Why are securities class action mediations different than mediations of other types of claims?

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To borrow a few of the words spoken in 1926 by F. Scott Fitzgerald to Ernest Hemingway in a quite distinct context, securities class action mediations "are different than" mediations of most other lawsuits.

One reason for this difference is that securities cases often have very large amounts of money at stake (hundreds of millions or even billions of dollars are commonly claimed). Furthermore, securities actions are governed by a highly complex body of case law from state and federal courts at all levels, including the Supreme Court, as well as pleading requirements, discovery stays, defenses and other special provisions and procedures that are unique to the Securities and Exchange Act of 1934, the Securities Act of 1933 and the Private Securities Litigation Reform Act. Because of the complexity of the analysis of the laws at issue, the parties often find themselves taking quite different views of the strength of the claims made. This combination of large amounts of money at stake and the complexity of laws at issue frequently results in parties whose settlement positions are far apart.

In addition to the size and complexity of securities cases, securities class actions are often "different" from other cases, because of the sheer number of people, usually with conflicting interests, involved in resolving these cases. Securities litigation commonly involves, not only multiple plaintiffs and multiple defendants, but also multiple insurers providing directors and officers ("D&O") insurance to some or all of the defendants, in appropriate case securities underwriters and in some unusual cases indemnitors of defendants are also parties to the negotiations. Each of these parties may have multifaceted and distinct interests, which vary even between parties which are in the same category of participant, resulting in inconsistent views of what constitutes a fair settlement.

All of these specialized and challenging circumstances often make securities cases at least unusual and sometimes with unique challenges. They also strongly support the conclusion that they are generally easier to settle in mediation with the unbiased expertise of an experienced independent mediator rather than among the parties alone with their disparate viewpoints and goals. Moreover, each securities class action mediation also comes with its own set of unique challenges.

When to Start Thinking about Settlement and the Value of Undertaking an Early Case Assessment

Settlement discussions may occur at any time during the course of a securities case. Most often, however, the parties wait until after a motion to dismiss is filed, fully briefed and ruled upon by the Court before beginning settlement discussions.

This is because securities case have an approximately 50% dismissal rate. For a defendant in particular this is one overriding reason to wait until a motion to dismiss is decided to broach settlement and D&O insurers will often oppose funding a settlement, or even discussing a settlement with the plaintiffs, until the motion to dismiss has been resolved. Most of the cases that are not dismissed eventually settle after the motion to dismiss decision and never make it to trial.

Early Case Analysis

In order to prepare for motions to dismiss, settlement negotiations, mediations and discovery, during the earliest stages of a case (pre-discovery), counsel should learn as much as possible about all available evidence, relevant facts and the applicable law(s) as part of an early case assessment. Whether dealing with motions, evaluating the risks and value of a case or preparing for discovery or a mediation, a total mastery of available facts is essential for counsel to best represent their clients. In addition to helping counsel set realistic expectations for clients and prepare for later stages of litigation, it almost always is helpful to counsel in evaluating whether or when to settle a case or to continue to litigate, including whether and when to engage in mediation.

When conducting an early case assessment, defense counsel should, among other things:

- Conduct interviews of available individuals;

- Gather important documents from clients;
- Engage an expert to conduct a preliminary damages analysis and assist in estimating potential ranges of damages as well as possibly other experts; and
- Evaluate the impact of a settlement on any parallel proceedings.

Why Mediation?

The securities cases that settle most commonly do so through mediation (98 percent of securities class actions either settle or are dismissed. In large part, because of the multiplicity of parties with differing viewpoints, counsel to any one party will likely find it very difficult, if not impossible, to effectively manage the multi-party simultaneous negotiations necessary to settle most securities cases. This is also in part because counsel is viewed as, and are, advocates for their own client(s). Therefore, the parties almost always engage an independent mediator familiar with securities class actions and the applicable law to help resolve the case.

These mediations are most often presided over by one of a relatively small group of mediators with known expertise in handling mediations of large complex cases and, importantly, a strong understanding of the securities laws. These successful mediators have self-confidence, are persuasive and can be forceful in expressing their own views of a case's merits, the risks involved for the parties and fair terms of settlement. These mediators all believe it helps them if the parties are represented by experienced, knowledgeable and reasonable counsel.

An experienced and capable mediator can:

- Provide expertise, impartiality, and creditability in dealing with the multiplicity of parties with conflicting interests and the complexity of the issues.
- Help foster constructive consideration by all parties of the many issues and risks existing in a case and emphasize the value for all parties in compromise; and
- Provide an independent, realistic and knowledgeable view of strengths and weaknesses in each party's position.

Role of D&O Insurers and Others in Mediation

Insurers frequently face potential liability for claims in securities class actions, and as a result, play a critical role in funding a settlement. These carriers are key participants in settlement discussions, including at mediation.

A defendant company, and directors and officers usually have different types of D&O insurance provided by multiple insurers in separate layers of coverage that are relevant to a particular securities litigation. These layers, often referred to as a tower of insurance, consist of a primary insurance carrier with a policy that covers the first layer of liability (for example, the first $5 million of liability above any retention amount called for by the insurance policy) and successive layers of additional insurance that cover liabilities exceeding the tranche of insurance directly

below it. These insurance amounts, including the primary policy and successive layers, add up to the total amount of available insurance.

Insurers in different tranches often disagree among themselves on what is a reasonable settlement due to the varying levels at which policies in an insurance tower come into play and therefore have different risks. Frequently, a mediator is faced with the need to persuade insurers to contribute tens of millions of dollars to resolve a case, despite these wide variations in risk.

Not infrequently, there is also disagreement amongst defendants or amongst plaintiffs about risks and reasonable settlement amounts. And, of course, the plaintiffs and defendants generally strongly disagree with each other on the merits of the case, the facts, the proper interpretation of the law and potential damages.

Sometimes expert witnesses are brought to mediation, most often to opine on the complex issue of how to calculate damages in these cases. Damages experts for plaintiffs and defendants almost always disagree by a significant amount on the quantum of damages. It is not uncommon for lawyers to think that some of the methodology used by some class action damage experts is arcane and/or debatable.

Given the surfeit of parties, the amount at stake and the complexity of applicable law, it is not surprising that only an experienced mediator with some gravitas, common sense, credibility and an understanding of the securities laws has

a chance of bringing the many viewpoints of the parties at a mediation to a global resolution.

How Settlement Will Impact Parallel Proceedings and Vice Versa

Counsel should consider the impact that a settlement of one securities case may have on other related litigations or investigations in which their clients are involved. Parallel proceedings can include some combination of regulatory and criminal proceedings (both state and federal) and related additional civil litigation. Depending on the specific facts, procedural posture of the proceedings, and the proposed terms of the resolution, resolving a criminal matter first may hamper a defendant's ability to defend itself in related civil securities proceedings or vice versa. For example, any admission in a settlement with the SEC or the Department of Justice, could impact ongoing civil litigation. Even if the defendant enters into a settlement on a "neither admit nor deny" basis, it risks affecting the civil case. On the other hand, resolving a civil case first may provide criminal prosecutors with access to discovery they might not have requested or had access to.. Nevertheless, it may be advantageous, depending on the facts and circumstances, for a defendant to resolve the civil case, which usually involves voluminous and costly discovery, before dealing with a related regulatory or criminal matter.

When deciding whether to settle one or more of multiple proceedings, defense counsel should consider:

- The strength of the claims. If a party is defending against weak claims, it may decide to continue litigating some or all of the parallel proceedings.
- The cost of settlement. It may not be worth settling either case where the opposing party has made an excessively costly settlement demand.
- Adverse party access to unfavorable facts. Prioritizing the litigation and settlement of one parallel proceeding over another, may give an adverse party access to facts that would otherwise be unavailable or unknown.

The authors would be happy to discuss any questions readers may have on any of the above topics.

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