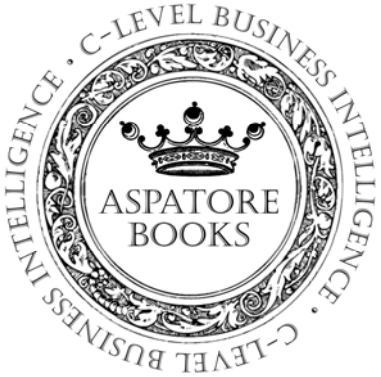
INSIDE THE MINDS

Inside the Minds:
Securities Law



BOOK IDEA SUBMISSIONS

If you are a C-Level executive or senior lawyer interested in submitting a book idea or manuscript to the Aspatore editorial board, please email authors@aspatore.com. Aspatore is especially looking for highly specific book ideas that would have a direct financial impact on behalf of a reader. Completed books can range from 20 to 2,000 pages – the topic and "need to read" aspect of the material are most important, not the length. Include your book idea, biography, and any additional pertinent information.

SPEAKER SUBMISSIONS FOR CONFERENCES

If you are interested in giving a speech for an upcoming ReedLogic conference (a partner of Aspatore Books), please email the ReedLogic Speaker Board at speakers@reedlogic.com. If selected, speeches are given over the phone and recorded (no travel necessary). Due to the busy schedules and travel implications for executives, ReedLogic produces each conference on CD-ROM, then distributes the conference to bookstores and executives who register for the conference. The finished CD-ROM includes the speaker's picture with the audio of the speech playing in the background, similar to a radio address played on television.

INTERACTIVE SOFTWARE SUBMISSIONS

If you have an idea for an interactive business or software legal program, please email software@reedlogic.com. ReedLogic is specifically seeking Excel spreadsheet models and PowerPoint presentations that help business professionals and lawyers accomplish specific tasks. If idea or program is accepted, product is distributed to bookstores nationwide.

Published by Aspatore, Inc.

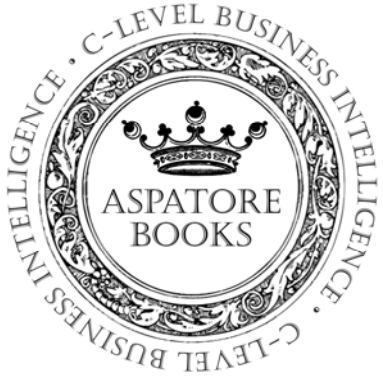
For corrections, company/title updates, comments or any other inquiries please email store@aspatore.com.

First Printing, 2005
10 9 8 7 6 5 4 3 2 1

ISBN 1-59622-037-6 Library of Congress Control Number: 2005902272
Inside the Minds Managing Editor, Laura Kearns, Edited by Marissa Berenson

Securities Litigation

Stewart Aaron
Partner
Arnold & Porter LLP



The Role Of A Securities Attorney

There are many different types of lawyers who can be referred to as "securities attorneys." Generally, a securities attorney is one whose experience or expertise involves some aspect of the federal securities laws, *e.g.*, the Securities Act of 1933, the Securities Exchange Act of 1934, the Investment Advisers Act of 1940, etc,. or some aspect of state securities laws, *e.g.*, so-called "Blue Sky" laws, which are laws various states have enacted to protect the public against securities frauds (the term is believed to have originated when a judge ruled that a particular stock had about the same value as a patch of blue sky).

There are different categories of securities attorneys, including regulatory, transactional, and litigation attorneys. A securities attorney specializing in regulatory matters addresses compliance with various securities laws and regulations. For example, a regulatory securities attorney would be responsible for the periodic filings that public companies make with the U.S. Securities and Exchange Commission (SEC). A transactional securities attorney works on deals among parties regulated by the SEC. Such attorneys are involved in mergers, acquisitions, and hostile takeovers. There are times when securities regulatory attorneys act as transactional attorneys, and vice versa.

A securities litigation attorney generally prosecutes or defends against all types of securities related claims. On the plaintiff side, litigation lawyers bring individual claims on behalf of investors or class actions on behalf of classes of investors. On the defense side, litigation lawyers defend against all manner of securities related claims. These claims could be brought by governmental authorities, such as the SEC; a state regulatory body; a state attorney general; a self-regulatory organization, such as the New York Stock Exchange or the National Association of Securities Dealers; or a private plaintiff or class of plaintiffs.

As a securities litigation attorney, I assist clients with a wide variety of issues, many of them related to disclosure. Often I provide the most value to clients by counseling them on how to avoid litigation. For example, if a public company is preparing a periodic report that will be sent to shareholders and filed with the SEC, I may be consulted in regard to how a sensitive issue should be addressed in the document.

Once a matter is in litigation, a securities attorney must pursue all available defenses and keep an eye towards what is in the best interest of the client. There are times when it might be in the client's best interest to settle a case early on. On the other hand, there may be principled reasons why a client should not settle and should vigorously litigate a case through trial and all levels of appeal. It is the securities attorney's responsibility to advise a client on which path is best.

Working With Clients

As a securities litigation attorney you typically work with different financial services clients, including public companies, underwriters, broker-dealers, hedge funds, and officers or employees. The most difficult representations often involve cases where an individual's liberty and livelihood may be at stake.

In working with a client on a new matter, it is essential that you acquire a quick and thorough understanding of the client's business and the facts surrounding the relevant issues. It's also extremely important that you secure all the relevant documents, including e-mail. The document preservation and review process should be coordinated by someone with technological expertise. All e-mail back-up tapes, hard drives, removable storage devices, etc., must be searched for information that may be relevant to the issues at hand.

It is not sufficient to merely speak on the telephone with an in-house lawyer for a corporate client; rather, face-to-face interviews of material witnesses should be conducted. The information gathering process is ongoing. As a project proceeds, it is inevitable that you will learn of new documents and information that should be pursued. You should also search public sources of information such as newspapers, magazine articles, or the Internet. You may find that a client has made public statements that are exculpatory in nature, as they relate to the facts presented.

In defending a corporate client in securities litigation, an attorney works with the client's office of general counsel; however, an attorney also may work with the company's senior management such as the chief executive officer, the president, the chief financial officer, or the head of compliance.

In order to help their own cause, corporate clients should create and promote a culture of cooperation with outside counsel. If employees from the top down actively work with counsel in gathering and organizing all relevant data, the securities litigation attorney's job is made much easier and there is an increased likelihood of success.

Choosing To Settle A Case

Before you decide to take a case to trial you have to determine if the facts and law are on your side; that being said, you should take a case to trial when the plaintiff's demand is too high. And there may be instances when you go to trial because you have no choice because the plaintiff refuses to enter into settlement discussions.

Given the costs of going to trial, and the risks of an adverse determination, most clients involved in securities fraud lawsuits settle. This generally occurs after a motion to dismiss is denied, meaning that a

judge has determined that the plaintiff's complaint is legally sufficient. Clients should always have an eye out for a possible resolution that makes good business sense; it is a good idea to settle whenever the terms of the settlement are reasonable.

In securities class actions, any settlement must be approved by the court and it generally will be binding on any absent class members. That means clients need not be concerned about additional cases being brought by similarly situated plaintiffs based upon the same facts. If, however, a company is a target of frequent lawsuits it may be a better strategy not to settle so that the client is not viewed as an easy mark.

Determining Case Outcomes And Damages

The length of time that elapses between the filing of a case and the start of a trial varies from case to case and is affected by many variables, including the court docket, the personal preferences of the assigned judge (*e.g.*, some judges put the parties on very short schedules and tight deadlines), the number of parties and issues involved, and the style of the adversary. By way of example, during the twelve-month period that ended June 30, 2004, the median time for a case to get to trial in the U.S. District Court for the Southern District of New York was 26 months.

In any given case, unique facts may call into doubt the merits of the case, such as loss causation. The plaintiff in a securities fraud lawsuit must plead and prove that the misrepresentations made by a public company to its shareholders caused economic loss. If, for example, the decline in the price of the company's stock is due to a general decline in the stock market and not attributable to any statements made by the defendant, then there is no viable claim.

One significant trouble spot involves when an employee of a corporate defendant commits a criminal act, or an act that is ultra vires – outside

the scope of the employee's duties. Because corporations only act through their employees, a corporate employee's acts can be imputed to the company and can cause the company to be liable, even if the employee was not authorized to engage in the acts in question.

The amount of damages sought can vary dramatically from case to case, and there are varying measures of damages in different cases. For example, if you have a case where a public company allegedly failed to disclose material information, the price of that company's common stock generally drops when the curative information is finally disclosed. The damages sought by a shareholder in subsequent securities litigation would likely be the difference between the price at which the stock was trading before the disclosure and the price after the disclosure multiplied by the number of shares held.

The amount of damages, if any, to be awarded is a matter that must be determined based upon the facts presented at trial. In a jury trial, the jury decides the amount of damages. In a bench trial, the judge decides. The decision on damages is often based in large part on an assessment of the testimony provided by the plaintiffs' and defendants' damages experts.

The overall financial exposure of a company in a securities class action will vary based upon the facts of the case. Exposure will be impacted by whether there is insurance coverage for the acts in question and the terms and conditions of such coverage.

On a motion to dismiss a securities class action, the court looks to the facts pled and the publicly available information to determine if the plaintiff has properly pled all the elements of a legal claim. For example, each of the following elements generally must be pled to properly state a legal claim in a securities fraud case: (1) a misrepresentation, (2) upon which the plaintiff reasonably relied, (3) which representation was made with scienter, (4) causing economic loss.

After depositions and document discovery, a defendant typically makes a motion for summary judgment in order to avoid a trial. At this stage, the court looks at all the facts gathered during discovery and determines if a claim has been properly stated. If there is any dispute regarding material facts, summary judgment will be denied and the case proceeds to trial.

Changes In Securities Law

In order to properly address change in the securities industry, attorneys must rely to a large extent on the support of their law firms. An excellent library staff is needed in order to ensure that electronic and hard copy subscriptions to relevant databases are maintained and routinely distributed. Attorneys must also rely on the depth of their law firm's securities practices; colleagues within the law firm, either informally or at group meetings, can share knowledge and expertise with one another. Clients can be kept up to date by advisories that are circulated and also posted on the law firm's website.

During the last five to ten years, we have seen both an entity and a person greatly influence securities law and regulation: Enron and New York Attorney General Eliot Spitzer. Enron was a highly touted, successful company that used special purpose entities (SPEs) to its economic advantage to present a very positive financial picture to its investors and lenders. When it came to light that Enron's financial reporting was based on often circular transactions with SPEs, Enron quickly unraveled and filed for bankruptcy. Attorney General Spitzer established a reputation by taking on Wall Street for research analyst practices, aggressively pursuing mutual funds for late trading and other practices and forcing insurance companies to stop making incentive commission payments to brokers. In the aftermath of Enron and Spitzer's actions, far more scrutiny is now given to all securities matters, from structured transactions to the responsibilities assigned to boards of

directors. New legislation has been passed (*e.g.*, Sarbanes-Oxley) and the SEC has increased its enforcement activities.

Over the next ten years I believe that the pendulum will swing back to some extent; we have now gone too far in the direction of over-regulation. There have been instances where companies have been pursued by regulators for conduct that previously had not been viewed as unlawful. More balance is needed and regulatory authorities should use greater caution in exercising their prosecutorial discretion. For example, given the immense power of the SEC over regulated entities, some entities feel forced to settle questionable charges simply because the failure to do so could have disastrous consequences to their reputations and otherwise.

Success As A Securities Attorney

In order to keep your edge as a securities attorney it's important to read constantly, subscribe to periodicals in the securities area, and participate in legal education seminars.
Reading recent court decisions and scholarly works helps you stay attuned to emerging areas of securities law.

In order to be innovative, you must constantly question assumptions and never settle for the easy answer. You should never rely on someone else's description of case law that is controlling on the facts presented; you should read the controlling case from beginning to end, including footnotes. As you read, other relevant issues inevitably come to mind, either relating to the subject case or to another case you are handling. In my view, preparation and thoroughness are the keys to innovation.

The best piece of advice I ever received as a practicing attorney is to always think and act ethically – your reputation is the only one you have.

When you have a good reputation you can maintain credibility with your clients, the court, and even your adversaries.

I can't stress enough how important it is to disclose, disclose, disclose. The federal securities laws are designed in large part to ensure that investors are provided with all the information necessary for them to make an informed investment decision. When in doubt as to whether a particular piece of information should be disclosed it's best to make disclosure. And speaking of disclosure, it is in your interest to make full disclosure of your business practices. If your investors and clients are fully aware of exactly what you're doing with their money or their stock, they will be more satisfied with your services and they will also have less of a basis on which to sue you.

One of my favorite quotes from a court's decision in the securities law context comes from a decision of the Seventh Circuit Court of Appeals: "'Even lies are not actionable' when an investor 'possesses information sufficient to call the [mis]representation into question.'" (*Teamster Local 282 Pension Trust Fund v. Angelos*, 762 F.2d 522, 529 (7th Cir. 1985)). What this court is basically saying is that, if you provide investors with all material facts, they cannot later sue you for an isolated public statement that might in and of itself be considered false. Again, it is in your interest to give full disclosure of all materials facts to your investors and customers in order to minimize the risk of securities litigation.

Stewart D. Aaron is a partner in Arnold & Porter LLP's New York office. He practices commercial litigation with an emphasis on securities law matters. Mr. Aaron's practice involves the representation of clients in litigated matters in state and federal courts, mostly in New York, and before regulatory bodies and self regulatory organizations.
His areas of expertise include class action and securities enforcement matters.

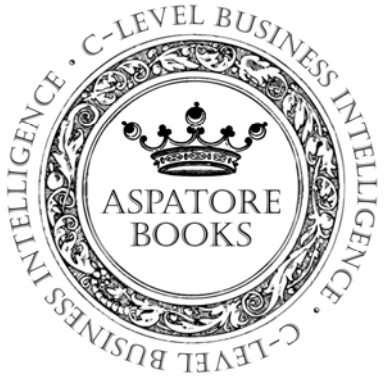
A member of the New York bar, he attended Cornell University and received his JD from Syracuse University College of Law.

www.Aspatore.com

Aspatore Books is the largest and most exclusive publisher of C-Level executives (CEO, CFO, CTO, CMO, Partner) from the world's most respected companies and law firms. Aspatore annually publishes a select group of C-Level executives from the Global 1,000, top 250 law firms (Partners & Chairs), and other leading companies of all sizes. C-Level Business Intelligence™, as conceptualized and developed by Aspatore Books, provides professionals of all levels with proven business intelligence from industry insiders – direct and unfiltered insight from those who know it best – as opposed to third-party accounts offered by unknown authors and analysts. Aspatore Books is committed to publishing an innovative line of business and legal books, those which lay forth principles and offer insights that when employed, can have a direct financial impact on the reader's business objectives, whatever they may be. In essence, Aspatore publishes critical tools – need-to-read as opposed to nice-to-read books – for all business professionals.

Inside the Minds

The critically acclaimed *Inside the Minds* series provides readers of all levels with proven business intelligence from C-Level executives (CEO, CFO, CTO, CMO, Partner) from the world's most respected companies. Each chapter is comparable to a white paper or essay and is a future-oriented look at where an industry/profession/topic is heading and the most important issues for future success. Each author has been carefully chosen through an exhaustive selection process by the *Inside the Minds* editorial board to write a chapter for this book. *Inside the Minds* was conceived in order to give readers actual insights into the leading minds of business executives worldwide. Because so few books or other publications are actually written by executives in industry, *Inside the Minds* presents an unprecedented look at various industries and professions never before available.


C-LEVEL BUSINESS INTELLIGENCE •
ASPATORE
BOOKS
• C-LEVEL BUSINESS INTELLIGENCE