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Asian Institute of International Financial Law
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Are Securities Class Actions in the U.S. "Supplemental" to SEC Enforcement? An Empirical Analysis

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Securities class actions have been justified in the U.S. as a necessary "supplement" to the Securities and Exchange Commission's enforcement of the rules governing disclosure by public companies. On the other hand, commentators generally believe that there are dysfunctional incentives present in class action litigation that lead to settlement of even non-meritorious cases with funds from the corporation and its D&O insurer. If it is true that defendants settle non-meritorious suits, then there is an incentive for plaintiffs' lawyers to bring non-meritorious suits. And if it is true that cases are always settled with company and insurer funds, then the deterrent effect of these suits on managers is questionable. In short, if dysfunctional incentives lead to these results, the justification of class actions as supplemental to SEC actions may be invalid. These concerns that commentators have raised have not been examined empirically.

This paper provides an empirical analysis of the targeting and outcomes of securities class actions in comparison to the targeting and outcomes of SEC enforcement actions. The paper concludes that, notwithstanding the presence of potentially dysfunctional incentives, securities class actions appear to be well targeted toward serious violations and therefore, in this respect, can be said to supplement SEC enforcement. But whereas SEC enforcement actions impose sanctions on individual managers who are responsible for legal violations, the outcomes of securities class actions rarely include individual liability for managers. These cases are nearly always settled with company and insurer funds. If class actions can be justified as supplemental to SEC enforcement, that justification would have to be based on ancillary disciplinary effects on managers who engage in misconduct, such as lost jobs and lost reputations. The extent of such effects has been the subject of research, but the results of that research to date are mixed.

A scholar of corporate law and corporate governance, **Michael Klausner** has conducted in-depth empirical studies of outside director liability and takeover defenses in firms at their initial public offering. He also has done theoretical work on the overall structure and function of corporate law, and on various topics in nonprofit law. His recent scholarship has focused on securities litigation, directors' and officers' liability insurance, and the liability risk of outside directors. Before joining the Stanford Law School faculty in 1997, he was a professor of law at New York University School of Law, a White House Fellow and deputy associate director in the Office of Policy Development, and a corporate law practitioner with Gibson, Dunn & Crutcher in Washington, D.C. and Hong Kong. He clerked for Justice William Brennan of the U.S. Supreme Court and Judge David Bazelon of the U.S. Court of Appeals for the District of Columbia Circuit.

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