

## Optimizing Damages Adjustments In Securities Class Actions

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Because most securities class actions settle, the statutory limitations on damages that plaintiffs are allowed to recover following a favorable verdict are often overlooked. Those limitations, however, can be surprisingly large, and understanding them can improve defendants' negotiating position in the vast majority of cases that actually settle.

There are two statutory limitations on damages found in the 1934 Securities Exchange Act: (1) Section 28(a)'s "actual damages" limitation and (2) Section 21D(e)(1), commonly called the "90-day bounce-back" rule, which was added as part of the Private Securities Litigation Reform Act's amendments and which limits plaintiffs to a form of nominal losses.

### Why Do Damages Get Adjusted?

A broad principle that applies to all damages awards in Rule 10b-5 cases is Section 28(a)'s requirement that no person "recover ... a total amount in excess of [that person's] actual damages." The statute does not define "actual damages," however, and courts have employed different methodologies in limiting plaintiffs' recoveries.

Any adjustments necessary to conform damages awards to those statutory damages limitations are applied as funds are administered to class members following settlement or, more rarely, a verdict. In order to better understand the adjustment methods commonly used, the authors reviewed 65 settlement allocation plans from 2012 and 2013, as well as two cases that produced jury verdicts for plaintiffs; in those cases (Vivendi and Household)[1] court orders defining the terms of their judgments

were reviewed, including the application of statutory offsets.

In addition, the application of the 90-day bounce-back rule in settlements and following verdicts was reviewed. That rule is really a form of a nominal loss cap that by statute is expressly applied to so-called “retention damages” (i.e., damages awarded for class period purchases that are retained through the end of the class period), and as a matter of practice, is typically applied in settlements to “in-and-out damages” for shares purchased and sold during the class period.

### **How Do Damages Get Adjusted?**

Statutory damages limitations manifest themselves in three basic ways in settlements and verdicts, and there is surprising inconsistency in how they are applied between and among settlements and verdicts.

The first and perhaps most obvious type of adjustment prevents plaintiffs from benefiting financially from the very same misrepresentations or omissions that caused their alleged harm. Say a plaintiff purchased a share of stock before the class period, when inflation was zero (i.e., before a company misrepresentation or omission had artificially inflated the stock price), and then sold that share during the class period, when the fraudulent statements had inflated the stock’s price by \$10 per share. That “undeserved” \$10 gain logically should offset that same plaintiff’s losses caused by subsequent purchases of inflated shares during the class period. This principle was applied in both Vivendi and Household, but it was not used in any of the 65 settlements reviewed. This probably is owing to the fact that as a condition of settlement, defendants agree not to interfere with settlement administration, and plaintiffs’ counsel may not feel it is their job to deny “windfalls” to class members. But it’s a zero-sum game in fixed-amount settlements (which is the only way securities cases settle), so in this respect one claimant’s gain is another one’s loss.

The second method of adjustment is perhaps less intuitive. It offsets an investor’s damages with her aggregate nominal gains (i.e., the sales price less purchase price). Thus, if a plaintiff bought a share of stock during the class period at \$40 (while inflation was \$10 per share), and it rose for nonfraudulent reasons during the class period to \$45, at which point the plaintiff sold (with inflation still at \$10), then the plaintiff’s damages for any subsequent class period purchase would be offset by her noninflationary nominal gain of \$5. This method was not referenced in either the Household or Vivendi judgments, but was observed in 57 percent of the 65 settlements analyzed.

The third method of limiting damages is a nominal loss cap on per-share damages. This cap is consistent with the Reform Act’s bounce-back rule limiting a plaintiff’s damages on a per-transaction basis to the difference between the purchase price and the actual sales price (or the mean trading price during the 90 days following the final corrective disclosure).[2] Thus, if the plaintiff bought a share of stock at \$40, held it through a \$10 correction following the revelation of the misrepresentation, but did not sell it until the stock had rebounded to a mean trading price of \$37 over the relevant period, this adjustment method would recognize only a \$3 loss. This method of adjustment was used in both the Household and Vivendi judgments, at least as applied to retention damages. A simple nominal loss cap (i.e., sales price less purchase price) was also used in almost all settlements reviewed, where it was generally applied to both retention and to in-and-out damages.

### **How Can Defendants Use Adjustments to Their Advantage?**

The size of potential adjustments can be quite surprising, particularly when it comes to offsetting gains from inflation, where the theoretical aggregate value of such offsets can actually exceed traditional

“plaintiffs’-style” damages estimates. That’s not really possible, of course, because one class member’s gains cannot be used to offset a different class member’s losses; instead, those gains and losses must be painstakingly calculated on an individual basis during the claims process. But this illustrates the basic proposition that the well of potentially available offsets can be quite deep.

Because one can calculate the theoretical maximum of inflationary gains available to the entire class, but can’t know the actual number of offsets available through matching principles until the end of the class administration process, it creates substantial uncertainty for both plaintiffs and defendants. That uncertainty can be used by defendants to settle cases, as the authors of this article recently did in a case involving a class action verdict in plaintiffs’ favor notwithstanding the exhaustion of all appeals. Defendants may not fully appreciate these potentially sizeable offsets, and the leverage that they give defendants in settlement negotiations.

The nominal gains offset likewise cannot be precisely calculated until after the claims process is complete, so the same principles apply, although in the typical case it is likely that this offset will be smaller than the others discussed in this article.

On the other hand, the aggregate impact of the Reform Act’s per-share nominal loss cap can be calculated using trading models on a classwide basis (at least by the end of the 90-day waiting period). This number can also be quite substantial, particularly where a stock’s price is appreciating at points during and after the end of the class period. Defendants ought to know this number before they enter into settlement discussions.

### **Damages Adjustments and Opt Outs**

If present practices remain constant, understanding statutory offsets can also affect the opt-out calculus. Large institutional traders might want to think twice about opting out of class actions if they have substantial inflationary gains that traditionally have not been recognized in settlements, but that have been applied in judgments following verdicts. Convincing potential opt outs to stay with a settlement on this basis can save considerable litigation expense and effort.

### **Conclusion**

In each of these ways, the often overlooked area of statutory damages limitations provides leverage to defendants in settlement discussions and is essential knowledge in any post-trial proceeding following a plaintiffs’ verdict.

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[1] In re Vivendi Universal S.A. Sec. Litig., 284 F.R.D. 144 (S.D.N.Y. 2012); Lawrence E. Jaffe Pension Plan v. Household Int'l., 756 F. Supp. 2d 928 (N.D. Ill. 2010). Household was recently overturned in significant part on appeal, but in ways that do not affect this analysis. See Glickenhau & Co. v. Household Int'l. (7th Cir. May 21, 2015).

[2] If sold within the 90-day period following the final corrective disclosure, the sales price is calculated as the mean trading price up to the date of sale.

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