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CHALLENGES TO PLAINTIFFS SEEKING LEAD PLAINTIFF STATUS IN SECURITIES FRAUD CLASS ACTIONS

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INTRODUCTION

In recent years, plaintiffs have faced various challenges when seeking lead plaintiff status in securities fraud class actions. Some of these challenges include determining whether plaintiffs should be allowed to form a group and aggregate their losses before the lead plaintiff filing deadline or form a group and aggregate their losses after the lead plaintiff filing deadline and what is the proper accounting methodology to apply when deciding who is the plaintiff with the "largest financial interest." After the United States Supreme Court's decision in Dura Pharm., Inc. v. Broudo, 125 S. Ct. 1627 (2005), plaintiffs have also faced attacks at the lead plaintiff stage questioning their ability to prove "loss causation," thereby rendering them atypical or inadequate to represent the class. This article addresses these various challenges plaintiffs face when seeking appointment as lead plaintiff in securities fraud class actions.

I. What Happens When Plaintiffs Aggregate Together at the Lead Plaintiff Stage?

The Private Securities Litigation Reform Act of 1995 (the "PSLRA") creates a rebuttable presumption that the most adequate lead plaintiff is "the person or group of persons" who: (1) has either filed the complaint or made a motion in response to a

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notice…; (2) has the largest financial interest in the relief sought by the class; and (3) otherwise satisfies the requirements of Rule 23 of the Federal Rules of Civil Procedure. 15 U.S.C. § 78u-4(a)(3)(B)(iii)(I). The PSLRA further provides that a member of the purported class has sixty (60) days from when notice is published to move the court to serve as lead plaintiff. 15 U.S.C. § 78u-4(a)(3)(A)(i)(II).

At times, plaintiffs join together when seeking lead plaintiff status to form a "group." Typically, this aggregation occurs prior to the sixty (60) day filing deadline under the PSLRA. At other times, plaintiffs aggregate after the lead plaintiff deadline, often banding together subsequent to the filing of competing motions against each other. In both situations, courts have come to varying conclusions as to whether aggregation is allowed and under what circumstances. Courts appear to struggle with this issue because of a conflict between the language in the PSLRA and the underlying legislative history behind the Act.

A. Aggregation of Plaintiffs Prior to the Sixty (60) Day Filing Deadline Under the PSLRA

The PSLRA directs the court to "appoint as lead plaintiff the member *or members* of the purported plaintiff class that the court determines to be the most capable of representing the interests of class members," 15 U.S.C. § 78u-4(a)(3)(B)(i) and also provides that "the court shall adopt a presumption that the most adequate plaintiff…is the person *or group of persons* that…has the largest financial interest in the relief sought…." 15 U.S.C. § 78u-4(a)(3)(B)(iii) (emphasis added); see also Newman v. Eagle Bldg. Techs., 209 F.R.D. 499, 503-04 (S.D. Fla. 2002) (finding aggregation of an unrelated institution and individuals acceptable since "[t]here is no requirement contained in the PSLRA that the group of persons serving as lead plaintiff have a relationship among

themselves"); In re Tyco Int'l, LTD Sec. Litig., No. 00-MD-1335, 2000 WL 1513772, at *5 (D.N.H. Aug. 17, 2000) ("declin[ing] to read into the PSLRA a pre-existing relationship requirement that appears nowhere on the face of the statute."). Other courts, however, point out that "[o]ne of the principal legislative purposes of the [PSLRA] was to prevent lawyer-driven litigation" and that "[t]o allow lawyers to designate unrelated plaintiffs as a 'group' and aggregate their financial stakes would allow and encourage lawyers to direct the litigation." In re Razorfish, Inc. Sec. Litig., 143 F. Supp. 2d 304, 308-09 (S.D.N.Y. 2001) (citation omitted); see also Yousefi v. Lockheed Martin Corp., 70 F. Supp. 2d 1061, 1068 (C.D. Cal. 1999) (noting that "the legislative history stresses the need to place control of securities class actions in a small and finite number of plaintiffs, [yet] the statute's language explicitly provides for more than one lead plaintiff….""). As a result, courts applying the PSLRA are divided over whether unrelated plaintiffs may aggregate their losses in order to satisfy the "largest financial interest" and thus be awarded presumptive lead plaintiff status.

The majority of courts, however, allow aggregation to some extent. Courts have followed one of three approaches when dealing with the aggregation of plaintiffs at the time lead plaintiff motions are filed by either finding: (1) aggregation is allowed as long as there is an adequate explanation and justification for the group; (2) aggregation of previously unrelated persons is allowed as long as the group is small and cohesive; or (3) aggregation is not allowed unless plaintiffs have a pre-litigation relationship. See Rozenboom v. Van Der Moolen Holding, N.V., No. 03 Civ. 8284, 2004 WL 816440, at *4 (S.D.N.Y. Apr. 14, 2004) (acknowledging the three different approaches adopted by courts but distinguishing the facts before it on the ground that formation of the group

occurred after the 60-day statutory period); Miller v. Ventro Corp., No. 01-CV-1287, 2001 WL 34497752, at * 7 (N.D. Cal. Nov. 28, 2001) (discussing the three different approaches adopted by courts).[2]

An analysis of the cases over the last couple of years indicates that courts continue to struggle with this issue and, in some instances, courts in the same district have adopted different approaches. For example, in In re General Motors Corp. Sec. Litig., 05 cv 8088, at 2 (S.D.N.Y. Jan. 17, 2006), the Court noted that "some courts in [the Southern District of New York] have adopted what is called a per se rule against aggregating the losses of unrelated plaintiffs to determine who is the most adequate plaintiff under the PSLRA," (citing to In re Razorfish, Inc. Sec. Litig., 143 F. Supp. 2d 304 (S.D.N.Y. 2001) and In re Donnkenny, Inc. Sec. Litig., 171 F.R.D. 156 (S.D.N.Y. 1997)), whereas "other courts in this district have adopted what is called a 'rule of reason' test." Id. (citing to In re eSpeed, Inc. Sec. Litig., 232 F.R.D. 95 (S.D.N.Y. 2005) and Barnet v. Elan Corp., PLC, 05 Civ. 2860, 2005 U.S. Dist. LEXIS 16388 (S.D.N.Y. Aug. 4, 2005)).

In General Motors, a group of unrelated institutional investors sought lead plaintiff status. Id. at 1-2. The Court rejected this group and instead appointed a group of institutions that possessed a pre-litigation relationship. Id. at 2. The Court noted that it did not need to adopt either of the two approaches followed by courts within the Southern District of New York since the unrelated institutional group failed under either approach. Id. at 3. The Court further noted that, under the "rule of reason" approach, the group of

[2] See Burke v. Ruttenberg, 102 F. Supp. 2d 1280, 1322-1341 (N.D. Ala. 2000) (setting forth a detailed analysis of the various tests adopted by courts in determining whether unrelated investors are allowed to aggregate their losses together in order to satisfy the "largest financial interest" requirement for lead plaintiff).

unrelated institutional investors "appears to have little or no 'organic' relationship among and between members other than to displace [another institution] as presumptive lead plaintiff." Id.

Some courts continue to adopt a "per se" approach against the aggregation of unrelated plaintiffs to form a lead plaintiff group in a securities class action lawsuit. See Stengle v. Am. Italian Pasta Co., No. 4:05-cv-00725, Order on Motion to Dismiss, Consolidate, and Appointment of Lead Plaintiff, at 7 (W.D. Pa. Dec. 19, 2005) (noting that "most courts have determined that the appointment of a group of unrelated plaintiffs is not appropriate under the PSLRA") (citations omitted); see also In re Pfizer Inc. Sec. Litig., No. 04 Civ. 9866, 2005 WL 2759850, at *2 (S.D.N.Y. Oct. 21, 2005) (rejecting the aggregation of unrelated plaintiffs as lawyer-driven and being used with no other apparent purpose than as "an attempt to create the highest possible 'financial interest' figure under the PSLRA"). For example, In re The Goodyear Tire & Rubber Co. Sec. Litig., No. 5:03 CV 2166, 2004 WL 3314943 (N.D. Ohio May 12, 2004), two unrelated institutions sought lead plaintiff status as a "group." The Court found the group to be an improper aggregation as "lead plaintiff movants must have a pre-existing relationship and basis for acting as a collective unit to qualify under the PSLRA as a viable lead plaintiff group." Id. at *5. After the institutions admitted that they had no pre-existing relationship prior to the litigation, the Court held the group to have "improperly aggregated their losses for the purpose of their lead plaintiff motion." Id.; see also In re Doral Fin. Corp. Sec. Litig., No. 05 MDL 1706, 2006 WL 305470, at *2 (S.D.N.Y. Feb. 8, 2006) (adopting "per se" rule against aggregation, finding that "by allowing unrelated groups to aggregate investments in an effort to generate the 'largest financial interest,' a

strong possibility emerges that lawyers will form such groups to manipulate the selection process, and thereby gain control of the litigation."); Aronson v. McKesson HBOC, Inc., 79 F. Supp. 2d 1146, 1154 (N.D. Cal. 1999) (adopting a "per se" rule against aggregation of unrelated plaintiffs); In re Telxon Corp. Sec. Litig., 67 F. Supp. 2d 803, 823 (N.D. Ohio 1999) (allowing two brothers to be considered a "group" but striking from the group a third individual unrelated to the two brothers).

Other courts continue to follow the "rule of reason" approach, looking at how and why the group was formed, the size of the group, and how the group plans to operate. See, e.g., In re Flight Safety Techs., Inc. Sec. Litig., 231 F.R.D. 124, 129 (D. Conn. 2005) (rejecting group with no preexisting relationship and noting that the joint motion submitted by the newly formed group "contain[ed] no indication of how the…group would function, such as whether certain lead plaintiffs would handle certain aspects of the litigation or whether decisions would be made by group consensus."); In re Carreker Corp. Sec. Litig., No. 03-cv-0250, 2003 U.S. Dist. LEXIS 25988, at *9-11 (N.D. Tex. Aug. 14, 2003) (refusing to allow aggregation where a group of seven individuals failed to demonstrate a detailed structure or otherwise show an ability and willingness to manage the litigation).

In In re OCA, Inc. Sec. Litig, No. 05-2165 (E.D. La. Nov. 18, 2005), an unrelated "group" consisting of an institution and individual investors sought appointment as lead plaintiff. The Court, although not adopting a "per se" rule against aggregation of unrelated plaintiffs, held that "to be eligible to serve as lead plaintiff, a group of unrelated investors must show that it is a cohesive group that will operate efficiently and that the group's appointment as lead plaintiff will provide some benefit to

the class that would not be achieved by the appointment of a single lead plaintiff." Id. at 16; see also Roth v. Knight Trading Group, Inc., 228 F. Supp. 2d 524, 529-30 (D.N.J. 2002) (appointing investment advisor sole lead plaintiff and rejecting advisor's attempt to aggregate with an individual investor because plaintiffs failed to demonstrate the necessity or effectiveness of representing the class as a group). The OCA Court held that although this group's size was acceptable, the plaintiffs failed to show it was "anything other than the aggregation of plaintiffs with no reason for being other than the aggregation of losses." In re OCA, No. 05-2165 at 18. Moreover, the Court noted that a proposed group should have provided the Court with a description of "how and why the group was formed, the specific benefits that each group member will bring to the prosecution of the litigation, other than the size of its loss, and the specific manner in which the group proposes to make decisions." Id. The Court found that general statements concerning "the benefits of joint decision-making" and a "group's ability to control counsel more effectively" coupled with the group's failure to provide the Court with a description of how the group would manage the litigation were found to be inadequate and the Court therefore rejected their attempts to aggregate as a group for lead plaintiff status. Id. at 19.[3]

[3] See also In re General Motors Corp. Sec. Litig., No. 05 CV 8088, at 3 (S.D.N.Y. Jan. 17, 2006) ("the grouping of the institutional investors appears to have little or no 'organic' relationship among and between members other than to displace [the related group] as presumptive lead plaintiff"); In re Bally Total Fitness Sec. Litig., No. 04 C 3530, 2005 WL 627960, at *4 (N.D. Ill. Mar. 15, 2005) (denying aggregation of unrelated investors, even though none of the groups consisted of more than five individuals or entities, because "there is no reason here to give weight to a 'mechanical aggregation' of unconnected investors assembled largely for their lawyers' benefit."); Meyer v. Paradigm Med. Indus., 225 F.R.D. 678, 682 (D. Utah 2004) (rejecting formation of a group who filed a joint supplemental submission on the date of the lead plaintiff hearing as "an eleventh-hour attempt by unrelated parties to aggregate solely for the purpose of creating a group that would have the largest financial interest in the litigation."); cf. In re Am. Bus. Fin. Servs., Inc. Sec. Litig., No. Civ. A. 04-0265, 2004 WL 1221353, at *4 (E.D. Pa. June 3, 2004) (when approving group of unrelated individual investors, the Court noted that the group "was not 'cobbled together by cooperating counsel for the obvious purpose of creating a large enough grouping of investors to qualify as lead plaintiff.") (citation omitted).

Yet other courts continue to allow the aggregation of unrelated investors as long as the group's size is not too large and the group is generally cohesive. For example, in In re Cardinal Health, Inc. Sec. Litig., 226 F.R.D. 298, 305-07 (S.D. Ohio 2005), the Court allowed the aggregation of six unrelated institutional investors. The Court adopted a "case-by-case" approach to the issue of aggregation. The Court sanctioned this group of institutions because it was "comprised of a small group of [sophisticated] investors" and "has adduced information about its proposed manner of communication and decision-making." Id. at 307; see also Barnet, 2005 U.S. Dist. LEXIS 16388, at *13-14 (holding the aggregation of five institutions and one individual permissible where "the group … is not too unwieldy a number to effectively manage the litigation" and there was no evidence that the "Group was formed in bad faith."); Olsen v. New York Cmty. Bancorp, Inc., 233 F.R.D. 101, 107 (E.D.N.Y. 2005) (finding the aggregation of one institution and one individual to form a group with the largest financial interest acceptable "given the PSLRA's preference for institutional investors, and given that the [group] consists of a manageable number of members."); Lentz v. Citadel Sec. Software, Inc., No. 05-cv-0100, 2005 WL 1249441, at *2 (N.D. Tex. May 25, 2005) (allowing aggregation of four individuals – a husband, a wife, and two unrelated individuals –

Other courts that have examined how the group was formed include: Crawford v. Onyx Software Corp., No. C01-1346, 2002 WL 356760, at *2 (W.D. Wash. Jan. 10, 2002) (disapproving the aggregation of three individuals and noting that "a loose group of investors whose relationship was forged only in an effort to win appointment as lead plaintiff has no real cohesiveness, is less likely to be in control of the litigation, and is subject to all of the obstacles that normally make group action difficult."); In re Cendant Corp. Litig., 264 F. 3d 201, 268 (3rd Cir. 2001) (finding no abuse of discretion when the presumptive lead plaintiff was a group of unrelated institutional investors since "there is no indication that the [group] was artificially created by its lawyers, and the fact that it contains three members offers no obvious reason to doubt that its members could operate effectively as a single unit.").

where they sustained the largest financial loss and the group did not otherwise "weaken [its] ability to manage and prosecute the litigation.").

Regardless of which approach a court follows, courts appear to limit how many plaintiffs are allowed to form a group since, at some point, the group becomes too large. In re Network Assocs., Inc. Sec. Litig., 76 F. Supp. 2d 1017, 1022 (N.D. Cal. 1999) (finding that at some point a group becomes so large that "there is no way such an assembly could control and manage counsel"); see also Yousefi, 70 F. Supp. 2d at 1068 (finding that 137 lead plaintiffs would frustrate the purpose of the PSLRA); In re Advanced Tissue Scis. Sec. Litig., 184 F.R.D. 346, 352 (S.D. Cal. 1998) (denying motion to appoint 250 class members as lead plaintiffs).[4]

[4] Other cases that discuss the size of the group when determining whether to allow aggregation include: In re Cendant, 264 F.3d at 267, (in an *amicus curiae* brief, the Securities and Exchange Commission stated "that courts should generally presume that groups with more than five members are too large to work effectively."); In re Enron Corp. Sec. Litig., 206 F.R.D. 427, 442 (S.D. Tex. 2002) ("where a movant seeks appointment of a group of Lead Plaintiffs, that group must be restricted to a few cohesive parties and the movant must bear the burden of demonstrating that the group not only has the largest financial interest in the outcome of the litigation, but also a pre-litigation relationship based on more than the losing investments at issue in the securities fraud class action"); In re Universal Access, Inc., 209 F.R.D. 379, 384 (E.D. Tex. 2002) (concluding "that selection of a group of [five] persons to act as lead plaintiffs is entirely appropriate under the PSLRA and, more specifically, is appropriate in this case".); In re Century Bus. Servs., Sec. Litig., 202 F.R.D. 532, 540 (N.D. Ohio 2001) (noting that "increasing the number of lead plaintiffs does nothing to further the goal [of the Act] of giving control to the litigants in this case"); In re Lernout & Hauspie Sec. Litig., 138 F. Supp. 2d 39, 44-45 (D. Mass. 2001) (permitting aggregation of three foreign individuals from three different countries where no pre-litigation relationship existed, but where the group was able to "demonstrate that they are capable of managing the litigation as a cohesive group."); Winn v. Symons Int'l Group, Inc., No. IP 00-310-C-B/S, 2001 WL 278113, at *3-4 (S.D. Ind. Mar. 21, 2001) (finding a group of three [related] individuals sufficiently small enough to allow aggregation); In re Ribozyme Pharms., Inc. Sec. Litig., 192 F.R.D. 656, 659-62 (D. Colo. 2000) (recognizing that courts disfavor aggregation to form large groups, but holding that aggregation of four named plaintiffs is permissible); Borenstein v. Finova Group, Inc., No. Civ. 00-619, 2000 WL 34524743, at *7-8 (D. Ariz. Aug. 30, 2000) (allowing aggregation of two individuals with large holdings where the individuals demonstrated a willingness and ability to manage the litigation, and they were experienced and educated investors, but nonetheless concluding that the group was inadequate on other grounds).

B. Aggregation of Plaintiffs After the Sixty (60) Day Filing Deadline Under the PSLRA

Courts have appeared more reluctant, however, to allow parties to aggregate after the sixty (60) day lead plaintiff filing deadline. Often this is done by plaintiffs filing a supplemental memorandum to their competing motions seeking appointment as lead plaintiff. Some courts consider these supplemental briefs to be a new motion seeking appointment as lead plaintiff. Courts who view this post-aggregation as a separate motion for appointment as lead plaintiff have denied the motion for failure to satisfy the PSLRA's sixty (60) day filing deadline. See In re Telxon Corp. Sec. Litig., 67 F. Supp. 2d 803, 819 (N.D. Ohio 1999) (noting that the (60) sixty-day statutory period to file a motion for appointment is unequivocal and allows for no exceptions).

In Ferrari v. Gisch, 225 F.R.D. 599, 603 (C.D. Cal. 2004), four groups of plaintiffs filed competing motions, each requesting appointment as lead plaintiff. Subsequent to filing these motions, two of the groups joined forces and submitted a joint memorandum in support of their appointment as lead plaintiff. Id. The Court construed this joint memorandum as a motion for appointment as lead plaintiff and held that it was untimely since it was filed after the sixty (60) day filing deadline. Id. The Court noted that considering a pleading "filed after the 60-day period had closed would encourage parties seeking lead plaintiff status to 'manipulate the size of their financial loss by…adding additional persons to a group in supplemental filings….'" Id. at 603-04 (citing In re Telxon Corp. Sec. Litig., 67 F. Supp. 2d 803, 819 (N.D. Ohio 1999)).

Other courts have also found post-aggregation to be improper, particularly when the post-aggregated group appears to have been manufactured by counsel in order to

obtain designation as lead plaintiff, In re Vaxgen Sec. Litig., No. C 03-01129, slip op. at 7 (N.D. Cal. Apr. 14, 2004), or absent some justification explaining why the recently-formed alliance would be more beneficial to the class than the status quo. Singer v. Nicor, No. 02 C 5168, 2002 WL 31356419, at *1 (N.D. Ill. Oct. 17, 2002); see also Weinberg v. Atlas Air Worldwide Holdings, Inc., 216 F.R.D. 248, 254 (S.D.N.Y. 2003) (denying lead plaintiff status to a group of parties who, after each submitting separate motions for appointment as lead plaintiff, informed the court they planned to seek appointment together as there was nothing to indicate "the overall quality of the action would be improved" by these parties joining forces).

Courts that have approved the post-aggregation of lead plaintiffs have generally done so in situations where either: (1) one of the plaintiffs, standing alone, has already satisfied the "largest financial interest" test or (2) where the newly-formed group was the only party seeking lead plaintiff status. See Montoya v. Mamma.com Inc., No. 05 Civ. 2313, 2005 WL 1278097, at *1 (S.D.N.Y. May 31, 2005) (allowing parties who had the largest and second-largest financial interests to aggregate their losses after the lead plaintiff deadline); see also Rozenboom, 2004 WL 816440, at *5 (permitting aggregation of two unrelated individuals where no institutional investor opposed the motion in order "to ensure stability in the litigation"); In re First Union Corp. Sec. Litig., 157 F. Supp. 2d 638, 643 (W.D.N.C. 2000) (allowing proposed lead plaintiffs to aggregate after filing separate motions for lead plaintiff status, noting that this was a unique situation where plaintiffs were not competing against each other for appointment); Richard NMI Bell v. Acendant Solutions, Inc., No. Civ. A. 3:01-CV-0166, 2002 WL 638571, at *5 (N.D. Tex. Apr. 17, 2002) (approving the aggregation of three plaintiffs into one lead plaintiff).

II. What Accounting Methodology Should Be Applied To Determine Who Has The "Largest Financial Interest"?

Plaintiffs must satisfy the "largest financial interest" requirement regardless of whether or not they seek such status individually or as a group. The PSLRA, however, "does not define 'largest financial interest' or provide any guidance as to how such a determination should is made." In re Nice Sys., Ltd. Sec. Litig., 188 F.R.D. 206, 217 (D.N.J. 1999).

In response, courts have adopted different approaches for calculating the "largest financial interest." Typically, courts choose between two distinct accounting methods: the "first in, first out" ("FIFO") method or the "last in, first out" ("LIFO") method, with a trend toward adopting the latter approach when the financial interest calculation is analyzed by the court or challenged by competing movants. See, e.g., Hill v. The Tribune Co., No. 05 C 2602, 2005 WL 3299144, at *2 (N.D. Ill. Oct. 13, 2005) (noting that "[t]he current majority view…is that securities fraud losses should be calculated using LIFO); see also In re eSpeed, 232 F.R.D. at 100-01(criticizing FIFO for its failure to take into account gains and adopting LIFO as the appropriate methodology); see also In re Pfizer, No. 04-cv-9866, 2005 WL 2759850, at *3 n.3 (citing In re eSpeed, Inc. Sec. Litig., 232 F.R.D. 95 (S.D.N.Y. 2005) and noting that FIFO "has fallen out of favor in this District because of its tendency to overstate the losses of institutional investors and to understate gains made from stock sold during the class period."); In re Doral Fin., 2006 WL 305470, at *3 n.7 (S.D.N.Y. Feb. 8, 2006) (same); In re Cable & Wireless, PLC, Sec. Litig., 217 F.R.D. 372, 378-79 (E.D. Va. 2003) (finding that courts generally reject

"FIFO as an appropriate, means of calculating losses in securities fraud cases" and adopting net share approach) (citation omitted).

The FIFO method is often applied by courts and the Internal Revenue Service to determine losses for tax purposes. In re eSpeed, 232 F.R.D. at 100-01. The main criticism of FIFO is that it fails to take into account gains that may have accrued to a potential lead plaintiff during the class period. Id. at 101; see also In re Comdisco Sec. Litig., 150 F. Supp. 2d 943, 945 (N.D. Ill. 2001) (pointing out that using the FIFO method may show losses when, in reality, the proposed lead plaintiff actually benefited from the alleged fraud). Under the FIFO method, shares sold during the class period are first matched with shares held prior to the start of the class period and then to the first shares purchased during the class period. Sales during the class period may be ignored and losses may be exaggerated. See id.; see also In re Cardinal Health, 226 F.R.D. at 302-03 (noting that, under FIFO, if the "first shares purchased" are pre-class period purchases, then the first shares sold are matched against these pre-class purchases and the resulting gain or loss is excluded from the loss calculation"). LIFO, on the other hand, "takes into account gains that might have accrued to proposed plaintiffs during the class period due to the inflation of the stock price." In re eSpeed, 232 F.R.D. at 101. The application of these two methods at times produces varying results such that one method may show plaintiff suffering a loss whereas another method may actually show plaintiff deriving a gain.

Even where courts have applied FIFO to calculate who has the greatest financial loss, they have done so reluctantly and often because the proposed lead plaintiffs have not provided calculations to the court under the LIFO method. See, e.g., Thompson v.

Shaw Group, Inc., No. Civ. A. 04-1685, 2004 WL 2988503, at *5 (E.D. La. Dec. 14, 2004) (noting that the Court has "resort[ed]" to the FIFO method and that its application of the FIFO method "may be insufficiently accurate and jettisoned in favor of LIFO"). There are many courts, however, who continue to prefer the FIFO approach in calculating financial loss at the lead plaintiff stage. See, e.g., In re Veeco Instruments, Inc. Sec. Litig., No. 1:05-MD-1615, 2005 WL 3288652, at *2 (S.D.N.Y. Oct. 12, 2005) (finding FIFO to be the "appropriate methodology to apply in matching purchases and sales for the purpose of considering the financial stake of a movant for lead plaintiff status, just as it is the well-settled methodology for computing losses on securities for tax purposes.") (citations omitted).

Some courts have also employed a four-factor inquiry to aid in their determination of which proposed lead plaintiff has the "largest financial interest" in the case. In Lax v. First Merchs. Acceptance Corp., Case No. 97 C 2715, 1997 U.S. Dist. LEXIS 11866, at *17 (N.D. Ill. Aug. 6, 1997), the Court cited the following four factors as "surely relevant" to the determination of who has the largest financial interest: "(1) the number of shares purchased; (2) the number of net shares purchased; (3) the total net funds expended by the plaintiffs during the class period; and (4) the approximate losses suffered by the plaintiffs (hereinafter referred to as the *Lax* factors)." Courts that apply this four-factor inquiry tend to utilize the LIFO approach when considering the fourth factor (i.e. plaintiff's "approximate losses"). See In re Cardinal Health, 226 F.R.D. at 302 (noting that courts that employ the four factor inquiry typically adopt the LIFO method to calculate the approximate loss).

It is unclear, however, how much weight courts should give to each of the four *Lax* factors. Some courts bestow paramount value to the last factor, the approximate losses suffered by plaintiffs. See Weiss v. Friedman, Billings, Ramsey Group, Inc., No. 05-CV-04617, 2006 WL 197036, at *3 (S.D.N.Y. Jan. 25, 2006) ("The amount of financial loss is the most significant of [the *Lax*-style] elements") (citing In re Vicuron Pharm., Inc. Sec. Litig., 225 F.R.D. 508, 510-11 (E.D. Pa. 2004)); In re Watchguard Sec. Litig., No. C05-678, 2005 U.S. Dist. LEXIS 40923, at *16 (W.D. Wash. July 13, 2005) (designating the plaintiff's approximate loss as the most important factor among the four, and emphasizing that "[c]alculating approximate loss under the PSLRA damage cap provides the only objective measure of economic loss that does not depend on the fraud premium."); Ferrari v. Gisch, 225 F.R.D. at 604 (distilling the four factors discussed in Lax to the following three factors: (1) the number of shares purchased during the class period; (2) the total net funds expended during the class period; and (3) the approximate losses suffered by the plaintiffs). For example, the Court in Weiss noted that the proposed lead plaintiff had not directed the Court "to any case where a plaintiff who did not have the greatest actual loss was found to have the greatest financial interest based on the remaining *Lax* factors." Weiss, 2006 WL 197036, at *3.

There has also been a small minority of courts that have focused their inquiry on the number of net shares purchased by a proposed lead plaintiff when determining which plaintiff has the "largest financial interest." For example, in In re Critical Path, Inc. Sec. Litig., 156 F. Supp. 2d 1102 (N.D. Cal. 2001), the Court relied on the number of net shares purchased during the class period to determine which plaintiff had the "greatest financial interest" in the litigation. The Court found this approach to be "the most

straightforward method for approximation of financial interest in the recovery sought." Id. at 1108 (supplementing the net approach with "in/out losses"); see also In re Cable & Wireless, 217 F.R.D. at 375 (citing approvingly to the method used in In re Critical Path to calculate plaintiff's "largest financial interest"); Weisz v. Calpine Corp., No. 02-cv-1200, 2002 WL 32818827, at *5 (N.D. Cal. Aug. 19, 2002) (employing the net shares approach and observing that "district courts, including two judges from [the Northern District of California], have equated 'largest financial interest' with the amount of potential recovery.") (citation omitted).

This "net approach," also referred to by some courts as the "retention value method," subtracts the number of shares sold during the class period from the amount of shares purchased during this same period to determine the net number of shares purchased. In re Ribozyme Pharm., Inc. Sec. Litig., 192 F.R.D. 656, 660 (D. Colo. 2000) (embracing the retention value method and noting that it "is the most common method for determining financial interest pursuant to PSLRA, and seems to be the only method ever utilized in [the district of Colorado]."). Under this approach, courts must assume a "constant fraud premium per share throughout the class period" because otherwise some transactions would result in greater losses than others. In re Network Assocs., 76 F. Supp. 2d at 1027 (applying the net approach); see also In re Peregrine Sys., Inc. Sec. Litig., No. Civ. 02 CV 870-J, 2002 WL 32769239, at *4 (S.D. Cal. Oct. 11, 2002) (applying the net approach but noting that it did so because this was the approach that the parties implicitly agreed to).

III. What is Required to Satisfy the Adequacy And Typicality Requirements Post-*Dura*?

After satisfying the notice and "largest financial interest" requirements at the lead plaintiff stage, a presumptive lead plaintiff must also satisfy the adequacy and typicality requirements under Rule 23 of the Federal Rules of Civil Procedure. See 15 U.S.C. § 78u-4(a)(3)(B)(iii)(I)(bb). Since the United States Supreme Court's landmark decision in Dura, the plaintiff's bar in securities class actions has been advancing challenges to presumptive lead plaintiff status on the grounds that the presumptive lead plaintiff is inadequate and/or atypical under Rule 23 of the Federal Rules of Civil Procedure for failure to establish "loss causation."

On April 19, 2005, the United States Supreme Court issued its decision in Dura, striking down the "inflated purchase price approach" as insufficient, in and of itself, to prove loss causation. 125 S.Ct. at 1631-32. More specifically, the Court found a loss has not necessarily occurred at the time one purchases stock at an inflated price. Id. The Court continued that a plaintiff who has sold its shares before the truth was revealed to the market has suffered no loss and may, in fact, have gained from the alleged fraudulent activity. Id.

Presumptive lead plaintiffs now face increased scrutiny at the lead plaintiff stage concerning whether any pre-disclosure sales render it subject to unique defenses. Since Dura, two courts, both in the Southern District of New York, found that a presumptive lead plaintiff who sold all its shares after a partial disclosure, but before the full disclosure, still satisfied the adequacy and typicality requirements of Rule 23 of the

Federal Rules of Civil Procedure. See Weiss, 2006 WL 197036, at *5; Montoya, 2005 WL 1278097, at *2.

In Montoya, competing groups challenged the Witkowski-Mamma.com Group's presumptive lead plaintiff status, arguing that "because the group included 'in and out purchasers' …. defendants could potentially argue that some of whom sold their shares before the class period ended …. must fail in any effort to establish loss causation." Montoya, 2005 WL 1278097, at *2 (citing Mem. Supp. of Lin at 3). The Montoya Court noted that "in accordance with the PSLRA, 15 U.S.C. § 78u-4 *et. seq.*, and Dura Pharmaceuticals, Inc. v. Broudo, 125 S.Ct. 1627, 1631 (2005), and Lentell v. Merrill Lynch & Co., Inc., 396 F.3d 161, 174 (2d Cir. 2005), plaintiffs need only allege 'that the misstatement or omission concealed something from the market that, when disclosed, negatively affected the value of the security,' and loss causation does not require *full* disclosure and can be established by *partial* disclosure during the class period which causes the price of the shares to decline." Id. (emphasis in the original). The Court then concluded:

> the Witkowski-Mamma.com Group demonstrated that the lead plaintiff, and other class members, purchased a substantial portion of their securities before the April 6, 2004 disclosure of the alleged fraud, sold a substantial portion of their shares after the April 6, 2004 disclosure of the alleged fraud and, therefore, can allege that 'the subject of the fraudulent statement or omissions was the cause of the actual loss suffered' and, therefore, satisfy the tests articulated by the Supreme Court in Dura and the Second Circuit in Lentell.

Id. The Court also dismissed any concerns that the Witkowski-Mamma.com Group was atypical of the class given that "six of the nineteen Movants currently before this Court were 'in-and-out purchasers.'" Id.

The Weiss Court also addressed the issue of loss causation. The Public Employees' Retirement System of Mississippi ("Mississippi PERS") challenged the adequacy of the Operating Engineering Trust as presumptive lead plaintiff on the grounds that it would be unable to "prove loss causation." See Weiss, 2006 WL 197036, at *5 (quoting Mississippi PERS's July 25, 2005 Opp. Brief at 7). The Weiss Court observed that "the Operating Engineers Trust is not unable to prove loss causation simply because all of its shares were sold before the end of the Class Period." Weiss, 2006 WL 197036, at *5. The Weiss Court cited Montoya, which held that "plaintiffs need only allege 'that the misstatement or omission concealed something from the market that, when disclosed, negatively affected the value of the security,' and loss causation does not require *full* disclosure and can be established by *partial* disclosure during the class period which causes the price of the shares to decline." Montoya, 2005 WL 1278097 at *2 (citations omitted) (emphasis in the original). Applying the Montoya reasoning, the Weiss Court held that "the presumption that Operating Engineers Trust is the most adequate lead plaintiff has not been rebutted here." Weiss, 2006 WL 197036, at *5.

Contrary to the cases discussed above, a number of other district courts have held that presumptive lead plaintiffs under the PSLRA are nonetheless atypical and/or inadequate where the presumptive lead plaintiff fails to hold its shares through the final curative disclosure to the market. See Stengle, No. 4:05-cv-00725, Order on Motion to Dismiss, Consolidate, and Appointment of Lead Plaintiff, at 13-14 (W.D. Pa. Dec. 19, 2005); In re Oca, Inc. Sec. and Derivative Litig., No. 05-2165, Order on Motion to Appoint Lead Plaintiff, at 11-12 (E.D. La. Nov. 18, 2005); and In re Veeco Instruments, Inc. Sec. Litig., 2005 WL 3288652, at *3.

In Oca, competing groups challenged Cannell Capital's presumptive lead plaintiff status, asserting that "Cannell Capital is an inadequate lead plaintiff regardless of the size of its purported loss because it may not be able to establish that any such loss was caused by the defendants' fraud." Oca, at 11. The parties argued that "Cannell Capital's claims might be subject to a defense for lack of loss causation" because "Cannell Capital sold all of its OCA shares by April 15, 2005 nearly two months before OCA's June 7, 2005 announcement that it would restate its financial results for the first three quarters of 2004." Id. Denouncing Cannell Capital's argument that it nonetheless suffered economic loss because it held OCA shares at least through a partial disclosure on March 17, 2005, the Court concluded that "the fact remains that Cannell Capital faces issues concerning loss causation that the other lead plaintiff candidates do not. Those issues are substantial enough to render Cannell Capital inadequate to serve as the lead plaintiff in this action." Id. at 12.

The Stengle Court evaluated the typicality and adequacy of the presumptive lead plaintiff, San Antonio Fire & Police Pension Fund, and expressed great concern about San Antonio's ability to demonstrate that it suffered economic loss given that it did not own shares of American Italian Pasta Co. on August 9, 2005 – the date on which the market arguably received curative information. See Stengle, at 12-13. Judge Smith summarized the requirements of demonstrating loss causation under the Supreme Court's Dura holding as follows:

> [A] party selling before the market learns the truth ordinarily has not suffered damages because any losses are unrelated to the correction in stock price arising from the revelation of the fraud. Consequently, (1) the measure of damages is ordinarily based on the value of the stock at the time full corrective information has

> been disseminated and (2) a party who sold before the correction has a difficult task in establishing damages.

Stengle, at 13.

Observing that a party who sells its shares prior to a curative disclosure to the market may still suffer economic damages, the Stengle Court nonetheless concluded that "such a case requires a heavily fact-intensive inquiry that is not appropriately undertaken at this preliminary stage of the proceedings." Stengle, at 13. The Court further observed that "[i]t must be determined whether and to what extent the losses were caused by the 'leaks of fraud' as opposed to normal market and business activity." Id. Acknowledging that San Antonio "may have suffered damages," but pointing out that "the existence and extent of those damages is uncertain," the Court concluded that "it is unnecessary and inappropriate to delay proceedings to ascertain the precise extent of its loss so that it may be compared to those who held their stock on the day of the correction." Id. at 13-14. Reaching this conclusion, the Stengle Court declared that "the entire issue represents a 'unique defense' that renders San Antonio ill-suited for service as a class representative." Stengle, at 14.

The Veeco Court also addressed the issue of loss causation at the lead plaintiff stage. There, the Court initially found that the Steelworkers Pension Trust ("Steelworkers") was the presumptive lead plaintiff. See In re Veeco Instruments, 2005 WL 3288652, at *1. The two remaining candidate groups, the Decatur Plan and the Capitanio Group, challenged this presumption "claim[ing] that Steelworkers is subject to the unique defense that it did not in fact suffer any loss on its Veeco shares." Id. at *2. They contended that the class period alleged by Steelworks was too short. Id.

Evaluating the Steelworkers losses using the FIFO method, the Court noted that "[t]he Decatur Plan would be no more representative of persons during the longer class period than Steelworkers," in light of the fact that it did not hold a single share on the date the curative disclosure was issued. Id., at *3. Judge McMahon expounded that "[u]nder the reasoning of the United States Supreme Court in Dura Pharmaceuticals, Inc. v. Broudo, 125 S.Ct. 1627, 161 L.Ed.2d 577 (2005), I question whether Decatur Plan can prove loss causation—or, for that matter, loss. The Decatur Plan is, at the very least, subject to a unique defense to which Steelworkers is not subject." Id. Furthermore, the Court noted that "[t]he Capitanio Group is one of those 'amalgamated' groups of unrelated persons who band together in the hope of thereby becoming the biggest loser for the PSLRA purposes." Id. Finding the Decatur Plan and the Capitanio Group's attack against the Steelworkers unpersuasive, the Court appointed the Steelworkers lead plaintiff concluding that "the Steelworkers is presently best positioned to represent the class of investors in Veeco." Id.

IV. Conclusion

Numerous uncertainties surround a court's threshold inquiry with respect to appointment of lead plaintiff in a securities fraud class action. The various uncertainties include, among others, what constitutes a group under the PSLRA, at what point may that group be formed and what accounting method should be applied to determine who has the "largest financial interest." Once a court has designated a presumptive lead plaintiff, that individual or group may still face challenges to its adequacy and typicality concerning its ability to establish loss causation. Stay tuned!