

# Advocate

A SECURITIES FRAUD AND CORPORATE  
GOVERNANCE QUARTERLY

## CLASS ACTIONS

### COMPENSATING VICTIMS AND DETERRING WRONGDOING

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A class action is a type of lawsuit where a representative prosecutes common claims of many, similarly-situated people. Thus, under appropriate circumstances, a court can efficiently resolve hundreds or even thousands of claims in a single action. This prevents piecemeal litigation and avoids inconsistent results. The class device also gives individuals with relatively small losses, where the potential recovery does not justify the cost of an individual lawsuit, the ability to obtain redress by aggregating losses with others. These greater damages compel defendants to take notice. Class actions, therefore, promote the two fundamental purposes of the American tort system: Compensating victims and deterring harmful behavior.

A securities fraud lawsuit is a quintessential case for class treatment. When, for example, a company and its officers issues false or misleading information that artificially inflates the price of publicly-traded securities, each investor who purchased the security at inflated prices suffered an injury and has a potential claim. This can impact the retirement money and savings of many thousands of people and institutions, amounting in the aggregate to billions of dollars. Because each investor's claim arises from common facts, it makes common sense for an investor with a substantial stake in the lawsuit (or a small group of investors, in certain circumstances) to represent the entire class and sue to recover class-wide losses in a single lawsuit. Absent such a class action, most investors would have no practical avenue for redress. Moreover, because the aggregate damages are sometimes enormous, class actions have greater economic power and deter corporate wrongdoing far better than individual lawsuits.

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Deterring corporate malfeasance is essential to the continued strength of our capital markets. Unquestionably, our securities markets are the safest and most efficient in the world. This is not an accident. After the stock market crash of 1929, investors lost confidence in the accuracy of corporate statements. To restore investor confidence, Congress created laws that require publicly-traded companies to make honest and timely disclosure of material information. We also have anti-fraud laws on the books that give private investors the ability to sue for damages when victimized by insider trading and similar schemes that undermine the market's strength and efficiency. Indeed, when enacting the Private Securities Litigations Reform Act of 1995 ("PSLRA") — which attempted to eliminate frivolous lawsuits — Congress reiterated that legitimate private actions are an "indispensable tool with which defrauded investors can recover their losses," "promote ... confidence in our capital markets" and "help to deter wrongdoing."

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Institutional investors, such as public pension funds, have a large stake in our capital markets and stand to benefit the most from the deterrence of corporate fraud. Institutional investors frequently have the largest financial interest in particular securities fraud class actions. As such, institutions are better able to maximize recoveries than investors with very small individual losses. Thus, when enacting the PSLRA, Congress sought to encourage institutional investors to take the lead in such cases. Since 1995, more and more institutions have stepped forward to represent the investor class in shareholder class actions. Consequently, the recoveries have been significantly higher than before the PSLRA. Since 1997, more than \$10 billion dollars has been recovered through settlement, which is a mean increase of more than \$10 million per settlement. Because institutions are entitled to the largest *pro rata* share of these recoveries, the participation of institutional investors in shareholder class actions has paid off handsomely.

As the larger recoveries show, shareholder class actions remain an effective tool to compensate victims of securities fraud and deter corporate wrongdoing. The PSLRA, after all, may have raised significant hurdles for defrauded investors, but it did not erect insurmountable barriers to legitimate securities fraud lawsuits. Now, as before, securities-fraud cases are perfectly suited for class treatment and are vital to the protection of shareholder interests and the continued strength of our capital markets.

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