Assessing Damages in Securities Litigation
Panelists

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Introduction

- Economic aspects of damages
- Various approaches in different jurisdictions
  - US approach may be the most well known, most utilized
    - May influence other approaches
  - How are damages calculated in different jurisdictions?
    - What are the sources for the calculations? Statutes, experts, precedent/case law, etc.
- Examples from US, Germany, Japan
Determining Damages

Geoff Jarvis, Grant & Eisenhofer
Calculating Damages

Damages – simply stated are the difference between the price paid and the value if the truth had been known.

In calculating damages, the goal is to determine the monetary damage to shareholders caused by defendants’ fraud.
Calculation of 10b-5 Damages Using An Event Study and Damages Ribbon

- An event study is a statistical analysis that attempts to measure the effects of the fraudulent conduct on the price of a stock.

- Use of an event study and damages ribbon is the most common methodology and is required by many courts.

- This methodology determines the damages suffered by a purchaser on each day of a pre-determined class period.
Using regression analysis, we use the following methodology to determine the inflation on each day of a Class Period:

a. Determine the impact of the overall market (S&P or DJIA) on the price of a stock and use regression analysis to cancel out market impacts.

b. Determine the impact of an industry index on stock price.
c. Use regression analysis to determine the days upon which the stock price moved differently from what would be predicted based upon market and industry indexes. (These so-called days of “abnormal” returns, are then presumed to be days when events specific to the company at issue impacted its stock price.)

d. Review the days identified as “abnormal” returns and determine on which days the price was influenced by events related to the fraud.
e. Sum all of the abnormal returns applicable to each trading day to determine (usually in percentage terms) the amount by which a stock is inflated on any given day). Also can use constant dollar inflation. The result is a damages ribbon that shows the amount of inflation on each day of a Class Period.
Determining Damages

Stock Chart & Value Line

Actual Stock Price

True Value Line
**Simple Loss Analysis Shows No Loss, but Damages Exceed $10 per share**

<table>
<thead>
<tr>
<th>Share Price</th>
<th>Damages</th>
<th>True Value</th>
<th>Purchase</th>
<th>Sale</th>
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<tbody>
<tr>
<td>$0</td>
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*Note:* The graph shows the fluctuation of share price, damages, and true value over time.
An economic perspective on damage calculations

Dr. Gerald A. Preidl, Valere Capital Partners
Economic perspectives on damage calculations

Damages relating to hedging strategies – disputes around public debt management:

• When does hedging become speculation?
• Unsuitability of hedging instruments;
• What should be the benchmark in assessing damages?
Economic perspectives on damage calculations

Valuation difficulties due to different pricing methodologies – recent examples:

- Bespoke synthetic CDOs (e.g. correlation mapping);
- Barrier options (e.g. volatility smile calibration);
- Non-availability of market prices (e.g. hedge fund investments).
Economic perspectives on damage calculations

Ambiguous documentation – ISDA Master Agreements:

- Weaknesses with respect to termination provisions (e.g. Lehman & Icelandic banks’ bankruptcies);
- Practical issues with ‘Market Quotation’ and ‘Loss’ method standards;
- Commercial reasonableness of ‘Calculation Agent.’
Calculation of Damages/Claims under German Law

Franz Braun, CLLB
Strict Calculation Obligatory

- Every single transaction of every single entity has to be revealed and described in detail (including Swaps, CDOs and other derivative instruments)
- Transactions within the period that have generated profits must be included
- FIFO is (not) required
- The calculation depends on whether reverse transaction is claimed or the difference between prices is claimed
Reverse Transaction

- Transaction would not have been initiated without the information in question
- Investor relied on the information
- Individual reliance has to be proven by investor, i.e. by a testimony of the fund manager
- “General” reliance on the validity of capital information in the markets is not sufficient
- § 21 WpPG (formerly §21 BörsG) presumes reliance for purchases made within six months
Difference Between Prices

- Transaction may have been initiated without the information in question.
- Transaction would have been executed at a different price level, i.e., impact of the information on the price level.
- Difference between price levels has to be proved by the investor.
Calculation Methods under Various Legal Bases

Price difference

- §§ 37b, c WpHG
- § 826 BGB: Reverse transaction, (arguably) difference between prices

Reverse

- § 21 WpPG (formerly § 44 BörsG)
- § 826 BGB: Reverse transaction, (arguably) difference between prices
- § 823 Abs. 2 BGB, div. penal provisions (§§ 263, 264a StGB, § 400 AktG)
Example: Porsche/VW
Calculation: difference between prices

- March 7, 2008: market price: €151.00
- March 10, 2008: “takeover is not planned” market price: €154.00
- October 16, 2008: market price: €398.00
- October 24, 2008: market price: €210.00
- October 26, 2008: “takeover is planned”
- October 27, 2008: market price: €611.00

Impact on the price level: Before the October 26, 2008 statement, the market price was €210. After the statement of October 26, 2008 there was a 204% increase in the market price.

It is fair to assume that if a takeover was already planned and announced before October 2008 there also would have been a 204% increase in the market price. So Early Sellers can claim the difference between the prices for which they actually sold shares and this hypothetical price.

If a takeover was unrealistic in October 2008 and thus the statement was misleading, without that statement the market price would not have exceeded €210.00. So Short Sellers can claim the difference between the actual costs for closing the open positions and this hypothetical costs.
Statute

(1) Financial Instruments and Exchange Act

- Presumption of Damages: the difference between the average price during one-month period before and after the “Disclosure Date” (Section 2, Article 21-2)
- This presumption only applies to shares that were purchased within one year before the “Disclosure Date” and continued to be held until the “Disclosure Date”.

(2) Civil Code – general tort provision (Art. 709 etc.)

- The above presumption under the FIEA does not apply.
Supreme Court Judgments

(1) Seibu Railway Case (September 13, 2011)
- Where an investor would not have purchased stock had the issuer not published false information, the investor can recover the difference between the purchase price and the sales price (or the price on the closing date of the trial, if investor continued to hold shares until the closing date of the trial).
- If the share price fell, before the investor sold the shares, due to a reason other than misrepresentation, however, such fall in share price must be excluded from the damages (the case was remanded to the High Court).

(2) Livedoor Case (March 13, 2012)
- The Court applied the presumption of the damages under Section 2, Article 21-2 of the FIEA.
Methods used to Calculate “Inflated Amount” by Japanese Courts

(1) The Japanese Supreme Court held that investors can recover the “Inflated Amount” (that they paid extra to purchase shares) as damages, but we do not know yet how to calculate the “Inflated Amount”.

(2) Some lower courts used “Look-back Price”. But no Japanese courts have adopted expert’s opinion (e.g. “event study” model) in calculating the “inflated amount”.
Assessing Damages In Securities Litigation

Panel discussion and audience Q&A
SUMMARY

- The basic principles in the US and these other countries is similar: loss calculation is aimed at determining what the value had the fraud not taken place.
- Issues are presented by complex securities, due to the varying methods used to measure their worth.
- Each jurisdiction has increasingly complicated and distinct damage measurements.