

Commentary

The Role Of Damages Issues — Post-Dura — In The Mediation Of Securities Class Actions

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Since the U.S. Supreme Court rendered its 2005 decision in Dura Pharmaceuticals v. Broudo, the issues of loss causation and damages have become much more prominent in the litigation of securities class actions. These issues also now play a significant role in the mediation of such cases. This article focuses on that role and, more specifically, on how both plaintiff and defense counsel can effectively present their perspective on these issues during the mediation process.

Needless to say, the foremost barrier to resolution in securities class actions is not always a failure to find common ground on how damages are analyzed. We have started a lot of mediations with the parties in a securities class action agreeing on a likely range of damages. Settlement discussions are just as likely to turn on any number of other issues including liability factors, such as scienter and statute of limitations, ability to pay, coverage issues, and procedural hurdles such as class certification. But, in many cases a driving issue dividing the parties is how damages are analyzed including the size of the loss and the causal

relationship between the particular loss and the alleged misrepresentation.

General Observations Regarding Dura And Securities Damage Models

The U.S. Supreme Court ruled in Dura Pharmaceuticals v. Broudo that plaintiffs had failed sufficiently to plead loss causation because they failed to plead a “relevant economic loss” as well as a causal connection between the loss and the alleged misrepresentations. 125 S.Ct. 1627, 1634. Courts have subsequently interpreted that ruling to require that plaintiffs show that “the loss be foreseeable and the loss be caused by the materialization of the concealed risk.” In Re: Initial Public Offering Securities Litigation 2005 WL 1529659 *citing* Lentell v. Merrill Lynch & Co., Inc. 396 F.3d 161 at 173 (2d Cir. 2005). The principle itself is simply enough stated; the level of refinement brought to it by lawyers on both sides of the securities class action bar is exquisitely complex.

After Dura, analysis of the market drop associated with an alleged misrepresentation, and defining the likely universe, or “bucket” of damages, at play in a given case, is frequently the beginning, but not the end, of the analysis. In addition to market drop, there are related recurring themes that present themselves in this aspect of a securities class action. For example, one theme is whether the market loss in a given case takes place on one date following a single alleged corrective disclosure, or whether the loss is spread out

over several dates as information is disseminated or “leaked” out. While the defense is likely to work to present theories for why the loss is associated with non-fraud related company and market factors, the plaintiffs will work to strip away alternative explanations and focus on the causal relationship of the drop with the new information disclosing the fraud. Both sides may point to analyst reports and financial news articles that support their theory of how the market was interpreting the release of information and that refer to other factors at play.

Before going any further, no discussion of damages would be complete without acknowledging the lack of empirical data on how these issues would actually be analyzed by juries. Because the majority of these cases are resolved far before even the first day of jury selection, actual trial experience is difficult to find. While we draw on common sense, relevant case law and jury reaction to analogous types of issues in analyzing these issues, until more of these cases are tried to juries, it is hard to know how a jury will react to competing damage models or dueling experts on these topics.

Preparing For A Mediation On Damages / Loss Causation

Any discussion of how to prepare effectively for the mediation of a securities class action in which damages and loss causation will be driving factors, must take in to account the procedural posture of the case. While full development of the record both factually and legally may give the mediator and the parties guidance in valuing the case and likely outcome, the transaction costs associated with getting to such a point are often prohibitive. We are increasingly seeing cases in mediation when only a complaint and answer are in the record, prior to any formal development of the damages and loss causation issues. There is frequently a common recognition on both sides of the securities bar that allowing a lawsuit to proceed through discovery — including incurring the substantial expense of e-discovery and other document review — will likely, in all but the biggest cases, dramatically reduce the money that might otherwise be available to resolve the case.

Even early on, however, there is likely more information available to the parties, at least as relates to liability factors, than in many other types of

litigations and mediations. The strenuous pleading requirements in a securities case means that plaintiff counsel has conducted a more comprehensive investigation than might occur in other types of litigation and has set forth the results of that investigation in a complaint. Moreover, in addition to knowing the plaintiff theory and data from the complaint, it is also likely that defense counsel has conducted its own extensive investigation early in the litigation, or possibly even before it was brought — particularly if there has been an SEC or similar governmental investigation.

While early settlements may mean the availability of additional money for settlement, they also likely mean that the parties have to make decisions based on an undeveloped record. We are respectful of the challenge presented to counsel and to risk managers in these early mediations. It is also a challenge for the mediator in that the mediator must help the parties identify what information may be critical to analyzing a case in the early stages and, if appropriate, the mediator must facilitate the exchange of such information. The goal of such an exchange is to hone in on the issues that divide the parties and to provide the information needed to assess the risk as to those issues.

For example, if each party has started to develop a damage analysis, but has not prepared a report, informal summaries of the analysis — prepared solely for the purpose of the mediation and subject to the confidentiality parameters of the mediation process — can be drafted and exchanged. These summaries can be included in the pre-mediation session memos that are generally submitted to the mediator and can be exchanged between the parties. Another approach which we have used is to have an informal presentation by the experts — either on a conference call before the first mediation session or at a preliminary in-person meeting — on damages and loss causation. Although it may be difficult to prepare a thorough analysis in the absence of full discovery, a report or presentation based on available information — even just on publicly available information — is frequently enough to start a dialogue about the strengths and weaknesses of the analysis. Finally, in some mediations, we have orchestrated limited and focused document discovery and depositions of key individuals as a way of providing information necessary to construct

at least the start of a meaningful damages and loss causation analysis.

It is important that this information exchange take place, if possible, before the mediation session take place — particularly if the mediation is scheduled for just one or two days. Each party needs the opportunity to assess the information provided, prior to being asked to negotiate. Both sets of attorneys likely need time to educate senior management of either the plaintiff institutional investor or the defendant company regarding the damages potential and risk. It is particularly important from the defense perspective to have the information in advance if there is insurance involved in the case. A realistic assessment of the damage potential might dictate how far up the insurance tower the defendant needs to go in both educating, and ensuring the active involvement of, the carriers. Moreover, insurance carriers need time internally to assess a matter and to determine how far up their internal approval chain it is necessary to go in order to secure settlement authority. (If information can not be exchanged prior to the mediation session, we encourage below the willingness to provide such information at the session itself.)

We acknowledge the concerns that counsel may have about revealing theories and evidence — be they about liability or damages — early in a litigation. There are clear risks to doing so, which may come back to haunt a party if the matter does not settle. Opposing counsel may tailor witness statements, expert reports and case theories in response to what was learned in mediation. That being said, the reality is that sophisticated parties conducting extensive investigations, preparing or receiving detailed pleadings and engaging in discovery (under the expansive federal standards), are rarely caught by surprise. Furthermore, if one side or the other truly has a devastating piece of evidence, there is likely an advantage to playing the card early, in order to maximize the settlement authority of the other party (either upwards or downwards). If there is a hesitancy to reveal information, an effective mediator can help the parties test the attitude of the other party early in the mediation process and strategize whether, when and how to reveal information that if taken seriously could move that party toward settlement, but if abused could better prepare it for the litigation ahead.

Presentations At The Mediation Session

Even if the parties have been cooperatively exchanging information prior to the mediation session, there remains significant value in counsel making a presentation at the session, summarizing the party's point of view on the main divisive issues. This is the opportunity to talk directly to the decision-makers from the other side — who may or may not have an in-depth understanding of the risks and weaknesses in their case. If there has not been an information exchange prior to the session, the presentation at the session becomes that much more important as the lawyer will also be conveying possibly significant information to opposing counsel for the first time.

We can not overstate the importance of the thought and attention that should be paid to the opening presentation at a mediation session — the outcome of the mediation may turn on how effective the presentation is. Lawyers sometimes assume that because they have had a cordial relationship with opposing counsel and engaged in “pillow talk” about the likely range of settlement, they can come to mediation unprepared and fall back on their negotiation skills and experience to get them where they want to end up. What this strategy misunderstands is that the people making the settlement decisions have likely not been privy to the “pillow talk” and may come away from a presentation by unprepared counsel underwhelmed and unwilling to move into a range that even their counsel had previously thought was possible.

As important as the presentation is, we are not advocating courtroom theatrics, just courtroom preparation. Careful thought needs to be put into the appropriate level of detail for the presentation. For example, assuming damages and loss causation are at issue, counsel should consider how most effectively to lay out the damage model and loss causation analysis. We have seen used very effectively in mediation graphics showing dramatic market drops or time lines that include alternative market factors.

Careful thought also needs to be put into the proper tone for the presentation. We see lawyers struggle with whether they should give a “mediation tone” presentation that acknowledges both the presence of sophisticated counsel across the table and the existence of potential weaknesses in their own case. We use the phrase “mediation tone” to refer both to the

Careful selection of arguments and the way in which they are delivered. Lawyers who choose to hone in on their strongest and most persuasive arguments, and perhaps make a concession or two along the way, tend to get a much more productive response from the other side than the lawyers who choose to throw even their most tortured and aggressive arguments against the wall. Even with a “mediation tone,” you can be quietly forceful and can convey the strength of your convictions regarding the points favoring your client’s position. This approach is generally more effective than theatrics intended to bully the other party.

Post-Session Mediation Steps

Mediators thrive on settlement. Admittedly, we are genetically encoded to pursue compromise. Frequently that does not happen, especially in the context of early mediation in a securities case, given the complexity of the issues, multiplicity of players and the possibility that important information has not been exchanged until the day of the mediation session.

Sometimes folks see their first session with the mediator as just that, the first session. Folks have come to test the mediator, as well as the willingness of the other party to compromise. Parties have come to explore whether they can engage in a process that will help to give them the information they need to assess the settlement value of a case.

The task for the mediator is to identify what caused the impasse at the first mediation session (or even at subsequent ones) and to help facilitate a process that bridges that impasse. The impasse may be as simple as disagreement as to how the judge will rule on a pending motion or as complex as the failure of the parties to have carefully analyzed loss causation in the case. By identifying the cause of the impasse a mediator who has the trust of the parties can help facilitate any number of post-session process options. For example, rather than wait for the judge to rule on the motion, the parties might agree to submit their briefing to a respected retired judge from the relevant jurisdiction to give the parties a “take” on the likely outcome. If the parties are at loggerheads over a loss causation issue, and sufficient information has not previously

been exchanged, the mediator might help facilitate a process in which the parties exchange expert reports or other information, protected by mediation privilege. Another option is that, with the permission of the parties, the mediator engages a “neutral” expert — say an economist or other loss causation expert — to review those issues and render an impartial opinion as to the validity of, for example, the parties’ different events analyses.

The point is that a good mediator never gives up. A good mediator figures out why the parties are analyzing the case differently and facilitates a process geared toward overcoming the impasse. The mediation ends when the parties reach settlement, not at the end of a day in which there has not been settlement.

Conclusion

We start and end with the premise and guiding principal that sharing more, rather than less, information with the other side — particularly as relates to issues like damages and loss causation — increases the likelihood of settlement. The principals on both sides need the opportunity to assess the risks of going forward. Engaging in the exchange of information also gives each side the opportunity to reassess the strengths and weakness of its own case after hearing what the other side has to say in response.

As loss causation and damages become more significant issues in the analysis of a securities class action, the need for the exchange of information on these issues becomes more important. As more mediations occur early in the litigation process, the need for cooperation between the parties on the exchange of information has become increasingly important.

Finally, as stressed above, we do not look at mediation — particularly when used for complex matters — as one day affair, but rather a process that is started weeks or months in advance of the first “sit down” and may well continue for some time afterwards. Mediation should be considered a fluid process that adapts to the needs of the parties and the underlying dynamics of the dispute. Commitment by all participants to the view that mediation is such a process increases the likelihood of success. ■