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Is Everything Securities Fraud?

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"An odd fact of the U.S. legal system for public companies is that every crime is also securities fraud: If a company does a bad thing, and regulators find out about it, then the bad-thing regulators can punish it for doing the bad thing, but the securities regulators can also punish it for not disclosing the bad thing to shareholders. . . . It is a strange combination: Generally speaking the companies do the bad things on behalf of shareholders—to make more money for them—but then the securities regulators come in and fine them for defrauding shareholders."

-Matt Levine[1]

Securities litigation is a virtually inevitable fact of life for any public company. Often, investors sue because the firm's managers engaged in fraud that directly harmed the shareholders—say, by doctoring the firm's financials, or lying about known business prospects. However, shareholders also sue their companies when those companies engage in conduct that primarily harms a different set of constituents. When a drug on the market proves to have dangerous side effects, a faulty car battery bursts into flames, or an oil rig explodes, it's difficult to say that the most direct victims are the companies' shareholders. Yet shareholders commonly sue under the federal securities laws based on precisely this kind of conduct, on the basis that the managers should have better disclosed the underlying facts, and investors were harmed by the resulting drop in stock price because they did not. In recent years, these cases, dubbed "event-driven securities litigation," have become more common and have drawn increasing criticism on the grounds that they are opportunistic and generally lack merit. However, there has so far been no comprehensive examination of these lawsuits.

This paper seeks to fill the gap by investigating the prevalence and attributes of these lawsuits. In a sample from 2010 to 2015, I find that roughly 16.5% of securities class actions arise from conduct where the most direct victims are not shareholders. However, I find that these cases have roughly a 20% lower likelihood of being dismissed and settle for significantly higher amounts. These

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1. Matt Levine, Opinion, *Snap Earnings and Emissions Fraud*, BLOOMBERG (May 11, 2017, 6:10 AM), https://www.bloomberg.com/opinion/articles/2017-05-11/snap-earnings-and-emissions-fraud [https://perma.cc/VKJ5-6LB6].

lawsuits are also more likely to be brought against large defendant firms, more likely to involve an institutional investor as a lead plaintiff, and much more likely to involve a non-SEC investigation or inquiry than cases where the primary victims are shareholders. Many of these attributes are used in the literature as proxies for merit. However, I argue that the merit of these cases is not clear-cut. Further, from a policy perspective, while these cases may have deterrence value, they may not be an optimal means to monitor corporate misconduct that harms outsiders.

INTRODUCTION

Securities litigation is a virtually inevitable fact of life for any public company. Often, investors sue because the firm's managers engaged in fraud that directly harmed the shareholders—say, by doctoring the firm's financials, or lying about known business prospects. However, shareholders also sue their companies when those companies engage in conduct that more directly harms a different set of constituents. When a pharmaceutical company sells dangerously contaminated drugs,[2] a faulty car battery bursts into flames,[3] or an oil rig explodes,[4] it's difficult to say that the direct victims of the misconduct are the companies' shareholders. Yet shareholders commonly sue under the federal securities laws based on precisely this kind of conduct, on the ground that the managers should have better disclosed the underlying facts, and investors were harmed by the resulting drop in stock price because they did not. This has led at least one notable commentator to argue that "everything is securities fraud."[5] Objections from industry and academia to these

2. Monk v. Johnson & Johnson, No. 10-4841, 2011 WL 6339824 (D.N.J. Dec. 19, 2011).
3. *In re* Tesla Motors Inc. Sec. Litig., 75 F. Supp. 3d 1034 (N.D. Cal. 2014).
4. *In re* BP P.L.C. Sec. Litig., 843 F. Supp. 2d 712 (S.D. Tex. 2012).
5. Matt Levine, Opinion, *Bored Apes Go to Court*, BLOOMBERG (Feb. 22, 2022, 10:43 AM), https://www.bloomberg.com/opinion/articles/2022-02-22/bored-apes-go-to-court [https://perma.cc/EMP8-R6ZP].

lawsuits, dubbed "event-driven litigation," are becoming increasingly vocal.[6] However, although there is general documentation of the rise in event-driven securities class actions in recent years,[7] there has so far not been a comprehensive study of their prevalence, attributes, and outcomes.

This Article seeks to address this gap in the literature by conducting a comprehensive analysis of securities class actions. I first seek to evaluate the extent to which securities class action lawsuits are driven by events in which the primary victims are not shareholders. Second, I examine the outcomes of these lawsuits and whether they are likely to be more lucrative for plaintiffs and their law firms. Third, I examine the role of government investigations in these lawsuits, with particular attention to inquiries by regulators other than the SEC. Fourth, I investigate who is behind these lawsuits, specifically focusing on major institutional investors and leading law firms. Finally, I consider whether these lawsuits are desirable, particularly whether they are an effective device in monitoring firms' compliance with regulation and mitigating harm to society.

For the observational analysis, I read almost 500 securities class actions against public firms using the data from the Stanford Law School Securities Class Action Clearinghouse from 2010 to 2015.[8] I code each case based on whether the primary victims of the company's conduct are its investors, or some other group. The first novel finding of this study is that roughly 16.5% of securities class actions arise from misconduct where the most direct victims are not shareholders. I also find that these cases have significantly lower dismissal rates and generate higher settlements than cases where the primary victims are shareholders. Investors have a 20% higher chance of having their lawsuit dismissed if the misconduct at issue primarily harms them. The average shareholder settlement in cases where the misconduct most directly harms other victims is more than double the average settlement for those cases where the primary victims are shareholders.[9] Accordingly,

6. Critics contend that these actions are problematic because plaintiffs' lawyers can simply capitalize on the investigative work of the government or the tort victims already suing the company for the same event, making them "easy for plaintiffs to bring even though they are likely to have less merit." Michelle Reed & Matthew Lloyd, *Stemming the Tide of Meritless Securities Class Actions*, EXPERT ANALYSIS (Thomson Reuters), Mar. 8, 2019, at 3, https://www.akingump.com/a/web/102513/SEC-Reed-Lloyd.pdf [https://perma.cc/M28Z-J3WC].

7. *See id.*; *see also* Michael Klausner, Sam Blake Curry & Jason Hegland, *Guest Post: "Stock Drop Lawsuits*,*"* D&O DIARY (June 28, 2020), https://www.dandodiary.com/2020/06/articles/securities-litigation/guest-post-stock-drop-lawsuits/ [https://perma.cc/R6KE-2X5X] (investigating the incidence of "stock drop" lawsuits).

8. *See Securities Class Action Clearinghouse: A Collaboration with Cornerstone Research*, STAN. L. SCH., http://securities.stanford.edu/filings.html [https://perma.cc/HU4P-C2R3] (last visited Aug. 25, 2022).

9. The correlations between dismissal and settlement rates and whether the conduct alleged directly harms shareholders or other victims persist even when controlling for firm size, class period duration, court expertise, and indicia of merits of the lawsuit, such as institutional investors as lead plaintiffs, earnings restatements within the class period, and whether the complaint cited an SEC investigation.

the empirical analysis supports the notion that event-driven securities class actions are big-ticket cases; substantial money and resources are tied up in securities lawsuits where the primary victim is not a shareholder. This success is likely due in large part to my second finding, which is that in these lawsuits, shareholder plaintiffs almost universally benefit from government investigations into the defendant firms' misconduct against third parties.

In examining the parties in event-driven securities class actions, I find that the majority of these lawsuits are brought by institutional investors (particularly pension funds), and the top-tier plaintiffs' lawyers that serve them. I also find that defendant firms in these cases are generally much larger than those in cases where the primary harm is to shareholders. This finding further confirms that event-driven lawsuits are not a trivial phenomenon, and that the major players in securities class action litigation are behind these lawsuits.

The first question to ask is whether these claims are meritorious. Many of the characteristics shared by the event-driven cases in my sample—low dismissal rates, high settlement values, government investigations, and institutional lead plaintiffs—are often viewed as proxies for merit in the securities class action context and used as such in the empirical literature. Should we then conclude that the criticism directed against these cases is misplaced? Not so fast. First, the pressure to settle in these lawsuits is intense, such that litigation outcomes may not accurately proxy for the merits of the lawsuit. Second, institutional investors may "cherry-pick" these lawsuits not because there was clearly investor fraud, but because, thanks to the government investigations that accompany the vast majority of them, bad facts are already public, and the defendants tend to have deep pockets. Third, the non-SEC investigations (brought by regulators such as the EPA, the FDA, and the NHTSA) that accompany these lawsuits may not constitute the same "hard evidence" of investor fraud that SEC investigations do in the literature. Accordingly, it is not clear that these characteristics necessarily signal meritorious grounds for shareholder recovery in event-driven cases.

Next, I turn to the broader policy question. Irrespective of their benefits to shareholders and their merits, do these lawsuits play a valuable role in deterring, compensating, or monitoring firms' externality of costs to third parties? First, with respect to deterrence, it is possible that these cases may help discourage firms from conduct that harms third parties. In fact, in about 20% of the event-driven cases in my sample, there is a shareholder recovery where neither the harmed third party nor any regulator recovered anything. Thus, it is possible that such event-driven securities class actions may fill a gap by punishing misconduct that regulators and direct victims cannot. However, some of these settlements may be for nuisance value, and therefore, this finding is not conclusive.

Second, from a compensation standpoint, these lawsuits are clearly lacking. These actions by definition do not compensate third parties who are victims of corporate misconduct, and much scholarly literature has argued that they do not compensate shareholders very effectively either.[10]

Third, these lawsuits are arguably suboptimal as monitoring mechanisms to curtail harm to third parties. To begin with, managers often externalize costs to third parties (whether by shoddy manufacturing, false advertising, or negligent safety measures) in order to bolster their company's share price. Thus, shareholders may actually prefer managers to pursue such misconduct as long as the odds of detection are low. The high probability that a securities class action based on this misconduct will be successful may reinforce this preference; shareholders may figure that if the management is not caught, shares will increase in value, and if the management is caught, they will be able to recoup at least some of their losses through settlements after the fact. Furthermore, although litigation is a mechanism for shareholder monitoring, event-driven securities class actions are suboptimal in this role because they occur *after* millions of barrels of oil flood the Gulf, the new sports car bursts into flame, or the contaminated Tylenol is in the medicine cabinet. And even as an ex post enforcement mechanism, such lawsuits are inadequate because they often do not incentivize disclosures that would be useful in monitoring a firms' risk for harming third parties. This is because under the existing securities regime, firms can usually better escape liability either by being excessively vague about such risks, or by saying nothing at all.[11]

Finally, I consider disclosure as a potential policy proposal to improve both the deterrent and monitoring functions of event-driven securities class actions lawsuits. Current policy proposals to address event-driven litigation (such as recovery caps[12]) tend to be starkly all-or-nothing, and do not appear to take into account the effect of these lawsuits on the outsiders that suffer direct harm from the alleged misconduct. I propose several broad measures that could improve the quality of the disclosures that are litigated in event-driven securities cases, such that investors and the public at large are better aware of the risks that firms create. Such reforms include the requirement of more specific operational risk and environmental, social, and governance (ESG) disclosures.[13] This proposal might be advantageous not only for improving firms' corporate citizenship and compliance with the law, as some have argued,[14] but could also improve the quality of these

10. *See* Amanda M. Rose, *Better Bounty Hunting: How the SEC's New Whistleblower Program Changes the Securities Fraud Class Action Debate*, 108 NW. U. L. REV. 1235, 1243 (2014).

11. *See* Donald C. Langevoort, *Disasters and Disclosures: Securities Fraud Liability in the Shadow of a Corporate Catastrophe*, 107 GEO. L.J. 967 (2019).

12. U.S. CHAMBER INST. FOR LEGAL REFORM, CONTAINING THE CONTAGION: PROPOSALS TO REFORM THE BROKEN SECURITIES CLASS ACTION SYSTEM 9 (2019) [hereinafter CONTAINING THE CONTAGION].

13. This is consistent with recent commentary. *See* Jill E. Fisch, *Making Sustainability Disclosure Sustainable*, 107 GEO. L.J. 923 (2019).

14. Leo E. Strine, Jr., Kirby M. Smith & Reilly S. Steel, Caremark *and ESG, Perfect Together: A Practical Approach to Implementing an Integrated, Efficient, and Effective* Caremark *and EESG Strategy*, 106 IOWA L. REV. 1885, 1889 (2021).

lawsuits and their effectiveness in curbing harmful practices by increasing the utility of the disclosures that event-driven securities class actions might enforce.

This Article proceeds as follows. Part II lays out institutional background and prior literature, and presents the questions to be tested. Part III presents the data, methodology, and results. Part IV assesses the desirability of event-driven securities class actions and briefly evaluates policy implications.

I. INSTITUTIONAL ANALYSIS AND HYPOTHESIS DEVELOPMENT

A. The Legal History of Securities Class Actions

The recent rise in event-driven securities litigation may itself be attributable, at least in part, to the reforms undertaken to limit securities class actions generally. Accordingly, before discussing event-driven litigation, it is useful to consider the broader framework for these lawsuits.

Since the advent of the private right of action under the Securities and Exchange Act of 1934,[15] the purpose and method for preventing securities fraud have provided fodder for generations of scholars. Many have challenged the efficacy of private securities fraud lawsuits in optimally compensating victims or deterring fraud.[16] With the rise of the securities fraud class action[17] came intense debate over the benefit of such lawsuits, which many argued were excessive, vexatious, and overly lawyer-driven.[18] The ultimate result was the Private Securities Litigation Reform Act (PSLRA), which Congress passed in 1995 over President Bill Clinton's veto.[19] In the PSLRA, Congress attempted to address the agency problems in securities class actions by, among other measures, heightening pleading standards for Exchange Act claims, imposing a discovery stay during pendency of motions to dismiss, and presumptively awarding the lead plaintiff role to the plaintiff that suffered the greatest loss from the alleged fraud.[20]

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15. *See* J.I. Case Co. v. Borak, 377 U.S. 426, 432 (1964), *abrogated on other grounds by* Alexander v. Sandoval, 532 U.S. 275 (2001); Kardon v. Nat'l Gypsum Co., 69 F. Supp. 512, 513 (E.D. Pa. 1946).

16. *See, e.g.*, John C. Coffee, Jr., *Rescuing the Private Attorney General: Why the Model of the Lawyer as Bounty Hunter Is Not Working*, 42 MD. L. REV. 215, 217 (1983); Bryant Garth, Ilene H. Nagel & S. Jay Plager, *The Institution of the Private Attorney General: Perspectives from an Empirical Study of Class Action Litigation*, 61 S. CAL. L. REV. 353, 354 (1988); William W. Bratton & Michael L. Wachter, *The Political Economy of Fraud on the Market*, 160 U. PA. L. REV. 69 (2011).

17. Basic, Inc. v. Levinson, 485 U.S. 224 (1988).

18. *See, e.g.*, Jennifer J. Johnson, *Secondary Liability for Securities Fraud: Gatekeepers in State Court*, 36 DEL. J. CORP. L. 463, 469 (2011) ("In 1995, Congress, in an effort to curb what it deemed vexatious litigation, enacted the Private Securities Litigation Reform Act ('PSLRA')."). For general discussion of problems in securities litigation prior to the PSLRA, see generally Coffee, *supra* note 16; Janet Cooper Alexander, *Do the Merits Matter? A Study of Settlements in Securities Class Actions*, 43 STAN. L. REV. 497, 570 (1991).

19. Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737 (codified as amended in scattered sections of 15 U.S.C. and 18 U.S.C.).

20. Michael A. Perino, *Did the Private Securities Litigation Reform Act Work?*, 2003 U. ILL. L. REV. 913, 923–29.

The PSLRA, in turn, spawned its own strand of literature, and controversy continues over whether it was effective or desirable.[21] The intent of the PSLRA was twofold: (1) to reduce the role of plaintiffs' lawyers in bringing and running these lawsuits, sometimes to the detriment of the actual investors, and (2) to reduce strike suits against public companies while allowing meritorious claims to proceed.[22] Some studies have found that following an initial dip,[23] the PSLRA has not appeared to reduce the number of securities class actions[24] or the number of nuisance lawsuits.[25] There is some evidence that the PSLRA has screened out non-nuisance cases; however, this screening effect diminishes where cases involve so-called "hard evidence" of fraud, such as earnings restatements or SEC investigations.[26]

One effect of the PSLRA's discovery stay and heightened pleading standards has been to augment the importance of government investigations in securities class actions, and with them the well-known species of litigation known as the "piggyback," "coattail," or "follow-on" lawsuit.[27] In these lawsuits, private plaintiffs seize on government investigations in order to capitalize on the government's factfinding.[28] Meeting the PSLRA's heightened pleading standard without the benefit of discovery, particularly for claims brought under Rule 10b-5 which require specific allegations of scienter, demands a level of specificity[29] that is at best, costly, and at worst, impossible for plaintiffs to meet on their own. However, a government investigation can give plaintiffs a leg up by making public the facts necessary for a

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21. *See generally, e.g.*, *id.*; Stephen J. Choi, Karen K. Nelson & A.C. Pritchard, *The Screening Effect of the Private Securities Litigation Reform Act*, 6 J. EMPIRICAL LEGAL STUD. 35 (2009) [hereinafter Pritchard et al., *Screening Effect*]; Stephen J. Choi, Jill E. Fisch & A.C. Pritchard, *Do Institutions Matter? The Impact of the Lead Plaintiff Provision of the Private Securities Litigation Reform Act*, 83 WASH. U. L.Q. 869 (2005) [hereinafter Choi, et al., *Do Institutions Matter*?]; Amanda M. Rose, *Reforming Securities Litigation Reform: Restructuring the Relationship Between Public and Private Enforcement of Rule 10b-5*, 108 COLUM. L. REV. 1301 (2008).

22. H.R. REP. No. 104-369, at 32 (1995) (Conf. Rep.).

23. Joseph A. Grundfest & Michael A. Perino, *Securities Litigation Reform: The First Year's Experience* (John M. Olin Program in L. & Econ. Working Paper No. 140, 1997).

24. *See* Perino, *supra* note 20, at 915 ("The best available evidence suggests that there are as many, if not more, class actions filed annually after passage of the PSLRA as before.").

25. *See* Choi et al., *The Screening Effect of the Private Securities Litigation Reform Act*, *supra* note 21, at 37 ("We do not find statistically significant evidence that nuisance suits have been discouraged.").

26. *Id.* at 877.

27. James D. Cox & Randall S. Thomas with Dana Kiku, *SEC Enforcement Heuristics: An Empirical Inquiry*, 53 DUKE L.J. 737, 761 (2003) ("From their fear that the PSLRA will prematurely extinguish meritorious suits, it is a short step to surmise that the plaintiffs' bar will now have an even keener interest in SEC enforcement actions because an enforcement action's fruits include facts that can support a class action's complaint, thereby filling the current discovery void faced by the plaintiffs' bar after the enactment of the PSLRA.").

28. *See* Coffee, *supra* note 16, at 228 (describing how "the filing of the public agency's action serves as the starting gun for a race between private attorneys, all seeking to claim the prize of lucrative class action settlements, which public law enforcement has gratuitously presented them").

29. Tellabs Inc. v. Makor Issues & Rts., 551 U.S. 308 (2007).

successful complaint that plaintiffs would otherwise have difficulty gathering.[30] There is, in general, a robust debate over the merits of these lawsuits; some commentators argue that piggyback litigation extends the benefits of public enforcement and protects against under-deterrence,[31] while other scholars decry such lawsuits as solely "multiplying wrongdoers' penalties: [a plaintiffs' lawyer] provides no independent search skills, no special litigation savvy, and no nonpoliticized incentives. She simply piles on and runs up the tab."[32]

Irrespective of whether piggyback litigation is desirable in the securities context, the existing literature suggests that it is often quite successful. Previous studies have found that securities class action settlement amounts are higher and litigants settle faster where there is a parallel SEC case, and that securities class actions where there is a parallel SEC case are less likely to be dismissed.[33] Such cases may settle for higher amounts because they are more likely to be meritorious; the resource-constrained SEC is less likely to investigate frivolous allegations, and instead probably focuses its energy on credible, serious misconduct that harms investors.[34] Such investigations may provide a platform not only for securities class actions, but for further shareholder litigation, such as derivative lawsuits, against the company.[35]

B. "Event-Driven" Securities Litigation

But what if the shareholders did not get the worst of the company's misconduct? Many securities class actions accompany front-page disasters caused by public firms. More often than not, the misconduct causing these disasters does not target the misbehaving firm's investors, but some other constituency. Nonetheless, the Supreme Court has twice held that adverse events may for the basis of a securities fraud class action, and a cursory look at headlines suggests that

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30. *See* Coffee, *supra* note 16; Garth, *supra* note 16; Alexander I. Platt, *"Gatekeeping" in the Dark: SEC Control Over Private Securities Litigation Revisited*, 72 ADMIN. L. REV. 27 (2020).

31. *See, e.g.*, *id.*; Garth, *supra* note 16; Zachary D. Clopton, *Redundant Public-Private Enforcement*, 69 VAND. L. REV. 285, 290 (2016) (arguing for the merits of "redundant public-private enforcement"); Howard M. Erichson, *Coattail Class Actions: Reflections on Microsoft, Tobacco, and the Mixing of Public and Private Lawyering in Mass Litigation*, 34 U.C. DAVIS L. REV. 1, 3 (2000) ("There is nothing inherently troubling about private class actions that seek to benefit from successful government litigation. Properly managed, such class actions offer a relatively fair and efficient mechanism for extending the benefits of government legal work to provide redress to injured citizens.").

32. William B. Rubenstein, *On What a "Private Attorney General" Is—And Why It Matters*, 57 VAND. L. REV. 2129, 2151 (2004).

33. Cox, Thomas, Kiki, *supra* note 27, at 763.

34. *Id.* Indeed, multiple studies use the presence of a parallel SEC investigation as a proxy for the merit of a lawsuit. *See infra* note 65.

35. Jessica M. Erickson, *Overlitigating Corporate Fraud: An Empirical Examination*, 97 IOWA L. REV. 49 (2011) [hereinafter Erickson, *Overlitigating*].

settlements to shareholders in these cases are substantial.[36] The growing visibility of these "event-driven" cases has sparked concern on the part of the defense bar,[37] calls for reform by business,[38] and increasing scholarly attention.[39] Anecdotally, defendant firms in such cases are large. Moreover, the front-page disasters giving rise to lawsuits are often dogged by an alphabet soup of regulatory investigations, which plaintiffs can use to surmount the heightened pleading requirements of the PSLRA. Some of these disasters are the subject of parallel SEC investigations. The SEC, after all, does not operate in a vacuum,[40] and may join forces with other regulators who are uninterested in the welfare of a company's shareholders, but are instead obligated to investigate harms to consumers, public health, competition, or the environment. And indeed, some of these cases involve *only* inquiries by non-securities regulators. Commentators have noted that these cases seem to be increasingly common,[41] and many have led to massive settlements.[42]

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36. Some well-known examples from my dataset include BP, Johnson & Johnson, and Toyota. *See* Rob Davies, *BP to Pay $175m to Investors Over Deepwater Horizon Spill*, GUARDIAN (Feb. 14, 2018, 1:03 PM), https://www.theguardian.com/business/2016/jun/03/bp-compensate-investors-deepwater-horizon-oil-spill#:~:text=BP%20has%20agreed%20to%20pay,Gulf%20of%20Mexico%20oil%20spill [https://perma.cc/YZ9A-89NK]; Ken Bensinger, *Toyota Settles Shareholder Lawsuit Related to Sudden Acceleration*, L.A. TIMES (Nov. 14, 2012, 12:00 AM), https://www.latimes.com/business/la-xpm-2012-nov-14-la-fi-mo-toyota-shareholder-lawsuit-20121114-story.html [https://perma.cc/YYZ6-CPGT]; Jessica Dye, *Johnson & Johnson Agrees to Pay $22.9 Million to End Recall Lawsuit*, REUTERS (July 17, 2013, 5:59 PM), https://www.reuters.com/article/us-johnson-recall-settlement-idUSBRE96H01S20130718 [https://perma.cc/7QFD-PVU4].

37. *See* Reed & Lloyd, *supra* note 6, at 1–2 ("The slack in decreased financial misstatement cases appears to have been picked up by a new class of securities cases: event-driven claims. These are claims filed in response to adverse company events such as a data security breach, sexual harassment allegations, a catastrophic explosion, allegations that a drug or product has side effects or caused injury, or a regulatory investigation or enforcement action."). *But see* Julie G. Reiser & Steven J. Toll, *Event-Driven Litigation Defense*, HARV. L. SCH. F. ON CORP. GOVERNANCE (May 23, 2019), https://corpgov.law.harvard.edu/2019/05/23/event-driven-litigation-defense/ [https://perma.cc/DSF5-P7JP] ("[E]vent-driven cases serve as a deterrent to companies who might otherwise conceal or misrepresent their operations because they recognize that investors will hold them accountable for doing so.").

38. *See, e.g.*, Peter Feltman, *U.S. Chamber Seeks Regulatory Review of 'Event-Driven' Securities Lawsuits*, CQ ROLL CALL (Feb. 26, 2019), 2019 WL 925526 ("Legal experts are skeptical about the merits of these securities claims . . . [b]ut they are powerful weapons for coercing settlements because of the costs of defense and the reputational harm from ongoing litigation focused on such adverse events.").

39. *See, e.g.*, John C. Coffee, Jr., *Securities Litigation in 2017: "It Was the Best of Times, It Was the Worst of Times,"* CLS BLUE SKY BLOG (Mar. 19, 2018), https://clsbluesky.law.columbia.edu/2018/03/19/securities-litigation-in-2017-it-was-the-best-of-times-it-was-the-worst-of-times/ [https://perma.cc/ZB5G-QVU8]; Klausner, Curry & Hegland, *supra* note 7.

40. *See* Verity Winship, *Enforcement Networks*, 37 YALE J. ON REG. 274 (2020).

41. *See, e.g.*, Coffee, *supra* note 39; Nessim Mezrahi & Stephen Sigrist, *Limiting the Severity of Deficient Securities Fraud Claims*, LAW360 (Jan. 8, 2021, 4:45 PM), https://www.law360.com/articles/1342523/limiting-the-severity-of-deficient-securities-fraud-claims [https://perma.cc/XJ98-K6NE] ("In 2018, Columbia Law School professor John C. Coffee Jr. indicated that the 'scope of event-driven litigation could expand rapidly,' which it has . . . . ").

42. *See, e.g.*, Mezrahi & Sigrist, *supra* note 41 (citing the BP, Signet Jewelers and Equifax settlements of recent of 2017, 2019, and 2020 respectively).

Many in the industry have been intensely critical of such lawsuits. The president of the Chubb Group, which provides, among other products, D&O insurance, recently stated:

[T]he class benefitting most from such litigation is not shareholders. Rather, the real winner is a growing cohort of lawyers who are filing meritless lawsuits in federal and state courts across the United States every time . . . a corporate misfortune impacts a company's share price . . . . In the last five years, half of the nearly $23 billion in securities claims costs have gone to lawyers—both plaintiff and defense.[43]

He is not alone in the assessment that event-driven cases are generally lacking in merit but create the opportunity for plaintiffs' lawyers to extract large settlements that are increasingly threatening to firms.[44] The U.S. Chamber Institute for Legal Reform (the "Institute") published two white papers arguing that "the legitimacy of [event-driven litigation is] suspect."[45] Specifically, it argues that such claims often follow a "file first, investigate later" model, and often lack sufficient allegations of materiality and scienter.[46] Nonetheless, it contends these claims generate severe pressure to settle because "[t]he plaintiffs' lawyer will focus on the underlying adverse event—and only tangentially on the alleged false statement or omission that occurred months or years earlier—which will keep the adverse event in the public eye, even if the company has settled any legal claims arising out of that event."[47]

There is little middle ground among the current policy prescriptions for event-driven litigation, with issuers, their counsel, and insurers on one side, and plaintiffs' lawyers, unsurprisingly, on the other. The most concrete proposal for decreasing the incidence of event-driven securities class actions has been promoted by the Institute, which argues that "courts have been slow to react to the event-driven cases . . . [and] do not appear to have recognized the differences between these suits and traditional securities fraud claims or to have developed tools for quickly weeding out unjustified claims."[48] The Institute first recommended that the SEC develop a policy paper outlining standards for materiality, scienter and loss causation in event-driven securities class actions, and use it as the basis for amicus

43. CHUBB, FROM NUISANCE TO MENACE: THE RISING TIDE OF SECURITIES CLASS ACTION LITIGATION (2019), https://www.chubb.com/content/dam/chubb-sites/chubb-com/ca-en/microsites/rims/documents/pdf/from-nuisance-to-menace--the-rising-tide-of-scas--chubb.pdf [https://perma.cc/G7HT-XYCS].

44. *See, e.g.*, Feltman, *supra* note 38 ("Legal experts are skeptical about the merits of these securities claims . . . [b]ut they are powerful weapons for coercing settlements because of the costs of defense and the reputational harm from ongoing litigation focused on such adverse events.").

45. CONTAINING THE CONTAGION, *supra* note 12.

46. *Id.* at 10; *see also* Coffee, *supra* note 39 (noting that the reasoning of complaints alleging scienter in some event-driven cases "seems strained").

47. U.S. CHAMBER INSTITUTE FOR LEGAL REFORM, A RISING THREAT: THE NEW CLASS ACTION RACKET THAT HARMS INVESTORS AND THE ECONOMY 14 (2018).

48. CONTAINING THE CONTAGION, *supra* note 12, at 2.

briefs to help courts analyze (and presumably, speedily dispose of) these lawsuits.[49] The Institute also recommended that Congress require more careful scrutiny of fee awards, provide interlocutory review of denials of motions to dismiss, and adopt a damages cap.[50]

Conversely, other stakeholders, particularly plaintiffs' lawyers, have argued emphatically against curbing event-driven litigation on the basis that "frequently investors are also injured when a corporation misrepresents the risks associated with its operations."[51] They blast the Institute's "reli[ance] on circular logic to conclude that unexpected events are, by definition, unexpected," arguing that event-driven lawsuits have, in fact, uncovered evidence that the defendant firm concealed significant risks and adverse events from their shareholders.[52] They further argue that no reforms are necessary, as judges under the current regime "are more than capable of weeding out the weak cases from the strong and, as historic mega-settlements show, the strong ones should proceed."[53]

C. Hypothesis Development

As the incidence of event-driven securities class actions appears to have increased and the commentary around it has become more common and heated, it would seem prudent to guide policy decisions on these lawsuits with data. However, although there has been some examination of so-called "stock-drop" securities class actions,[54] there has been little, if any, methodological study of the prevalence and attributes of event-driven securities class actions. In this paper I attempt to fill this gap by answering some basic questions about these cases, so far as the information is available. How often do shareholders sue firms when the alleged corporate misconduct harmed others more directly? Is there a difference in dismissal rates and settlement values when a third party is the primary victim of the firm's conduct? If so, are government investigations the primary channel for this effect, and if so, which ones? Do these cases, as headlines imply, involve primarily large defendant firms? Who are the plaintiffs and their lawyers in these lawsuits? What other characteristics do these lawsuits share? And finally, to the extent the information is available, how do shareholder recoveries in these cases compare with what the government and the primary victims recover for the same conduct? Answering these questions can help inform a policy debate around event-driven securities class actions.

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49. *Id.* at 17.
50. *Id.* at 18–19.
51. Reiser & Toll, *supra* note 37.
52. *Id.*
53. *Id.*
54. *See* Klausner, Curry & Hegland, *supra* note 7.

II. DATA, METHODOLOGY, AND RESULTS

A. Sources and Coding

To test these questions, I use a sample comprised of securities class action cases from 2010 to 2015 from the Stanford Securities Class Action Clearinghouse (SSCAC).[55] I omit from the sample lawsuits against financial, services, and utility firms, and drop lawsuits that were remanded to state court. I also drop all so-called "merger objection" cases,[56] on the basis that claims in these cases are recognized to be different from other types of securities class actions.

Using the most recent amended complaint in each action, I manually code these lawsuits with an indicator variable that equals "1" if the alleged misconduct in the case primarily harmed the firm's shareholders. For example, a case in which the management knew it would be unable to meet its own rosy projections at the time they were made would be coded "1." In this instance, shareholders attempting to value their own investments are clearly the population most directly harmed by the misstatement. By contrast, a case where an auto manufacturer was alleged to have knowingly used batteries in its cars that burst into flame some percent of the time[57] would be coded "0," because the most direct victims of the misconduct are not the shareholders, but the drivers whose cars risk conflagration. Another example might be Drug Company A, which was sued for alleged misstatements about the probable FDA approval of a drug in clinical trials. If the FDA declined to approve the drug citing severe side effects, the case would be coded "1" because the primary victims of the misstatement are the firm's shareholders who bought their stock in reliance on the company's assurance that the drug would be approved. In this scenario, patients cannot be harmed by the misstatements because the drug is not yet on the market. However, if plaintiffs alleged that Drug Company B failed to heed the FDA's warning about dangerous side effects for a drug already on the market, the case would be coded "0" because the primary victims of the misconduct are the patients taking the drug, and thus risking or suffering the side effects. Hereinafter, I refer to cases coded "1" and alleging conduct primarily harming shareholders as "SH" cases. Cases coded "0" and alleging misconduct more directly harming other victims are referred to as "OV" or "event-driven" cases.[58]

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55. Stan. L. Sch., *supra* note 8. Although there is later data available, many actions beyond 2015 are still ongoing, and could bias the results.

56. *See* Coffee, *supra* note 39 (suggesting that these cases migrated from Delaware to the federal courts as Delaware case law increasingly restricted the disclosure-only settlements that often accompany such cases).

57. *See In re* Tesla Motors Inc. Sec. Litig., 75 F. Supp. 3d 1034 (N.D. Cal. 2014).

58. There is some definitional confusion around the term "event-driven litigation." *See* Reiser & Toll, *supra* note 37 (arguing that "event-driven litigation describes almost any securities fraud action that does not arise from an accounting restatement"). However, the term generally appears to refer to securities litigation that follows catastrophic events which cause harm to a potentially wide

None of this is to say that shareholders are not harmed in cases where, for example, car batteries explode. It is quite true that the stock price of the car company will likely drop when the explosions become public, injuring the firm's investors.[59] If the car company's management makes a material misstatement or omits information it was obligated to disclose in order to minimize the incidents or prevent share value from falling, these misstatements or omissions are actionable under federal securities laws. However, it is difficult to dispute that the victims most negatively impacted by the core misconduct—the knowing manufacture and distribution of cars that could explode—are the drivers of those cars, rather than the company's shareholders.

The sample contains a total of 487 cases, decreasing to 399 after I drop merger challenges. Of these 399 cases, 373 involve Section 10(b) claims and 48 involve Section 11 claims. Based on the most recent complaint in each lawsuit, I code each case according to whether the alleged misconduct most directly harmed shareholders or some other victim. I code 66 cases as primarily harming other victims, which amounts to 16.5% of the sample. In addition to coding whether the alleged misconduct primarily harmed shareholders, I record whether the action was dismissed and the shareholder settlement amount, if there is one, from documents on the SSCAC or PACER.

To better evaluate the correlation of dismissal rates and settlement amounts with the primary victim of the alleged misconduct, I also gather information on firm size, class period duration, the circuit in which the lawsuit was brought, whether a lead plaintiff was an institutional investor, the plaintiffs' law firms, whether the firm restated its financials in the class period, and whether the firm was subject to an SEC or other investigation during the class period. It is possible that settlement amounts are correlated with the size of the firm; as a proxy for firm size, I use information on firms' total assets[60] from Compustat.[61] Settlements may also be larger where the class period is longer and therefore projected damages amounts are higher;[62] I source class period information, measured in months, from the SSCAC. Additionally, judicial expertise in securities litigation may impact dismissal rate or settlement amount. I therefore include a dummy variable equal to 1 if the lawsuit

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array of non-shareholder victims. The OV label is meant to capture this litigation, and I use the terms interchangeably.

59. And indeed, if this is not the case, the shareholders cannot demonstrate loss causation or damages, and thus have no claim under the securities laws. *See* Dura Pharms., Inc. v. Broudo, 544 U.S. 336 (2005).

60. *See* James J. Park, *Securities Class Actions and Bankrupt Companies*, 111 MICH. L. REV. 547, 571 (2013); James D. Cox, Randall S. Thomas, & Lynn Bai, *There Are Plaintiffs and . . . There Are Plaintiffs: An Empirical Analysis of Securities Class Action Settlements*, 61 VAND. L. REV. 355, 368 (2008).

61. *See Compustat*, WHARTON RSCH. DATA SERVS., https://wrds-www.wharton.upenn.edu/ [https://perma.cc/J42S-RXCM] (last visited Sept. 8, 2022).

62. *Id.*

was brought in the Second or Ninth Circuits, which are commonly considered to be the most expert.[63]

Dismissal rates and settlement amounts may also be correlated with the probable merit of each lawsuit. Following numerous empirical studies of securities class actions, I use the presence of an institutional investor as lead plaintiff, the presence of financial restatements by the firm during the class period, and the presence of a parallel SEC inquiry as indicia of merit.[64] I code information on lead plaintiffs from court documents on the SSCAC and PACER. I gather information on earnings restatements from Audit Analytics.[65] I include only restatements indicating fraud or misrepresentation, rather than errors or changes in accounting rules.[66] Finally, I use a dummy variable to code whether the plaintiffs cited an SEC investigation in the most recent amended complaint. Cases in which an SEC investigation was cited were coded "1" using this dummy even if other regulatory investigations were also cited. I also used an additional dummy variable to code if plaintiffs cited other regulatory investigations without the presence of an SEC investigation. Accordingly, cases coded "1" for SEC investigations may involve other regulators, but cases coded "1" for non-SEC investigations do not involve the SEC. Finally, I gather data from the SSCAC on plaintiff law firms and use a dummy variable equal to 1 to code where any of the plaintiff law firms appears in the Legal 500's list of the top fifteen securities class action plaintiff firms.[67]

Further, for the OV lawsuits, I examine court filings and press reports to determine whether there was a regulatory penalty paid, and if so, how much. In addition, for OV lawsuits, I do a press search to see if the primary victims sued the firm, and if so, whether and how much they recovered.

B. Descriptive Statistics and Empirical Analysis

The majority of lawsuits in my sample—roughly 83.5%—are SH cases and involve alleged misconduct that appears to target shareholders specifically. Accordingly, most securities class actions do seem to be brought in response to

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63. Park, *supra* note 60, at 571; *see also* James D. Cox, Randall S. Thomas & Lynn Bai, *Do Differences in Pleading Standards Cause Forum Shopping in Securities Class Actions?: Doctrinal and Empirical Analyses*, 2009 WIS. L. REV. 421, 430–38.

64. *See* Park, *supra* note 60, at 562; Choi et al., *supra* note 21, at 872; Pritchard, et al., *supra* note 21, at 41.

65. *See Audit Analytics*, WHARTON RSRCH. DATA SERVS., https://wrds-www.wharton.upenn.edu/pages/about/data-vendors/audit-analytics-and-oia-other-independent-audits/ [https://perma.cc/923M-4BDE] (last visited Sept. 8, 2022).

66. *See* Choi et al., *supra* note 21.

67. *See Securities Litigation: Plaintiff*, LEGAL 500, https://www.legal500.com/c/united-states/dispute-resolution/securities-litigation-plaintiff/ [https://perma.cc/9RSX-7Y9U] (last visited Sept. 8, 2022). The relevant firms that appear in my sample are Bernstein Litowitz Berger & Grossmann LLP, Labaton Sucharow LLP, Robbins Geller Rudman & Dowd LLP, Cohen Milstein Sellers & Toll PLLC, Grant & Eisenhofer P.A., Kasowitz Benson Torres LLP, Kessler Topaz Meltzer & Check, LLP, Pomerantz LLP, and Bernstein Liebhard LLP.

misconduct that directly harms investors rather than in response to any corporate wrongdoing. However, the 16.5% of cases which are OV cases—involving misconduct that more directly harms victims who are not investors—reveal some interesting trends. In this Section, I compare dismissal rates, settlement amounts, and other characteristics for SH and OV cases.

1. Descriptive Statistics

SH and OV lawsuits differ along some key dimensions. Table 1 shows descriptive statistics for SH versus OV lawsuits, omitting merger objection cases. First, I find that OV lawsuits are less likely to be dismissed and result in higher settlement values than SH lawsuits. In my sample, nearly 55% of SH cases are dismissed. By contrast, roughly 36% of OV cases are dismissed. Similarly, the OV lawsuits settle on average for higher amounts. The average settlement amount for SH cases is $7.2 million. The average settlement amount for OV cases is more than triple that amount, $24.3 million.

These sets of cases diverge in other potentially important ways. Defendant firms in OV cases tend to be much larger, as measured by their total assets; these firms average $29.6 billion in total assets the year prior to the lawsuit. By contrast, SH firms average $8 billion. Moreover, the average class period for OV lawsuits is four months longer than for SH lawsuits, potentially increasing the damages for which defendants could be liable. Nearly 70% of OV lawsuits have an institutional investor as a lead plaintiff, compared with only 42% of SH lawsuits. Further, roughly 85% of OV cases involve a Legal 500 plaintiffs' law firm, where only 57% of the SH cases do. Finally, perhaps the most striking difference between the SH and OV cases in my sample are the government investigations associated with each. SEC investigations appeared in SH and OV complaints with similar frequency, 19% and 17% of the time respectively. However over 70% of OV cases cited *only* inquiries or actions by non-SEC regulators, while only 4% of SH cases cited such inquiries. Nearly 90% of complaints for OV lawsuits cited some government investigation.

Other characteristics, however, do not seem appreciably different for these two types of cases. Both types are brought with slightly more frequency in the Second and Ninth Circuits, with 54% of SH cases and 52% of OV cases appearing there. Roughly 4% of both types of cases involve defendant companies that restated their financials during the class period.

In Table 3, I show descriptive statistics for the sample cases based on whether and what kind of government investigation was cited in the complaint. As discussed above, cases in which there was an SEC investigation are coded as such even if other regulators were conducting a parallel investigation with the SEC. Cases in which there was an SEC investigation have a lower dismissal rate than those with a non-SEC investigation, but both have significantly lower dismissal rates than cases in which no investigation was cited. Median settlements for SEC and non-SEC investigation cases are similar, at $31 million and $28.6 million respectively. The class periods for SEC and non-SEC investigation cases are likewise very similar. However, the median total assets for non-SEC investigation defendant firms are more than twice the amount of that of SEC investigation defendant firms. Finally, non-SEC investigation lawsuits have a somewhat higher percentage of institutional investor lead plaintiffs than SEC investigation lawsuits.

To assess the possibility that institutional investors are "cherry-picking" non-SEC investigation cases,[68] I show in Table 4 descriptive statistics for sample cases based on whether at least one lead plaintiff was an institutional investor. In my sample, as in prior studies,[69] institutional investor lead plaintiffs are associated with lower dismissal probability and dramatically higher settlement values. They also generally appear to sue much larger firms. Moreover, institutional investor lead plaintiffs in my sample cite government investigations in their complaints much more frequently than individual lead plaintiffs do, at 39% and 24% respectively. However, there does not appear to be a dramatic distinction by institutional investors between citing SEC and non-SEC investigations.

Finally, in Table 5, I break down the OV cases in my sample based on the type of misconduct underlying the lawsuit. Of the 68 OV cases in my sample,[70] 33 are based on underlying misconduct involving faulty drugs or medical devices.[71] Roughly 30% of these cases were dismissed, and the average shareholder settlement was $24.5 million. An additional 11 cases involve allegations of abusive or deceptive practices involving medical facilities or services, such as physical or occupational therapy, pharmacies, or nursing homes. While 36.4% of these cases were dismissed, the average settlement was significantly lower, at $8.2 million. Eight of my OV cases were based on misconduct involving the environment, such as oil spills, inadequate pollution systems, and improper disposal of toxic materials. Fifty percent of these cases were dismissed, and the average settlement was $26.4 million. I note that the average firm size (based on mean total assets) of the defendant firms in environmental OV cases was, at $61.6 billion, triple or quadruple the size of the next largest category of firms and twice the average size of all OV defendant firms. Four of the OV cases reflect misconduct relating to motor vehicles, including exploding batteries, uncontrollable acceleration, and other manufacturing and design flaws. Only 25% of these cases were dismissed, and the average settlement was roughly four times larger than the next largest average OV settlement by type,

68. For a discussion of cherry-picking by some institutional investors, see Choi et al., *supra* note 21, at 872.

69. *See* Cox et al., *supra* note 60, at 371.

70. In this count, to present the most inclusive picture of these cases with a small sample, I include two cases that are brought as proxy fraud claims but where the underlying misconduct is based on harm to non-shareholder parties.

71. The prevalence of this type of litigation is consistent with the observations of other commentators, who have noted a rise in securities class actions against pharmaceutical and medical device companies in recent years. *See* Coffee, *supra* note 39 (finding that such cases accounted for twenty percent of securities class actions in 2017).

at $109 million. The remaining cases are based on a smorgasbord of misconduct, including that relating to consumers (largely false advertising), antitrust, food and beverage, hazardous working conditions, sexual harassment, and miscellaneous.[72] These remaining categories have higher dismissal rates, between 50% and 100%. They also have lower average settlements, between $0 and $11.3 million.

2. Empirical Analysis

To assess whether OV cases have lower dismissal rates and higher settlement amounts based on their status as such or on some other characteristic, I use Ordinary Least Squares (OLS) regressions. Because the vast majority of OV cases involve Section 10(b) claims, I report below the results of the regressions using only the cases in the sample that involve such claims.

Table 6 reports OLS regressions in which the dependent variable, *Dismiss Dummy*, is a dummy variable equal to 1 if the case was dismissed.[73] *OV Case* is a dummy variable equal to 1 if the case is coded as an OV case. *Log Assets* is the log of the total assets of the firm measured in millions of dollars. *Class Period Months* is the class period of the lawsuit measured in months. *2nd or 9th Circuit* is a dummy variable equal to 1 if the lawsuit was brought in the Second or Ninth Circuits. *Institutional LP* is a dummy variable equal to 1 if at least one lead plaintiff in the lawsuit is an institutional investor. R*estatement* is a dummy variable equal to 1 if the defendant firm restated its financials during the class period and the restatement involved a misrepresentation or fraud, rather than an error or change in accounting rules. *SEC Action* is a dummy variable equal to 1 if an SEC inquiry, investigation, or enforcement action involving the alleged misconduct was cited in the most recent complaint. All regressions use robust standard errors.

Table 6 shows that lawsuits classified as OV cases are roughly 20% less likely than SH cases to be dismissed. This finding is consistent across specifications and significant at the 5% level. Firm size is also a statistically significant predictor of dismissal. Conversely, the length of the class period is negatively associated with dismissal (though the results are weaker). Table 5 shows that the presence of an institutional investor as lead plaintiff and especially the presence of a parallel SEC investigation are predictors that a securities class action will survive a motion to dismiss.

Table 7 reports the results of OLS regressions in which the dependent variable, *Log Shareholder Settlement*, is the log of the amount for which the securities class action settled plus 1. All other variables are the same as those defined in Table 5.

72. This category includes cases where the misconduct is difficult to characterize. For example, in Kasper v. AAC Holdings, Inc., the complaint is based on allegations that a manager committed dependent adult abuse and second-degree murder. *See* Class Action Complaint for Violations of the Federal Securities Laws, Kasper v. AAC Holdings, Inc., No. 15-cv-00923 (M.D. Tenn. Aug. 24, 2015), 2015 WL 5012605.

73. I obtain similar results when I estimate the coefficients using a logistic model.

Here, I find that OV cases are associated with dramatically higher settlement values. This finding is significant at the 5% level.[74] Firm size is also a statistically significant predictor of lower settlements in securities class actions.[75] The length of the class period is associated with increased settlement amounts. Consistent with previous studies, I find that the presence of an institutional investor as lead plaintiff and the presence of a parallel SEC investigation are predictors of higher settlement amounts.[76]

To test the intuition that the lower dismissal probabilities and higher settlement values of the OV cases are driven by the non-SEC investigations that frequently accompany them, I run the same regressions using the *Non-SEC Action* dummy instead of the *OV Case* dummy.[77] Tables 8 and 9 show these regressions. I find that dismissal probability is negatively associated with a non-SEC action, and settlement value is positively correlated, echoing the results from the regressions using the *OV Case* dummy. One reason that the results are not identical may be that while the vast majority of OV cases involve investigations by non-SEC regulators, some involve SEC investigations in addition to those of other regulators and are therefore coded as SEC investigation cases.

Finally, the descriptive statistics in my sample suggest that institutional investors are lead plaintiffs in most OV cases and that they cite government investigations in their complaints at a higher rate than individual plaintiffs. Table 10 shows the results of OLS regressions, testing the relationship between whether a lead plaintiff is an institutional investor and other relevant variables. I find that, controlling for firm size and class period, designation as an OV case predicts an institutional investor as lead plaintiff. However, no investigations of any kind predict an institutional investor lead plaintiff at a statistically significant level.[78]

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74. In unreported regressions, I regress *Dismiss Dummy* and *Log Shareholder Settlement* respectively on OV cases broken down into two types: healthcare-related and non-healthcare-related. The coefficients for the healthcare-related OV cases are very similar across specifications to those that I report for OV Cases and are significant at the 5% level. The coefficients for non-healthcare-related OV cases are similar in direction though slightly lower in magnitude, but are not statistically significant. However, t-statistics in the specifications with controls are relatively high, and it is likely that the results are not statistically significant because the sample is small and I use robust standard errors.

75. A potential reason for this may be that large firms can hire more prestigious and expensive defense counsel.

76. *See* Cox et al., *supra* note 27, at 767.

77. Since the DOJ criminally prosecutes violations of the federal securities laws, I carefully scrutinized DOJ involvement in the sample cases. Only one case cited a DOJ investigation for misconduct targeting investors without a concurrent SEC investigation. Because the DOJ was prosecuting in this instance on behalf of investors, I coded this as an *SEC investigation* case.

78. In particular, unlike Cox et al., *supra* note 60, at 377, I do not find that an SEC investigation is a statistically significant predictor of an institutional investor as lead plaintiff.

III. ARE EVENT-DRIVEN SECURITIES CLASS ACTIONS DESIRABLE?

As previously discussed, event-driven securities class actions have prompted increasing scholarly and industry discussion of late. Some commentators believe that, like other securities class actions, there are good cases and bad cases, but nothing renders event-driven cases uniquely problematic.[79] A question implicit in this viewpoint is whether the distinction between event-driven securities class actions and other securities class actions is even a viable one for policy purposes. On the other side of the debate are those who consider event-driven securities class actions both unique and problematic, driven largely by unfortunate circumstances, opportunistic plaintiffs, and pressure to settle.[80]

In this Section, I examine whether event-driven securities class actions are desirable. After addressing the threshold question of why it is insufficient to address this question simply on the basis of whether shareholders are defrauded, I examine whether these lawsuits are, by and large, meritorious. These cases display several features that are frequently cited in the literature as "indicia of merit"—specifically, they have lower dismissal rates and settle for higher amounts, they frequently involve an institutional investor, and a large majority involve a government investigation. In drilling down on these features, however, it is not clear that these attributes are unambiguous proxies for merit in the context of event-driven securities class actions. I then examine these cases from a broader policy perspective to assess whether the cases serve a valuable role in deterring, compensating, or monitoring corporate misconduct against outsiders.

A. Recovery of Secondary Victims and the Utility of the Shareholder Harm/Other Victim Framework

A threshold question is whether the distinction between shareholder class actions based on misconduct that harms primarily shareholders or more directly harms other victims matters to any analysis of these cases. Just because shareholders are secondary victims, why shouldn't they recover? And if shareholders in a given case, though they are secondary victims, are defrauded and thus entitled to recover, why should that not end the inquiry as to whether these cases are desirable? The answer is that in practice, there is usually extraordinary ambiguity in these cases about whether the shareholders were defrauded. This ambiguity arises from both conceptual and pragmatic sources.

First, in a given event-driven securities class action, it is very often factually unclear whether or not the shareholders were wronged by the company. This is in part because the pressure for defendant firms to settle in any securities class action is intense, and it is impossible to say for certain how many shareholders recover for good, as opposed to meritless, claims. Although the PSLRA was intended to

79. *See, e.g.*, Reiser & Toll, *supra* note 37.
80. *See, e.g.*, Reed & Lloyd, *supra* note 37.

eliminate meritless strike suits, it did not succeed; various studies have shown that nuisance settlements still appear to be pervasive in this area.[81] Claimed damages in securities class actions are often massive, and although the likelihood of success may be low for plaintiffs, defendants are often not willing to risk losing these "bet the company" lawsuits.[82] Moreover, the burden of expensive discovery falls overwhelmingly on defendants in securities class actions, and many may rationally choose to settle early rather than go through discovery in order to dismiss the case.[83]

The pressure to settle even claims with a low probability of success is compounded in event-driven cases for several reasons. First, such firms are typically fighting battles on multiple fronts. In addition to claims from its shareholders, a defendant firm in an OV case is likely to be dealing with a regulatory inquiry or enforcement action. This is not specific to OV cases, as SH cases may also involve investigations, usually by the SEC. However, OV defendants must contend with a third set of adversaries: the direct victims of its misconduct. Although some lawsuits by direct victims may be amenable to consolidation and a generally more efficient process, many involve geographically and situationally diverse plaintiffs that bring multiple class actions or their own individual claims. In putting out these fires, a defendant firm might not have the resources to devote to battling out a shareholder lawsuit of even unclear merit, particularly when doing so will likely keep the initial misconduct in the news cycle and the stock price depressed. Moreover, an adverse ruling or bad facts from a parallel proceeding could provide collateral estoppel to any other plaintiffs, raising overall costs significantly.

Further, the application of 10b-5 jurisprudence in event-driven securities cases has been inconsistent, leading to great uncertainty for defendants. To be liable to shareholders for nondisclosure of the risks that often lead to OV disasters, courts typically require "active rather than passive concealment and thus, literally, wordplay: there is no antifraud-based duty to disclose risks unless and until the issuer has said enough to put the particular kind of risk 'in play.' But when that is, and why, flummoxes [judges]."[84] Different judges' decisions under these

81. *See* Jessica Erickson, *Investing in Corporate Procedure*, 99 B.U. L. REV. 1367, 1381 (2019) ("Low-dollar settlements . . . are seen in a sizable minority of securities class actions."); Laarni T. Bulan, Ellen M. Ryan & Laura E. Simmons, *Securities Class Action Settlements: 2016 Review and Analysis*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Apr. 18, 2017) https://corpgov.law.harvard.edu/2017/04/18/securities-class-action-settlements-2016-review-and-analysis/ [https://perma.cc/23P6-F94L] (finding that 25% of securities class actions settle for less than $2 million).

82. *See* Erickson, *supra* note 81, at 1382–83 ("Potential damages in securities class actions can easily rise to hundreds of millions of dollars, which means that these suits can become 'bet the company' lawsuits. In such low-probability suits involving the potential for large verdicts, defendants are often risk-averse. As a result, they are often willing to settle meritless claims to avoid . . . risking the company's financial stability.").

83. *Id.* at 1383 ("[D]efendants make the rational cost-benefit calculation that it is cheaper to settle the case and pay the plaintiff's fees than go through discovery and then get the case dismissed.").

84. Donald C. Langevoort, *Disasters and Disclosures: Securities Fraud Liability in the Shadow of a Corporate Catastrophe*, 107 GEO. L.J. 967 (2019) (noting that 10b-5 liability in these cases typically arises under the half-truth doctrine).

circumstances, even when based on the same set of facts, can lead to dramatically different results,[85] and in the interest of avoiding this uncertainty, defendants may be more inclined to settle early.

Finally, and more broadly, using whether shareholders were actually defrauded as the measuring stick for whether OV cases are desirable is problematic because liability in class actions under 10b-5 is not, strictly speaking, fraud. Few would object in other areas of law to compensating a victim who was actually defrauded with respect to an act that more directly harmed someone else. But in 10b-5 class actions, plaintiffs need not prove reliance so long as the securities at issue traded in an efficient market.[86] This means that shareholders, as indirect victims, can be compensated for a reduction in the value of their shares as a result of the harms that their firms inflict on third parties without having ever become aware of an actionable misstatement or omission. Accordingly, it seems inapposite to define the merits of OV lawsuits solely by whether shareholders were defrauded.[87]

Factually, shareholders may not be defrauded in many of the cases in which they nonetheless extract settlements because the pressure on securities class action defendants in general, and on OV defendants in particular, is extremely high. And conceptually, shareholders are arguably not defrauded in these actions because they need not—and generally do not—rely on any misstatement or omission. Accordingly, the sole metric for the desirability of event-driven class actions cannot be whether shareholders were in fact defrauded. The SH/OV distinction provides a different metric for assessing event-driven litigation by looking at its effect on third parties.

B. Do "Indicia of Merit" Indicate Merit?

By many measures currently used in the literature, the OV cases in my sample are meritorious cases. They are dismissed at lower rates than SH cases and they settle for considerably higher amounts,[88] most involve institutional shareholders,[89] and the striking majority involve government investigations. In this Section, I evaluate each of these "indicia of merit" in the context of event-driven litigation.

First, if the metric for merit is a relatively successful litigation outcome such as survival of a motion to dismiss or a settlement, it appears, based on my results, that event-driven cases are generally meritorious. But as just discussed, although settlements take place "in the shadow of a judgment," the intensity of the pressure

85. *Id.* at 4–5 (describing, as an example, the divergent treatment of securities litigation arising from the Fundao dam disaster by two different courts).

86. *Id.*

87. Samuel W. Buell, *What Is Securities Fraud?*, 61 DUKE L.J. 511, 555 (2011).

88. C.S. Agnes Cheng, Henry He Huang, Yinghua Li & Gerald Lobo, *Institutional Monitoring Through Shareholder Litigation*, 95 J. FIN. ECON. 356, 357 (2010).

89. Park, *supra* note 60.

to settle securities class actions in general, and event-driven cases in particular, should make us cautious about fully embracing this metric.[90]

The second potential indicator of merit that the OV cases in my sample display is the involvement of an institutional investor as a lead plaintiff. The descriptive statistics show that institutional investors are lead plaintiffs in roughly 42% of SH cases, but nearly 70% of OV cases. Further, a top plaintiffs' law firm is involved with 56% of SH cases, but a whopping 85% of OV cases.[91] I further examine the lead plaintiffs of OV cases in my sample to see specifically which institutional investors are most likely to bring these lawsuits. Table 11 shows the institutional investor lead plaintiffs in the OV cases broken down by type. Many cases have multiple lead plaintiffs; all are counted here. The majority of OV cases in my sample—60%—have at least one lead plaintiff that is a pension fund, and pension funds account for roughly 85% of the total number of institutional investor lead plaintiffs who bring OV cases. It is perhaps unsurprising that pension funds should make up the majority of OV lead plaintiffs; recent commentators have described pension funds as the "sheriffs of Wall Street,"[92] who are much less reluctant to litigate securities class actions than virtually any other kind of institutional investor.[93]

Copious prior literature has found that institutional investors are associated with better litigation outcomes,[94] and the presence of an institutional investor as a lead plaintiff is used in some studies as a proxy for the merit of a lawsuit.[95] However, previous studies also suggest that institutional investors might "cherry-pick" the strongest cases with the largest defendants.[96] My data on event-driven cases is consistent with this hypothesis, suggesting that many defendant firms in OV

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90. *See supra* Section III.B.

91. This is not surprising, as prior literature has documented the repeat relationships of institutional investors with top-tier plaintiffs' law firms. *See* Coffee, *supra* note 39 (noting that established plaintiffs' firms dominate relationships with institutional investors); *see also* Stephen J. Choi & Robert B. Thompson, *Securities Litigation and Its Lawyers: Changes During the First Decade after the PLSRA*, 106 COLUM. L. REV. 1489, 1529 (2006) (finding that "institutional investors that potentially may act as lead plaintiffs tend to develop repeat relationships with only a handful of the top-tier plaintiff law firms"). The data from my sample is at least facially inconsistent with the more recent hypothesis of commentators suggesting that event-driven litigation is primarily promulgated by less established plaintiffs' firms that lack these relationships with institutional investors, although I note that this commentary largely post-dates the filing of the cases in my sample. *See* Coffee, *supra* note 39; Reed & Lloyd, *supra* note 37.

92. *See* DAVID WEBBER, THE RISE OF THE WORKING-CLASS SHAREHOLDER: LABOR'S LAST BEST WEAPON 45, 171 (2018).

93. Cox et al., *supra* note 60, at 368 ("The institutional lead plaintiffs in our cases are mostly pension funds, either public pension funds or labor union pension funds.").

94. Choi et al., *supra* note 21; James D. Cox, Randall S. Thomas & Dana Kiku, *Does the Plaintiff Matter? An Empirical Analysis of Lead Plaintiffs in Securities Class Actions*, 106 COLUM. L. REV. 1587, 1588 (2006).

95. Park, *supra* note 60.

96. Pritchard et al. *supra* note 21 (finding specifically that pension funds are more likely to be lead plaintiffs in cases with better evidence of fraud, such as SEC investigations or earnings restatements with greater projected damages).

lawsuits are attractive litigation targets. A look at the descriptive statistics reveals some interesting trends. First, recall that 88% of OV cases involve a government inquiry or action and that 71% involve only non-SEC actions. There appears to be a hierarchy among these different types of investigations with respect to litigation outcomes. Cases involving an SEC inquiry have the lowest dismissal rates and the highest settlements. Next in line are the cases involving a non-SEC action. And while these do not result in dismissal rates or settlements as favorable as SEC actions, they are more likely to produce plaintiff-favorable results than cases with no investigations at all. Second, the defendant firms in cases involving non-SEC investigations tend to be large. While the median assets of SEC action firms are comparable to those where there is no government action ($534 million and $489 million respectively), the median assets of the non-SEC action firms are more than double at roughly $1.3 billion.

These figures suggest that while plaintiffs might select small and large defendant firms to sue when the firms are the subject of an SEC inquiry, they choose only large firms that are the subject of a non-SEC inquiry. A possible rationale for this is the potential trade-off between the probability and magnitude of a successful litigation outcome. A case involving a non-SEC action is not as likely as one involving an SEC action to yield a plaintiff-friendly outcome—but if plaintiffs select only large firms experiencing non-SEC investigations, the payoff is potentially great, even if the likelihood of success is somewhat lower. It is also noteworthy that OV cases tend to have longer class periods, further increasing claimed damages in these lawsuits (and thus, settlement amounts). Another contributing factor may be publicity; large firms that cause significant harm to third parties are often subject to significant media attention, and therefore plaintiffs' lawyers may incur fewer monitoring costs to find these cases in the first instance.[97]

These results suggest possible plaintiff opportunism and are consistent with patterns recognized by previous scholarship finding that securities plaintiffs' lawyers invest more time in cases against large defendants, and frequently capitalize on bad facts that are publicly available, such as restatements, investigations, and the termination of senior officers, in effort to reap larger fees with less effort.[98] Other recent accounts of event-driven securities litigation similarly find that the likelihood of a securities class action following a drop in stock price increases with the size of the defendant firm, even as the relative size of the stock drop decreases, likewise

97. *See* A Rising Threat, *supra* note 47, at 14 (noting that event-driven securities class actions keep catastrophic events "in the public eye").

98. Stephen J. Choi, Jessica Erickson & A.C. Pritchard, *Working Hard or Making Work? Plaintiffs' Attorney Fees in Securities Fraud Class Actions*, 17 J. Empirical Legal Studs. 438, 441 (2020); *see also* STEPHEN J. CHOI, JESSICA ERICKSON & ADAM C. PRITCHARD, U.S. CHAMBER INST. FOR LEGAL REFORM, RISK AND REWARD: THE SECURITIES FRAUD CLASS ACTION LOTTERY 2 (2019) (noting that plaintiffs' lawyers are "packaging publicly-available information [on firm size and investigations] into a complaint that is highly likely to generate a settlement").

suggesting that these cases are driven, at least in part, by plaintiff opportunism.[99] The attractiveness of OV defendants as litigation targets may mean that there is significant competition for the role of lead plaintiff, and institutional investors are, by design,[100] well positioned to win this competition.

The third, and perhaps most important, indicator of merit implicated by my findings is the government investigation. Many studies use SEC investigations specifically as an indicator of merit,[101] and event-driven cases usually (although not universally) do not involve an SEC investigation. However, they generally do involve a *non*-SEC investigation, and my results indicate that these investigations are significant predictors of the success of OV lawsuits.

Should these non-SEC investigations qualify as indicia of merit, similar to SEC investigations in the existing literature? Previous studies have used SEC investigations as "hard evidence" of investor fraud[102] because the SEC has limited resources and is therefore likely to focus its efforts on cases where defendants' conduct was likely fraudulent.[103] At first blush, non-SEC investigations are not analogous because the investigators at issue—the FDA, EPA, NHTSA, etc.—are not charged with investigating misconduct against investors. Yet it is certainly plausible that a firm, having marketed a drug with harmful side effects or a car with uncontrollable acceleration, might compound its problems by failing to disclose its actions to its shareholders when disclosure is obligatory, or by affirmatively concealing them. It may be only through the efforts of non-securities investigators that facts underlying a potential misstatement to investors are brought to light. If, for example, drug company X touts specific safety measures in its manufacturing process, an FDA investigator is well positioned to alert investors if, in fact, those measures are not in place, and the company's primary factory is negligently run and badly contaminated.

But the fact that non-SEC regulators discover that something went wrong does not necessarily mean that investors were defrauded. To begin with, it may be the case that even though there was a disaster, there was no misstatement or omission to investors punishable under the federal securities laws. For example, the fact that an oil rig exploded and was investigated by the authorities does not

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99. Coffee, *supra* note 39, at 12; Klausner et al., *supra* note 39.

100. *See* Perino, *supra* note 20, at 915 (noting that "the lead plaintiff provisions [of the PSLRA] were intended to reduce the race to the courthouse and increase institutional investor participation in class actions.").

101. *See, e.g.*, Park, *supra* note 60; Choi et al., *supra* note 21, at 872; Pritchard, et al., *supra* note 21; Tom Baker & Sean J. Griffith, *How the Merits Matter: Directors' and Officers' Insurance and Securities Settlements*, 157 U. PA. L. REV. 755 (2009); Stephen J. Choi, *Do the Merits Matter* Less *after the Private Securities Litigation Reform Act?*, 23 J.L. ECON. & ORG. 598, 620–21 (2006); Dain C. Donelson, Justin J. Hopkins & Christopher G. Yust, *The Role of Directors 'and Officers' Insurance in Securities Fraud Class Action Settlements*, 58 J.L. & ECON. 747 (2015).

102. *See id.*

103. *See* Pritchard, et al., *supra* note 21, at 43.

implicate fraud against investors if the firm made no misstatements about the underlying facts and did not hide any information that it was obligated to disclose.[104] Moreover, even if there was such a misstatement or omission, it must be material and made with scienter to constitute a 10b-5 claim. Many of the catastrophes that result in OV lawsuits may truly be black swan events, such that the risk that they would occur was so slight as to be immaterial, and thus disclosure of the risk was not required under the securities laws.[105] Alternatively, even if the risk ultimately was material, managers may not have perceived it to be so, and therefore did not disclose the risk not because they thought they had anything to hide, but because they honestly and un-recklessly misjudged the likelihood that the disaster would occur. Under 10b-5, this constitutes mistake, rather than fraud, because the managers lacked scienter. In both of these situations, the fact of the underlying disaster opens the door to hindsight bias,[106] potentially increasing pressure on defendants to settle.

Accordingly, the characteristics that proxy for merit in the literature may not always signal that event-driven lawsuits are, in fact, meritorious. Large settlements may be driven by the difficulties of managing mass litigation on multiple fronts; institutional investors may be enticed by the potentially lucrative combination of government investigations and deep-pocketed defendants; and the government investigations that accompany these lawsuits may not reliably indicate fraud against investors. To be sure, massive settlements with shareholders may indicate true investor fraud,[107] and it is undoubtedly the case that some percentage of managers

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104. *See, e.g.*, Foley v. Transocean Ltd., 861 F. Supp. 2d 197, 204 (S.D.N.Y. 2012) (noting that "[i]t is difficult to discern from Lead Plaintiff's sprawling [complaint]—and even its brief in opposition to the motion to dismiss—the specific misrepresentations or omissions that Lead Plaintiff intended to assert as being actionable under the securities laws," and that "this holding has no bearing on whether Transocean has substantive liability for the Macondo accident. Despite Lead Plaintiff's attempts to conflate the two issues, they are wholly separate").

105. *See* Basic, Inc. v. Levinson, 485 U.S. 224 (1988) (establishing the "probability/magnitude" test for materiality); *see also* Gay v. Axline, 23 F.3d 394 (1st Cir. 1994) (unpublished table decision) (possibility of large sale was not material despite the magnitude of potential event because the probability of its occurrence was very low).

106. Mitu Gulati, Jeffrey J. Rachlinski & Donald C. Langevoort, *Fraud by Hindsight*, 98 NW. U. L. REV. 773, 774 (2004) (noting that hindsight bias implicates both the materiality and scienter elements of 10b-5 claims, and commenting that "[e]ven in the absence of any misconduct, a bad outcome alone might lead people to believe that corporate managers committed securities fraud. The hindsight bias thus creates a considerable obstacle to the fundamental task in securities regulation of sorting fraud from mistake"); *see also* John C. Coffee, Jr., *The Changing Character of Securities Litigation in 2019: Why It's Time to Draw Some Distinctions*, CLS BLUE SKY BLOG (Jan. 22, 2019), https://clsbluesky.law.columbia.edu/2019/01/22/the-changing-character-of-securities-litigation-in-2019-why-its-time-to-draw-some-distinctions/ [https://perma.cc/BX3T-27SD] (noting that when predicting the risk of future catastrophes, "[w]hen the risk seemed remote at the time the corporate issuer made its disclosures, both the materiality of the issuer's omission and its alleged scienter would seem open to serious challenge").

107. *See* Reiser & Toll, *supra* note 37 (discussing the "mega-settlements" that have arisen from some event-driven securities class actions and arguing that these constitute meritorious cases that should be allowed to proceed).

depraved enough to externalize costs to innocent third parties are also depraved enough to lie to their shareholders about it. However, it is difficult to determine exactly what this percentage is.

C. Do Event-Driven Securities Class Actions Deter, Compensate, or Monitor Firms' Externality of Costs to Third Parties?

Irrespective of their merits, it is also necessary to examine event-driven lawsuits from a broader policy perspective. Does the possibility of being sued in an event-driven securities class action help deter firms from externalizing their costs to third parties? Do these lawsuits help make whole victims that were damaged by the firm's misconduct? Are these lawsuits an effective mechanism for helping shareholders and the general public oversee firms' conduct? Although these questions easily become conceptually entangled, I address them below under the rubric of deterrence, compensation, and monitoring. These criteria constitute further metrics by which we can assess whether event-driven securities class actions are desirable.

1. Deterrence

Proponents of securities class actions often back up their arguments on deterrence grounds. The securities class action in general has been touted by some scholars as picking up regulatory slack in an arena where public enforcers face serious resource constraints;[108] others argue that private securities class actions provide deterrence where enforcers lack the proper incentives to do so effectively.[109] Although the deterrence rationale for securities class actions generally is not without its numerous detractors in the literature,[110] there may be reasons to

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108. *See, e.g.*, Renee M. Jones, *Dynamic Federalism: Competition, Cooperation and Securities Enforcement*, 11 CONN. INS. L.J. 107, 126–27 (2005) ("Because the SEC lacks adequate resources to effectively police the national securities market, supplemental enforcement is essential to achieve an appropriate level of deterrence."); Donald C. Langevoort, *Capping Damages for Open-Market Securities Fraud*, 38 ARIZ. L. REV. 639, 652 (1996) (agreeing with "the conventional view that private litigation is a necessary supplement to SEC enforcement").

109. *See, e.g.*, Elizabeth Chamblee Burch, *Securities Class Actions as Pragmatic* Ex Post *Regulation*, 43 GA. L. REV. 63, 99 (2008) ("[S]ecurities class actions . . . guard against selective enforcement and inaction by the SEC" and "overcome[] lackluster governmental incentives."); James J. Park, *Rules, Principles and the Competition to Enforce the Securities Laws*, 100 CALIF. L. REV. 115, 121 (2012) ("[C]ompetition among enforcers can prevent a captured regulator from underenforcing the securities laws.").

110. *See, e.g.*, Amanda M. Rose, *The Multienforcer Approach to Securities Fraud Deterrence: A Critical Analysis*, 158 U. PA. L. REV. 2173, 2184 (2010) (arguing that overdeterrence of securities fraud is costly, and may increase the cost of capital, or induce suboptimal disclosure); Rose, *supra* note 21, at 1327 (arguing that "[i]t is also very difficult for profit-driven plaintiffs' lawyers to achieve the optimal level of sanctions because the amount that the defendant pays out determines the level of enforcement, which "leads to excessive enforcement and, as a predictable result, overdeterrence"); Frank H. Easterbrook & Daniel R. Fischel, *Optimal Damages in Securities Cases*, 52 U. CHI. L. REV. 611, 641

think that these actions play a deterrence role in the context of event-driven securities class actions specifically. One reason why securities class actions may not generally be effective deterrents to bad conduct is that much securities fraud tends to be the product of last-period concerns by management; unless the firm is in dire straits, the threat of firing is often sufficient to prevent managers from committing fraud.[111] However, it is possible that the misstatements driving OV cases are not necessarily the product of last-period concerns. Where they are not, OV cases arguably present a better case for deterrence than garden-variety financial misstatements, since they may depress share value, and therefore could give managers, who presumably own stock, the incentive to appropriately disclose the risks that may result in the disasters underlying these lawsuits.[112] However, the likelihood that this occurs turns on the probability that the misconduct will be discovered.[113] Moreover, as discussed above, these risks may be highly improbable or difficult to calculate, and under such circumstances, deterrence on these grounds would be minimal.

Another reason that event-driven securities class actions might serve as a useful deterrence mechanism is that they may extract penalties from defendant firms for bad conduct where other constituencies have difficulty doing so. Commentators have also argued that piggyback lawsuits specifically "may cure existing under-enforcement and deter future under-enforcement by allowing a second agent to fill the remedial gap."[114]

In OV cases, there are two potential sets of plaintiffs who might piggyback on a regulatory investigation: (1) the people whose harm the government is investigating (for example, the coastal residents at an oil spill site or the patients knowingly fitted with faulty medical devices), and (2) the shareholders of the defendant firm. Accordingly, there are two levels of redundancy to remedy potential underdeterrence. If regulators or primary victims underdeter OV defendant firms, either may sue as backup for the other. But even if neither of these actors is able or willing to penalize the defendant firm, shareholders may nonetheless deter future misconduct by extracting meaningful settlements.

(1985) (explaining that "the higher the payoff [from the lawsuit], the more people will spend investigating and bringing suits"); A.C. Pritchard, *Markets as Monitors: A Proposal to Replace Class Actions with Exchanges as Securities Fraud Enforcers*, 85 VA. L. REV. 925, 958–59 (1999) (arguing that securities class actions "target the wrong party for sanctions" because the firm pays the settlement while the manager who actually committed the fraud is, at worst, fired); *see also* Erickson, *Overlitigating*, *supra* note 35, at 77.

111. Jennifer H. Arlen & William J. Carney, *Vicarious Liability for Fraud on Securities Markets: Theory and Evidence*, 1992 U. ILL. L. REV. 691, 702–03.

112. *See* Jonathan M. Karpoff, D. Scott Lee & Gerald S. Martin, *The Cost to Firms of Cooking the Books*, 43 J. FIN. & QUALITATIVE ANALYSIS 581, 582 (2008).

113. I am grateful to Jennifer Arlen for this insight.

114. Clopton, *supra* note 31, at 290.

Assessing the deterrence value of OV cases in this context requires some insight into how often and with what results shareholders, regulators, and direct victims pursue defendant firms for the same misconduct. Accordingly, I use press releases and media articles to investigate lawsuits brought by the direct victims of the OV defendant firms' misconduct. Table 12 shows how many OV cases involve investigations by regulators, and how many involve follow-up litigation by the primary victims of the misconduct. The vast majority of OV cases—sixty out of sixty-eight—involved some regulatory investigation or other action by the government. Forty-five total OV cases involved lawsuits by the primary victims of the firms' misconduct. It thus appears that the direct victims of such misconduct take action less frequently than the government, and at only about sixty-five percent of the frequency with which shareholders sue.

Even more striking are the recovery rates for primary victims in OV cases who sue on their own behalves. Table 11 shows the amounts that regulators and primary victims recovered and compares these figures with the amounts that shareholders recovered in the OV cases where there was a recovery. Mean recoveries for regulators appear to be significantly larger than for the primary victims when they sue, although median recoveries for primary victims are larger than median regulatory penalties. In any case, both are larger than the recoveries that shareholders receive. Note, however, that shareholders recover more frequently than either regulators or primary victims.

These findings suggest that OV shareholder lawsuits may be valuable because they may impose penalties on firms where other actors have difficulty doing so. Although settlement amounts to shareholders are smaller, they arguably increase deterrence by adding to what defendant firms must pay in regulatory penalties and to direct victims. Moreover, I find that in fifteen of OV cases in the sample, the shareholder settlement is the *only* monetary penalty that the firm pays. Accordingly, it appears that shareholder lawsuits might serve a deterrence function particularly where regulatory penalties are low[115] or non-pecuniary,[116] or where the direct victims of the firm's misconduct have difficulty suing on their own behalves.[117]

There are, however, several caveats to the conclusion that OV lawsuits help to optimally deter corporate misconduct. The first is a data constraint. Although it does appear from the information I was to gather that some kinds of corporate misconduct may not be adequately deterred by regulators and direct victims alone, I find that many settlements with direct victims are private. It is therefore possible that lawsuits by direct victims play a larger role in deterrence than the sample shows, and pile-on shareholder litigation actually overdeters defendant firms.

Second, even if the data were completely reliable, it may not indicate that OV cases are optimally deterrent. Although the sample shows that there are OV lawsuits in which the shareholder settlement is the only penalty the defendant firm pays, this may not necessarily indicate that without the shareholder settlement, the defendant firm would be underdeterred. Since the vast majority of OV lawsuits—sixty out of sixty-eight—follow a regulatory action, it is possible that the relevant regulators in the twenty cases where neither regulators nor direct victims recovered concluded that the defendant firm's misconduct was insufficient to merit a penalty, and the firms settled the shareholder lawsuits for nuisance value. It is difficult to say, based on my sample, if this is occurring; the median shareholder settlement for OV actions where neither the government nor the direct victims collected a monetary award is $3.2 million.[118] A settlement value of three million dollars or below is a common

115. *See, e.g.*, Tapia-Matos v. Caesarstone Sdot-Yam, Ltd., No. 15-CV-6726, 2016 WL 3951184 (S.D.N.Y. July 20, 2016) (defendant firm's subpar workplace standards allegedly led to silicosis-related injuries and deaths of its workers, but firm was fined only $7,619 by OSHA); *Inspection: 1198695.015*, OCCUPATIONAL SAFETY & HEALTH ADMIN., https://www.osha.gov/pls/imis/establishment.inspection_detail?id=1198695.015 [https://perma.cc/F9PB-MVHR] (last visited Sept. 8, 2022). In this case, shareholders recovered $2.2 million and the injured workers roughly $2.6 million. *See Caesarstone Enters Settlement Agreement Related to Occupational Risks with Silica Dust*, REUTERS (Jan. 4, 2018, 8:46 AM), https://www.reuters.com/article/brief-caesarstone-enters-settlement-agre/brief-caesarstone-enters-settlement-agreement-related-to-occupational-risks-with-silica-dust-idUSFWN1OZ0OE [https://perma.cc/4R2M-L28A].

116. *See, e.g.*, Second Amended Class Action Complaint, *In re* Atossa Genetics, Inc. Sec. Litig., No. 13-CV-01836, 2014 WL 4983551 (W.D. Wa. Oct. 19, 2017), 2017 WL 5906539 (alleging that defendant firm marketed breast cancer diagnostic test as equivalent to mammogram or pap smear even though the test was not effective or FDA approved, and then pulled the product from the market when it received a warning letter—but no penalty—from the FDA), *aff'd in part, vacated in part*, 868 F.3d 784 (9th Cir. 2017). There does not appear to have been any lawsuit by patients receiving the test in this case. Shareholders recovered $3.5 million. *See In re* Atossa Genetics, Inc. Sec. Litig., No. 13-CV-01836, 2018 WL 3546176 (W.D. Wa. July 20, 2018). Of the 69 OV cases in the sample, 35 involve regulatory inquiries or actions that did not impose monetary penalties.

117. *See, e.g.*, Amended Complaint for Violation of the Federal Securities Laws at 4, Cambridge Ret. Sys. v. Invacare Corp., No. 13-CV-01165 (N.D. Ohio Nov. 15, 2013) (alleging that defendant firm had ignored repeated FDA warnings with respect to, among other things, hospital beds that caught fire and suffocated patients). No patient lawsuits were found based on this misconduct, but shareholders recovered $11 million. *See* Stipulation and Agreement of Settlement, Cambridge Ret. Sys. v. Invacare Corp., No. 13-cv-01165 (N.D. Ohio June 2, 2015).

118. There are twenty OV cases that meet these criteria. The mean settlement amount is $6.2 million.

proxy for nuisance litigation.[119] Accordingly, while it is possible that OV securities class actions serve a deterrence function by penalizing misconduct that would otherwise go unpunished, it is difficult to assert with confidence that this is the case. Finally, it appears that most OV lawsuits are brought against large firms,[120] but this does not necessarily mean that small firms do not also externalize their costs to third parties. Accordingly, OV cases may underdeter third-party misconduct perpetrated by smaller firms.

Accordingly, while the available information does lend some support to the idea that OV cases play a deterrence role, there exist some potential caveats.

2. Compensation

The second end that OV shareholder lawsuits might serve is compensation. Piggyback litigation in other contexts is not without its champions on the ground that government investigations make it easier for victims to recover.[121] However, this defense of piggyback litigation may not always be salient to an analysis of OV cases. First, and most obviously, event-driven securities class actions do not compensate the primary victims of the firms' misconduct. Further, as previously discussed, the non-SEC investigations that are prevalent in event-driven cases are not conducted with shareholders in mind and may not always shed light on whether they have actually been defrauded.[122] Therefore, it does not always make sense that investors should be compensated based on such investigations. Moreover, although compensation is the original justification for allowing a private right of action under Section 10(b),[123] few commentators currently justify securities class actions on compensatory grounds.[124] As is widely acknowledged, recoveries by injured shareholders are paid by the corporation and its insurance policies, and thus are

119. *See* James D. Cox & Frank Partnoy, *Introduction: Professor Randall Thomas's Depolarizing and Neutral Approach to Shareholder Rights*, 72 VAND. L. REV. 1755, 1765 (2019) ("Securities class action suits ending in small settlements, those smaller than $2–3 million, have long been suspected of being 'strike suits'—suits without much merit brought primarily to extort a settlement that provides fees to the attorney but little to nothing to class members."). These settlements likely represent avoided litigation costs. *See* Joseph A. Grundfest, *Why Disimply?*, 108 HARV. L. REV. 727, 740–41 (1995).

120. *See infra* Table 1.

121. *See* Erichson, *supra* note 31.

122. *See supra* notes 105–08 and accompanying text.

123. Kardon v. Nat'l Gypsum Co., 69 F. Supp. 512, 513 (E.D. Pa. 1946).

124. *See, e.g.*, Rose, *supra* note 10 ("[F]ew today defend FOTM suits on compensatory grounds."); TOM BAKER & SEAN J. GRIFFITH, ENSURING CORPORATE MISCONDUCT 6 (2010) ("[A]n emerging consensus among most corporate and securities law scholars rejects compensation as a justification for shareholder litigation."); Langevoort, *supra* note 108, at 651 ("[T]he compensatory system has relatively few informed, non-self-serving defenders."); *see also* STEFANO CASSELLA & ANTONINO EMANUELE RIZZO, DO SHAREHOLDERS GAIN FROM THEIR RIGHT TO SUE? EVIDENCE FROM FEDERAL JUDGE TURNOVER (2022), https://ssrn.com/abstract=3310090 [https://perma.cc/R8JL-HVFT] (finding that "strengthening the right to sue causes an equity value loss.").

inevitably circular.[125] These lawsuits are also lawyer-driven, and thus any recovery is diminished by substantial attorney fees.[126] Therefore, compensation, especially for third-party victims, is an unlikely policy justification for these lawsuits.

3. Monitoring

However, even if shareholder compensation in securities class actions nets out to zero, the subset of shareholders who sue are compensated by those that do not, and the prospect of being compensated as a plaintiff in an OV case may affect incentives of shareholders to monitor what the firm is doing. Shareholders may have incentives to pursue securities class actions after the fact rather than electing directors committed to pursuing preemptive measures to prevent third-party harm because much third-party harm, if undetected, benefits shareholders.[127] Cost-cutting measures that might lead to quality control problems, design issues, or negligence in execution may, so long as these problems remain under the radar, lead to an increase in profits, and thus shareholder wealth.[128] Accordingly, it is possible that investors might prefer their directors and managers to ignore red flags or simply not inquire about potential problems so long as the share price remains high.

On the most cynical view, there may be circumstances under which the event-driven securities class action acts as a type of insurance to shareholders that rationally prefer their management to externalize costs to third parties: if the management gets away with it, the shareholders win. And if the management is caught, the litigating shareholders do not lose (or at least probably will not lose as

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125. *See* Bratton & Wachter, *supra* note 16, at 72–73 (stating that 10b-5 class actions relying on the fraud on the market (FOTM) theory are "now generally seen to have altogether failed to deliver on the [goal of investor compensation]. Real-world [] actions proceed on an enterprise-liability theory with corporate—as opposed to individual—defendants funding the compensation; investor 'victims' are accordingly compensated from the pockets of other innocent investors. It follows that not only does FOTM fail as a compensatory mechanism, it doesn't even make sense."); *see also* Rose, *supra* note 10, at 1244 (arguing that 10b-5 securities class actions "result in a transfer of funds from one group of innocent shareholders to another. Over time well-diversified shareholders will find themselves on both sides of the 'v.' in roughly equal measure, meaning to them FOTM suits are an exercise in pocket shifting or, worse, a negative proposition once attorneys' fees and other litigation costs are taken into account").

126. Janet Cooper Alexander, *Rethinking Damages in Securities Class Actions*, 48 STAN. L. REV. 1487, 1503 (1996) ("[P]ayments by the corporation to settle a class action amount to transferring money from one pocket to the other, with about half of it dropping on the floor for lawyers to pick up.").

127. *See* Urska Velikonja, *The Political Economy of Board Independence*, 92 N.C. L. REV. 855, 896–97 (2014) ("[C]urrent shareholders generally have an economic incentive to underinvest in monitoring to the extent that they reap the full benefit of corporate wrongdoing, but externalize part (or all) of the cost to nonshareholders . . . . [I]nvestors have an interest to underinvest in compliance designed to prevent illegality that benefits the firm."); Donald C. Langevoort, *Internal Controls after Sarbanes-Oxley: Revisiting* Corporate Law*'s "Duty of Care as Responsibility for Systems*,*"* 31 J. CORP. L. 949, 960 (2006) (arguing that investors do not benefit from the revelation of wrongful conduct and therefore would rather have "less-than-full transparency ex post").

128. *See* Velikonja, *supra* note 127; Langevoort, *supra* note 127.

much) because they will likely be able to extract a settlement in a securities class action. This is consistent with scholarship that posits that securities class actions in general constitute a "litigation put" by which shareholders are entitled to recover a portion of their losses if the stock price falls a sufficient amount, irrespective of the merits of the claim under the securities laws.[129] But this issue is even more problematic for event-driven securities class actions specifically, because rather than simply insuring against business loss, it reinforces a shareholder preference for managers to externalize costs to third parties to bolster stock price. This could increase the likelihood that third parties will ultimately be harmed.

While event-driven securities class actions are not unique in allowing shareholders to sue for their firms' infliction of harm on third parties, other similar types of lawsuits do not create the same incentives. The most obvious analog is the strand of jurisprudence imposing the duty of managers to monitor, laid out in the Delaware cases *Caremark*[130] and *Stone v. Ritter*.[131] Under these cases, shareholders may recover for breach of fiduciary duty when directors fail to adequately inform themselves of risks requiring their attention.[132] This line of cases is the original source of much of firms' modern compliance infrastructure.[133] Such infrastructure is meant to allow boards to monitor conduct within their companies that not only might harm shareholders, but that might harm other parties.[134]

However, shareholder recoveries in OV cases provide different incentives from those under *Caremark*. First, *Caremark* claims are narrower in scope than OV lawsuits, as they target only directors,[135] and they are generally brought as derivative lawsuits, meaning that the firm, rather than the shareholders, recovers. This setup may help mitigate the "lawsuit as insurance" problem described above; even if shareholders win or settle a *Caremark* claim, any award goes to the firm, and not into the plaintiffs' pockets. Second, the standard that plaintiffs must meet under *Caremark* is high, as it requires that "the directors utterly failed to implement any reporting or information system or controls; or . . . having implemented such a

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129. Alexander, *supra* note 18 (explaining that "[b]ecause the recovery depends only on the occurrence of a large loss and does not require proof that a securities violation has actually occurred, the process is more akin to no-fault insurance against market losses than to judicial enforcement of substantive law"). To the extent that the PSLRA has decreased non-merit-based settlements, this argument, of course, holds less force. As previously discussed, however, the PSLRA has not eliminated nuisance settlements for meritless claims.

130. *In re* Caremark Int'l Inc. Derivative Litig., 698 A.2d 959 (Del. Ch. 1996).

131. Stone *ex rel.* AmSouth Bancorporation v. Ritter, 911 A.2d 362 (Del. 2006).

132. *Id.*

133. Paul E. McGreal, Caremark *in the Arc of Compliance History*, 90 TEMP. L. REV. 647, 648 (2018) (arguing that *Caremark* is responsible for the "visibility and urgency of compliance and ethics in the board room").

134. Indeed, some recent significant *Caremark* cases involve precisely this kind of conduct. *See, e.g.*, Marchand v. Barnhill, 212 A.3d 805 (Del. 2019) (involving a listeria outbreak in the manufacturing plant of one of America's largest ice cream producers).

135. *In re Caremark*, 698 A.2d 959.

system or controls, consciously failed to monitor or oversee its operations thus disabling themselves from being informed of risks or problems requiring their attention."[136] This makes a recovery notoriously difficult in these lawsuits.[137] Third, Delaware's chancery courts are lauded for their efficiency.[138] By contrast, securities class actions are typically lengthy, drawn-out affairs[139] that increase pressure on defendants to settle, even if the merits of the plaintiffs' case are dubious. While *Caremark* has been criticized as "irrelevant"[140] and "underwhelming"[141] in prompting managers to pursue adequate compliance, shareholders who suspect that their management is not taking adequate precautions to protect third parties know that a *Caremark* claim is unlikely to insulate them from the firm's drop in value when the skullduggery is discovered.

To be sure, securities class actions are themselves a form of shareholder monitoring, and in view of the information asymmetries inherent in corporate governance, probably the dominant one. However, they are not ideal for costs that firms externalize to third parties. This is because securities class actions are brought after the harm is inflicted; a more socially optimal form of monitoring would be one that prevents these harms in the first instance. This is doubly true because the information from my sample (though admittedly patchy) seems to suggest that direct victims of the firms' misconduct are significantly less likely than shareholders to sue, and even less likely to recover *ex post*.[142]

But even independent of the problem that third parties must actually be harmed in order for it to be deployed, event-driven lawsuits are not ideal as a

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136. AmSouth Bancorporation, 911 A.2d at 370.

137. *See* Matthew W. Abbott, Ariel J. Deckelbaum, Ross A. Fieldston, Andrew G. Gordon, Jaren Janghorbani & Jeffrey D. Marell, *Paul Weiss Discusses Delaware Decisions Showing Renewed Focus on Board Oversight*, CLS BLUE SKY BLOG (Nov. 20, 2019), https://clsbluesky.law.columbia.edu/2019/11/20/paul-weiss-discusses-delaware-decisions-showing-renewed-focus-on-board-oversight/ [https://perma.cc/6FGV-2G3Q] ("As a result of these high pleading standards, Caremark claims have historically had limited success.").

138. Sara Lewis, Note, *Transforming the "Anywhere but Chancery" Problem into the "Nowhere but Chancery" Solution*, 14 STAN. J.L. BUS. & FIN. 199, 200 (2008) ("Delaware's judges typically have considerable expertise in corporate law matters, and Delaware courts provide litigants with an expedited process that results in speedier and more efficient resolutions of disputes.").

139. *See* ELLEN M. RYAN & LAURA E. SIMMONS, CORNERSTONE RSCH., SECURITIES CLASS ACTION SETTLEMENTS: 2011 REVIEW AND ANALYSIS 5 (2012), https://amlawdaily.typepad.com/Cornerstone_Research_Settlements_2011_Analysis.pdf [https://perma.cc/5A54-6HBW] (finding that more than forty percent of securities class actions take between three and four years to settle).

140. Mercer Bullard, Caremark*'s Irrelevance*, 10 Berkeley Bus. L.J. 15, 44 (2013).

141. Todd Haugh, Caremark*'s Behavioral Legacy*, 90 TEMP. L. REV. 611, 614 (2018).

142. For a recent example of this phenomenon, see Matt Levine, *Money Stuff: It Doesn't Pay to Be Too Ethical*, BLOOMBERG (May 1, 2020, 9:02 AM), https://www.bloomberg.com/news/newsletters/2020-05-01/money-stuff-it-doesn-t-pay-to-be-too-ethical [https://perma.cc/FQ45-LXSR] ("[W]omen who worked at [the defendant firm] started suing the company for discrimination in 2008, there is a class action involving 70,000 of them, there was a New York Times Magazine story about it last year, and it still has not been resolved. The women who were harassed and underpaid have not been compensated; the shareholders, of course, have been.").

monitoring mechanism. This is because in many instances, these lawsuits do not actually induce firms to disclose the information that investors, and indeed, the general public, would like to know about disasters that harm third parties. Absent a duty to speak, firms are not obligated to disclose many material facts that go into the making or mitigation of a disaster.[143] Most 10b-5 claims in this area are based on the "half-truth" doctrine, which requires defendants to disclose sufficient information to prevent statements already made from being misleading;[144] but where most disclosures are voluntary,[145] defendants can circumvent this obligation by not speaking at all.

Moreover, where defendants do make statements that could be considered misleading after disaster strikes (for example, to tout their safety procedures or sustainability/governance initiatives in somewhat general terms), when the lawsuits hit, they "commonly claim that whatever was said, no matter how positive, was too general, speculative, or vague to be anything more than 'puffery,' such that it was neither material nor misleading regardless of what was left unsaid."[146] This gives defendant firms incentive only to speak about potential risks in the most general terms, which does not promote effective monitoring. Because a firm's best response to the possibility of an OV lawsuit is typically "gamesmanship or stone-cold silence,"[147] it seems hard to say that these lawsuits promote meaningful disclosure.

Relatedly, OV lawsuits may draw attention away from securities lawsuits that could promote better disclosure, such as, for instance, those involving financial disclosures. To return to the sample, these lawsuits are likely to produce better outcomes for the plaintiffs who bring them—they are less likely to be dismissed[148] and are more likely to produce high settlement amounts than lawsuits for misconduct whose primary victims are the shareholders themselves.[149] They are also significantly more likely to involve an institutional investor as lead plaintiff, and pension funds especially are likely to participate in this capacity.[150] One interpretation of these results is that these institutional investors—the "sheriffs of Wall Street"[151]—may be focusing their resources on cases that are likely to result in high payouts but unlikely to incentivize disclosures that are of much value to anyone. Accordingly, it appears that the value of OV cases as a mechanism for

143. *See* Langevoort, *Disasters and Disclosures*, *supra* note 84, at 991–92 (discussing the items in SEC disclosures that firms are actually obligated to disclose in the Form S-K, and remarking that risk assessments "can easily devolve to boilerplate, offering a recitation of risks the majority of which an intelligent investor could surmise even without the disclosure," while the MD&A is "less than entirely reliable as an early warning device").

144. *Id.* at 974.

145. *Id.* at 979.

146. *Id.* at 978.

147. *Id.* at 1015.

148. *See infra* Table 6.

149. *See infra* Table 7.

150. *See infra* Tables 6, 7, 11.

151. WEBBER, *supra* note 92.

monitoring may be questionable, and these cases may also distract shareholders who could be more effective monitors in other contexts.

D. Potential Policy Prescriptions

As previously discussed, proponents of event-driven securities class actions—the most vocal of whom are plaintiffs' counsel—do not consider these actions in need of reform. Conversely, opponents of these actions in the industry and in academia suggest that these actions often lack merit, and significant steps should be taken to limit them.[152] The truth probably lies somewhere between these divergent and self-interested perspectives. But any discussion of reform to OV lawsuits ignores the obvious: these lawsuits are suboptimal because in order for the lawsuit to be brought, the third party must be injured. In a perfect world, the solution to this problem would be for firms to adopt better mechanisms to prevent this injury altogether. As previously discussed, this may not be the result that shareholders prefer; they may prefer that the management continue to externalize costs to third parties as long as the stock price remains high, and then they may sue to at least partially make up their losses if the management is caught. However, it is unlikely that shareholders would be more vigilant monitors of misconduct against third parties in the absence of event-driven lawsuits, simply because they lack the ability. In general, shareholders face serious constraints with respect to access to information and collective action.[153] Voter apathy, particularly among retail investors, is rampant.[154] Large index fund managers, which collectively vote roughly twenty-five percent of the S&P 500, tend to defer excessively to managers.[155] The structural overhaul of corporate governance that would be necessary to remedy these problems is beyond the scope of this Article. Instead, I address two more targeted mechanisms that might help shareholders and the general public better monitor firm conduct that externalizes costs to third parties: more specific catastrophic risk disclosures and mandatory ESG disclosures. Although event-driven securities class actions can only be brought in the wake of harm that

152. Though it is almost certainly too blunt an instrument, my sample strongly suggests that limiting the use of non-SEC inquiries as facts that may be pleaded in a 10b-5 class action complaint would dramatically decrease the success and probably the incidence of event-driven securities class actions. Without regulatory findings, many plaintiffs likely could not meet the specificity requirements to withstand a motion to dismiss, and a significant number probably would not even try.

153. Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247, 310 (1999); Mark J. Roe, *A Political Theory of American Corporate Finance*, 91 COLUM. L. REV. 10, 12–13 (1991); Zohar Goshen, *Controlling Strategic Voting: Property Rule or Liability Rule?*, 70 S. CAL. L. REV. 741, 749–63 (1997).

154. *See* Dorothy S. Lund, *Nonvoting Shares and Efficient Corporate Governance*, 71 STAN. L. REV. 687, 695 (2019); Mary Ann Cloyd, *2014 Proxy Season Mid-Year Review*, HARV. L. SCH. F. ON CORP. GOVERNANCE (July 17, 2014), https://corpgov.law.harvard.edu/2014/07/17/2014-proxy-season-mid-year-review/ [https://perma.cc/5BXX-934H].

155. Lucian Bebchuk & Scott Hirst, *Index Funds and the Future of Corporate Governance: Theory, Evidence, and Policy*, 119 COLUM. L. REV. 2029, 2030, 2033 (2019).

has already occurred, these lawsuits could enforce the accuracy of my proposed disclosures, which might mitigate such harm the next time around.

First, requiring more specific disclosures about the probability of catastrophic operational risks would force managers to reveal those risks. The general public, including outsiders that might bear the brunt of a manifestation of such risks, would thus be on notice. Such disclosure might also induce better monitoring; if such risks were more explicitly in the public eye, detection of the kinds of cost-cutting that could cause those risks to materialize might be more likely. Accordingly, the odds of a stock price increase from undetected conduct that externalizes risks to outsiders might be lower, mitigating shareholders' preferences for management to engage in such conduct. To be useful, such disclosures would not only need to identify the risk but also the probability that it might occur, and how the management arrived at that probability.[156]

A complementary solution to make event-driven securities class actions better mechanisms to prevent firms from harming third parties might be to implement mandatory, measurable ESG standards.[157] Several reforms would be required to achieve this goal. First, ESG disclosures currently are not mandatory, and the SEC has generally resisted calls to update disclosures to include ESG metrics[158] (although more recent proposals appear to be gaining increasing traction).[159] Investors, who are increasingly interested in ESG issues,[160] have resorted to shareholder proposals under Rule 14a-8 to seek disclosures from their companies,[161] but recent

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156. *See* Langevoort, *supra* note 84, at 991 (noting that current line-item disclosures require identification, but not the probability, of significant risks). Because such specific information is difficult to calculate and could form the basis for substantial liability, however, a nontrivial safe harbor might be required to induce managers to make such disclosures.

157. Indeed, such reforms have been recently proposed. Press Release, U.S. Sec. & Exch. Comm'n, SEC Proposes to Enhance Disclosures by Certain Investment Advisers and Investment Companies About ESG Investment Practices (May 25, 2022), https://www.sec.gov/news/press-release/2022-92 [https://perma.cc/6GMT-P55S].

158. Fisch, *supra* note 13. For a discussion of the shortcomings of ESG metrics, see Ofer Eldar, *Designing Business Forms to Pursue Social Goals*, 106 VA. L. REV. 937, 956–57 (2020).

159. *See* SEC. & EXCH. COMM'N INV. ADVISORY COMM., RECOMMENDATION OF THE SEC INVESTOR ADVISORY COMMITTEE RELATING TO ESG DISCLOSURE (2020), https://www.sec.gov/spotlight/investor-advisory-committee-2012/esg-disclosure.pdf [https://perma.cc/6QH5-EP2F] (arguing that "the time has come for the SEC to address the issue" of incorporating ESG materials into the integrated disclosure regime for registered issuers). The SEC has also increased its focus on ESG and climate-related disclosures generally. *See, e.g.*, Press Release, U.S. Sec. & Exch. Comm'n, Satyam Khanna Named Senior Policy Advisor for Climate and ESG (Feb. 1, 2021), https://www.sec.gov/news/press-release/2021-20 [https://perma.cc/HLQ3-987C]; Press Release, U.S. Sec. & Exch. Comm'n, SEC Announces Enforcement Task Force Focused on Climate and ESG Issues (Mar. 4, 2021), https://www.sec.gov/news/press-release/2021-42 [https://perma.cc/C2T3-9PJ3].

160. *See* Fisch, *supra* note 13, at 940; *see also* Letter from Cynthia A. Williams & Jill E. Fisch to Brent J. Fields, Sec'y, Sec. & Exch. Comm'n, 10–11 (Oct. 1, 2018), https://www.sec.gov/rules/petitions/2018/petn4-730.pdf [https://perma.cc/YK8W-7UJC] (noting that high-profile institutions such as Blackrock, Bloomberg, and the Human Capital Management Coalition have called for improved sustainability disclosure).

161. *See* Fisch, *supra* note 13, at 940.

evidence indicates that ESG shareholder proposals are often omitted from corporate ballots.[162] Notably, the most common plaintiffs in the OV cases in my sample—pension funds, which are involved with the majority of OV cases[163]—are, out of all institutional investors, the least likely to support such measures.[164] Importantly, recent studies have also shown that public pension funds' votes are "critical to the success of a proposal,"[165] raising the chances of passing management proposals by 7.2% and shareholder proposals by 8.7%.[166] It may be evidence of the distorted incentives that event-driven cases produce that the plaintiffs driving these cases do not appear to play an active role in ESG measures that might protect third parties, and such governance measures might be particularly hard to pass without the participation of these institutions.

The potential difficulty of procuring voluntary ESG disclosures is not the only problem. Despite the defects of the 14a-8 process, firms have increasingly responded to investor demand for ESG-related information by issuing standalone ESG reports.[167] However, these reports are "fragmented, of inconsistent quality, and often unreliable."[168] First, multiple scholars have commented on the proliferation of standard-setters that have emerged due to the absence of a uniform disclosure regime.[169] This makes ESG disclosures difficult to evaluate and compare. Relatedly, because such disclosures are voluntary, firms can use vague language, emphasize positive information, omit negative information, and generally finesse their disclosures to make their sustainability practices look rosier than they really are.[170] This practice is known as "greenwashing."[171] High-profile examples of firms

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162. *See, e.g.*, Richard Alsop & Yoon-jee Kim, *Shareholder Proposals 2019—ESG No-Action Letter Trends and Strategies*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Mar. 25, 2020), https://corpgov.law.harvard.edu/2020/03/25/shareholder-proposals-2019-esg-no-action-letter-trends-and-strategies/ [https://perma.cc/5Q84-538X] (finding that forty percent of the no-action letters reviewed from the 2019 proxy season involved ESG proposals).

163. *See infra* Table 11.

164. YING DUAN, YAWEN JIAO & KINSUN TAM, CONFLICT OF INTEREST AND PROXY VOTING BY INSTITUTIONAL INVESTORS (2021), http://dx.doi.org/10.2139/ssrn.3252801 [https://perma.cc/3L46-26LX] (noting that public pension funds are the least likely to vote in favor of ESG measures); *see also* Roberta Romano, *Public Pension Fund Activism in Corporate Governance Reconsidered*, 93 COLUM. L. REV. 795, 798 (1993) (finding that there is an "inverse relation between the return on funds' investments . . . and policies favoring social investing").

165. Ying Duan, Yawen Jiao & Kinsun Tam, *The Role of Public Pension Funds in Governance*, CLS BLUE SKY BLOG (Oct. 24, 2018), https://clsbluesky.law.columbia.edu/2018/10/24/the-role-of-public-pension-funds-in-corporate-governance [https://perma.cc/7S27-6TX5].

166. *Id.*

167. Fisch, *supra* note 13, at 950.

168. *Id.* at 947.

169. *See id.*; Ofer Eldar, *The Role of Social Enterprise and Hybrid Organizations*, 2017 COLUM. BUS. L. REV. 92 [hereinafter Eldar, *Role of Social Enterprise*]; Eldar, at 939; Strine, Smith & Steel, *supra* note 14, at 1912.

170. *See* Fisch, *supra* note 13, at 948.

171. *See id.*; Eldar, *Role of Social Enterprise*, *supra* note 169, at 167.

engaged in greenwashing include BP[172] and Volkswagen;[173] the Deepwater Horizon oil spill and VW emissions scandal respectively (both of which led to massive event-driven securities class actions) illustrate the extent to which these companies' ESG reports may not have told the whole story. Second, because many sustainability reports are not incorporated into firms' SEC filings, they may be unreliable because they are likely prepared with less care, often by PR or marketing personnel, and without the oversight of gatekeepers such as securities lawyers, auditors, or upper-level management.[174]

Nonetheless, mandatory, measurable ESG disclosures could play a valuable role in preventing firms from externalizing costs to third parties, and event-driven lawsuits might help enforce the accuracy of such disclosures. If firms undertake, in measurable terms, to be responsible citizens, there may be less leeway for them to maintain operational risks that could result in harm to third parties.[175] Indeed, some commentators have argued that while "[m]ost people view sustainability as an effort to ensure that company decisions are in line with certain social or moral values . . . by operationalizing their commitment to these values, companies are also seeking to avert the reputational uproar, stock price drop, and legal troubles following misconduct."[176] Similarly, others have noted,

> If directors are seeking to go beyond the legal minimum and to treat all the corporation's stakeholders and communities of impact in an ethical and considerate manner, the corporation is by definition minimizing the risk of breaking the law. By trying to engage in EESG [employee, environment, social, and governance] best practices, the corporation will have a margin of error that keeps it largely out of the legal grey . . . . [177]

Accordingly, where ESG encourages companies "to engage in ethical, safe, and non-deceptive conduct," it may mitigate a firm's propensity to tolerate risks that externalize costs to outsiders.[178] If uniform, mandatory disclosures required firms to reveal specific facts about the methods and efficacy of their ESG efforts,

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172. Eldar, *Role of Social Enterprise*, *supra* note 169.

173. Fisch, *supra* note 13, at 948.

174. *Id.* at 950.

175. Jonathan Neilan, Peter Reilly & Glenn Fitzpatrick, *Time to Rethink the S in ESG*, HARV. L. SCH. F. ON CORP. GOVERNANCE (June 28, 2020), https://corpgov.law.harvard.edu/2020/06/28/time-to-rethink-the-s-in-esg/ [https://perma.cc/BCG2-W6RA] (noting that ESG practices are a "barometer for corporate culture").

176. Stavros Gadinis & Amelia Miazad, *Corporate Law and Social Risk*, 73 VAND. L. REV. 1401, 1426 (2020).

177. *See* Strine, Smith & Steel, *supra* note 14, at 1909 (commenting in addition that such a strategy will "create a reputation that will serve the company well with its stakeholders and regulators when there is a situational lapse").

178. *See id.* at 1906–07 (noting specifically that ESG policies may reinforce company obligations not to expose "consumers to financial harm, unsafe products, or theft of personal data").

event-driven securities class actions could play a role in enforcing the accuracy of those disclosures.[179]

While an ideal policy solution would be one that empowers shareholders to prevent firms from externalizing costs to third parties in the first instance, such a solution is improbable under our current system of corporate governance. But event-driven securities class actions could be more effective as *ex post* monitoring mechanisms if the disclosures on which they were based were more useful. Requiring more specific disclosures of catastrophic risks that might affect outsiders, as well as of the measures firms take to be responsible corporate citizens, would enable shareholders and the general public to better monitor these risks. And event-driven class actions could play a potentially valuable role in holding firms accountable for the accuracy of such disclosures.

CONCLUSION

Over the last several years, "event-driven litigation" has become more visible, such that it seems reasonable to wonder whether everything is, indeed, securities fraud. In this Article, I find that cases involving alleged misconduct that primarily harms victims other than shareholders comprise a small but important portion of securities class actions. I find that these cases are generally more successful and lucrative than those where a firm's misconduct primarily harmed shareholders. Moreover, I find that the plaintiffs in these cases are generally more sophisticated and hire more prestigious lawyers, and that the defendant firms are generally wealthier. Perhaps most importantly, I find that these cases involve a dramatically higher proportion of non-SEC actions, which may, for better or for worse, be driving successful outcomes for plaintiffs. While these cases may have deterrence value, they may also create incentives for suboptimal monitoring of firms' conduct with respect to third parties and do not seem to promote disclosures that are helpful in mitigating such conduct. Accordingly, I suggest several targeted mechanisms for increasing the utility of the disclosures that event-driven securities class actions might enforce. My proposal could improve both the social value and the overall quality of these lawsuits.

179. I note that here too, as some commentators have suggested, a safe harbor might be required to induce issuers to reveal information that is specific enough to be helpful. *See* Fisch, *supra* note 13, at 965 n.259 (recommending a safe harbor so a firm's "identification of a new sustainability issue does not subject it to liability for previously failing to discuss that issue"). However, such a safe harbor could be more narrowly cabined than one for disclosures requiring firms to disclose the probability of unlikely but catastrophic risks, and therefore OV actions might play a greater role in enforcing ESG disclosure despite a safe harbor.

TABLES

	Primary Harm to Shareholders				Primary Harm to Other Victims				
	Mean	Median	Std. Dev.	Obs.	Mean	Median	Std. Dev.	Obs.	t-stat
Section 10b	.9249249	1	.263909	333	.9848485	1	.1230915	66	1.8048
Section 11	.1291291	0	.3358475	333	.0757576	0	.2666375	66	-1.2168
Dismissal	.5465465	1	.4985779	333	.3636364	0	.4847319	66	-2.7351
Settlement	7213097	0	23500000	333	24300000	6062500	64700000	66	3.7457
Assets ($m)	8017.251	400.88	30935.3	278	29558.17	1262.29	64830.57	61	3.8887
Class Period	13.36937	10	12.017	333	16.87879	13	13.33188	66	2.1276
Inst. LP	.4174174	0	.4938751	333	.6969697	1	.4630899	66	4.2432
2nd or 9th Cir.	.6036036	1	.4898847	333	.5151515	1	.5036001	66	-1.3339
Restatement	.048048	0	.2141896	333	.0454545	0	.2098951	66	-0.0902
SEC Action	.1921922	0	.3946163	333	.1666667	0	.3755338	66	-0.4838
Non-SEC Action	.045045	0	.2077151	333	.7121212	1	.4562439	66	18.6909
Govt Action	.2372372	0	.4260291	333	.8787879	1	.3288746	66	11.5655
Pl. Law Firm	.5675676	1	.4961591	333	.8484848	1	.3612978	66	4.3736

Table 1: Descriptive Statistics (Non-Merger Cases)

	Primary Harm to Shareholders				Primary Harm to Other Victims				
	Mean	Median	Std. Dev.	Obs.	Mean	Median	Std. Dev.	Obs.	t-stat
Dismissal	.5649351	1	.4965723	308	.3692308	0	.4863522	65	-2.8975
Settlement	6454419	0	21100000	308	24600000	6125000	65200000	65	4.0170
Assets ($m)	7944.469	363.89	31124.7	254	30047.73	1299.546	65263.87	60	3.8605
Class Period	13.69805	10	12.20227	308	17.12308	13	13.28593	65	2.0242
Inst. LP	.3993506	0	.490562	308	.6923077	1	.4651303	65	4.4137
2nd or 9th Cir.	.5974026	1	.4912191	308	.5230769	1	.5033541	65	-1.1038
Restatement	.0519481	0	.2222833	308	.0461538	0	.211451	65	-0.1926
SEC Action	.2045455	0	.4040255	308	.1692308	0	.3778736	65	-0.6474
Non-SEC Action	.038961	0	.193817	308	.7076923	1	.4583625	65	18.8813
Govt Action	.2435065	0	.4298966	308	.8769231	1	.3310821	65	11.1945
Pl. Law Firm	.5714286	1	.495677	308	.8615385	1	.3480716	65	4.4886

Table 2: Descriptive Statistics (10(b) Cases Only)

	SEC Action				Non-SEC Action				No Govt. Action			
	Mean	Median	Std. Dev.	Obs.	Mean	Median	Std. Dev.	Obs.	Mean	Median	Std. Dev.	Obs.
Dismissal	0.320988	0	0.469765	81	0.439394	0	0.500117	66	0.64706	1	0.478589	340
Settlement	2550000	3100000	65200000	81	14700000	2864500	35200000	66	424875	0	1.77E+0	340
Assets ($m)	24787.71	534.968	70613.47	64	18209.89	1299.55	48738.05	62	7866.38	489.9	25477.08	293
Class Period	16.90123	13	13.37778	81	16	12.5	13.02778	66	10.4235	7	11.91972	340
Inst. LP	0.493827	0	0.503077	81	0.560606	1	0.500117	66	0.35882	0	0.480362	340
2nd or 9th Cir.	0.567901	1	0.498454	81	0.515152	1	0.5036	66	0.54118	1	0.499036	340
Restatement	0.123457	0	0.33101	81	0.030303	0	0.172733	66	0.02059	0	0.142211	340
Pl. Law Firm	0.666667	1	0.474342	81	0.818182	1	0.38865	66	0.45723	0	0.498904	339

Table 3: Descriptive Statistics (Investigations)

	Inst. Investor as Lead Plaintiff				Individual as Lead Plaintiff			
	Mean	Median	Std. Dev.	Obs.	Mean	Median	Std. Dev.	Obs.
Dismissal	.4522613	0	.4989711	199	.6423611	1	.4801393	288
Settlement	19000000	1955000	50500000	199	2441007	0	8356813	288
Assets ($m)	20274.11	1120.143	50320.06	178	5856.78	291.569	28647.59	241
Class Period	14.03518	9	12.44397	199	11.02778	7.5	12.60548	288
2nd or 9th Cir.	.5577889	1	.4979018	199	.53125	1	.4998911	288
Restatement	.0502513	0	.2190139	199	.03125	0	.1742955	288
SEC Action	.201005	0	.4017625	199	.1423611	0	.3500283	288
Non-SEC Action	.1859296	0	.3900311	199	.1006944	0	.3014475	288
Govt. Action	.3869347	0	.4882769	199	.2430556	0	.429675	288
Pl. Law Firm	.7336683	1	.4431546	199	.4076655	0	.4922587	287

Table 4: Descriptive Statistics (Institutional Investor Lead Plaintiff)

	Obs.	Percent Dismissed	Mean Shareholder Settlement	Mean Total Assets ($ millions)	Percent Institutional Lead Plaintiff	Percent SEC Investigation
Drug/Medical Device	33	30.3%	24,500,000	14556.47	57.5%	6.0%
Other Healthcare	11	36.4%	8,204.545	16646.18	90.1%	36.3%
Environmental	8	50%	26,400,000	61588.98	87.5%	25%
Motor Vehicle	4	25.0%	109,000,000	153506.1	50%	50%
Consumer	3	67%	500,000	250.9075	100%	0%
Antitrust	2	50%	11,300,000	3456.537	50%	0%
Food & Beverage	1	100%	0	1362.399	0%	0%
Working Conditions	1	0%	2,200,000	439	0%	0%
Sexual Harassment	1	100%	0	129517	100%	0%
Other	4	50%	8,750,000	18266.11	75%	25%
All Non-Healthcare	22	50%	29,500,000	57133.86	70.8%	20.8%

Table 5: Descriptive Statistics (OV cases by type)

	(1)	(2)	(3)
OV Case	-0.196**	-0.218**	-0.199**
	(-2.95)	(-3.05)	(-2.87)
Log Assets		0.0313**	0.0481***
		(2.75)	(4.35)
Class Period Months		-0.00597**	-0.00472*
		(-2.63)	(-2.13)
2nd or 9th Cir.		-0.0415	-0.0510
		(-0.75)	(-0.94)
Institutional LP			-0.169**
			(-3.00)
Restatement			0.140
			(1.02)
SEC Action			-0.284***
			(-4.26)
Constant	0.565***	0.483***	0.486***
	(19.94)	(5.31)	(5.61)
Adjusted R^2	0.0195	0.0555	0.123
N	373	314	314

t statistics in parentheses
$^{*}\ p < 0.05$, $^{**}\ p < 0.01$, $^{***}\ p < 0.001$

Table 6: Dismissal (OV Case)

Table 6 reports OLS regressions in which the dependent variable, *Dismiss Dummy*, is a dummy variable equal to 1 if the case was dismissed. *OV Case* is a dummy variable equal to 1 if the case is coded as an OV case. *Log total assets* is the log of the total assets of the firm measured in millions of dollars. *Class period* is the class period of the lawsuit measured in months. *2nd or 9th Circuit* is a dummy variable equal to 1 if the lawsuit was brought in the Second or Ninth Circuits. *Institutional LP* is a dummy variable equal to 1 if at least one lead plaintiff in the lawsuit is an institutional investor. *Class period restatement* is a dummy variable equal to one if the defendant firm restated its financials during the class period and the restatement involved a misrepresentation or fraud, rather than an error or change in accounting rules. *SEC Action* is a dummy variable equal to 1 if an SEC inquiry, investigation, or enforcement action involving the alleged misconduct was cited in the most recent complaint.

	(1)	(2)	(3)
OV Case	3.774***	3.914**	3.567**
	(3.45)	(3.31)	(3.15)
Log Assets		-0.320	-0.616***
		(-1.72)	(-3.45)
Class Period Months		0.0894*	0.0700*
		(2.49)	(2.03)
2nd or 9th Cir.		0.636	0.766
		(0.72)	(0.89)
Institutional LP			2.913**
			(3.27)
Restatement			-4.077*
			(-2.13)
SEC Action			4.932***
			(4.64)
Constant	6.648***	6.993***	7.048***
	(15.05)	(4.80)	(5.14)
Adjusted R^2	0.0301	0.0509	0.135
N	373	314	314

t statistics in parentheses
* $p < 0.05$, ** $p < 0.01$, *** $p < 0.001$

Table 7: Log Settlement (OV Case)

Table 7 reports OLS regressions in which the dependent variable, *Log Settlement*, is the log of the settlement amount shareholders recovered. *OV Case* is a dummy variable equal to 1 if the case is coded as an OV case. *Log total assets* is the log of the total assets of the firm measured in millions of dollars. *Class period* is the class period of the lawsuit measured in months. *2nd or 9th Circuit* is a dummy variable equal to 1 if the lawsuit was brought in the Second or Ninth Circuits. *Institutional LP* is a dummy variable equal to 1 if at least one lead plaintiff in the lawsuit is an institutional investor. *Class period restatement* is a dummy variable equal to one if the defendant firm restated its financials during the class period and the restatement involved a misrepresentation or fraud, rather than an error or change in accounting rules. *SEC Action* is a dummy variable equal to 1 if an SEC inquiry, investigation, or enforcement action involving the alleged misconduct was cited in the most recent complaint.

	(1)	(2)	(3)
Non-SEC Action	-0.139	-0.175*	-0.250***
	(-1.96)	(-2.41)	(-3.45)
Log Assets		0.0268*	0.0481***
		(2.30)	(4.37)
Class Period Months		-0.00649**	-0.00486*
		(-2.84)	(-2.21)
2nd or 9th Cir.		-0.0392	-0.0526
		(-0.70)	(-0.97)
Institutional LP			-0.186***
			(-3.39)
Restatement			0.144
			(1.10)
SEC Action			-0.333***
			(-4.79)
Constant	0.552***	0.506***	0.510***
	(19.66)	(5.54)	(5.93)
Adjusted R^2	0.00746	0.0450	0.133
N	373	314	314

t statistics in parentheses
* $p < 0.05$, ** $p < 0.01$, *** $p < 0.001$

Table 8: Dismissal (Non-SEC Action)

Table 8 reports OLS regressions in which the dependent variable, *Dismiss Dummy*, is a dummy variable equal to 1 if the case was dismissed. *Non-SEC Action* is a dummy variable equal to 1 if the plaintiffs cited a non-SEC inquiry (without an SEC inquiry) in the most recent version of the complaint. *Log total assets* is the log of the total assets of the firm measured in millions of dollars. *Class period* is the class period of the lawsuit measured in months. *2nd or 9th Circuit* is a dummy variable equal to 1 if the lawsuit was brought in the Second or Ninth Circuits. *Institutional LP* is a dummy variable equal to 1 if at least one lead plaintiff in the lawsuit is an institutional investor. *Class period restatement* is a dummy variable equal to one if the defendant firm restated its financials during the class period and the restatement involved a misrepresentation or fraud, rather than an error or change in accounting rules. *SEC Action* is a dummy variable equal to 1 if an SEC inquiry, investigation, or enforcement action involving the alleged misconduct was cited in the most recent complaint.

	(1)	(2)	(3)
Non-SEC Action	2.259	2.571*	3.789**
	(1.97)	(2.13)	(3.24)
Log Assets		-0.226	-0.599***
		(-1.17)	(-3.33)
Class Period Months		0.0993**	0.0739*
		(2.72)	(2.13)
2nd or 9th Cir.		0.578	0.776
		(0.64)	(0.91)
Institutional LP			3.231***
			(3.71)
Restatement			-4.164*
			(-2.14)
SEC Action			5.656***
			(5.04)
Constant	6.954***	6.586***	6.625***
	(15.70)	(4.48)	(4.84)
Adjusted R^2	0.00803	0.0303	0.136
N	373	314	314

t statistics in parentheses
* $p < 0.05$, ** $p < 0.01$, *** $p < 0.001$

Table 9: Log Settlement (Non-SEC Action)

Table 9 reports OLS regressions in which the dependent variable, *Log Settlement*, is the log of the settlement amount shareholders recovered. *Non-SEC Action* is a dummy variable equal to 1 if the plaintiffs cited a non-SEC inquiry (without an SEC inquiry) in the most recent version of the complaint. *Log total assets* is the log of the total assets of the firm measured in millions of dollars. *Class period* is the class period of the lawsuit measured in months. *2nd or 9th Circuit* is a dummy variable equal to 1 if the lawsuit was brought in the Second or Ninth Circuits. *Institutional LP* is a dummy variable equal to 1 if at least one lead plaintiff in the lawsuit is an institutional investor. *Class period restatement* is a dummy variable equal to one if the defendant firm restated its financials during the class period and the restatement involved a misrepresentation or fraud, rather than an error or change in accounting rules. *SEC Action* is a dummy variable equal to 1 if an SEC inquiry, investigation, or enforcement action involving the alleged misconduct was cited in the most recent complaint.

	(1)	(2)	(3)
Log Assets	0.0690***	0.0691***	0.0676***
	(6.24)	(6.23)	(6.14)
Class Period	0.000751	0.000767	0.000312
	(0.37)	(0.37)	(0.15)
OV Case	0.173**	0.176*	0.290***
	(2.63)	(2.28)	(3.45)
Gov't Action		-0.00464	
		(-0.07)	
SEC Action			0.0529
			(0.77)
Non-SEC Action			-0.168
			(-1.90)
Constant	-0.0138	-0.0133	-0.00178
	(-0.18)	(-0.17)	(-0.02)
Adjusted R^2	0.146	0.143	0.153
N	314	314	314

t statistics in parentheses
* $p < 0.05$, ** $p < 0.01$, *** $p < 0.001$

Table 10: Institutional Investor Lead Plaintiff

Table 10 reports OLS regressions in which the dependent variable, *Institutional Lead Plaintiff*, is a dummy variable equal to one if at least one institutional investor was a lead plaintiff in the case. *OV Case* is a dummy variable equal to 1 if the case is coded as an OV case. *Log total assets* is the log of the total assets of the firm measured in millions of dollars. *Class period* is the class period of the lawsuit measured in months. *Govt Action* is a dummy variable equal to 1 if any government inquiry, investigation, or enforcement action involving the alleged misconduct was cited in the most recent complaint. *SEC Action* is a dummy variable equal to 1 if an SEC inquiry, investigation, or enforcement action involving the alleged misconduct was cited in the most recent complaint. *Non-SEC Action* is a dummy variable equal to 1 if an inquiry, investigation, or enforcement action involving the alleged misconduct was cited in the most recent complaint that did not involve the SEC.

Institutional LP Type	**Frequency**	**Percent**
Public pension fund	28	53%
Union pension fund	17	32%
Mutual Fund	2	3.7%
Commercial bank	4	7.5%
Other	2	3.7%

Table 11: Descriptive Statistics (OV Lead Plaintiff Institution Types)

	No. Lawsuits	**No. Settlements**	**Mean Settlement**	**Med. Settlement**
Shareholder	68	42	38.2 million	11 million
Regulator	60	30	1.15 billion	60 million
Other Victim	45	28	849 million	153 million

Table 12: Descriptive Statistics (OV Cases: Shareholders, Regulators and Other Victims)