

## A Rare Spectacle: Two Securities Lawsuits Go To Trial

The life pattern of security class action lawsuits can vary widely according to numerous factors particular to the case. Regardless of differences, one aspect of the securities class action lawsuit has remained predictable: the conclusion. Most securities class action lawsuits either settle or are dismissed, with very few actually going to trial. As such, it was a very unusual occurrence recently when not one, but two, securities lawsuits went all the way to a jury verdict. The two verdicts went in opposite directions, with one case being decided in favor of the defendants and the other verdict resulting in an award of damages to the plaintiffs. This article discusses the two cases, analyzes their outcomes, and considers the possible significance of the two verdicts for future securities class action lawsuits.

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### The JDS Uniphase Trial

The first of the two cases involved JDS Uniphase (JDSU). JDSU and four of its former directors and officers were first sued in March 2002 in the United States District Court for the Northern District of California, on behalf of persons who acquired JDSU shares between October 28, 1999 and July 26, 2001. The plaintiffs alleged that the defendants engaged in a scheme to artificially inflate JDSU's stock price by falsely representing that there was a strong demand for JDSU's products. The plaintiffs also alleged that defendants overstated the value of the company's inventory by failing to write-off excess and returned product inventory.

The plaintiffs alleged that the inflated share price enabled the company to complete several stock-for-stock acquisitions at inflated terms, and permitted the individual defendants to sell more than \$500 million worth of shares from their personal holdings of company stock. The company lost \$65 billion in 2001 and 2002 (and has failed to turn a profit since).

The defendants argued that the company was caught off guard — along with the rest of the technology industry — when technology spending abruptly stopped at the end of the dot-com boom. Further, the defendants argued that — until the bubble burst — the company's executives continued

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### Contact:

**Lisa McNamara Hughes**  
Phone: 860-906-0103  
lhughes@oakbridgeins.com  
www.oakbridgeins.com

to believe that demand would continue. The defendants also argued that the individuals' stock sales were proper and fell within the individuals' normal trading patterns.

The plaintiff class was represented at trial by the lead plaintiff, the Connecticut Retirement Plan and Trust Fund. Although there were pre-trial settlement negotiations, the parties were unable to reach a settlement agreement, and as such, the case went to trial on October 23, 2007.

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On November 27, 2007, the civil jury returned a verdict in favor of the defendants on all counts. The parties' post-trial motions are now pending before the court. Unless the plaintiffs are substantially successful in their post-trial motions, the case will likely be headed next to the United States Court of Appeals of the Ninth Circuit.

### **Victory: Defendants**

#### **The Apollo Group Trial**

The second of the two cases to go to trial involved Apollo Group. Apollo Group and two of its former officers were first sued in October 2004 in the United States District Court of the District of Arizona, on behalf of persons who purchased Apollo stock between February 27, 2004 and September 14, 2004.

Apollo is the corporate parent of the University of Phoenix (UOP), the largest for-profit provider of higher education in the United States. The lawsuit relates to an investigation commenced by the U.S. Department of Education (USDE) based on the allegations of two former UOP employees that UOP received funding in violation of regulations specifying the way that educational recruiters may be compensated.

On February 4, 2004, a USDE employee issued a "Program Review Report" accusing UOP of violating Department rules on recruiter compensation. The plaintiff in the securities lawsuit later alleged that the violations in the report could have resulted in the limitation or termination of UOP's funding from the Department.

On September 7, 2004, Apollo agreed to pay the USDE \$9.8 million to settle the program review. Apollo did not admit to any wrongdoing or liability. News of the settlement first became public on September 14, 2007, but Apollo's stock price did not react significantly until a securities analyst issued a report on September 24, 2004, expressing concern about the settlement.

The plaintiffs in the securities lawsuit argued that Apollo improperly failed to disclose the February report and that the company's disclosures between February and September 2004 were misleading. The defendants countered by arguing that the company's lawyers had advised that it had no duty to disclose the February report, which the company viewed as incomplete, interim and inaccurate. The defendants further argued that there was no evidence of *scienter*, and that the plaintiffs could not show loss causation given the absence of a stock price drop when the settlement was first disclosed.

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Trial in the case commenced on November 14, 2007. The plaintiff class was represented at trial by the lead plaintiff, the Policeman's Annuity and Benefit Fund of Chicago. The jury began deliberations on January 10, 2008, and on January 16, the jury returned a verdict in favor of the plaintiff. The jury awarded damages of \$5.55 per share.

According to Apollo's January 24, 2007 press release, "the actual amount of damages payable cannot be determined until notices are published and shareholders present valid claims." Based on estimates of the number of shares in the class, "the damages would range between \$166.5 million and \$277.5 million." The company intends to record its best estimate of its potential loss, including future legal costs, in its next quarterly financial report.

### **Victory: Plaintiffs**

#### **Discussion & Analysis**

According to the *Securities Litigation Watch* blog, only 19 securities class action lawsuits have gone to trial since 1996, of which only six cases (including JDSU and Apollo Group) involved conduct that took place after the passage of the Private Securities Litigation Reform Act. Of those six cases, three verdicts have been given in favor of the plaintiffs and three in favor of the defendants, although (as discussed further below), one of the three defense verdicts was recently reversed by the Ninth Circuit.

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It is important to keep in mind that these two cases are far from over. The unsuccessful parties in both cases will, if their post trial motions are unsuccessful, undoubtedly appeal to the Ninth Circuit. On appeal, all parties (and, in particular, the

plaintiffs in the JDSU case) will look with interest at the Ninth Circuit's November 26, 2007 opinion in the *Thane International* case, in which the Ninth Circuit reversed and remanded a trial verdict that had been entered on behalf of the defendants in that case.

(*Thane International* is one of the six post-PSLRA securities cases to reach a verdict mentioned above.) The defendants in the Apollo Group case will likely advocate that they have substantial appeal grounds on the questions of *scienter* and loss causation, and on the issue of whether the company even had a duty to disclose the interim Education Department report. In short, the JDSU and Apollo Group cases may yet have a long way to go.

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Because these two trials resulted in opposite outcomes, it might be assumed that the two cancel each other out. There may be some truth to this analysis; it certainly could be argued that securities cases are no more likely to go to trial than they ever were.

But there may be some reason to believe that defendants may be more reluctant to push a case all the way to a jury verdict than they were before.

First, the magnitude of the damages in the Apollo Group case cannot be overlooked and would seem to be a substantial deterrent for any securities lawsuit defendant contemplating taking a case to the jury. Even though the ultimate costs of damages to Apollo Group is still uncertain, by any measure, it will be significant.

Second, the impact of the verdict on Apollo Group's financial position also makes a statement that no corporate defendant could easily ignore. The verdict clearly creates a very unpleasant financial reporting and disclosure situation for the company. Indeed, Apollo Group also disclosed that the verdict may put the company in technical noncompliance with its covenants to its creditors. These practical concerns are in addition to the even more basic concerns such as the burden, distraction and expense of a trial and could daunt any defendant.

Third, although we have no first-hand knowledge of Apollo Group's insurance program, the Apollo Group verdict may create insurance coverage issues for the company. While neither the particulars of Apollo Group's insurance coverage nor the Apollo Group's insurance carriers' coverage position have been publicly disclosed, there is a question as to whether the jury verdict represents an adjudication of fraud sufficient to trigger the fraud exclusion typically found in most directors and officers liability insurance policies. In that regard, the company's January 24 press release states that:

The Company does not expect to receive material amounts of insurance proceeds from its insurers to satisfy any amounts ultimately payable to the plaintiff class. In addition, although the insurers have made or are expected to make payments under the policy for defense costs, including legal fees incurred of \$25 million, the insurers have not waived their right to object to the coverage.

So, while Apollo Group's insurance situation appears uncertain at best, the implication offers a stark reality. Companies and their directors and officers may risk precluding their insurance coverage by forcing a case to a jury verdict. This will serve as a substantial deterrent for defendants to take a case to trial.

What remains unclear at this point is whether these trial developments will have any impact on the dynamics of settlement negotiations. It is possible that plaintiffs may be emboldened to take a harder line, in the hopes that the threat of an Apollo Group-type verdict will weaken defendants' resolve and encourage them to seek a settlement — even a disadvantageous settlement — rather than risk an adverse verdict.

It is worth noting that both of the cases that recently went to trial involved institutional plaintiffs, whose relatively greater sophistication and resources may make them more willing to accept the risks and burdens of trial. Notwithstanding the defense verdict in the JDSU trial, other institutional plaintiffs may feel empowered to push a case to trial and use the threat of an adverse verdict to encourage more generous settlement terms. But this more aggressive strategy would have significant risks for plaintiffs. In the end, few litigants — plaintiffs included — truly want to endure the burden, risks and expense of trial.

### Conclusion

The spectacle of two securities cases going to trial is noteworthy in and of itself. The *significance* of this spectacle is less certain. The split in the outcome of the two cases seems to suggest that there may be no change in the small likelihood of other cases going to trial. But practical and prudential considerations — including, in particular, the possibility of a runaway jury verdict and the risk of losing insurance coverage — may even more strongly incline defendants against trial. The more interesting question may be the potential effect of these verdicts on future settlement negotiations, an outcome that remains to be seen.

### About the Author

This article was prepared by Kevin M. LaCroix, Esq. of OakBridge Insurance Services. Kevin has been advising clients concerning directors' and officers' liability issues for nearly 25 years. Prior to joining OakBridge, Kevin was President of Genesis Professional Liability Managers, a D&O liability insurance underwriter. Kevin previously was a partner in the Washington, D.C. law firm of Ross Dixon & Bell. Kevin is based in OakBridge's Beachwood, Ohio office. Kevin was the co-Chair of the 2007 PLUS D&O Symposium. Kevin's direct dial phone number is (216) 378-7817, and his email address is [klacroix@oakbridgeins.com](mailto:klacroix@oakbridgeins.com).

A version of this article previously appeared on The D&O Diary, the author's Internet weblog. You can access the blog via our website at [www.oakbridgeins.com](http://www.oakbridgeins.com). To monitor developments on this and other important topics relating to directors' and officers' liability, readers are encouraged to refer to The D&O Diary regularly.

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