Parallel Derivative Action Settlement Outcomes

Laarni T. Bulan
Matthew Davis

INTRODUCTION

Building on Cornerstone Research's study of securities class action settlements,[1] this report analyzes the settlement outcomes of shareholder derivative actions associated with securities class actions that settled between 2019 and 2021.[2]

These parallel lawsuits—a securities class action and a shareholder derivative action with the same or similar underlying allegations—are fairly common. For example, Choi et al. (2017) find that 45% of the 582 securities class actions filed against public corporation defendants between July 1, 2005, and December 31, 2008, had parallel lawsuits, such as a shareholder derivative action in which the named defendants included the officers and/or directors of the public corporation.[3] However, more recent data and comprehensive information on shareholder derivative actions are relatively sparse.

This report analyzes the settlement outcomes of shareholder derivative actions associated with securities class action settlements between 2019 and 2021.

ALLEGATIONS AND DEFENDANTS

The securities class actions that are the basis for this report are lawsuits brought by purchasers of a corporation's common stock alleging Rule 10b-5, Section 11, and/or Section 12(a)(2) claims. In these lawsuits, plaintiff shareholders typically allege that a public corporation's statements were false or misleading, damaging investors who purchased the corporation's securities after these statements were made.[4]

A shareholder derivative action is a lawsuit brought by a corporation's current shareholder(s) on behalf of the corporation.

A shareholder derivative action is a lawsuit brought by a corporation's current shareholder(s) on behalf of the corporation. Often, the defendants in these derivative actions include executives and/or members of the corporation's board of directors.[5]

The vast majority of parallel derivative actions identified by Choi et al. (2017) are "follow-on" suits, that is, derivative lawsuits filed after the securities class action and based on similar underlying allegations. Among such follow-on suits, it is not uncommon for derivative plaintiffs to allege injury to the corporation as a result of the claimed false or misleading statements made by the defendants, and/or that the board of directors breached its fiduciary duty in failing to properly oversee the corporate actions or circumstances that led to the alleged misconduct.[6]

As the corporation is alleged to have been harmed, any settlement resulting from derivative suits is paid to the corporation, typically only benefiting the plaintiff shareholder(s) indirectly.[7]

DERIVATIVE ACTION SETTLEMENTS AND SECURITIES CLASS ACTION SETTLEMENTS

Monetary settlements in derivative suits are relatively uncommon. Instead, most settlements include only therapeutic provisions instituting corporate governance reforms. For example, Choi et al. (2017) find that only 21% of the parallel derivative suit settlements in their sample included a monetary component, while the remaining 79% of settlements resulted in corporate governance reforms only. The average settlement amount for those monetary parallel derivative suit settlements was $100.5 million (or 53% of the associated securities class action settlement).[8] Notably, however, despite the low overall prevalence of a monetary component in derivative settlements, there have been very large monetary derivative suit settlements observed in the last decade.[9]

Nearly half of securities class action settlements during 2019–2021 had a parallel derivative action.

As most recently reported in *Securities Class Action Settlements—2021 Review and Analysis*, 49% of securities class action settlements between 2019 and 2021 were accompanied by a parallel shareholder derivative action.[10]

Among those securities class action settlements, the median settlement amount (adjusted for inflation) was $11.0 million.[11] Securities class action settlements with accompanying derivative claims are typically associated with higher settlements than those without accompanying derivative claims, with a 44% premium observed over the last decade based on the median settlement amounts.[12]

SETTLEMENT OUTCOMES

Parallel Derivative Action Settlements Sample[13]

Type of Settlement	No. of Cases	% of Cases
Securities Class Action Settlements	239	
Parallel Derivative Actions	118	49%
Parallel Derivative Action Settlements	67	
Monetary Settlements	16	24%
Therapeutic Provisions	56	84%

The research presented in this report has identified 67 parallel derivative actions that have settled, 84% of which resulted in therapeutic provisions while only 24% included a monetary component.[14]

Of those cases with a monetary component, the median derivative settlement was $7.2 million (or 34% of the associated securities class action settlement).

Parallel Derivative Action Settlements with Monetary Component[15]

25th Percentile	$843,750
Median	$7,185,462
75th Percentile	$30,376,937

Note: Amounts are adjusted for inflation; 2021 dollar equivalent figures are presented.

The median derivative settlement was $7.2 million among settlements with a monetary component.

THERAPEUTIC PROVISIONS

Consistent with prior research, the derivative settlements in the sample are much more likely to feature therapeutic provisions, in the form of corporate governance reforms, than a monetary component. Examples of corporate governance reforms include:

- Enhancements to board independence, such as the addition of independent directors or the granting of additional authority to a lead independent director.
- Revisions to the charters of key board committees, such as the audit, compensation, or disclosure committees.
- Reforms tailored to case-specific allegations, such as accounting controls, insider trading policies, or rules governing related-party transactions.
- The adoption or strengthening of compensation clawback rules, whistleblower policies, and/or director independence standards.

PLAINTIFF ATTORNEY FEES

The median plaintiff attorney fee award associated with the derivative settlements in the sample was approximately $610,750. The median fee among cases with a monetary settlement was $3.1 million, while the median fee for those without a monetary settlement was 82% lower—consistent with the absence of a direct financial benefit associated with those settlements.[16]

The median fee award among cases with a monetary settlement was $3.1 million.

Median Plaintiff Attorney Fee Award[17]

Non-Monetary Settlements	$539,996
Monetary Settlements	$3,073,950
All Parallel Derivative Action Settlements	$610,750

Note: Amounts are adjusted for inflation; 2021 dollar equivalent figures are presented.

DERIVATIVE SETTLEMENTS AND RELATED ACTIONS

This research also allows for comparisons between settlements of securities and derivative suits with parallel claims. Overall, derivative settlements with a monetary component are associated with higher securities class action settlements compared to those without a monetary component, consistent with a view that the monetary settlements correlate with the strength of the underlying allegations.

Parallel Derivative Settlements and Corresponding Securities Class Action Settlement Amounts

	Average Securities Class Action Settlement	Median Securities Class Action Settlement
Derivative Settlements with Monetary Component	$102,946,500	$21,199,656
Derivative Settlements without Monetary Component	$21,183,038	$9,946,500

Note: Amounts are adjusted for inflation; 2021 dollar equivalent figures are presented.

The alleged misconduct underlying both securities and derivative suits could also be associated with government enforcement actions filed by the U.S. Securities and Exchange Commission (SEC), U.S. Department of Justice (DOJ), or other regulators.

Derivative settlements with a monetary component in the sample were more likely to be associated with an SEC action or criminal charges against the defendants or related parties in connection with the allegations covered by the underlying class action.[18]

Parallel Derivative Settlements and Other Related Actions

	Corresponding SEC Action	Corresponding Criminal Charges
Derivative Settlements with Monetary Component	43.75%	18.75%
Derivative Settlements without Monetary Component	19.61%	9.80%

Monetary derivative settlements are more common in cases with large securities class action settlements and when SEC actions or criminal charges are present.

CASE EXAMPLES

As previously discussed, relatively few derivative settlements include a monetary component, but occasionally derivative suits settle for relatively large amounts. For example, other research has identified 11 derivative suits settling for at least $50 million since 2017.[19] The data in this report show that monetary derivative settlements are more common in cases with large securities class action settlements and when there are related SEC actions or criminal charges.

To illustrate the types of settlement outcomes in the data, two recent settlements are described—one that resulted in therapeutic provisions only, and one that resulted in both a monetary settlement and therapeutic provisions.

World Wrestling Entertainment Inc.

In March 2020, a shareholder class action was brought against World Wrestling Entertainment Inc. (WWE) alleging that WWE made misrepresentations relating to its business in Saudi Arabia.[20] That suit ultimately settled for $39 million in December 2020, and in the intervening months, six shareholder derivative suits were filed describing similar allegations as the securities class action. All derivative plaintiffs agreed to a September 2021 settlement that prescribed corporate governance reforms (in particular, enhanced reporting requirements for "material contracts" and a revised insider trading policy), no monetary settlement, and $3.65 million in fees awarded to plaintiff counsel for the various derivative suits.[21]

SeaWorld Entertainment Inc.

In February 2020, SeaWorld Entertainment Inc. (SeaWorld) announced the simultaneous settlement of a securities class action and a related derivative suit (both filed in 2014) pertaining to the company's alleged failure to disclose information linking declining park attendance to the public's reaction to the documentary film *Blackfish*.[22] Under the terms of the settlement, the class members in the securities suit received $65 million, while SeaWorld received a $12.5 million settlement and agreed to institute corporate governance reforms, such as increased empowerment of board committees, director independence measures, and efforts to increase transparency. Attorneys for the derivative plaintiff also received a $3.125 million fee award.[23] Notably, SeaWorld had also settled an SEC suit with similar allegations in September 2018.[24]

CONCLUSION

Tracking derivative lawsuits is a time-consuming process, leading to a dearth of systematic data on the outcomes of such suits. This report analyzes a specific type of derivative suit—those with a parallel securities class action—revealing a number of stylized facts.

Consistent with prior research, even though parallel derivative lawsuits are fairly common, monetary settlements in such suits are less so. Of the settlements in the dataset analyzed, only 24% included a monetary component.

Overall, the likelihood of a monetary settlement in a derivative lawsuit correlates with the strength of the parallel securities class action, as proxied by the size of the class action settlement. Derivative settlements with a monetary component are also more common in cases associated with SEC actions or criminal charges.

ABOUT THE AUTHORS

Laarni T. Bulan is a principal in Cornerstone Research's Boston office, where she specializes in finance. Her work has focused on securities and other complex litigation addressing class certification, damages, and loss causation issues; firm valuation; and corporate governance, executive compensation, and risk management issues. She has also consulted on cases related to insider trading, market manipulation and trading behavior, financial institutions and the credit crisis, derivatives, foreign exchange, securities clearing and settlement, and real estate.

Matthew Davis is a manager in Cornerstone Research's San Francisco office. His work has focused on securities and other complex financial litigation addressing class certification, damages, and loss causation issues, as well as antitrust issues in financial markets, market manipulation, executive compensation, valuation, and real estate.

RESEARCH SAMPLE AND DATA SOURCES

The source database on securities class action settlements used in this report focuses on cases alleging fraudulent inflation in the price of a corporation's common stock, as described more fully in *Securities Class Action Settlements—2021 Review and Analysis*. Specifically, utilizing this database, the research described in this report focuses on 118 securities class actions settled between 2019 and 2021 for which a related derivative suit either was outstanding at the time of settlement or settled simultaneously.

This report relies on a variety of sources to obtain information on the derivative suit settlement, including SEC filings, court filings, Lex Machina, public press, and *D&O Diary*. All reported settlement information reflects the information recorded in the settlement stipulation, which is subject to change before the settlement is finalized.

ENDNOTES

1 See, e.g., Cornerstone Research, *Securities Class Action Settlements—2021 Review and Analysis* (2022), https://www.cornerstone.com/wp-content/uploads/2022/03/Securities-Class-Action-Settlements-2021-Review-and-Analysis.pdf.

2 Sample includes securities class action settlements that occurred between 2019 and 2021. The parallel derivative suit settlement may have taken place either before or after this time period.

3 Stephen J. Choi, Jessica Erickson, and A.C. Pritchard, "Piling On? An Empirical Study of Parallel Derivative Suits," *Journal of Empirical Legal Studies* 14, no. 4 (2017): 653–682 ("Choi et al. (2017)").

4 Jessica Erickson, "Corporate Governance in the Courtroom," *William and Mary Law Review* 51 (2010): 1749–1831 ("Erickson (2010)").

5 Erickson (2010).

6 Erickson (2010).

7 Erickson (2010). It is understood that in rare instances, the corporation's shareholders may benefit directly from a monetary derivative suit settlement.

8 Choi et al. (2017).

9 See, e.g., Kevin LaCroix, "Largest Derivative Lawsuit Settlements," *D&O Diary*, December 5, 2014 (updated February 12, 2022), https://www.dandodiary.com/2014/12/articles/shareholders-derivative-litigation/largest-derivative-lawsuit-settlements/. This list includes derivative lawsuits that are not accompanied by a parallel securities class action.

10 The frequency of accompanying derivative actions observed in 2021 (43%) was the lowest rate observed in the last five years.

11 Except when referencing specific case examples or figures from third-party research, all monetary figures in this report are adjusted for inflation (2021 dollar equivalent figures are presented).

12 Premium is calculated based on the median settlement amounts among cases with and without an accompanying derivative action.

13 Figures represent settled derivative suits identified by this research. The 56 settlements identified with therapeutic provisions may or may not include a monetary component.

14 Cases featuring no monetary payment other than reimbursement of attorney fees and/or plaintiff service awards are considered non-monetary settlements. Reported settlement amounts for monetary settlements include attorney fees. Both settlement amounts and attorney fees are inferred from settlement stipulations and are ultimately subject to court approval. The 51 cases not associated with a settlement include dismissed cases, pending cases, and cases for which an outcome could not be determined.

15 Settlement amounts are as reported in the settlement stipulation and may not always conform to the amount ultimately approved by the court.

16 Choi et al. (2017) find that therapeutic-provision-only settlements are correlated with significantly lower hours and fees for the plaintiff attorneys.

17 Attorney fees are as reported in the settlement stipulation and may not always conform to the amount ultimately approved by the court. Attorney fees could not be determined for all settlements.

18 A corresponding SEC action against the issuer, other defendants, or related parties is identified by an SEC administrative proceeding listed on the SEC's website. Identification of a criminal charge or criminal indictment is based on review of SEC filings and public press. For purposes of this research, criminal charges and/or indictments are collectively referred to as "criminal charges."

19 Kevin LaCroix, "Largest Derivative Lawsuit Settlements," *D&O Diary*, December 5, 2014 (updated February 12, 2022), https://www.dandodiary.com/2014/12/articles/shareholders-derivative-litigation/largest-derivative-lawsuit-settlements/. As noted previously, this list includes derivative lawsuits that are not accompanied by a parallel securities class action.

20 WWE Form 10-K for the year ending December 31, 2021, p. F-37. The settlement was approved by the court in July 2021.

21 Settlement Stipulation dated September 20, 2021; Order and Final Judgment Approving Settlement of Derivative Actions dated December 23, 2021.

22 SeaWorld Form 8-K dated February 11, 2020; Dean Seal, "SeaWorld Settles 'Blackfish' Litigation for $65M," *Law360*, February 11, 2020.

23 Jeff Montgomery, "Chancery Court OKs $15.6 Million Deal Ending SeaWorld 'Blackfish' Suit," *Law360*, May 21, 2021.

24 SEC Press Release, "SeaWorld and Former CEO to Pay More than $5 Million to Settle Fraud Charges," September 18, 2018.