

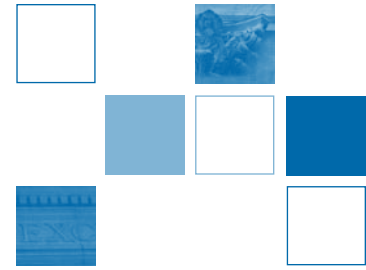
November 10, 2008



# SEC Settlements: A New Era Post-SOX

Jan Larsen with Dr. Elaine Buckberg and Dr. Baruch Lev

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## SEC Settlements: A New Era Post-SOX

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*NERA has developed a proprietary database of settlements in SEC enforcement actions, by reviewing every litigation release and administrative proceeding document published from July 31, 2002 through September 30, 2008. This paper provides an overview of trends we have identified in the number of settlements and settlement values in the six years since the passage of the Sarbanes-Oxley Act (SOX). More detailed statistics and analysis are available on our Securities Litigation Trends website ([www.SecuritiesLitigationTrends.com](http://www.SecuritiesLitigationTrends.com)).*

In recent years the Securities and Exchange Commission (SEC) has imposed unprecedented penalties in its enforcement actions.<sup>2</sup> Prior to the passage of the Sarbanes-Oxley Act (SOX), the largest penalty imposed in an SEC enforcement action against a publicly-traded company for financial fraud was the \$10 million penalty against Xerox in April 2002.<sup>3</sup> Our research has shown

that since SOX, the SEC has imposed penalties of \$10 million or more against 115 parties, including 14 that were penalized at least \$100 million. In February 2006, the SEC reached an \$800 million settlement with American International Group, the largest settlement since SOX.<sup>4</sup> The top 10 settlements identified in this study are shown in Exhibit 1.

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1 Mr. Larsen is a Consultant at NERA; Dr. Buckberg is a Senior Vice President at NERA; and Dr. Lev is the Director of the Vincent C. Ross Institute of Accounting Research and the Philip Bardes Professor of Accounting and Finance at New York University Stern School of Business, and a Special Consultant to NERA. The authors would like to thank Ilian Georgiev, Ashley Hartman, Mayanka Mudgal, and Masha Tarasyuk for research assistance, and Paul Hinton, Pat Conroy, and Linda Chatman Thomsen for valuable comments and suggestions.

2 See, e.g., Chester S. Spatt, "Speech by SEC Staff: 'Penalties and Sanctions for Securities Fraud': Remarks Before the American Economic Association," January 6, 2007 (<http://www.sec.gov/news/speech/2007/spch010607css.htm>).

3 See US Securities and Exchange Commission Statement, "Xerox Settles SEC Enforcement Action Charging Company with Fraud," <http://www.sec.gov/news/headlines/xeroxsettles.htm>.

4 This settlement consisted of disgorgement of \$700 million and a \$100 million penalty.

## Exhibit 1. The Top 10 Settlements Range from \$250 Million to \$800 Million\*

July 31, 2002 to September 30, 2008

Settling Defendant	Date of SEC Announcement (1)	Civil Penalty (\$ mil) (2)	Disgorgement (\$ mil) (3)	Total (\$ mil) (4) (2) + (3)	Description of Allegation (5)
American International Group, Inc.	2006	\$100	\$700	\$800	Alleged misstatements/omissions
WorldCom, Inc.**	2003	750	0	750	Alleged misstatements/omissions
Citigroup Global Markets Inc.***	2003	250	150	400	Financial Services—Analyst Fraud
Federal National Mortgage Association	2006	400	0	400	Alleged misstatements/omissions
Invesco Funds Group, Inc.	2004	110	215	325	Alleged market timing/late trading
Time Warner Inc.	2005	300	0	300	Alleged misstatements/omissions
Prudential Equity Group, LLC	2006	0	270	270	Alleged market timing/late trading
Alliance Capital Management, L.P.	2003	100	150	250	Alleged market timing/late trading
Bear, Stearns & Co.	2006	90	160	250	Alleged market timing/late trading
Qwest Communications International Inc.	2004	250	0	250	Alleged misstatements/omissions

\* The combined settlement between the SEC and the United States Attorney's Office for the Southern District of New York with the Rigas family and Adelphia Communications Corporation has been excluded from this table. The Rigas family agreed to forfeit "in excess of \$1.5 billion in assets," including certain cable properties, to Adelphia. Adelphia agreed to pay \$715 million to a victim fund established in district court upon receipt of these assets.

\*\* A court judgment imposed a civil penalty of \$2.25 billion on WorldCom. However, per a plan of reorganization reached in bankruptcy court, WorldCom's obligations were deemed to be satisfied by the company's payment of \$500 million in cash and by its transfer of \$250 million of common stock in the reorganized company to a distribution agent.

\*\*\* Formerly known as Solomon Smith Barney Inc.

Prior to 1990, the SEC was only authorized to levy monetary penalties for insider trading.<sup>5</sup> This changed with the Securities Enforcement Remedies Act of 1990, which allowed the SEC to bring civil cases in federal court for any violation of the securities laws.<sup>6</sup> However, former SEC staff members have said that this authority was used sparingly, because extracting financial penalties from publicly traded companies was viewed as "yet another kick to already aggrieved shareholders."<sup>7</sup> According to these authors, the SEC's resistance to penalizing public companies was substantially mitigated by certain provisions of SOX, which went into effect on July 30, 2002. In particular, Section 308 of SOX provides for the establishment of a "Fair Fund," a mechanism by which penalties collected in enforcement actions can be distributed to shareholders deemed to have been injured by the alleged offense.<sup>8</sup>

Previously, all penalties collected by the SEC were deposited into the United States Treasury.<sup>9</sup> The SEC has imposed substantial monetary penalties on a wide array of public companies in the time since it gained the power to establish Fair Funds.

5 See, e.g., Statement of the Securities and Exchange Commission Concerning Financial Penalties, January 4, 2006 ([http://www.sec.gov/news/press/2006-4.htm#P18\\_1888](http://www.sec.gov/news/press/2006-4.htm#P18_1888)).

6 Ibid.

7 Colleen P. Mahoney, Charles F. Walker, and Erich T. Schwartz, "SEC Penalties: Assessing the Financial Risk in an SEC Enforcement Action," Skadden Arps Insights, Fall 2006. See also Commissioner Annette L. Nazareth's March 3, 2006 Remarks Before the SEC Speaks Conference (<http://www.sec.gov/news/speech/spch030306aln.htm>).

8 Penalty amounts obtained from a defendant in an enforcement action can be added to a Fair Fund at the SEC's discretion if a disgorgement amount was also obtained from that defendant.

9 See, e.g., Securities and Exchange Commission, "Report Pursuant to Section 308(c) of the Sarbanes Oxley Act of 2002," January 24, 2003. See also Statement of the Securities and Exchange Commission Concerning Financial Penalties, January 4, 2006 ([http://www.sec.gov/news/press/2006-4.htm#P18\\_1888](http://www.sec.gov/news/press/2006-4.htm#P18_1888)).

The surge in high-value settlements in recent years has created a great deal of uncertainty among defendants.<sup>10</sup> On January 4, 2006, the SEC published its Statement of the Securities and Exchange Commission Concerning Financial Penalties, in which it acknowledged that “The authority to impose such penalties is relatively recent in the Commission’s history, and the use of very large corporate penalties is more recent still. Recent cases have not produced a clear public view of when and how the Commission will use corporate penalties, and within the Commission itself a variety of views have heretofore been expressed, but not reconciled.” In an attempt to clarify the situation, the SEC described nine factors the Commission takes into account when weighing potential monetary penalties:

- Whether the corporation directly benefited as a result of the violation;
- The degree to which the penalty will recompense or further harm the injured shareholders;
- The need to deter the particular type of offense;
- The extent of the injury to innocent parties;
- Whether complicity in the violation is widespread throughout the corporation;
- The level of intent on the part of the perpetrators;
- The degree of difficulty in detecting the particular type of offense;
- The presence or lack of remedial steps by the corporation; and
- The extent of cooperation with the SEC and other law enforcement.

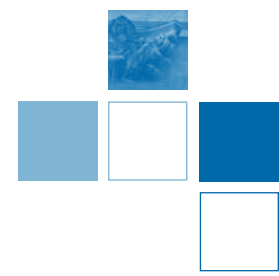
On the same day this guidance was published, Linda Chatman Thomsen, Director of the SEC’s Division of Enforcement, gave a speech explaining two concurrent settlements: one with McAfee, Inc. for \$50 million and another with Applix, Inc., which did not include a monetary payment. Thomsen stated that “In Applix it would be difficult to impose a penalty that would be large enough to make distribution to victims practical without causing undue harm to the company and its current shareholders,”<sup>11</sup> implying that ability to pay

a penalty in proportion to the alleged offense is an additional factor the SEC takes into account when considering penalties.

This paper is concerned with SEC settlements,<sup>12</sup> but of course many SEC investigations conclude with no punitive action taken. SEC investigations can be triggered in many ways, including the review of forms filed with the SEC, routine inspections of persons or entities regulated by the SEC, tips from members of the public, referrals from other government agencies, news reports, and information received in other SEC investigations.<sup>13</sup> Regardless of how they are triggered, SEC investigations are almost always conducted privately.<sup>14</sup>

The stages of a typical SEC investigation are represented as a flowchart in Exhibit 2. The first stage of an SEC action is typically an *informal investigation*. At this stage, the Commission staff has no formal subpoena power, and hence must rely on the cooperation of the relevant individuals and entities to gather information. At the conclusion of an informal investigation, SEC staff may recommend that the Commission undertake an enforcement action seeking sanctions, seek a *formal order of investigation* from the Commission, or conclude the investigation without recommending an enforcement action.

When SEC staff request and receive a formal order, the next stage is a *formal investigation*. The Commission approves requests for formal orders when it finds that it is likely that a securities law violation has occurred.<sup>15</sup> The formal order grants designated SEC staff the ability to issue subpoenas and to administer oaths.



10 See, e.g., Mahoney, et al. (2006) (“The SEC has continued to demand multi-million dollar settlements, with little or no articulated guidance on how the amounts were derived.”).

11 A transcript of this speech is available at <http://www.sec.gov/news/speech/spch010406lct.htm>.

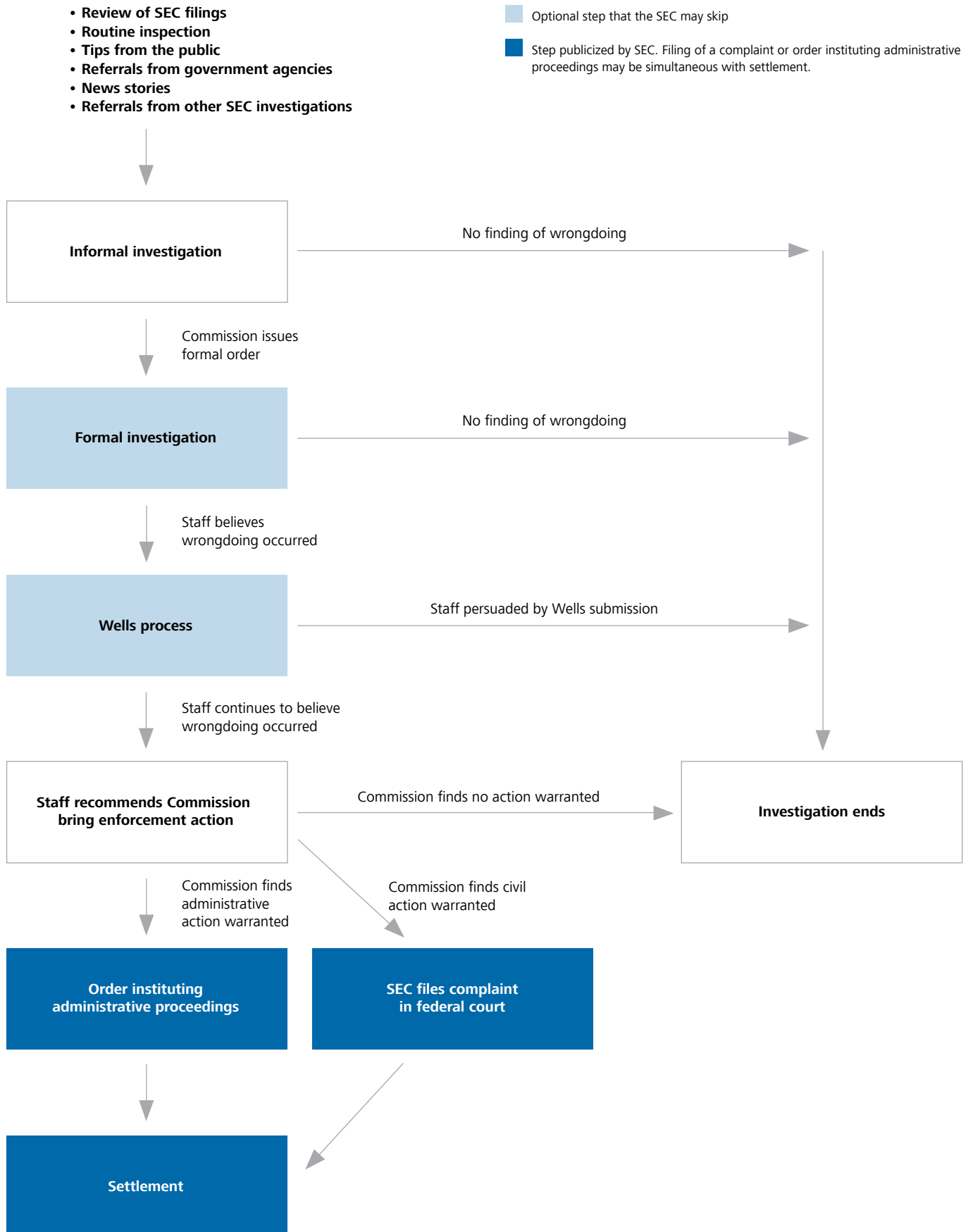
12 For the purposes of this paper, the term “settlement” also refers to decisions in federal court and in administrative proceedings. The majority of cases identified in our research were resolved through settlement rather than through decisions.

13 W.R. McLucas, J.L. Taylor, and S.A. Matthews, “A Practitioner’s Guide to the SEC’s Investigative and Enforcement Process,” 70 *Temple Law Review* 53, 74 (1997).

14 See also SEC Statement, “The Investor’s Advocate: How the SEC Protects Investors, Maintains Market Integrity, and Facilitates Capital Formation,” <http://www.sec.gov/about/whatwedo.shtml>.

15 McLucas et al. (1997).

## Exhibit 2. Steps in an SEC Action



When the staff has concluded its investigation, it may recommend to the Commission that enforcement proceedings be commenced, or it may determine to take no further action. If the staff has determined to recommend that the Commission commence an enforcement proceeding, it typically gives prospective defendants a *Wells notice* informing them of the staff's intent. The recipient of a Wells notice has a period of time, generally one month, to provide the staff with a *Wells submission*, which is essentially a brief arguing that an enforcement action is not merited. Upon reviewing the Wells submission, the staff may elect to modify or reverse its recommendation to the Commission. There is no formal requirement that the staff provide Wells notices to potential defendants, and they are not provided when the circumstances of the investigation require "the Commission to act quickly to protect the public interest."<sup>16</sup> But otherwise, the Commission reviews the Wells submission before determining whether to follow the staff's proposed course of action.

**Exhibit 3. Settlement Counts by Defendant Type**  
July 31, 2002 to September 30, 2008

	Companies	Individuals
Federal Court Cases	704	2,218
Administrative Proceedings	640	1,911
Total	1,261	3,495

Note: Defendants that settled in federal court and in an administrative proceeding are included in each respective count. The double counting is eliminated in the totals.

Upon the staff's recommendation to bring an enforcement action, the Commission has several options. It may authorize a civil action in federal court, an administrative proceeding before an administrative law judge, or no enforcement proceeding at all. Whether the Commission authorizes a civil action in federal court or an administrative proceeding depends on several factors, including the severity of the allegations, the nature of the conduct alleged, tactical considerations, and the type of sanctions sought.<sup>17</sup> For instance, the failure of SEC-regulated entities to properly supervise their employees may only be addressed through an administrative proceeding,<sup>18</sup> while monetary penalties against persons and entities not directly regulated by the SEC may only be sought in federal court.<sup>19,20</sup> As an example of tactical concerns, the SEC may only subpoena individuals to appear in federal court if they reside within 100 miles of the courthouse, whereas in administrative proceedings the Commission has nationwide subpoena power.<sup>21</sup> When the circumstances warrant it, the Commission may bring both types of action.<sup>22</sup> Exhibit 3 shows the number of post-SOX settlements with companies and individuals in federal court and administrative cases.

The SEC makes public announcements when it files complaints in federal court and when it enters orders instituting administrative proceedings. Because this is typically the SEC's first public disclosure of the fact of an investigation, many defendants attempt to settle the enforcement action before these documents are filed. By doing so, the defendant minimizes litigation costs and avoids the additional round of negative publicity that would occur if a settlement were announced at a later date.<sup>23</sup> Thus, many SEC announcements that a complaint has been filed or that an administrative proceeding has begun also contain the details of the settlement.

<sup>16</sup> Ibid.

<sup>17</sup> Ethiopis Tafara, Director, Office of International Affairs, SEC, "Remarks Before the Panamanian Securities Regulatory Community and Industry," April 15, 2004 (<http://www.sec.gov/news/speech/spch041504et.htm>).

<sup>18</sup> McLucas et al. (1997).

<sup>19</sup> In future work we will distinguish between settlements with regulated and non-regulated entities.

<sup>20</sup> Stephen M. Cutler, "Testimony Concerning The Securities Fraud Deterrence and Investor Restitution Act, H.R. 2179, Before the House Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises, Committee on Financial Services," June 5, 2003 (<http://www.sec.gov/news/testimony/060503tssmc.htm>).

<sup>21</sup> Ibid.

<sup>22</sup> See <http://www.sec.gov/about/whatwedo.shtml>.

<sup>23</sup> Ray Garrett, Jr., "A Look at the SEC's Administrative Practice," April 25, 1974 (<http://www.sec.gov/news/speech/1974/042574garrett.pdf>). Note: this is an address the former SEC chairman gave to the Southwestern Legal Foundation. See also SEC Rules of Practice and Rules on Fair Fund and Disgorgement Plans, January 2006 (corrected March 2006), p. 50 (allowing for settlement negotiations to occur before an enforcement proceeding has begun).

## Exhibit 4. The Five Most Frequent Allegations in SEC Settlements

July 31, 2002 to September 30, 2008

Allegation Category	Description	Settling Defendants	
		Companies	Individuals
Microcap Fraud	Includes boiler room operations, pump-and-dump schemes, fraudulent offerings, etc.	306	1,039
Misstatements/Omissions (including options backdating)	Includes misstatements and omissions in SEC filings, press releases, and other public statements.	197	700
Financial Services—Misappropriation of Investor Funds	Includes, for example, alleged Ponzi schemes.	193	468
Financial Services—Misrepresentations to Customers	Includes, for example, misrepresentations concerning past fund performance, investment plans, etc.	195	323
Insider Trading	Self-explanatory.	25	480

Note: Settlements with multiple allegations count towards each of their respective allegation categories. Thus, these allegations are double counted in this table.

While the SEC publicizes only its enforcement actions and not its investigations,<sup>24</sup> the management of public companies under investigation must make a determination as to whether the securities laws require public disclosure. Of the 197 public companies we have identified that settled enforcement proceedings related to company misstatements or omissions, we have found investigation announcement dates for 181. The average time from the investigation announcement to settlement for these 181 companies was 2.3 years. By way of comparison, over half of all enforcement actions initiated in the year ending September 30, 2007 were brought within two years of the beginning of the investigation.<sup>25</sup>

NERA's analysis of trends in SEC settlements is based on data compiled from documents available from the SEC's website. We have developed a proprietary database of SEC settlements by reviewing every litigation release and administrative proceeding document published from July 31, 2002 through September 30, 2008.<sup>26</sup> We have distinguished individual from company settlements and classified them by type of alleged offense. The five most frequent SEC allegations that we have identified in our study period are shown in Exhibit 4.<sup>27</sup>

24 While the SEC does not announce the initiation of specific investigations publicly, it does report the aggregate number of investigations initiated each fiscal year in its annual Performance and Accountability Reports. For example, the SEC reported that it initiated 776 investigations and 656 enforcement actions in its report for fiscal year 2007 (ending September 30, 2007). While the 2008 Performance and Accountability Report is not available at the time of this paper, the SEC recently announced that in fiscal year 2008 it initiated 671 enforcement actions, the second-highest total in agency history ("SEC Announces Fiscal 2008 Enforcement Results: Agency Brings Second-Highest Number of Actions Ever; Significant Increase in Insider Trading and Market Manipulation Cases," <http://www.sec.gov/news/press/2008/2008-254.htm>).

25 The SEC states that in fiscal year 2007, 54% of all enforcement actions (not just those against public companies) were brought within two years of opening an investigation. US Securities and Exchange Commission, 2007 Performance and Accountability Report, <http://www.sec.gov/about/separ2007.shtml>.

26 The date range is such that all settlements are post-SOX.

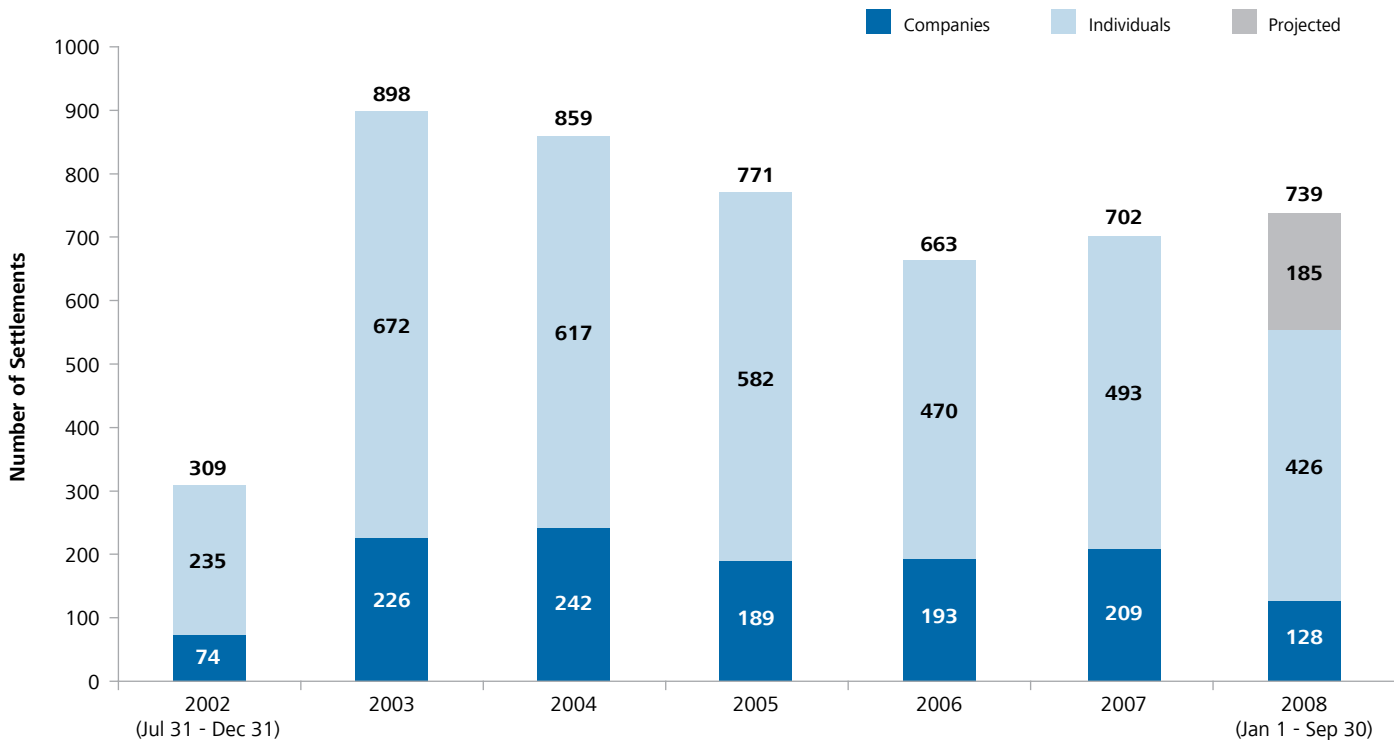
27 There are a limited number of allegations that we have not included in our analysis. These include failure to file periodic financial statements with the SEC, administrative proceedings barring accountants because of felony convictions, and administrative proceedings barring brokers, dealers, and accountants for practicing while unregistered.

## 2008 has seen an increased pace in the number of defendants settling...

As Exhibit 5 shows, the SEC is on pace to reach 739 settlements in 2008, which would be the second straight year of increase after three years of steady decline from 898 in 2003 to 663 in 2006. This increase is being driven by settlements with individuals, which are on pace to total 568 for the year. Company settlements, on the other hand, are on pace to total only 171, which would be the lowest number in any full year since SOX. It may be tempting to draw a comparison with the number of shareholder class action filings, which also increased in 2007 after two years of decline.<sup>28</sup> However, such a comparison would be misleading for two reasons. First, the filing of a securities class action represents the first stage of class action legal proceedings, whereas SEC settlements are the last

stage of the legal process. Because the SEC does not announce its investigations publicly, it is generally not possible to track the beginning of investigations. Instead, this paper tracks settlements, which are often the first public information about an SEC matter. Second, most SEC settlements do not parallel shareholder class actions. In 2007, only 22% of SEC settlements were with public companies or their employees and related to misstatements, and were therefore closely comparable to shareholder class actions. Many SEC settlements involve individual or private company defendants and the range of allegations includes churning, market timing, FCPA violations, insider trading, and Ponzi schemes, among other allegations.

**Exhibit 5. After Steady Declines from 2003 to 2006, the Number of Settlements Is on the Rise**



Note: Projected settlements in 2008 are computed assuming settlements in the fourth quarter of 2008 occur at the same rate observed through the first three quarters of the year.

<sup>28</sup> Securities class action filings increased to 195 in 2007 from 131 in 2006 and 188 in 2005 (see "2008 Trends: Subprime and Auction-Rate Cases Continue to Drive Filings, and Large Settlements Keep Averages High," by Stephanie Plancich, Svetlana Starykh, and Brian Saxton, July 29, 2008, [http://www.nera.com/Publication.asp?p\\_ID=3544](http://www.nera.com/Publication.asp?p_ID=3544)).

**...but company settlement amounts remain below 2004-06 levels**

Since the passage of SOX, SEC settlements have included monetary payments for more than half of company defendants in federal court and administrative cases. For individual defendants, monetary payments have been a component of over 80% of settlements in federal court cases but only 18% of administrative cases (Exhibit 6).

Exhibit 7 shows the annual median amount paid by defendants whose settlements involved a monetary component. It can readily be seen that companies typically pay far more than individuals. In 2007, the median company settlement dropped to \$0.7 million, less than half the 2006 high of \$1.5 million. Through the first three quarters of 2008, the median settlement was \$1 million, which, while an increase over 2007, is otherwise the lowest value observed since 2003. This is consistent with press speculation that penalties would fall due to the new requirement, effective January 1, 2007, that SEC staff obtain Commission approval for

**Exhibit 6. Proportion of Non-\$0 Settlements by Defendant Type**

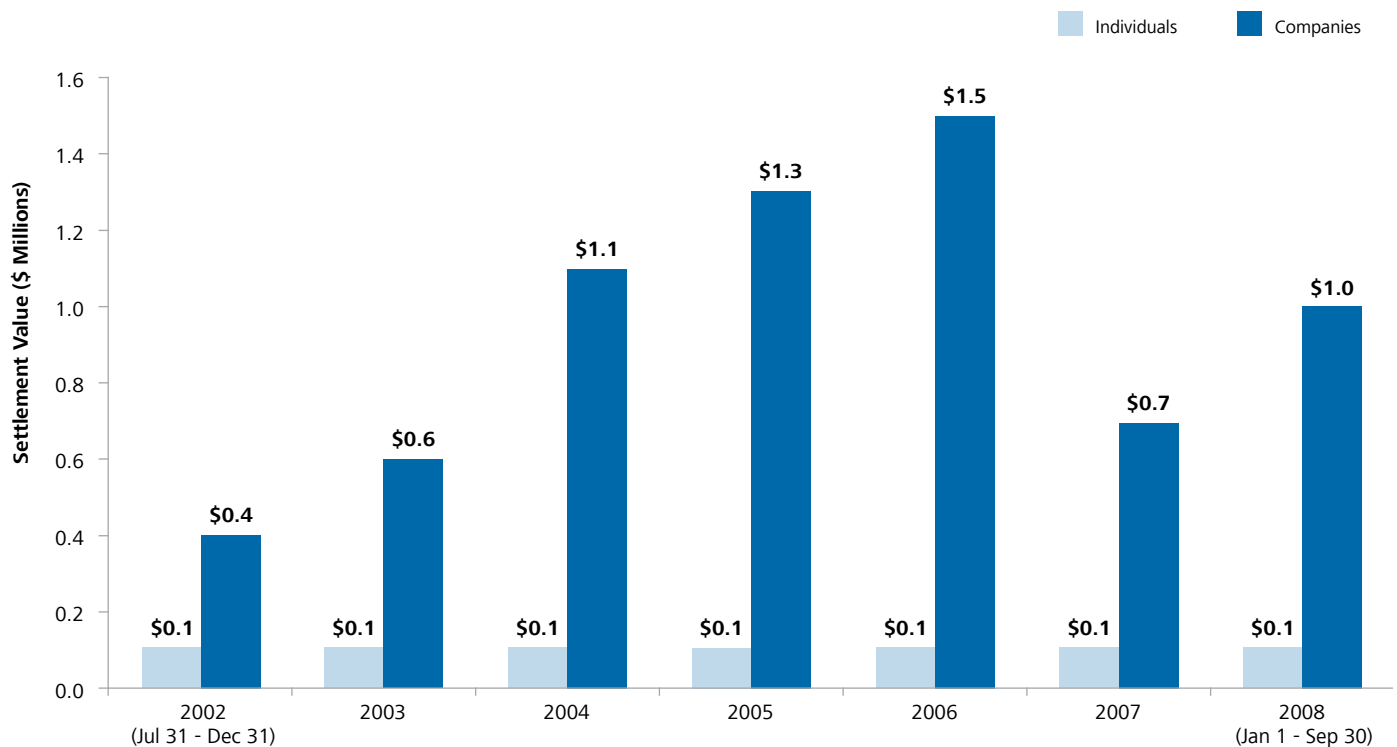
July 31, 2002 to September 30, 2008

	Companies	Individuals
Federal Court Cases	54.3 %	80.8%
Administrative Proceedings	52.7	17.8
Total	56.2	60.4

Note: Defendants that settled in federal court and in an administrative proceeding are included in each respective count. The double counting is eliminated in the totals.

penalty amounts prior to beginning settlement negotiations with public companies.<sup>29</sup> However, SEC Chairman Christopher Cox predicted the policy could lead to larger penalties,<sup>30</sup> and less than two years may not be enough to fully observe the impact of the pre-approval policy. The median settlement for individuals has consistently been \$0.1 million in each year since SOX.

**Exhibit 7. After Increasing from 2002 through 2006, Median Company Settlement Values Have Declined**



Note: \$0 Settlements have been excluded from the calculations. All dollar amounts in millions.

29 Carrie Johnson, "SEC Shift May Lead To Lower Penalties; Policy Addresses Firms' Culpability," *Washington Post*, April 13, 2007. See also Judith Burns, "SEC's Cox Defends Pre-Approval of Corporate Fines," *Dow Jones Newswires*, April 13, 2007 (indicating that the policy had been in effect since January 1, 2007).

30 Christopher Cox, "Speech by SEC Chairman: Address to the Mutual Fund Directors Forum Seventh Annual Policy Conference," April 13, 2007.

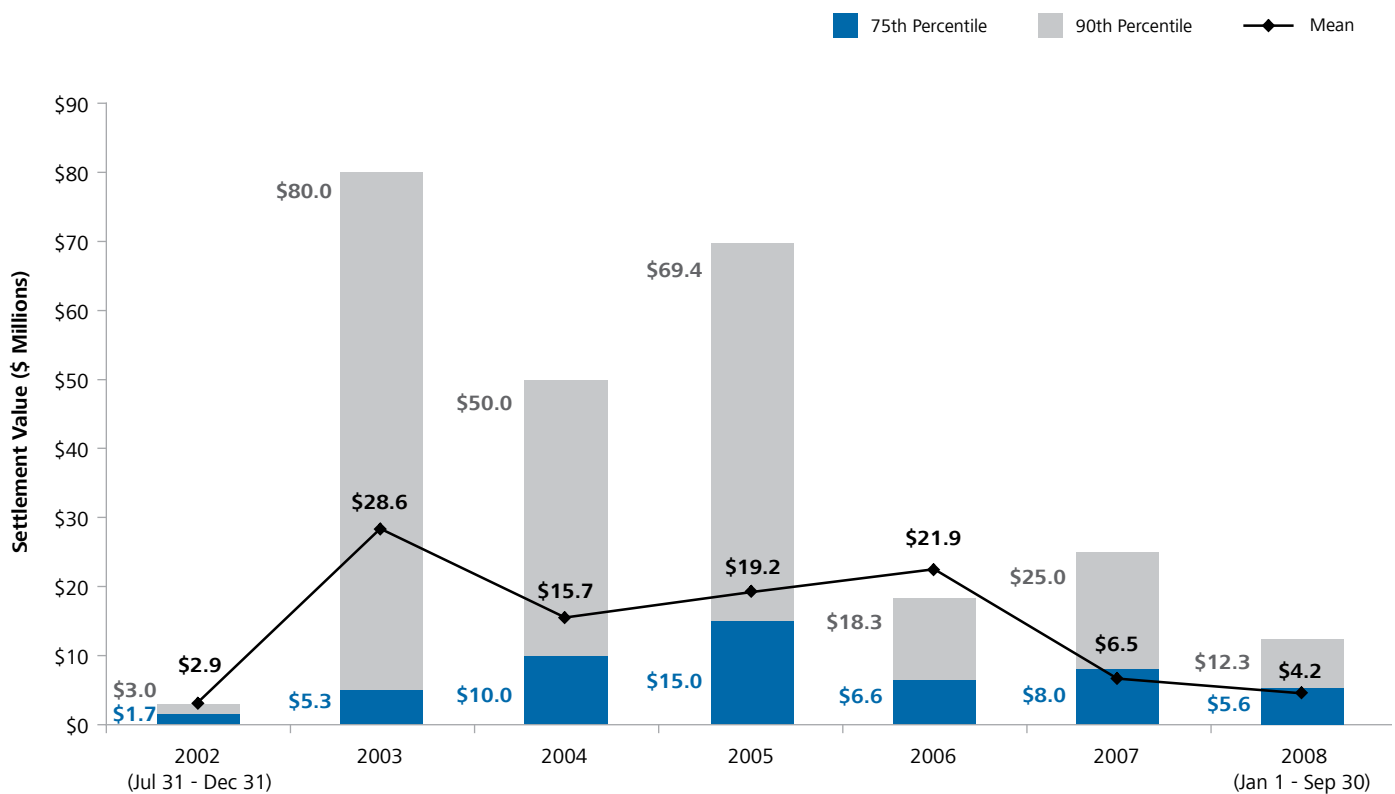
Forty-three percent of company payments have been in the form of disgorgement, with 57% being civil penalties. On the other hand, disgorgement comprises 88% of individual payments.

## A look at the highest value company settlements

The increase in median company settlements in 2005 and 2006 and the drop in 2007 are also observed in the mean values. Exhibit 8 shows the annual trend in the 75th percentile, 90th percentile, and average settlements. The 75th percentile settlement is the settlement that is larger than 75% of all other settlements in each year. Similarly, the 90th percentile settlement is the settlement that is larger than 90% of all other settlements in each year. As can be seen in the exhibit, from 2003 through 2006, the mean settlements were influenced by the presence of very

large settlements, such as the \$800 million settlement with American International Group in 2006. In 2007, the average declined even as the 75th and 90th percentiles increased, indicating a large number of small settlements. Through the first three quarters of 2008, the average, 75th, and 90th percentile settlements all decreased. The 90th percentile settlement in the first three quarters of 2008 is \$12.3 million, less than half the 2007 value and only 15% of the 2003 value of \$80.0 million, which was the post-SOX high.

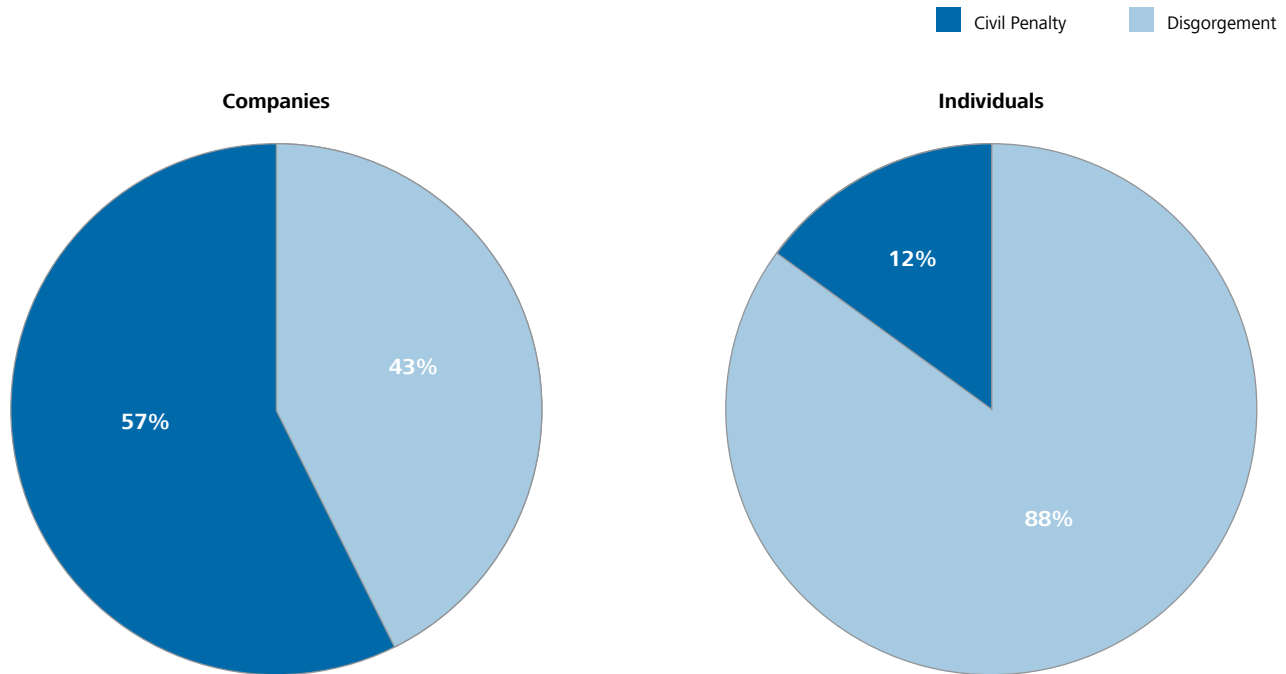
**Exhibit 8. The Highest Value 2006–2008 Company Settlements Are Below 2003–2005 Levels**



Note: \$0 Settlements have been excluded from the calculations.

## Exhibit 9. Company Monetary Settlements Are Mostly Comprised of Civil Penalties, While Disgorgement Dominates Settlements with Individuals

July 31, 2002 to September 30, 2008

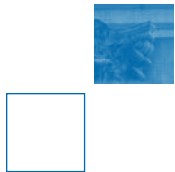


Note: The SEC does not always report disgorgement and prejudgment interest separately. Therefore the disgorgement data underlying these charts include some prejudgment interest amounts.

### Disgorgement is the dominant component of settlements with individuals

The SEC often discloses the amount of its settlements attributable to civil penalties, disgorgement, prejudgment interest, and amounts waived. In cases where the SEC has provided this level of detail on the settlements, 43% of company payments have been in the form of disgorgement, with 57% being civil penalties. On the other hand, disgorgement comprises 88% of individual payments (Exhibit 9). An interpretation of this result may be that the desire to deter repeat offenses (via civil penalties) is a larger consideration in company penalties, while individual penalties are mainly intended to prevent unjust enrichment.

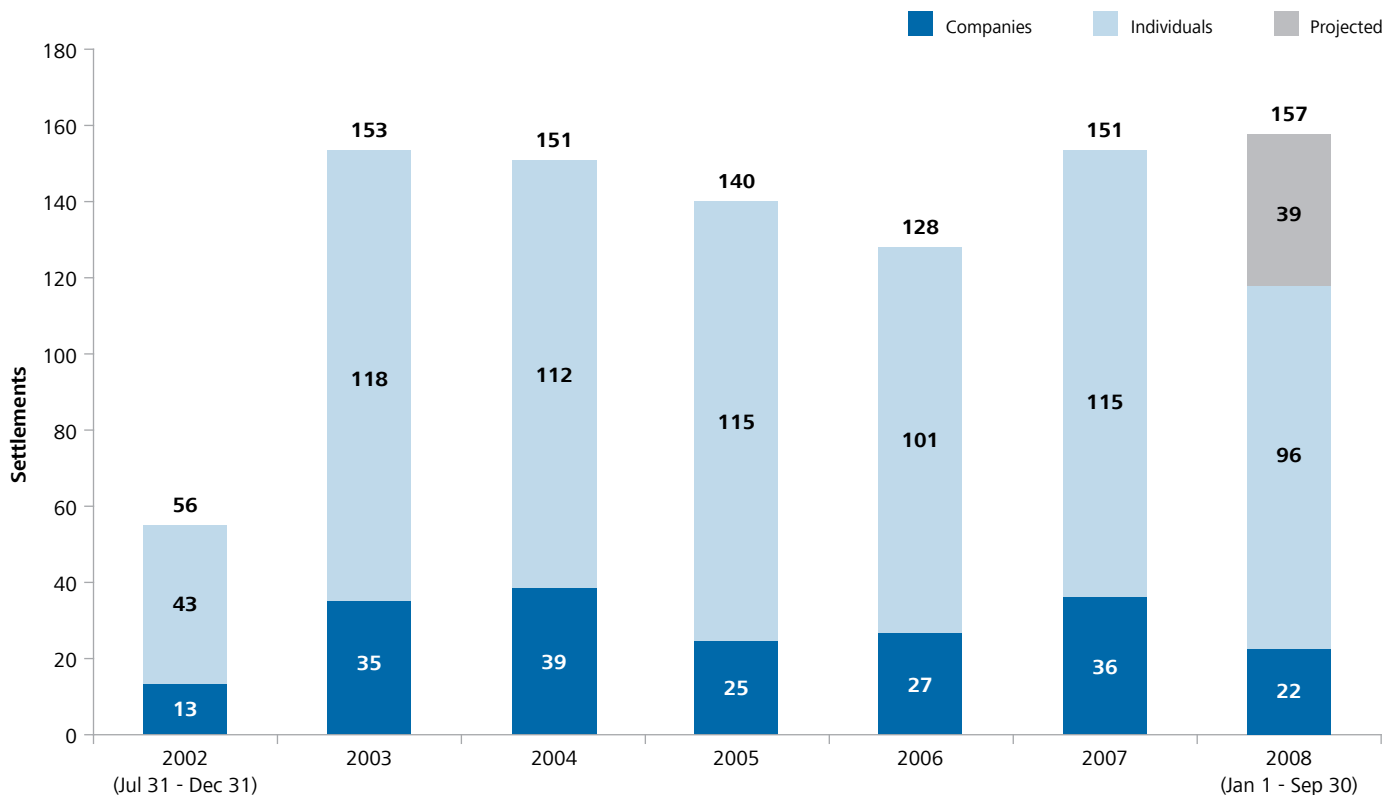




## The number of public company misstatement settlements is on pace to increase for the second straight year...

Misstatements and omissions are among the allegations most frequently brought by the SEC and account for the majority of cases brought against publicly-traded companies. These cases include allegations of false public statements or important omissions about the company's finances or business prospects, such as earnings misstatements and incorrect press releases. The number of settlements involving company misstatements<sup>31</sup> rebounded strongly in 2007, after three years of declines (Exhibit 10). Both the number of settling companies and individuals increased. The 151 settling defendants in 2007 nearly equaled the 2003 post-SOX high. 2008 is on pace to set a new post-SOX record for the number of misstatement settlements, but, as with the trend in overall settlements, the growth is coming in individual settlements. Settlements with companies are on pace to total 30, which would represent a decrease from 2007.

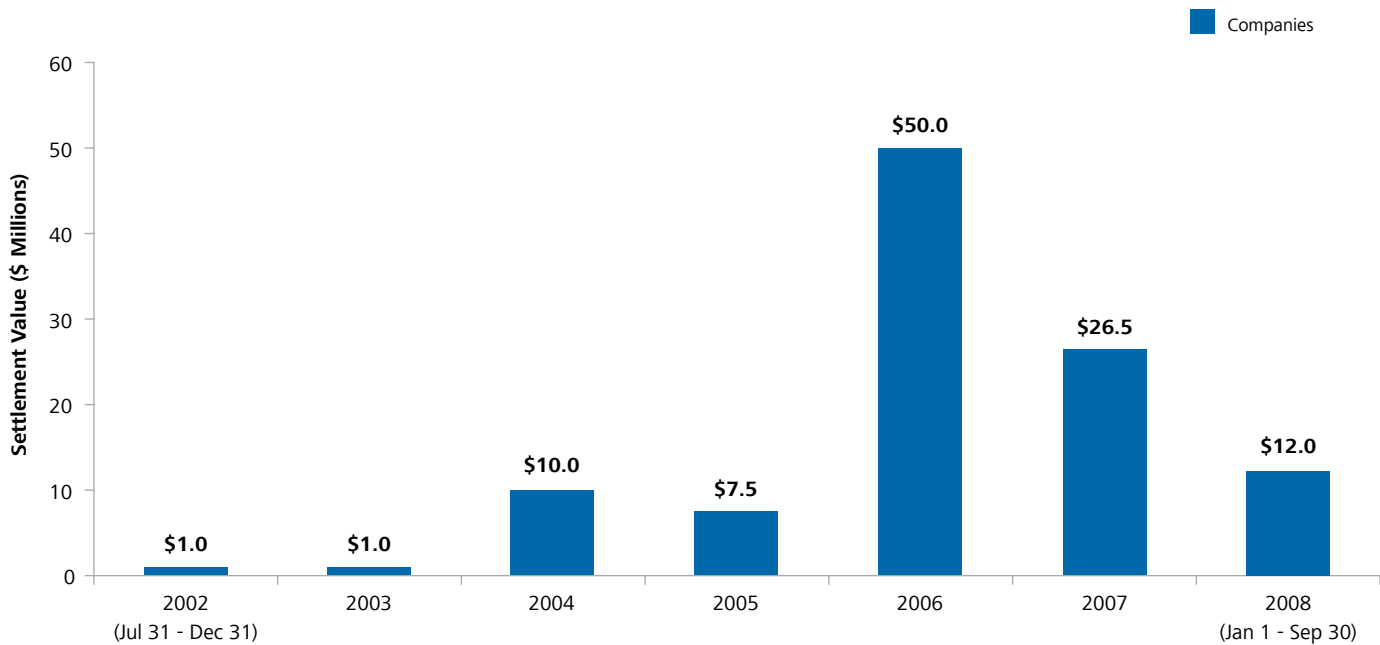
**Exhibit 10. The Number of Settlements in Misstatement Cases Is on Pace to Set a Post-SOX Record in 2008**



Note: Includes cases with multiple allegations. Excludes cases relating to OTC-traded stocks. Projected settlements in 2008 are computed assuming settlements in the fourth quarter of 2008 occur at the same rate observed through the first three quarters of the year.

<sup>31</sup> Cases involving stocks traded over-the-counter are excluded from this analysis. Cases involving these stocks often involve allegations of a different character from cases involving stocks listed on major exchanges. For instance, misstatement cases for stocks trading in the over-the-counter market often involve allegations of boiler room operations and/or pumping-and-dumping.

## Exhibit 11. Median Misstatement Settlement Values Have Fallen from their 2006 High



Note: Includes cases with multiple allegations. Excludes cases relating to OTC-traded stocks. Excludes \$0 settlements.

### ...but settlement values have fallen from their 2006 high

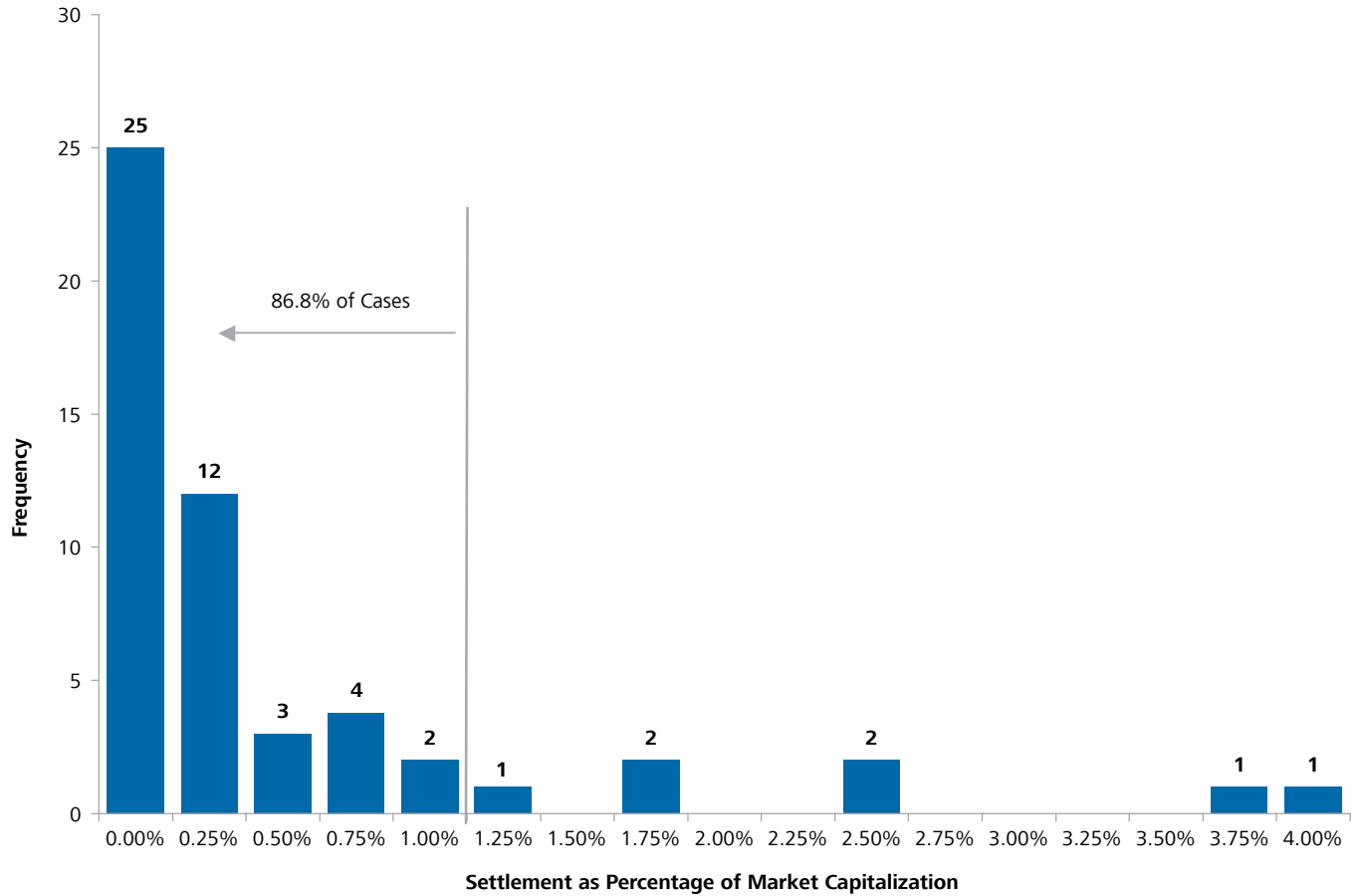
Misstatement cases against public companies also account for many of the SEC's largest settlements. After reaching a high of \$50 million in 2006, the median company settlement value fell to \$26.5 million in 2007 and \$12 million in the first three quarters of 2008 (Exhibit 11). As noted in the discussion of Exhibit 7, this drop was anticipated by the press because, as of January 1, 2007, SEC staff have been required to obtain Commission approval for penalty amounts prior to beginning settlement negotiations with public companies. The median settlement amounts for individuals are not shown in Exhibit 11, but have ranged from a low of \$75,000 in 2003 to a high of \$225,000 in 2002.

It is not only US companies that face regulatory risk regarding misstatements. Of the 197 total post-SOX settlements with company defendants in misstatement cases, 18 (or 9.1%) involve foreign issuers. In comparison, during this same period non-US companies<sup>32</sup> accounted for approximately 14% of listings on US exchanges. Thus, non-US companies were somewhat less likely to settle misstatement cases with the SEC than US companies. Of the 18 foreign companies, 10 had shares directly listed on US exchanges, while the other eight had ADR programs in the US.

32 Non-US Companies are defined as those that are not domiciled in the United States.

**Exhibit 12. The Overwhelming Majority of Public Company Misstatement Settlements Are for Less than One Percent of Market Capitalization**

July 31, 2002 to September 30, 2008



Note: Excludes 139 companies that settled for \$0. Excludes five additional companies that were not publicly traded at time of settlement.

**Company settlements in misstatement cases are typically less than 1% of market capitalization**

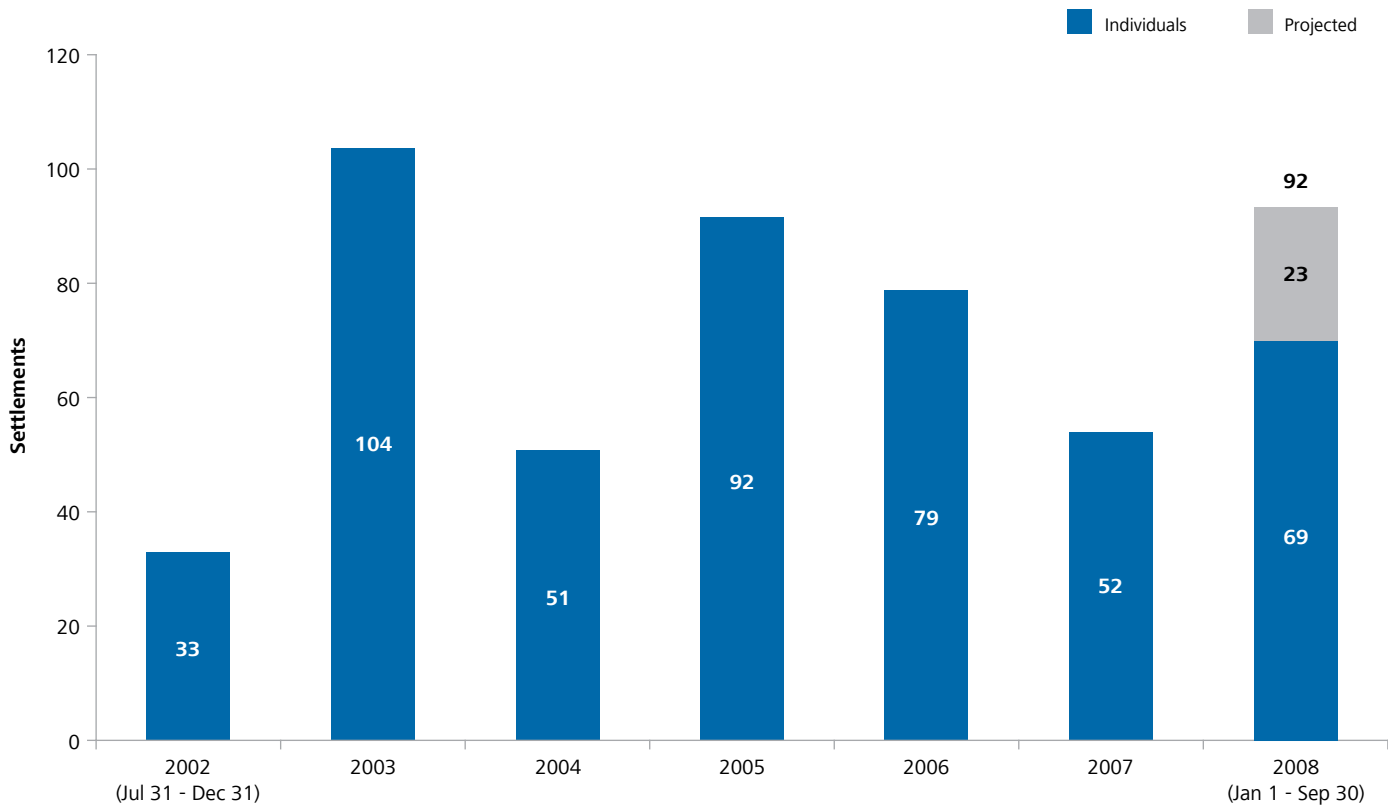
Of the 197 misstatement cases identified in this study, only one, Qwest Communications International Inc., settled for more than 4% of market capitalization (Exhibit 12). In fact, 139 companies settled for \$0, and an additional 25 settled for less than 0.25% of market cap, while only nine settled for more than 1% of market cap. One interpretation of this result is that market capitalization is acting as a proxy for ability to pay, which is a factor the SEC acknowledged that it considered in connection with the Applix settlement.



## The number of insider trading settlements has increased in 2008

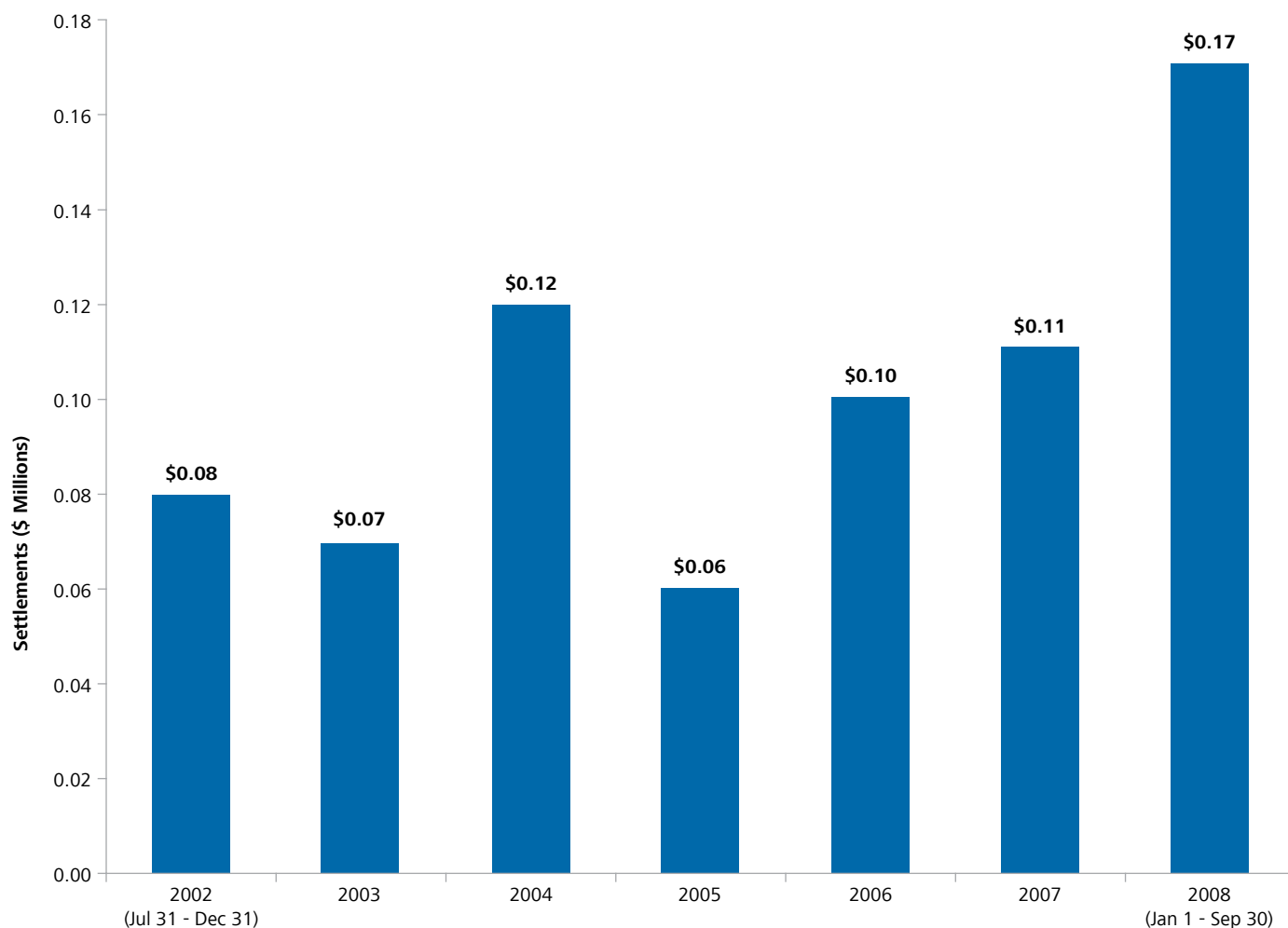
Insider trading is the most frequent allegation in SEC settlements with individuals (Exhibit 13). Few companies have settled insider trading charges in the period examined in this paper—the annual number has ranged from only one in 2004 to a high of seven in 2007. The median monetary penalty for individuals settling insider trading cases was \$170,000 for the first three quarters of 2008, putting the year on pace for a new record (Exhibit 14).

**Exhibit 13. After Two Years of Declines, the Number of Insider Trading Settlements With Individuals Has Increased in 2008**



Note: Projected settlements in 2008 are computed assuming settlements in the fourth quarter of 2008 occur at the same rate observed through the first three quarters of the year.

## Exhibit 14. Median Insider Trading Settlement Values for Individuals Have Also Increased



### Conclusion

The six years since SOX have been a dynamic period for SEC enforcement actions. SOX gave the SEC the ability to distribute penalties obtained through its enforcement actions to harmed investors, and record penalties against issuers ensued. This shift has caused considerable uncertainty among defendants, which the SEC has attempted to resolve by articulating the factors it considers when determining penalty amounts. Additionally, as of January 1, 2007, SEC staff are required to obtain Commission pre-approval for penalties sought in settlements with public companies.

Through the first three quarters of 2008, the median settlement with public companies for misstatements or omissions was \$12 million, putting it on track to decline for the second straight year since reaching a post-SOX high of \$50 million in 2006. On the other hand, the number of settlements of this type increased in 2007, and is on pace to set a new post-SOX record this year.

Are these trends related to policy shifts within the SEC, or is the mix of cases settled since the beginning of 2007 somehow different from prior years? Future papers in this series will examine the characteristics of settling companies so that this question, and many others, may be answered.

### Vist Our Website

Additional statistics and analysis, as well as a searchable database of documents relating to SEC settlements, are available on the NERA Securities Litigation Trends website ([www.SecuritiesLitigationTrends.com](http://www.SecuritiesLitigationTrends.com)).

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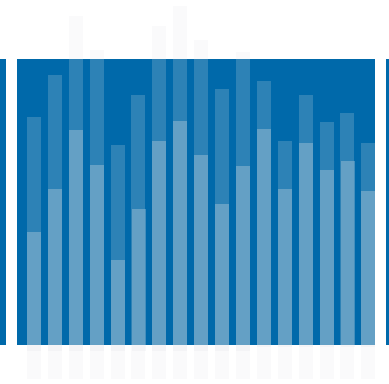
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