lists of suits and filing details are available at Advisen's online store, Advisen Corner, at http://corner.advisen.com/reports_topical_securities_quarter2_home.html and available at no extra charge to Advisen subscription members through their advisen.com logins. For more information please call +1.212.897.4800 or e-mail corner@advisen.com.

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