Small companies, big targets

2015 Securities Litigation Study

April 2016

pwc

As emerging growth companies continue to maintain a strong share of the IPO market, shareholder litigation focuses on the small

2015 overview

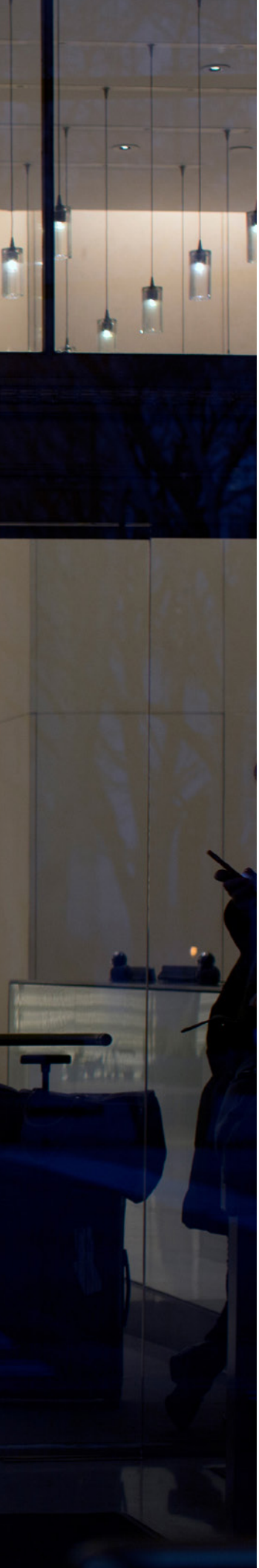
For the third straight year, we saw an annual increase in the number of federal securities class action lawsuits filed, with 195 new filings in 2015. The growth in filings follows a trend we've frequently recognized in the past — the number of new actions is inversely related to year-over-year market performance. In line with this observation, the total number of newly filed class actions increased from 2014 to 2015 while, over the same period, the performance of the S&P 500 declined.

A continuing trend is emerging from the data. Two-thirds of the 2015 federal securities class action cases targeted smaller companies. Following the 2012 passage of the Jumpstart Our Business Startups Act (the "JOBS Act"), the initial public offering (IPO) market has been dominated by small, emerging growth companies (EGCs).

As reflected in PwC's 2015 Annual U.S. Capital Markets Watch, 94% of all IPOs in 2015 were valued at less than $500 million. Half of all IPOs in 2015 were valued at less than $100 million, and a quarter were valued at less than $50 million (below which the Securities and Exchange Commission (SEC) exempts certain offerings from registration). Through the JOBS Act, Congress aimed to reduce the barriers to those smaller EGCs coming to market, thereby opening their access to capital and, presumably, opening the door to growth opportunities. An EGC is allowed, for instance, to:

- Omit financial statements from its initial filing, under certain circumstances;
- Disclose two years of audited financial statements in its IPO registration statement (as opposed to three years for a non-EGC);
- Keep its draft Form S-1 confidential with the SEC for up to 15 days before its roadshow; and
- Be exempt from the Sarbanes-Oxley Act's Section 404 (b) requirement for external auditor attestation of internal controls over financial reporting.

But going public comes with public scrutiny, and the increased share of EGCs in the market is reflected in the bulk of 2015 federal securities class action cases targeting small- and micro-cap companies. Smaller companies are at particular risk for accounting-related allegations, given their typically leaner staff size and limited resources. While only one-quarter of the federal securities class action cases filed in 2015 alleged some form of accounting irregularity, nearly 70% of those accounting-related suits targeted small- and micro-cap companies. Such suits are likely to increase as the new U.S. Generally Accepted Accounting Principles (GAAP) revenue recognition rules come into effect next year, and as many of the companies who took early advantage of the JOBS Act reach the EGC status expiration date.



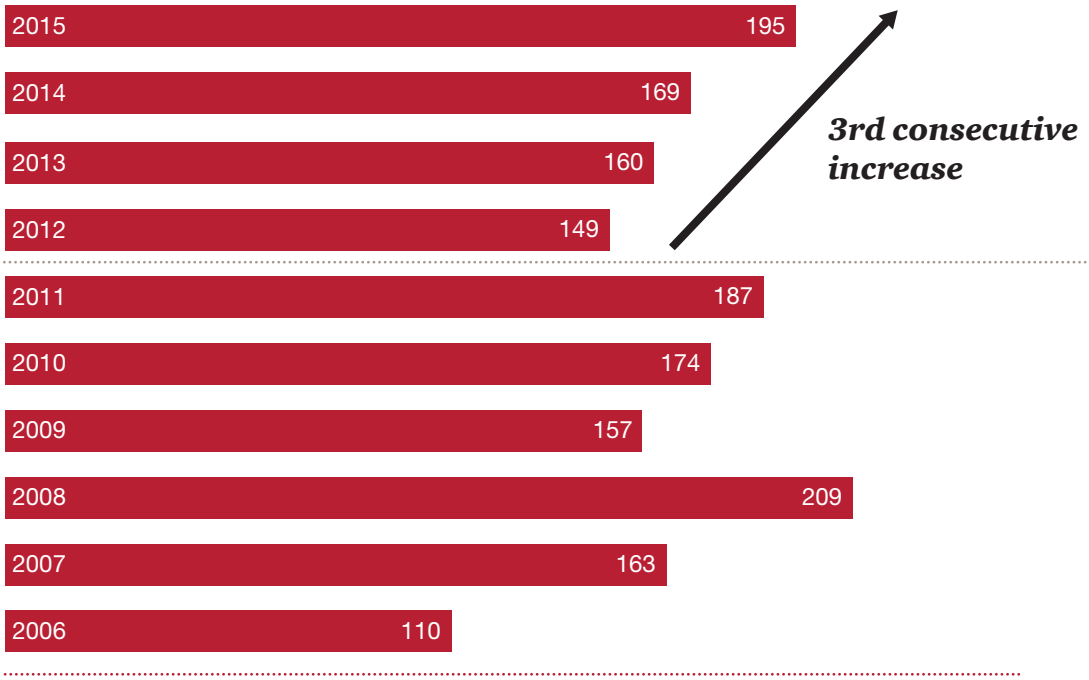
Spotlight on 2015

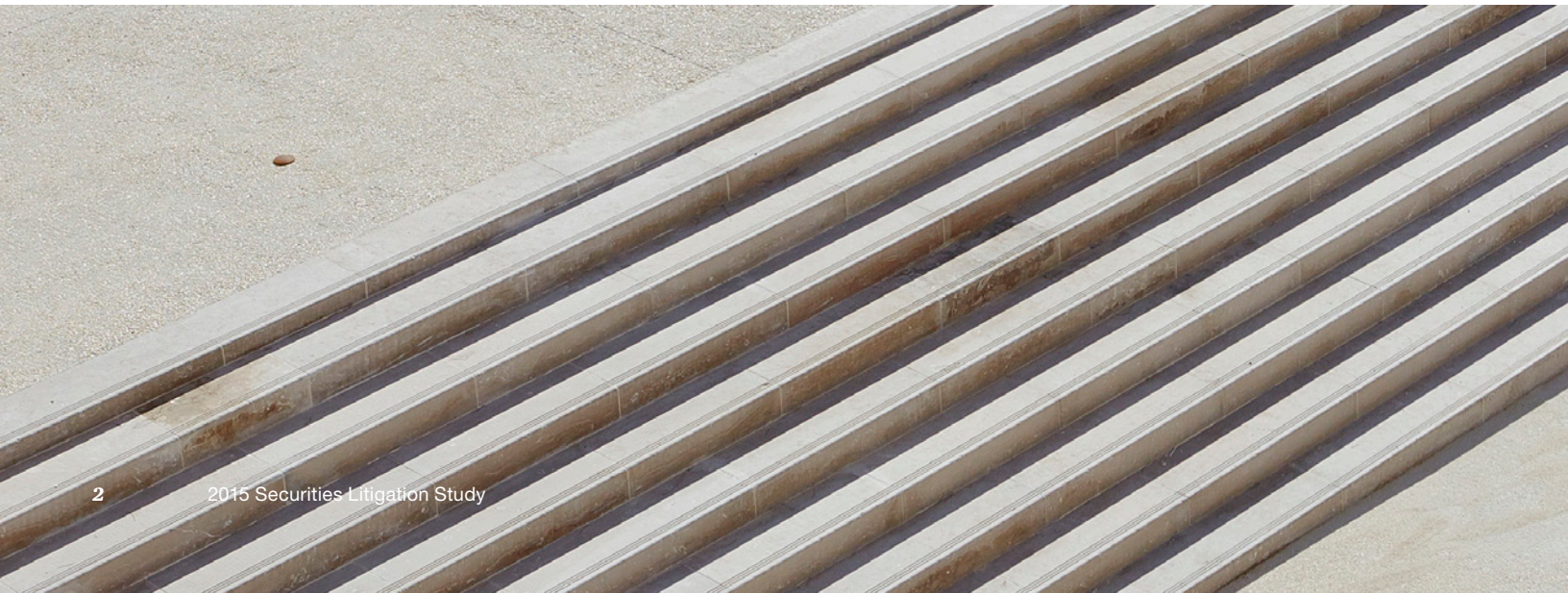
Number of cases filed in 2015

There were 195 federal securities class action cases filed in 2015, representing the third consecutive increase year-over-year.

Figure 1:

Number of US federal securities class action lawsuits filed per year, 2006–2015





The inverse relationship between the relative performance of equity markets and the number of new federal securities class action complaints continued to hold in 2015. As the S&P 500 performance decreased from 2013 to 2015, the number of federal securities class action cases filed each year increased.

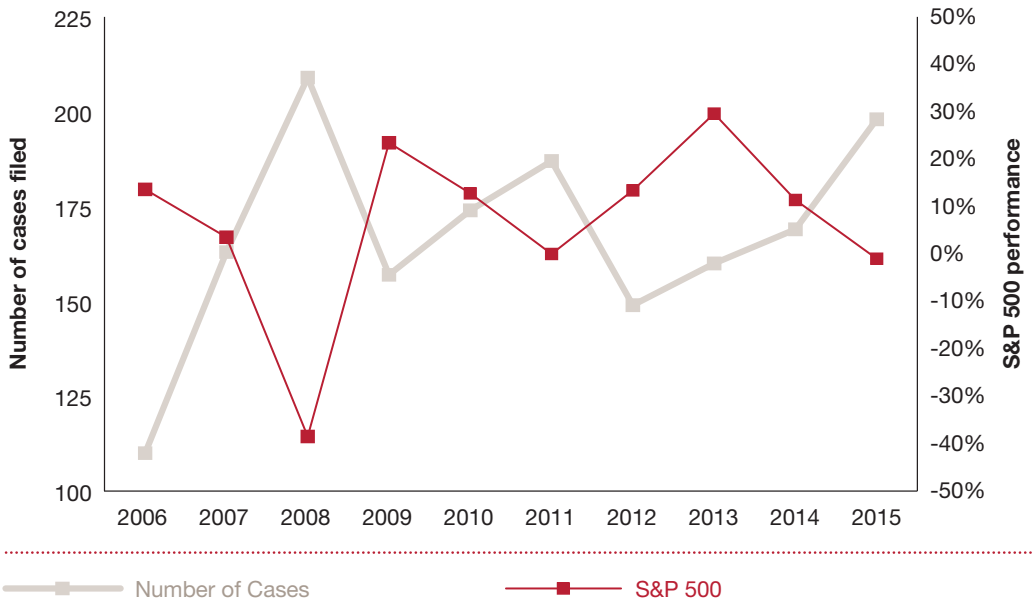
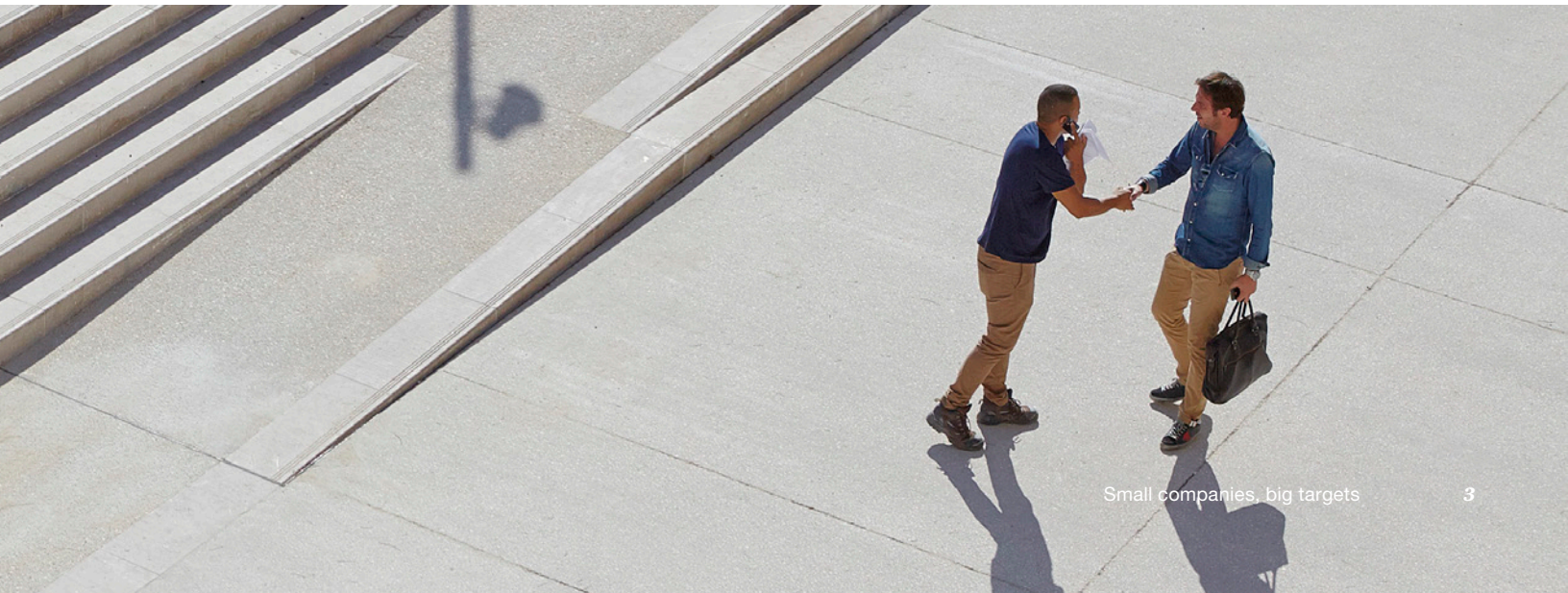


Figure 2:

Number of US federal securities class action lawsuits filed vs. S&P 500 performance, 2006–2015

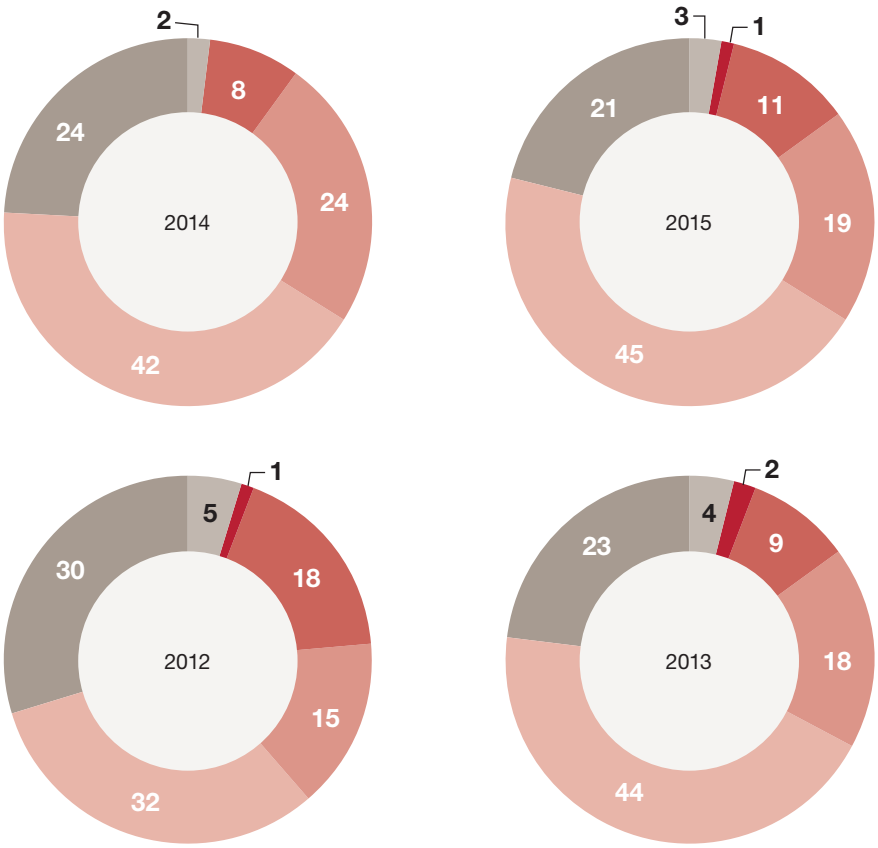


No company too small

"Micro-cap" and "small-cap" companies remain the primary focus of the plaintiffs' bar. Two-thirds of cases filed in 2015 were against micro-cap (market capitalization under $300 million) and small-cap (market capitalization between $300 million and $2 billion) companies.

Figure 3:

Percentage of companies with US federal securities class action lawsuits filed against them by market capitalization, 2012–2015†



- Mega Cap (Market Cap ≥ $200B)
- Large Cap ($10B ≤ Market Cap < $200B)
- Mid Cap ($2B ≤ Market Cap < $10B)
- Small Cap ($300M ≤ Market Cap < $2B)
- Micro Cap (Market Cap < $300M)
- Unlisted

† Market capitalization is calculated as the average market capitalization during the defined class period within the complaint.

In cases alleging accounting fraud, plaintiffs named micro-cap and small-cap companies more often than larger market cap filers. A total of 70% of 2015 accounting-related cases named these smaller companies as defendants, and the majority of those accounting-related allegations involved improper revenue recognition and inadequate internal controls over financial reporting.

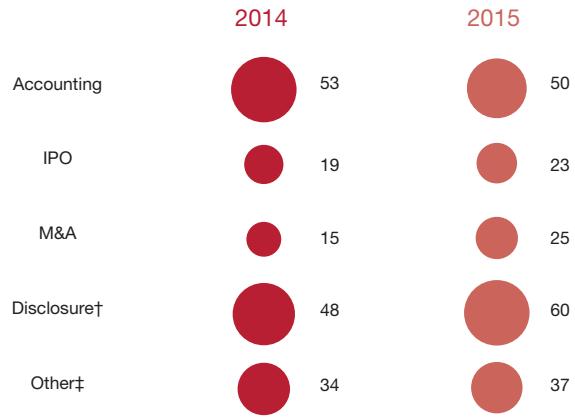
The focus on internal controls, while a secondary allegation in the bulk of the accounting-related federal securities class action cases, is of particular concern to smaller companies. The JOBS Act sheltered many of these companies from scrutiny by limiting the type and scope of public disclosures required in the IPO registration statements. The JOBS Act grace period was intended to afford EGCs the benefit of access to capital markets under streamlined reporting requirements. As they emerge from EGC status, however, these companies will face increased scrutiny. Yet their resources dedicated to — and, in some cases, their experience — handling financial matters, will remain relatively limited. This may leave some EGCs exposed from a disclosure and internal controls perspective, and potentially make them attractive targets for litigation.

Types of cases filed in 2015

Accounting-related allegations were cited in only 26% of the federal securities class action litigation cases filed in 2015. Non-accounting cases, however — particularly those filed in connection with IPOs and mergers and acquisitions — saw a notable increase in 2015, and contributed to the increase in federal securities class action cases from 2014 to 2015.

Figure 4:

Number of US federal securities class action lawsuits by allegation type, 2014–2015



† Includes adverse factors, declining market, false/misleading statements, and touting.
‡ Includes improper activity/investigation, insider trading, pharmaceutical-efficacy, Ponzi scheme, product-efficacy, and other.

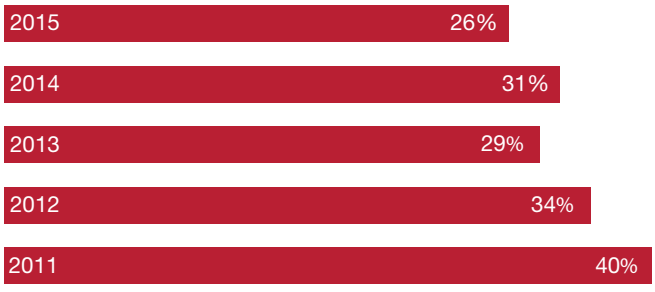
Accounting-related cases

Plaintiffs included accounting-related allegations in 50 of the federal securities class action litigation cases filed in 2015 (26% of total cases). Seventy-four percent of those cases included secondary allegations that the primary accounting irregularities exposed, or arose from, a failure to establish adequate internal controls over financial reporting — up from 58% in 2014.

Such allegations raise the stakes for the officers and directors, who hold a duty of care, to ensure that their organizations have the proper fraud protections in place. Allegations of inadequate internal controls over financial reporting are also a significant concern for smaller companies — the defendants in the vast majority of these suits — who, given their size and resources, are not likely to have the same sophisticated controls environment as their larger brethren.

Figure 5:

Accounting-related cases as a percentage of US federal securities class action lawsuits filed per year, 2011-2015†



† Cases filed between 2011 and 2014 may have been updated with accounting allegations if the amended complaints alleged accounting violations not previously recognized. Numbers for 2015 cases reflect initial case complaints.

The following chart presents the percentage share of the specific accounting-related allegations in the body of securities class-action cases filed in 2014 and 2015.

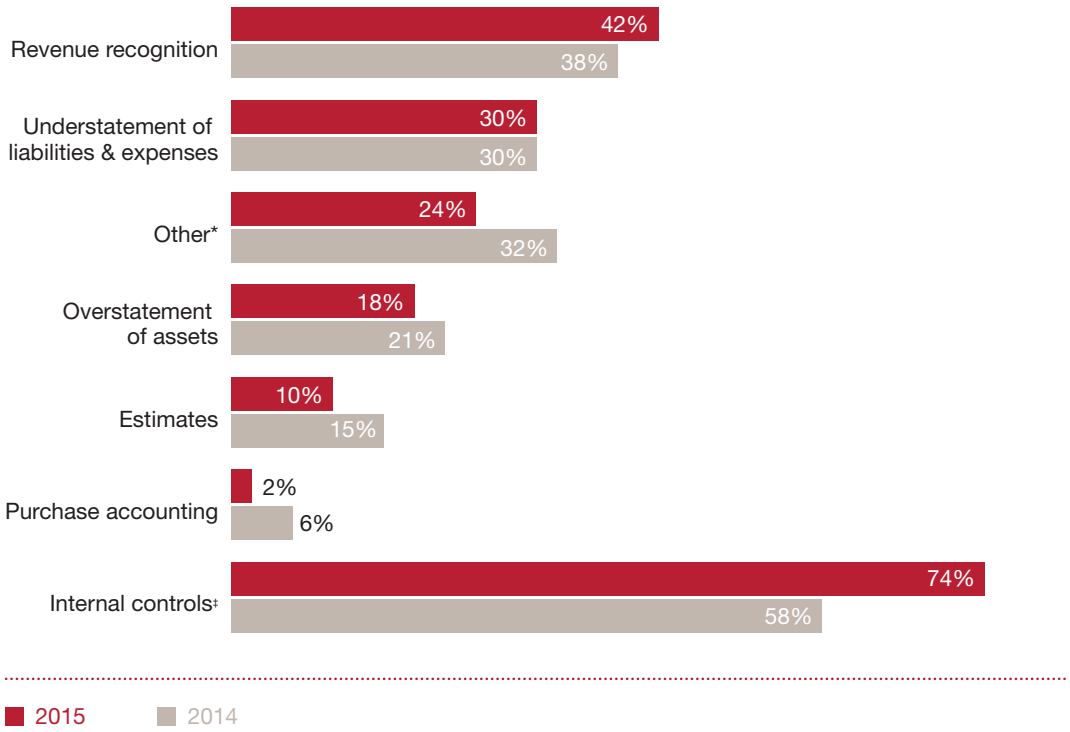


Figure 6:

Percentage of accounting cases citing specific issues, 2014–2015†

† Some cases allege multiple accounting issues.
‡ Internal controls is a secondary accounting issue.
* Includes earnings management, FCPA, related party transactions, restructuring costs, side letters, and other.

The most prevalent primary allegations in the 2015 accounting-related federal securities class action litigation cases continued to be improper revenue recognition and understatement of liabilities and expenses.

There were 21 accounting-related cases in 2015 that alleged improper revenue recognition. Eleven of the 21 cases alleged that fictitious revenue was recorded. The remaining ten of the 21 cases alleged that the recognition of revenue was fraudulently accelerated prior to meeting all criteria for recognizing revenue under GAAP. The latter is particularly noteworthy given that GAAP rules surrounding revenue recognition are set to change (and become more subjective) over the next year.

New revenue recognition standards

Principles-based revenue recognition standards are replacing the existing rules-based standards required under both GAAP and its cousin, the International Financial Reporting Standards (IFRS).

The new revenue recognition standards, which are set to go into effect in 2017, will require companies to make more judgments and estimates with respect to recognizing revenue from customer contracts. In addition, companies will have increased disclosure obligations regarding their assumptions underlying reported revenue. This may lead to a continued growth in future federal securities class action litigation cases alleging revenue recognition issues, and will likely include a secondary allegation of inadequate internal controls over financial reporting.

Non-accounting cases dominated by disclosure-related issues

The bulk of 2015 federal securities class action cases, 145 in all, did not concern accounting issues. Instead, they arose from:

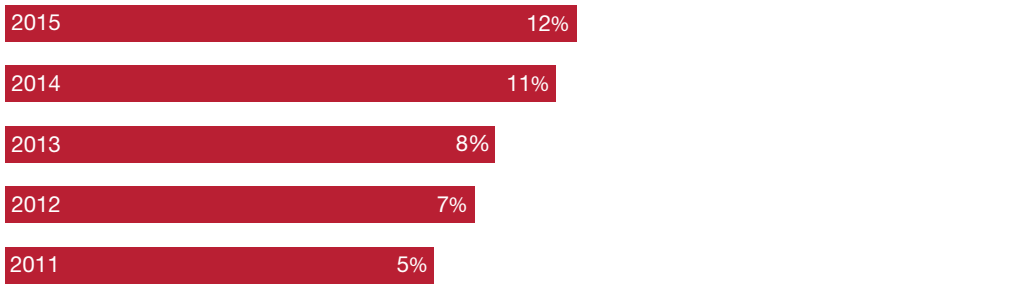
- IPOs (23 cases);
- M&A transactions (25 cases);
- Allegedly false or misleading disclosures by public companies (60 cases); and
- Allegedly late disclosure of negative information including investigations and poor product performance (37 cases).

Initial Public Offerings

There were 196 IPOs in 2015 – down approximately 36% from 2014. Nonetheless, IPO activity has been robust, with over 800 companies having gone public since the enactment of the JOBS Act in 2012. This influx of new, mostly small, companies into the capital markets has led to a rise in IPO-related litigation. This trend continued in 2015, with IPO-related federal securities class action filings increasing from 19 cases in 2014 (11% of total cases) to 23 cases in 2015 (12% of total cases).

Figure 7:

IPO-related cases as a percentage of US federal securities class action lawsuits filed per year, 2011-2015



The 23 IPO-related cases filed in 2015 centered on pre-IPO financial disclosures — precisely those disclosures that the JOBS Act targeted in reducing the burden to market entry. In each case, the plaintiffs alleged that they were misled and had paid an inflated price for their shares because management had made materially false and misleading statements, or omitted material disclosures.

Representative examples of allegations contained in 2015 IPO-related cases include allegations that the Prospectus/Registration Statement included false and/or misleading statements, and/or failed to disclose material information related to:

- Significant internal control deficiencies;
- Flawed manufacturing processes or other production-related issues;
- Uncertainty around collectability of payments from major customers; or
- Questionable and/or illegal activities brought to the company's attention by regulators.

The securities laws typically provide for a three-year statute of limitations for such suits. Accordingly, there may be a significant lag time between the filing of an IPO and a corresponding shareholder action. As an illustration, the following table depicts the year of the IPO and the number of IPO-related cases filed after the IPO occurred.

Year of filing	Year of IPO 2010	2011	2012	2013	2014	2015	Total
2010	3	-	-	-	-	-	**3**
2011	5	4	-	-	-	-	**9**
2012	1	5	4	-	-	-	**10**
2013	3	4	3	3	-	-	**13**
2014	-	-	2	10	7	-	**19**
2015		-	-	3	12	8	**23**
Total	**12**	**13**	**9**	**16**	**19**	**8**	

Figure 8:

Number of IPO-related US federal securities class action lawsuits filed by year, 2010–2015

At the end of 2015, nearly 95% of the 738 IPOs completed between 2013 and 2015 have not been the subject of a federal securities class action lawsuit — yet still fall within the applicable statute of limitations.

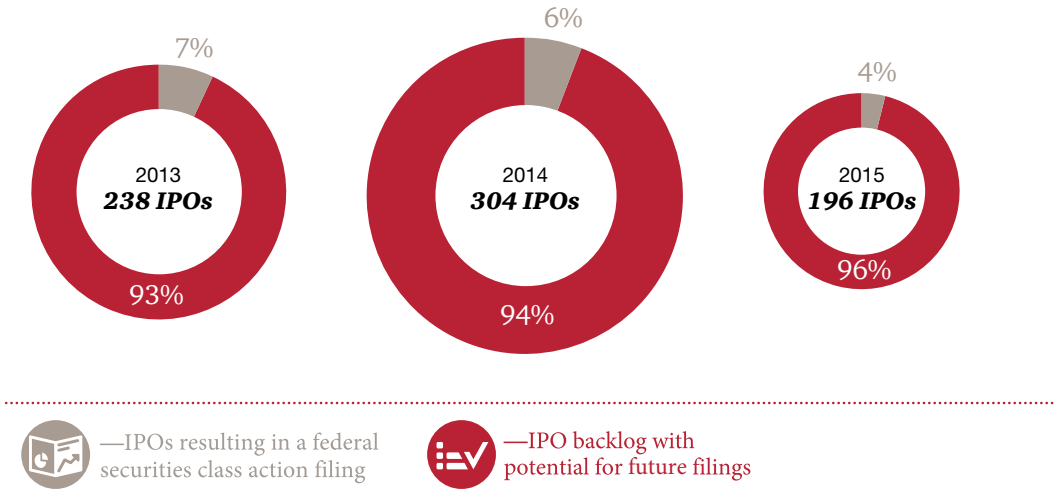


Figure 9:

Percentage of IPOs resulting in US federal securities class action lawsuit filings per year, 2013–2015

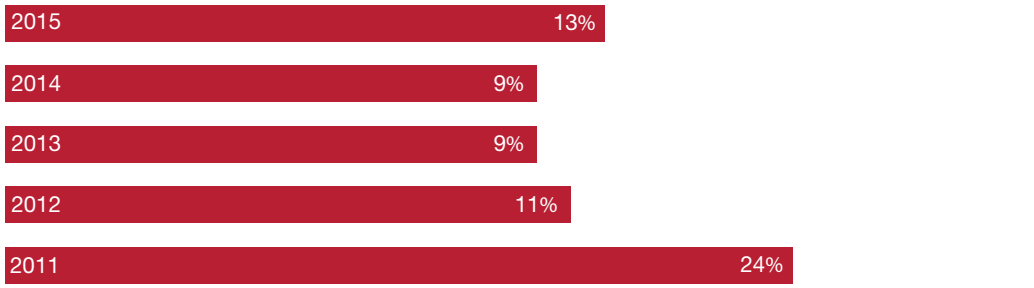
While only a small percentage of IPOs result in litigation, the bulk of the IPO-related cases filed in 2015 (65%) focused on EGCs. As with the accounting-related suits, the reduced disclosure requirements of the JOBS Act may be fueling increased litigation.

Mergers & Acquisitions

In 2015, 25 federal securities class action litigation lawsuits (13% of total cases) related to M&A transactions. Twenty-four of the 25 M&A-related cases were pre-merger objection cases, in which shareholders sought additional disclosures and information, allegedly to help them make more informed decisions regarding the proposed acquisition. One M&A-related case was a post-merger action.

Figure 10:

M&A-related cases as a percentage of US federal securities class action lawsuits filed per year, 2011-2015



Pre-merger objection cases are typically filed shortly after the M&A transaction is announced. In 2015, such cases were filed, on average, approximately 53 days from the deal's announcement — the earliest being 17 days from announcement and the latest being 160 days from announcement.[1] Pre-merger objection cases are usually settled or dismissed shortly after their filing date. The fast-moving nature of these cases is mainly attributable to the companies' desire to promptly complete the proposed transaction. Because these cases target further disclosure, companies often find that they can expedite settlement by providing the additional information plaintiffs seek and generally avoid a monetary settlement.

Nine of the 24 2015 pre-merger objection cases were resolved by the end of the year, and six of such cases saw the proposed transaction close in 2015. The nine cases settled, on average, within 90 days from the date of the federal securities class action filing, and within 160 days from the announcement of the proposed transaction. Three of the 15 cases that remained open at the end of 2015 were pending rulings on motions for settlement or dismissal.

Deals continue to get done at a feverish pace and are reaching sky-high values. Through the first 11 months of 2015, there were more than 10,000 announced U.S. deals with a total deal value of over $2 trillion — the highest on record. The recent frenzy of megadeal (deals valued over $5 billion) activity points toward a continued extension of the M&A bull run. A low-growth environment coupled with disruptive forces are fueling this hyper-megadeal environment momentum going into 2016. In 2016, shareholder activism will become the new norm. The C-suite, becoming more proactive on portfolio reviews in addition to divestitures, will be part of that outcome.[2]

1 One of the 24 merger objection cases took 1,136 days (approximately 37 months) from the announcement of the merger until the filing of the case. We did not include this anomaly in calculating the 53-day average cited above.
2 Source: PwC Deals Blog. http://usblogs.pwc.com/deals/dealmakers-are-running-with-the-bulls-2/

The single case related to a post-merger action involved the incorporation of the surviving entity in a foreign country. The complaint alleged that the pre-merger proxy statement misstated the risks and potential consequences of the overseas incorporation, thereby depriving investors of their ability to cast a fully-informed vote. In particular, it alleged that the proxy statement misled investors about the rules that would govern the listing of the resulting company's stock.

False/misleading statements and adverse factors

Sixty of the non-accounting cases filed in 2015 alleged either false or misleading disclosures made by the company, or late disclosure of adverse facts earlier known to the company. Those cases can be grouped into two categories:

1. Disclosures concerning business operations and future financial prospects. Representative cases alleged a failure to timely disclose:
    - Slower demand and/or weaker-than-expected sales;
    - Weakening relationships with major customers;
    - Inventory build-up and other supply-chain related issues; or,
    - Failure to comply with an earlier FTC settlement concerning false advertising.
2. The issuer fraudulently inflated its stock price by using both paid and undisclosed stock promoters and/or authors to tout the issuer's stock.

Cases citing other non-accounting issues

Plaintiffs filed 37 non-accounting cases in 2015 subsequent to the issuer's announcement of a negative incident, such as an investigation of alleged improper activity or a product-efficacy-related issue.

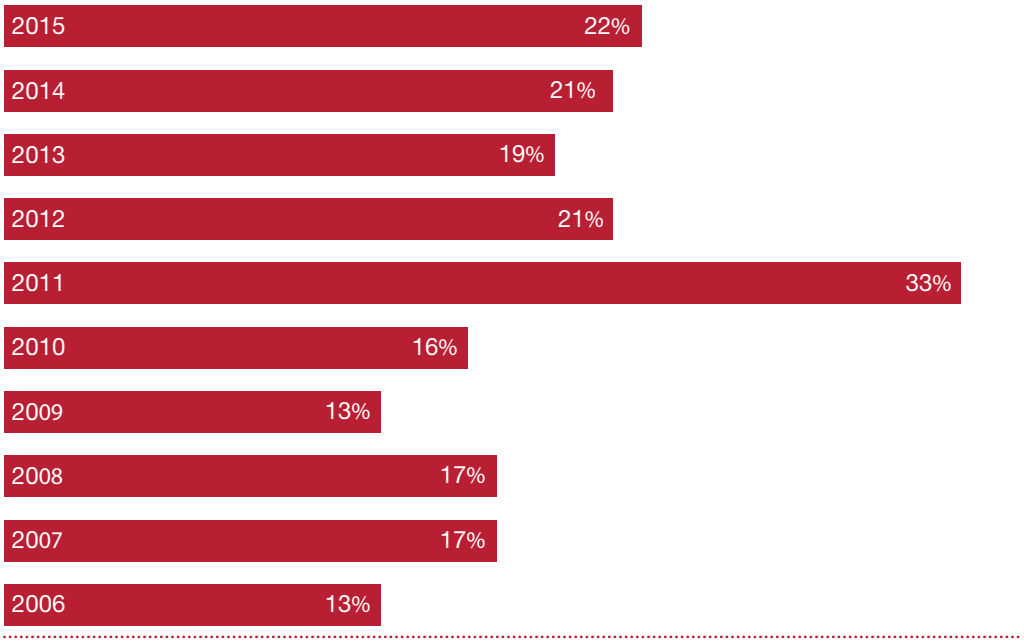
More than half of the 37 cases involved companies in the pharmaceutical/health industry. Fifteen cases alleged that the company failed to disclose issues concerning the safety and efficacy of a drug or medical device, the circumstances of which only became known to shareholders either through company drug trials or through inquiry/testing by the Food & Drug Administration (FDA) or other federal or state regulators. Another five cases filed against companies in the pharmaceutical industry alleged undisclosed improper or illegal activity — including off-label marketing, embezzlement by executives, and an investigation into unsafe practices at a company facility.

Foreign issuers remain in the crosshairs

Federal securities class action litigation cases filed against foreign issuers ("FIs") listed on US exchanges—including those who have American Depositary Receipts that trade over the counter in the United States—remained a target of the plaintiffs' bar in 2015.

Figure 11:

Percentage of US federal securities class action lawsuits filed against foreign issuers per year, 2006-2015



Forty-three cases were filed against FIs in 2015 (22% of total cases). A closer look at the 43 cases, the majority of which related to China and Canada-based entities, reveals that 42% were accounting-related, whereas only 21% of cases filed against U.S.-based companies in 2015 were accounting-related. Similar to allegations against U.S.-based companies, the vast majority of the accounting-related cases filed against FIs in 2015 alleged improper revenue recognition and inadequate internal controls.

Trends to watch

Cybercrime

In 2014, plaintiffs commenced derivative actions against two large U.S.-based companies — one in the retail industry and the other in the hospitality industry — both in response to data breaches. These actions led to some speculation that cyber breaches could become a source of viable securities class action filings.

In 2015, one of the two derivative lawsuits from 2014 was dismissed and only one new shareholder derivative suit was filed, despite the occurrence of several high-profile data breaches in 2015. We have yet to see a cybercrime-related federal securities class action case.

Since 2011, the SEC has required registrants to issue disclosures regarding cybersecurity risks and cyber incidents. Over the past few years, we have seen regulators paying increased attention to cyber-readiness (e.g., the SEC's continued focus on cybersecurity and its associated controls). In 2014, the SEC announced that its Office of Compliance Inspections and Examinations would undertake a series of examinations within the financial services industry to identify cybersecurity risks and assess cybersecurity preparedness in the securities industry. The SEC expanded that program in 2015, to cover: (a) governance and risk assessment; (b) access rights and controls; (c) data loss prevention; (d) vendor management; (e) training; and (f) incident response.

The SEC's cyber focus — in concert with heightened regulator cyber focus in such industries as health services, banking, and defense, along with the Federal Trade Commission's success in prosecuting false advertising claims concerning privacy protections — is certain to encourage future litigation around cyber security disclosures.

Judicial Update

While investors drove the landscape of federal securities class action litigation, 2015 was not without noteworthy events from the courts and regulators.

On March 24, 2015, the U.S. Supreme Court rendered its decision in Omnicare, Inc. v. Laborers District Council Construction Industry Pension Fund concerning the scope of an issuer's liability under Section 11 of the Securities Act of 1933. Specifically, the Court held that an issuer may be liable for false statements of opinion in a registration statement if the issuer does not genuinely hold the opinion or if a fact offered in support of the opinion is itself materially false or misleading. The Court further held that an issuer may be liable for omitting material facts about an opinion "if those facts conflict with what a reasonable investor, reading the statement fairly and in context," would understand an opinion statement to convey with respect to "how the speaker has formed the opinion" or "the speaker's basis for holding that view."[3]

The Court's decision may be of particular importance given the increase in IPOs in recent years and the always-present risk of the filing of a federal securities class action subsequent to the IPO. As plaintiffs in such IPO-related cases prepare their complaints, it seems likely that they will allege that material facts were omitted from statements of opinion — and, therefore, that the statements of opinion were both misleading and actionable.

The February 2016 death of Associate Justice Antonin Scalia could also lead to a shift in the balance of power in the Supreme Court. Depending on who ultimately joins the Court, the Supreme Court could see a change in majority, which, in turn, may impact decisions in securities litigation cases in the future.

Regulatory Update

During its 2015 fiscal year[4], the SEC continued to focus on accounting as well as financial reporting and disclosure issues. Of the 807 enforcement actions filed by the Commission in FY2015, 135 were financial reporting and disclosure actions — up from 96 in FY2014, and 68 in FY2013.[5, 6, 7] Those 135 cases led to only one follow-on federal securities class action lawsuit in 2015.

While enforcement actions did not drive significant litigation in 2015, public disclosure of SEC and/or U.S. Department of Justice (DOJ) investigations or inquiries continued to trigger federal securities class action lawsuits. At least six accounting-related cases were filed in 2015 following companies' disclosures of investigations or inquiries by the SEC and/or DOJ, one of which resulted from the Commission's routine review of the company's annual report.

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3 Omnicare, Inc. v. Laborers District Council Construction Industry Pension Fund, Supreme Court of the United States, No 13-435.
4 The SEC's fiscal year is from October 1 to September 30.
5 "Select SEC and Market Data Fiscal 2015," U.S. Securities and Exchange Commission. https://www.sec.gov/about/secstats2015.pdf
6 "Select SEC and Market Data Fiscal 2014," U.S. Securities and Exchange Commission. https://www.sec.gov/about/secstats2014.pdf
7 "Select SEC and Market Data Fiscal 2013," U.S. Securities and Exchange Commission. https://www.sec.gov/about/secstats2013.pdf

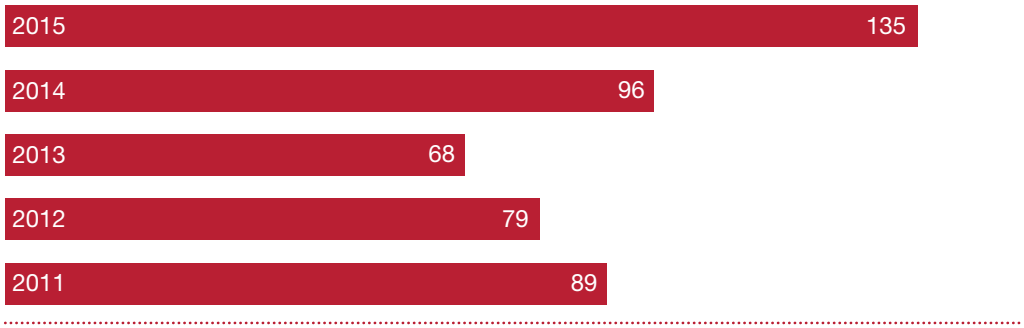


Figure 12:

Number of SEC issuer reporting and disclosure enforcement actions initiated per year, 2011–2015†

† Source: Select SEC and Market Data Fiscal 2011-2015, U.S. Securities and Exchange Commission.

That said, the SEC's focus in its 2015 fiscal year spanned a number of topics and initiatives, including the Financial Reporting and Audit (FRAud) task force's Accounting Quality Model (AQM), revenue recognition and related internal controls, and the Commission's busy whistleblower program.

Announcing CIRA, formerly known as the AQM

With an eye on identifying and investigating accounting abuses, the SEC initially deployed AQM, a computerized tool that analyzes filings of issuers to identify areas that stand out (e.g., discretionary accruals, non-cash transactions, off-balance sheet financing). Ultimately, the AQM quantified how a company's financial statements compared with those of other companies in its peer group.

In 2015, the SEC announced the Corporate Issuer Risk Assessment (CIRA) program, an advanced version of AQM. Its multiple dashboards enable SEC staff to compare a specific company to its peers in order to detect abnormal activity, identify financial reporting anomalies, and generate lists of companies that meet the criteria for further analysis. The agency stated that CIRA will be used along with the SEC's FRAud task force and whistleblower program in an effort to detect financial misconduct at an early stage. Any investigations triggered by this program are sure to affect share price and draw shareholder attention, leading to possible litigation.

Revenue recognition and internal controls

As noted above, a new principles-based revenue recognition standard is replacing the rules-based revenue recognition requirements of GAAP. The implementation of the new standard, and how it will impact registrants, is important to the SEC.[8] The Commission has been involved in facilitating the identification and resolution of broad-based practice issues on the revenue recognition standard and has encouraged companies to take a fresh look at their revenue-related internal controls, thereby promoting successful implementation of the standard.

8 "Remarks at the Bloomberg BNA Conference on Revenue Recognition," Wesley R. Bricker, Deputy Chief Accountant of the U.S. Securities and Exchange Commission. Sep 17, 2015. https://www.sec.gov/news/speech/wesley-bricker-remarks-bloomberg-bna-conf-revenue-recognition.html

Further, the agency is maintaining its focus on internal controls, with SEC staff continuing to ask questions when a filing discloses immaterial accounting errors — especially where there have been multiple errors. This attempt to understand what is happening at the transactional level is aimed at uncovering the deeper cause of the deficiency, to ensure companies have made the appropriate conclusion regarding the classification of the control deficiency.

Whistleblower update

The SEC's Office of the Whistleblower continues to receive tips on potential securities law violations, including alleged accounting-related fraud. In its annual whistleblower report, the SEC announced it had received a total of 14,116 whistleblower tips since the August 2011 inception of the whistleblower program, over 3,900 of which were received in its 2015 fiscal year. The SEC has authorized awards to 22 whistleblowers, including nine awards during its 2014 fiscal year and eight awards in its 2015 fiscal year.[9] Increases in the number of tips received will likely lead to an increased number of inquiries/investigations made by the Commission, which may spark future federal securities class action litigation.

The Yates Memo

In a September 9, 2015 memo from Deputy Attorney General Sally Yates to all federal prosecutors (the "Yates Memo"), the DOJ reinforced its commitment to targeting individual corporate officials/executives. In the near future, we could see increased numbers of corporate officials investigated, prosecuted, and convicted for actions they took as representatives of their company — which may spark derivative suits to claw back income from convicted corporate officials/executives.

Whether the DOJ's focus on individuals will alter the landscape of follow-on shareholder litigation has yet to be seen.

9 "2015 Annual Report to Congress on the Dodd-Frank Whistleblower Program," US Securities and Exchange Commission. https://www.sec.gov/whistleblower/reportspubs/annual-reports/owb-annual-report-2015.pdf

What this means for your business

Be alert and be aware.
Small- and micro-cap companies are facing shareholder litigation at a faster pace than their larger brethren. Given the economics of shareholder litigation and capitalization considerations, small companies have not traditionally been seen as lucrative targets for suit. Yet as legislation and capital market pressures encourage, if not drive, these companies into the equity markets, the threat of litigation accelerates.

Weigh your resources, opportunities, and costs.
Litigation poses a greater risk to small firms than it does to larger, better-capitalized, more-established corporations. Because small companies typically have relatively fewer resources, less-mature financial departments — and, following the JOBS Act, less regulation placed on them — they could be at greater risk for not spotting or preventing accounting irregularities. At the same time, such companies have fewer resources to expend on defense, raising the stakes for them should they be sued. With these risks in mind, smaller firms' directors, executives, and accountants should weigh the opportunities for lighter regulation and less detailed disclosures available to them against the potential cost of litigation from accounting- and disclosure-related issues.

Keep an eye on GAAP.
There are changes on the horizon for GAAP. A more subjective standard for revenue recognition may make it easier for companies to take a liberal view of their revenue streams. Will we see smoother earnings — a sign of potential fraud — and a raising bar on which to gauge fraudulent intent? Whether plaintiffs view the window on revenue-recognition allegations closing — leading to an uptick this year, ahead of the accounting changes — or whether the changes themselves will reveal past irregularities, leading to an increase in future litigation, is one of the issues we will follow this year.

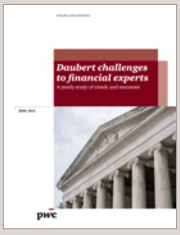
Watch emerging trends as 2016 unfolds.
As the protections of the JOBS Act expire for its early entrants, we expect the focus on micro- and small-cap companies to continue. But several other events may also drive overall shareholder litigation in 2016. Among the questions to be answered this year: Who will be in the White House for the next four years? Will a vacancy on the Supreme Court persist, potentially leaving Circuit splits in place for the foreseeable future — and, if not, who will ascend the bench? And what will be the makeup, and priorities, of next year's U.S. Congress?

In summary...

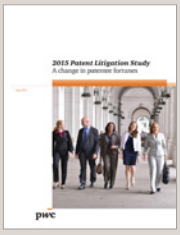
The lesson from 2015 is clear. A small market capitalization does not shield a public company from the large attention of a shareholder suit, nor is regulatory protection from disclosure and attestation a defense to inadequate internal controls. Any potential accounting issue or disclosure, no matter how small, may catch the attention of investors. Issuers must, therefore, be open and transparent regarding their business operations and financial results, and continuously evaluate the effectiveness of their accounting controls and financial reporting and disclosure procedures — no matter their size.

Want more?

Global Economic Crime Survey 2016 – US Results



Daubert Challenges to Financial Experts



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To have a deeper conversation about how this subject may affect your business, please contact:

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By the numbers

Total dollar value of federal securities class action settlements at highest level since 2008

Figure 13:

Settlements: all cases, 2011–2015†

Year settled	2011	2012	2013	2014	2015
Number of settled cases	72	72	69	77	80
Less: zero-dollar ($0) & undisclosed settlements	3	4	3	2	3
Net settlements‡	69	67	66	75	77
Total settlement value‡ (in thousands $)	**3,721,800**	**2,826,400**	**3,720,500**	**2,889,100**	**3,968,200**
Average settlement value (in thousands $)	53,900	42,200	56,400	38,500	51,500
Median settlement value (in thousands $)	8,900	10,000	9,100	6,500	9,800
Number of outliers	–	1	–	–	–
Settlement value of outliers (in thousands $)	–	2,425,000	–	–	–
Total settlement value including outliers (in thousands $)	**3,721,800**	**5,251,400**	**3,720,500**	**2,889,100**	**3,968,200**

† Year of settlement is determined based on the primary settlement pronouncement. Any subsequent settlement amounts are attributed to the primary announcement year. Settlement information reflects only those cases filed and settled after passage of the PSLRA (12/22/1995).

‡ Number of cases and amounts used to calculate average and median settlement values. Figure excludes outlier settlements.

Eighteen percent of the cases that settled in 2015 were mega-settlements ($100+ million), the highest percentage in the 20 years that PwC has conducted the *Securities Litigation Study*.

Figure 14:

Percentage of settled cases by settlement value range, 2011–2015†‡

Total settlement (in millions $)	2011–2014 %	2015 %
100+	10	18
50–99.99	8	5
20–49.99	12	11
10–19.99	14	14
5–9.99	17	14
2–4.99	23	14
0–1.99	17	25

† Year of settlement is determined based on the primary settlement pronouncement. Any subsequent settlement amounts are attributed to the primary announcement year. Settlement information reflects only those cases filed and settled after passage of the PSLRA (12/22/1995). Percentages have been rounded to whole numbers. Totals may not sum exactly due to rounding.

‡ The 2012 outlier settlement is included in this figure.

Non-accounting-related cases drove a higher total settlement value than accounting-related cases for the first time since 2012

Figure 15:

Settlements: accounting cases, 2011–2015†

Year settled	2011	2012	2013	2014	2015
Number of settled cases	33	36	34	41	36
Less: zero-dollar ($0) & undisclosed settlements	–	1	–	–	-
Net settlements‡	33	35	34	41	36
Total settlement value‡ (in thousands $)	**2,700,400**	**1,063,500**	**2,223,000**	**1,561,000**	**1,222,100**
Average settlement value (in thousands $)	81,800	30,400	65,400	38,100	34,000
Median settlement value (in thousands $)	13,000	5,500	6,800	6,300	5,900

† Year of settlement is determined based on the primary settlement pronouncement. Any subsequent settlement amounts are attributed to the primary announcement year. Settlement information reflects only those cases filed and settled after passage of the PSLRA (12/22/1995).
‡ Number of cases and amounts used to calculate average and median settlement values. Figure excludes outlier settlements.

Figure 16:

Settlements: non-accounting cases, 2011–2015†

Year settled	2011	2012	2013	2014	2015
Number of settled cases	39	36	35	36	44
Less: zero-dollar ($0) & undisclosed settlements	3	3	3	2	3
Net settlements‡	36	32	32	34	41
Total settlement value‡ (in thousands $)	**1,021,400**	**1,762,900**	**1,497,500**	**1,328,100**	**2,746,200**
Average settlement value (in thousands $)	28,400	55,100	46,800	39,100	67,000
Median settlement value (in thousands $)	6,600	19,300	11,000	7,300	12,000
Number of outliers	–	1	–	–	–
Settlement value of outliers (in thousands $)	–	2,425,000	–	–	–
Total settlement value including outliers (in thousands $)	**1,021,400**	**4,187,900**	**1,497,500**	**1,328,100**	**2,746,200**

† Year of settlement is determined based on the primary settlement pronouncement. Any subsequent settlement amounts are attributed to the primary announcement year. Settlement information reflects only those cases filed and settled after passage of the PSLRA (12/22/1995).
‡ Number of cases and amounts used to calculate average and median settlement values. Figure excludes outlier settlements.

Cases with institutional investors named as lead plaintiffs continued to drive more, and higher–dollar-value, settlements in 2015.

Figure 17:

Settlement values: by institutional investor as lead plaintiff, 2011–2015†

	2011		2012		2013		2014		2015	
	Cases settled	Settlement (in thousands $)	Cases settled	Settlement (in thousands $)	Cases settled	Settlement (in thousands $)	Cases settled	Settlement (in thousands $)	Cases settled	Settlement (in thousands $)
Public pension	28	2,983,300	32	4,200,000	30	2,667,300	35	2,323,500	40	3,125,800
Other institutional	10	213,200	14	330,200	7	117,200	14	320,500	8	336,300
Total institutional investors	38	3,196,500	46	4,530,200	37	2,784,500	49	2,644,000	48	3,462,100
Less: zero-dollar ($0) & undisclosed settlements	1		–		–		–		–	
Less: outlier settlements	–	–	1	2,425,000	–	–	–	–	–	–
Net settlements‡	37	3,196,500	45	2,105,200	37	2,784,500	49	2,644,000	48	3,462,100
Average settlement	–	86,400	–	46,800	–	75,300	–	54,000	–	72,100

† Year of settlement is determined based on the primary settlement pronouncement. Any subsequent settlement amounts are attributed to the primary announcement year. Settlement information reflects only those cases filed and settled after passage of the PSLRA (12/22/1995).
‡ Number of cases and amounts used to calculate average settlement values.

Companies in the high-technology and health industries were the target of nearly 45% of cases filed in 2015.

Figure 18:

Percentage of US federal securities class action lawsuits by industry, 2011–2015†

Industry	2011 %	2012 %	2013 %	2014 %	2015 %
High-technology: computer services, electronics, and telecommunications	22	16	18	15	22
Health: pharmaceuticals, medical devices, and health services	13	23	23	26	22
Energy: energy, utilities, and oil and gas	11	13	13	9	10
Financial services	11	9	9	15	9
Business services	3	4	9	9	9
Retail	4	5	8	7	6
Manufacturing	9	4	8	5	4
Other	27	26	14	15	18

† Percentages have been rounded to whole numbers. Totals may not sum exactly due to rounding.

1-10% 11-20% 21%+

The Ninth Circuit takes the lead as most active venue of federal securities class action filings, over the Second Circuit.

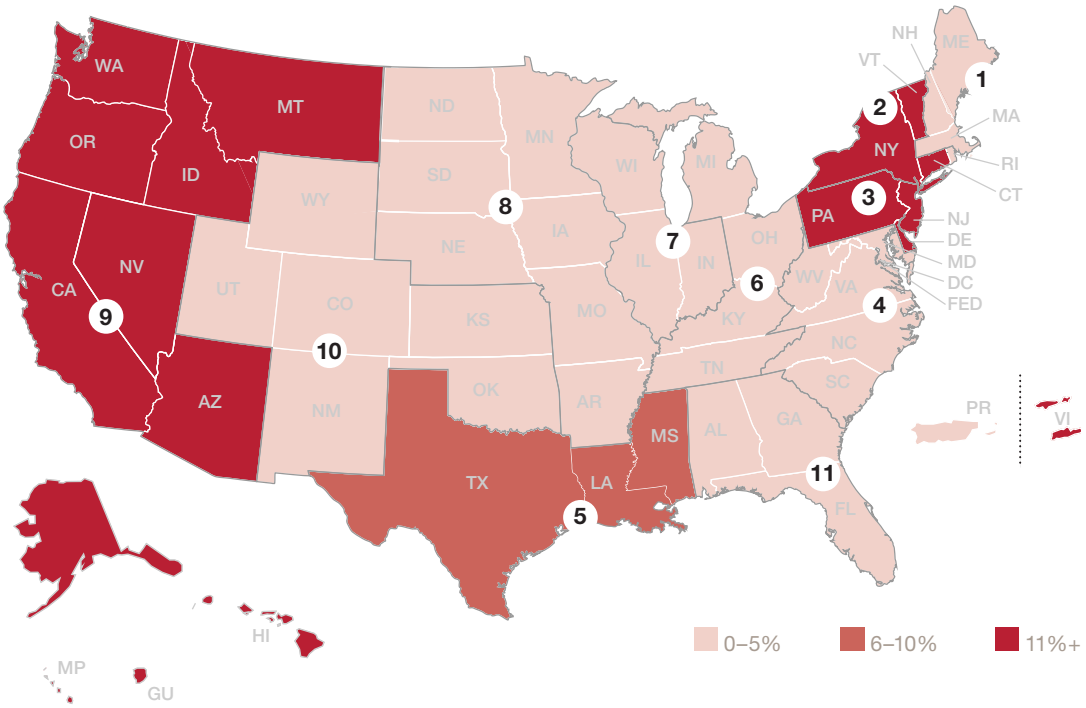


Figure 19:

Percentage of US federal securities class action lawsuits filed by circuit, 2015

Circuit	2011 %	2012 %	2013 %	2014 %	2015 %
District of Columbia	1	–	1	1	0
First	4	6	6	4	4
Second	28	30	34	31	26
Third	9	7	10	13	11
Fourth	5	5	4	4	3
Fifth	6	5	6	7	8
Sixth	5	6	2	5	1
Seventh	3	6	5	4	3
Eighth	4	4	1	2	2
Ninth	28	19	28	24	35
Tenth	4	5	1	2	2
Eleventh	5	6	3	4	5

Figure 20:

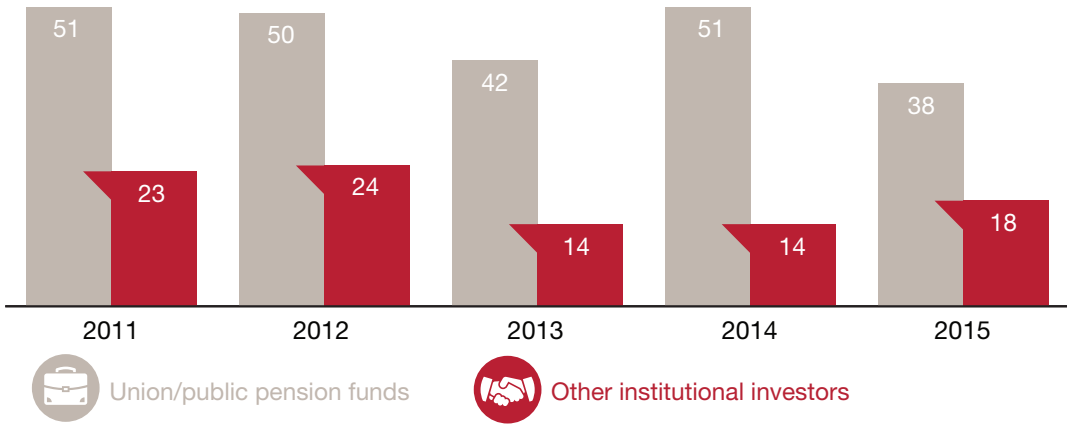
Percentage of US federal securities class action lawsuits filed by circuit, 2011–2015†

† Percentages have been rounded to whole numbers. Totals may not sum exactly due to rounding.

Number of institutional investors named as lead plaintiff remains down from historical averages.

Figure 21:

Number of US federal securities class action lawsuits filed with institutional investors as lead plaintiff, 2011–2015†



† Final 2015 data is not available to date; the full-year projections are based upon filings through June 30, 2015.

Percentage of cases naming specific officers or committees in 2015.

Title	2011 %	2012 %	2013 %	2014 %	2015 %
CEO	90	94	91	94	96
CFO	72	78	76	80	75
Chairman	59	57	52	41	50
President	56	68	61	53	46
Director	65	62	48	55	55
Audit Committee	10	6	7	4	9

† Titles are based on those named in the complaint.

Figure 22:

Percentage of US federal securities class action lawsuits naming particular officers or committees, 2011–2015†

Methodology

The PwC Securities Litigation database contains shareholder class actions filed since 1994. The focus of this study is on all cases filed after passage of the Private Securities Litigation Reform Act (PSLRA). PwC tracks all cases filed and more than 50 data points related to each case, including court, circuit, company location, SIC code, class period, stock exchange, and lead plaintiff type.

PwC also analyzes a variety of issues, including whether the case is accounting-related, a breakdown of accounting issues, and settlement data.

Sources include case dockets, news articles, press releases, claims administrators, and SEC filings.

Filings from 1996 onward occurred after the PSLRA of December 22, 1995; filings for 1999–2012 occurred after the Securities Litigation Uniform Standards Act of November 3, 1998.

The year a case was filed is determined by the filing date of the initial complaint in state or federal court. Multiple filings against the same defendant with similar allegations are counted as one case.

Company names used to reference cases throughout this study are determined according to one of the following:

(1) the first named defendant;
(2) the company of the affected security or securities; and/or
(3) the management company of the security or securities.

All figures, except when noted, exclude "IPO laddering," "analyst," and "mutual fund" cases pertaining to the 2003-2004 "market timing" and "revenue sharing" cases.

Figures also exclude securities suits filed as individual actions or group actions, and only include securities suits filed as shareholder class actions. Figures for 2011 and 2012 presented in this study have been revised from previously published figures to exclude securities suits filed as individual actions or group actions. Securities suits filed in previous years as individual actions or group actions continue to be separately monitored for class certification.

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