BEST'S REVIEW
November 2004

Regulatory/Law

Suiting Up

When the top securities class-action law firm becomes two firms, D&O insurers could take a double hit.

by Fran Matso Lysiak

As courts can be sharply divided in their opinions, so too are opinions surrounding the split earlier this year of the highly successful class-action firm Milberg Weiss Bershad Hynes & Lerach LLP and its impact on underwriters of directors and officers insurance.

Corporate America—and directors and officers insurers—now are facing "two 800-pound gorillas," said Mark Pruner, vice president of marketing for RD Legal Funding, an Englewood, N.J.-based company that provides post-settlement funding to class-action firms.

The split of the firm into two fierce competitors, one based on the East Coast, the other on the West Coast, will bring new challenges to D&O underwriters, said Peter R. Taffae, managing director of the Los Angeles-based Executive Perils Inc., a national wholesale broker specializing in D&O and employment-practices liability.

"Based on the D&O landscape today, do underwriters have legitimate concerns? My answer is absolutely, rock-solid, yes," said Taffae.

In May 2004, Institutional Shareholders Services released its first annual "SCAS (Securities Class Action Services) 50" report. The SCAS 50 lists the top 50 plaintiffs' law firms ranked by the total dollar amount of final securities class-action settlements occurring in 2003 in which the law firm served as lead or co-lead counsel, according to Bruce Carton, executive director of ISS's SCAS, as quoted on the ISS Web site.

Topping ISS's list for 2003 was Milberg Weiss Bershad Hynes & Lerach, which was lead or co-lead counsel in final settlements totaling $2.1 billion, according to Carton. In terms of total settlement dollars, Milberg Weiss more than doubled the total of the No. 2 firm on ISS' list, Bernstein Litowitz Berger & Grossmann, at $950 million, and Milberg Weiss participated in two-thirds of all settlement dollars obtained in 2003, according to Carton.

In the total number of final settlements, Milberg Weiss led with 65 settlements, according to Carton.

But the litigation landscape changed dramatically on May 1, 2004, when the West Coast partners of Milberg Weiss Bershad Hynes & Lerach formed a new law partnership.

Milberg Weiss Bershad Hynes & Lerach, founded in 1965 and among the nation's largest plaintiffs' contingency fee-based law firms, now is known as Milberg Weiss Bershad & Schulman LLP and has its main office in New York City. The former West Coast partners' new law partnership now is known as Lerach Coughlin Stoia Geller Rudman & Robbins LLP and has its main office in San Diego.

Melvyn I. Weiss, founding partner of Milberg Weiss and widely regarded as one of the leading securities attorneys, is senior partner of Milberg Weiss Bershad & Schulman. William S. Lerach, also widely recognized as among the leading securities attorneys, founded the West Coast operation of Milberg Weiss almost 30 years ago. He is chairman of Lerach Coughlin.

Both Weiss and Lerach have led in the prosecution of hundreds of securities class actions, resulting in recoveries amounting to billions of dollars for individual and institutional investors who claimed they were defrauded.

"It used to be Milberg Weiss and then all the rest," said David Bradford,

Key Points

- Because each of the firms, Milberg Weiss and Lerach Coughlin, has only a combined past track record, it's being suggested that a large number of quick cases will appear with the goal of building an inventory of successes.
- According to the Tillinghast 2003 Directors & Officers Liability Survey, the D&O market continued to be hard, with increasing premiums, tightening policy limits and deductibles/retentions, and a reduction of insurance capacity.
- The potentially most dangerous trend for D&O insurers is in the new areas of corporate fraud being discovered and the new theories that New York Attorney General Eliot Spitzer and others are using.

Photo illustration by Ellen Wagner

executive vice president of Advisen Ltd., which provides strategic information services to the insurance industry. "Now, there are a number of firms closer in size and strength competing for business. It is not a given that Milberg Weiss or Lerach Coughlin will ultimately emerge as the dominant firm, and it seems quite likely that the two firms will give up some portion of their collective 'market share' to their strong competitors."

The split isn't likely to impact D&O insurers in any way, he said. The supply of meritorious securities class-action suits is finite and currently falling, and there is no shortage of law firms to handle them, Bradford said.

Lead Counsel Position

The official reason for the split is that the firm had grown so large that the senior partners were spending too much time on administrative issues, said Taffae. "The rumor mill suggests a number of possible other reasons, including that the two vastly different styles and philosophies of Mel Weiss and Bill Lerach had gotten too bitter," he said.

"You now have two very strong, well-funded plaintiff class-action firms," said Pruner. "And what we have seen over the past several years, particularly since the Private Securities Litigation Reform Act of 1995, is that the lead counsel position has been concentrated on a small number of firms, with the original Milberg Weiss being head and shoulders above the competition."

Before Congress enacted the PSLRA, plaintiffs' counsel could file a lawsuit with a frivolous claim and demand that the defendant company, or issuer, along with its investment banks and accountants, produce millions of documents, according to the Securities Industry Association Web site. The goal would be to make the cost of defending the case so high as to force the defendant to settle, even if there was no merit to the case, according to the SIA.

"Whenever a company's stock price would drop, there would almost always be an immediate filling of a securities fraud class action," said Paul R. Bessette, head of the securities litigation practice at Akin, Gump, Strauss, Hauer & Feld, calling these "abusive strike suits."

"It was a knee-jerk reaction to the stock price drop ... file the suit first and ask questions later," Bessette said.

Many believe the motivating factor behind the PSLRA, backed by corporations, was to stop the original Milberg Weiss, according to Taffae.

To stop the abuse, the PSLRA made several changes to the procedures for bringing a private lawsuit, according to the SIA. The law heightened the pleading standard, meaning that it no longer was sufficient for plaintiffs to assert that the defendant did something wrong, according to the SIA. The plaintiff must identify specific events, such as alleging a defendant's untrue statements of material fact that, if proved in court, would constitute fraud.

The PSLRA also encouraged lead plaintiff status to be granted to parties who suffered the largest financial losses—mostly institutional investors, particularly public and multiemployer funds, according to Taffae, referring to the California Public Employees Retirement Fund, among others.

No longer was the first plaintiff to

And Then There Were Two

Milberg Weiss Bershad & Schulman LLP

Founded: 1965 by Lawrence Milberg and Melvyn I. Weiss

Offices: New York (headquarters); Boca Raton, Fla.; Wilmington, Del.; Washington, D.C.; Seattle; and Los Angeles

Attorneys: 110

Practice Areas: Accountant liability, antitrust, consumer, corporate, environmental, False Claims Act litigation, health care, human rights, insurance/annuities, labor and employment practice, mass tort, securities and shareholder corporate litigation

Recent Prominent Cases

- **NASDAQ Market-Makers Antitrust Litigation:** Milberg Weiss was co-lead counsel for a class of investors who alleged that the NASDAQ market makers set and maintained wide spreads under an industrywide conspiracy in this major antitrust case. The case was settled for $1.03 billion.
- **Initial Public Offering Securities Litigation:** A proposed settlement between the issuer defendants, their directors and officers, will guarantee at least $1 billion to class members from the insurers of the issuers.
- **Lucent Technologies Inc. Securities Litigation:** The third-largest securities settlement in history provides $600 million to shareholders who purchased Lucent stock between October 1999 and December 2000.
- **Recoveries:** Milberg Weiss attorneys have been responsible for more than $30 billion in recoveries.

Source: Milberg Weiss Bershad & Schulman LLP Web site

Lerach Coughlin Stoia Geller Rudman & Robbins LLP

Founded: 2004 by William S. Lerach, Patrick Coughlin, John J. Stoia Jr. and Darren J. Robbins

Offices: San Diego (headquarters); San Francisco; Los Angeles; New York; Boca Raton, Fla.; Washington, D.C.; Houston; Philadelphia; and Seattle

Attorneys: 125; includes 51 partners formerly with the West Coast operation of Milberg Weiss Bershad Hynes & Lerach

Practice Areas: Securities, insurance, antitrust, consumer

Recent Prominent Cases

- **NASDAQ Market-Makers Antitrust Litigation**
- **American Continental Corp./Lincoln Savings & Loan Securities Litigation:** Lerach Coughlin attorneys served as the co-lead counsel for a class of purchasers of debentures and/or stock in American Continental Corp., the parent company of Lincoln Savings & Loan. The suit charged Charles Keating, other insiders, three major law firms, Drexel Burnham, Michael Milken and others with racketeering and violations of securities laws. Recoveries totaled $240 million.
- **3Com Inc. Securities Litigation:** A class action alleging violations of federal securities laws in which Lerach Coughlin attorneys served as lead counsel for the class and obtained a recovery of $259 million.
- **Recoveries:** Lerach Coughlin attorneys have been responsible for recoveries of more than $25 billion.

Source: Lerach Coughlin Stoia Geller Rudman & Robbins LLP Web site

the courthouse guaranteed to be the lead, he said.

Now, firms must compete to be designated by the court as lead plaintiff attorney, explained RD Legal Funding's Pruner.

"The firms are trying to attract as many plaintiffs as they can, with the largest number of shares, so that each will have a better opportunity of being named lead plaintiffs' attorney," he said.

Quick Inventory of Cases

Because each of the firms, Milberg Weiss and Lerach Coughlin, has only a combined past track record, it's being suggested that a large number of quick cases will appear with the goal of building an inventory of successes, said Taffae, referring to the strike suits.

"Each of the new firms will require either rebuilding or at the minimum, strengthening its infrastructure, including a well-trained internal team of forensic accountants, investigators and damage analysts," Taffae said. "In addition to these costs, substantial amounts will be required to solicit institutional investors as clients."

"The quickest and easiest capital-raising activity a plaintiff firm can do is bring in lots of litigation with settlements," said Taffae, warning that the frequency of the suits should have D&O underwriters concerned.

Photo courtesy of Lerach Coughlin Stoia Geller Rudman & Robbins LLP

Having two large class-action firms, rather than one, may result in a small uptick in litigation, "but this effect will be swamped by the rising stock market, which tends to hide corporate malfeasance until the next market downturn," said Pruner.

"Of course we are competing," with Lerach Coughlin, said Weiss when asked the question. But he took issue with the idea of "strike suits."

"Why would we spend resources, which are very dear to us, and expensive to maintain, to file frivolous lawsuits?" Weiss said. "The lawyers don't do that in today's world because the defense bar knows how to take care of defending those cases, and the judges are very attuned to their role in getting rid of them quickly."

"Our clients are going to ... try to shake the prosecution of a good securities fraud case, just like they are," said Darren J. Robbins, co-founder of Lerach Coughlin and a former partner with Milberg Weiss. "Will there be some competition? Of course there are cases in which their clients will probably seek to be appointed lead plaintiff, as will ours, and the courts will determine that."

As of early September 2004, Lerach Coughlin had 62 new securities cases and Milberg Weiss had 17 new securities cases, Bradford said.

"Lerach Coughlin's is a lot, but I'm more surprised by Milberg Weiss' paltry 17," said Advisen's Bradford, who declined to comment on the merits of the individual cases.

However, "it's common for class-action law firms to file a lot of suits

Clark Jones for *Best's Review*

William S. Lerach

The West Coast Guy: William S. Lerach founded the West Coast operation of Milberg Weiss almost 30 years ago; today he is chairman of Lerach Coughlin. His history of successful securities-fraud litigation has made his name synonymous with being sued—"being Lerached."

Melvyn I. Weiss

Founding Father: Melvyn I. Weiss established Milberg Weiss in 1965 with Lawrence Milberg. Weiss was involved in policyholder litigations with New York Life, where he recovered more than $300 million and Prudential Life Insurance, recovering $4 billion.

to be sure they are in the game, then weed them out, or get weeded out, as more information develops," Bradford said. "So-called 'strike suits' are still a part of the game, even though the PSLRA was supposed to be the end of them.

The competition to attract clients in all areas of litigation appears fierce.

In its press release announcing the split, Milberg Weiss touted the IPO securities litigation and the Washington Public Power Supply cases; the Lucent Technologies securities case, in which Lucent paid more than $600 million; and the Drexel Burnham/Michael Milken case, in which the firm said it jointly recovered $2 billion.

In its press release, Lerach Coughlin said it would continue to represent institutional investors in high-profile securities cases such as those against Enron Corp., Dynegy, WorldCom, Qwest and HealthSouth. It cited, among others, the settlements in Sprint Corp. and Hanover Compressor securities litigations and a $1.027 billion recovery as co-lead counsel in a case charging that Nasdaq market makers manipulated the price spread, which it calls the largest antitrust recovery in history.

"Institutional investors are larger, better capitalized and aggressive," Robbins noted. "My firm has hundreds of those kinds of clients."

"It's just a temporary situation," Weiss said of the current balance of institutional investment clients between the two firms. "What happened was when we were together, Lerach was in charge of developing those clients because that was the way we were doing it internally. And at the time of the split-up, he had more of those relationships, but since then, we have built up a huge department to handle those things and we've increased our institutional monitoring

Top D&O Writers

In 2003, the top 10 carriers wrote 68.5% of premiums.

Share of D&O Premiums*

Insurer Group	2001	2002	2003
AIG	28.9%	24.9%	21.7%
Chubb	22.3	11.6	14.4
XL	1.1	0.6	6.7
Lloyd's	10.9	5.5	5.7
Hartford	1.8	3.2	4.8
Ace	1.6	0.9	3.5
Aegis	3.7	4.3	3.4
Travelers	2.7	2.6	2.9
Zurich	3.5	2.2	2.7
CNA	3.1	2.6	2.7

*Sorted in order of 2003 premium
Source: 2003 RIMS Benchmark Survey by the Risk and Insurance Management Society Inc. and Advisen Inc.

Securities Suits, Post-SOX

Although fewer securities class-action suits are currently being filed, fewer also are being dismissed. There has been a "major drop" in securities class-action filings, said Mark Pruner, vice president of marketing for RD Legal Funding, citing Stanford Securities Class Action Clearinghouse data. The number of class-action filings in 2003 was 175, down from 225 cases filed in 2002, he said.

At the same time, the rate at which suits are being dismissed "has fallen off drastically," said David Bradford, executive vice president of Advisen Ltd., which provides strategic information services to the insurance industry. One theory is that the heightened reporting requirements of the Sarbanes-Oxley Act, or SOX, provide plaintiffs' attorneys with more ammunition to survive challenges under the Private Securities Litigation Reform Act of 1995, which was intended to weed out cases that have no merit, Bradford said.

Paul R. Bessette

David Bradford

The Sarbanes-Oxley Act, named after its main sponsors, was signed into law by President Bush on July 30, 2002, following a series of high-profile accounting scandals such as Enron. The act brought major changes to financial practice and the regulation of corporate governance, including strict new rules intended "to protect investors by improving the accuracy and reliability of corporate disclosure made pursuant to the securities laws," according to the Sarbanes-Oxley Act Forum Web site.

"It is only natural in this post-SOX environment for courts to allow complaints that are close calls—that is, really questionable as to whether sufficient facts were pled—to pass the pleading stage," said Paul R. Bessette, head of the securities litigation practice at Akin, Gump, Strauss, Hauer & Feld. "That's because it is a judgment call, and some courts, post-SOX, exercise their judgment and allow these marginal cases to go forward."

"It is these marginal cases that are getting through, which may not have been allowed to proceed past the pleading stage pre-SOX, that are causing the dismissal rate to come down in the last few years," Bessette said.

The rate at which dismissals are falling is outpacing the decrease in filings, according to Bradford. In other words, more suits in total are making it to trial, or at least to the inevitability of a trial, if they aren't settled first, he said.

Bradford also said it appears that the expected settlement value of more recently filed cases is falling.

"There are some blockbuster cases still in the pipeline, but fewer of the cases filed in the past couple of years seem to be in the blockbuster category," he said, adding that the "run of the mill" blockbuster case ranges from $250 million to $500 million.

For cases other than blockbusters, the average settlement is falling, according to Bradford. "This may mean that insurers will be on the hook for more cases, but will be paying out less on average for each case," Bradford said.

"The quickest and easiest capital-raising activity a plaintiff firm can do is bring in lots of litigation with settlements."

—Peter R. Taffae, Executive Perils Inc.

agreements ninefold since the split-up. And that's only a few months, since April."

Insurers' Claims Costs

According to a summary of the results of the Tillinghast 2003 Directors & Officers Liability Survey, the D&O market continued to be hard, with increasing premiums, tightening policy limits and deductibles/retentions, and a reduction of insurance capacity. There were, however, signs that the hard market may be stabilizing a little, according to the survey.

Elissa Sirovatka, consulting actuary and D&O survey leader at the Tillinghast business of Towers Perrin, said that starting in 2004, D&O insurance rates have come down—about 10% to 20%, particularly for large Fortune 500 companies.

Sirovatka said the market is "perplexed," however, because although the rates are coming down, insurers' claims costs have not. The market is responding to competitive price pressures, she said, explaining that the market is starting to cut costs to remain competitive, particularly with new entrants to the market.

The potentially most dangerous trend for D&O insurers is in the new areas of corporate fraud being discovered and the new theories that New York Attorney General Eliot Spitzer and others are using, said Pruner. Each of the past three years has seen a major new area arise, Pruner said, whether it be IPO allocation, analyst reporting or mutual funds.

"There is no reason for [D&O] rates to come down," warned Taffae. "It makes no sense whatsoever based on what's currently happening and what's going to happen in the foreseeable future."

"Five, 10 years ago, you didn't have to worry about Spitzer," Taffae said. "He's cost the insurance industry hundreds of millions of dollars."

The top five D&O insurers for primary limits insurance are Chubb Corp., American International Group Inc., Ace Ltd., Admiral Insurance Co. and XL Specialty, according to Sirovatka. Based on participants in the Tillinghast survey, Chubb, Hartford and XL Specialty lead the excess limits market.

The split of Milberg Weiss "is certainly not good news, but not necessarily big enough news to change underwriting philosophies or pricing," said John Rafferty, vice president and national D&O underwriting director at Hartford Financial Products, a unit of Hartford Financial Services Group Inc.

Chubb, AIG and Ace declined to comment. XL couldn't be reached for comment.

D&O insurers may view the split as "a net positive," Bradford said.

"Time and energy spent on winning business, such as courting institutional investors and lead plaintiffs for securities class-action suits, is a further distraction of senior partner resources from litigation," Bradford said. "Neither firm will have the breadth and depth of expertise that the combined firm had."

"The big issue going forward is how many times each firm is named sole lead counsel and how many times each firm is named co-counsel," Pruner acknowledged. "A major issue may turn out to be how effectively they can work together as co-counsel."

DeAndre Salter, founder and president of Professional Risk Solutions, a firm that markets and sells professional and executive liability insurance products, also is in the camp that says the split won't impact D&O underwriters in any way.

"I imagine a short-term increase in filings, but these firms still need to submit good cases with merit under securities laws reforms," Salter added. BR

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