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Circularity if Life in Securities Class Actions

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Recent criticism of securities class actions has principally concerned the “circularity” found in the damages remedy prescribed by the U.S. securities laws. The circularity argument is more correctly characterized as a number of related but distinct arguments. These circularity arguments are related in that they each emanate from the fact that a company’s current shareholders (or its insurers) pay the remedy for securities fraud to former and current shareholders. The circularity arguments are distinct in that the underlying economic basis for each argument can be analyzed and addressed separately.

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In this article, I address the economics of each of these arguments that comprise the circularity concerns espoused by securities class action critics. My overall conclusion is that these critics of securities class actions have a political need in search of an economic theory. In essence, all circularity arguments ultimately lead to the question of deterrents. Do existing securities laws sufficiently deter fraud? If the answer is yes, then the circular nature of damages for securities fraud is largely inconsequential. At best, the empirical research regarding how well damages under securities laws deter fraud is mixed.

**Critics’ Argument: The Winners and Losers Circularity**

The first circularity argument is that for a given company, a securities class action settlement will result in some “winner” shareholders and some “loser” shareholders. According to the critics, winners are those shareholders that purchased shares in the class period, while losers are shareholders that purchased shares outside the class period. Thus, the first argument evidently concerns the apparent illogical nature of transferring wealth from one group of a given company’s shareholders to another group.

Damages under the U.S. securities laws, specifically damages for violations of Section 10(b) of the 1934 Securities Exchange Act, are based on shares that were purchased during a time period in which the stock price had been inflated because of misrepresentations made by the company and then sold after revelation of the fraud.\(^3\) This time period generally coincides with the “class

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\(^3\) Since the U.S. Supreme Court decision in *Dura Pharm.*, it is generally held that only shares purchased in an artificially inflated market and still held (or sold) after the revelation of the
period” in securities class actions. Consequently, investors who purchased shares before or after the class period would not be eligible to claim a recovery as a result of the fraud.

If the company has to pay damages for perpetrating securities fraud, the damages award will be impounded in the stock price, which reflects the loss in the company’s equity value from such a payment. For example, if a company is required to pay $100 million (present value) in damages and the company has 20 million shares outstanding, then the stock price will be lower by $5 per share ($100 million divided by 20 million shares) after the market fully anticipates that such a damages payment will be made. Consequently, the wealth of those investors who own the shares at that time is reduced by $5 per share.

Therefore, the damages award by itself (exclusive of the losses or gains caused by the fraud) can have different wealth effects for different groups of shareholders.


4 In an efficient market, the stock price can reflect an estimate of the expected damages before any settlement announcement.
Figure 1 shows the wealth effect on different groups of shareholders from a given damages award in a securities fraud case.

**Figure 1**

<table>
<thead>
<tr>
<th>Shareholders who sold before the stock price reflects the damages award</th>
<th>Shareholders who did not sell the stock before the price reflects the damages award</th>
</tr>
</thead>
<tbody>
<tr>
<td>Shareholders who have damage claims</td>
<td>+</td>
</tr>
<tr>
<td>Shareholders who do not have damages claims</td>
<td>0</td>
</tr>
</tbody>
</table>

As can be seen from figure 1, shareholders who have damage claims (row 1) but who sell before the stock price fully reflects the damages award gain from the damages award (row 1 - column 1). Likewise, shareholders who do not have damages claims and hold their shares after the stock price reflects the damages award will generally lose wealth because of the damages award (row 2 - column 2).
For shareholders who do not have claims, but who sell their shares before the stock price reflects the damages award, they neither gain nor lose - their wealth is generally neutral (row 1 - column 1). Lastly, for shareholders who have claims, but who hold their shares after the stock price reflects the damages, their wealth effect may be positive or negative depending on their claims on the damages award relative to the wealth effect on the shares of the stock they own (row 1 - column 2).

This analysis shows that the wealth effects on shareholders is not nearly as clear cut as the over-simplified discussions found in most circularity critiques. And who wins and who loses is ultimately a function of several factors including when and how often purchases are made and the timing of sales.

More importantly, however, is that the critics have not adequately explained why the general circularity argument applies only to securities class action and not to other corporate wrongdoing. After all, the damages remedies in other types of corporate litigation have similar consequences to shareholders. For example, damages from environmental and product liability wrongdoing are typical borne by existing shareholders, despite the fact that the benefits from such wrongdoing likely redounded to a different set of shareholders. There is nothing

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5 Arlen and Carney (1992) state that because securities fraud is, according to the authors, “generally committed by some of the very directors and senior officers hired to manage the firm and to deter fraud,” securities fraud is distinguished from other corporate wrongdoing. This Arlen and Carney (1992) state that because securities fraud is, according to the authors, “generally committed by some of the very directors and senior officers hired to manage the firm and to deter fraud,” securities fraud is distinguished from other corporate wrongdoing. This same argument, however, can be applied to environmental or product liability problems. See Arlen & Carney, [1992] 3 U. ILL. L. REV. at 693.
particularly unusual or adverse to economic thought about existing shareholders paying the damages remedy from events that occurred at a time when these existing shareholders did not own the stock. So, to some extent there are always winners and losers among shareholders of a company depending upon when each bought and sold stock.

Indeed, like securities class actions, some paying shareholders for environmental or product liability damages may also be recipients (directly or indirectly) of the damages award – just like in securities litigation – or may be among the shareholders who previously benefitted from the wrongdoing.

Evidently what sets damages from securities class actions apart from damages for other types corporate wrongdoing is that all recipients of damages awards have been at sometime or other shareholders of the company paying the damages. While this observation is true, it does not necessarily advance the ball for the critics. Pointing out characteristics that are peculiar to securities class action litigation without providing an economic analysis as to why these peculiarities are uneconomic is not persuasive. Thus, the circularity critics generally tie the winners and losers circularity argument with other arguments related to investor diversification.

_Critics’ Argument: Lack of Diversification for Non-Institutions Makes Them Losers_

This circularity argument relates to an assumption that many small, non-institutional shareholders are mostly undiversified and that these investors can fare far worse from securities
fraud remedies than diversified, institutional shareholders because institutional investors are diversified against corporate fraud and individuals are not. Moreover, the contention is that these non-institutional investors mainly comprise the loser category in securities litigation because they are generally long-term investors and consequently are less likely to have purchased in a class period.

First, the critics have over-reached on arguments that shareholders with diversified portfolios are unaffected by financial fraud (even before any transaction costs). Financial theory teaches that the expected return compensates investors for only systematic risk. This means that shareholders with undiversified portfolios will not, on an expected basis, be compensated for the higher risk associated with unsystematic risk associated with the lack of diversification. The diversification axiom, however, does not imply that investors are no longer concerned about choosing between stocks based upon company-specific criteria. For example, investors would not be indifferent between two identical companies in all respects other than one has demonstrated good corporate governance and the other has not. The upshot of the diversification axiom is that whatever stocks are chosen should be part of a well-diversified portfolio, but it does not follow from finance theory that financial fraud is irrelevant to diversified investors.

Financial fraud imposes costs on shareholders just as any other company-specific risk and investors are no less concerned about the risk of financial fraud than they are with the risk that a company’s manufacturing technology falls behind its competition or that customers switch allegiance to other company’s products.
Second, arguments that securities class actions favor institutional shareholders over non-institutional shareholders are specious. First, commonly accepted finance theory teaches that the primary benefits from diversification can be accomplished by a portfolio with as few as 30 different stocks. 6 Thus, there is nothing inherent in the size of institutions relative to individual investors that support a theory that institutions must reap greater benefits from diversification by their nature than individual investors.

Moreover, there has been no empirical evidence that non-institutional shareholders are less diversified than institutions. To the contrary, commonly cited sources indicate that non-institutional investors hold well diversified portfolios within the vast number of mutual funds available. 7 In addition, the SEC provides education for investors in its Beginners Guide to Asset Allocation, Diversification, and Rebalancing, stating:

The Magic of Diversification. The practice of spreading money among different investments to reduce risk is known as diversification. By picking the right group of investments, you may be able to limit your losses and reduce the


fluctuations of investment returns without sacrificing too much potential gain.

If critics truly believe that there are many non-diversified individual investors, then efforts would be better spent at improving the education of these investors on the benefits of diversification rather than using this alleged widespread value-decreasing investment policy to advance changes in enforcing securities laws. Indeed the direct losses from holding an undiversified portfolio far outweigh the potential effect on these purported undiversified shareholders from being “losers” in a securities fraud case.

**Critics’ Argument: Circularity Causes Inefficient Wealth Transfer**

The inefficient wealth transfer argument is based on the supposition that shareholders with diversified portfolios have effectively diversified away the risk of corporate fraud. Consequently, this criticism is dependant on the previous criticism, which lacks economic basis as discussed above. But this criticism is faulty for other reasons as well.

Critics observe that a shareholder may benefit from a given fraud by selling artificially inflated stock and also incur loses by buying an artificially inflated stock in the same fraud or a different fraud.\(^8\) This observation merely states the obvious – for every seller there is buyer. Indeed, if

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\(^8\) See **Anjan V. Thakor with Jeffrey S. Nielsen & David A. Gulley, The Economic Reality of Securities Class Action Litigation** (U.S. Chamber Inst. for Legal Reform, 2005).
one multiplied the amount of artificial inflation per share by all the inflated shares purchased by 
buyers and summed these amounts it would equal the sum of the product of all shares sold 
multiplied by the amount of artificial inflation per share in each stock sale.

Thus, before any transaction costs, securities litigation is a zero sum game - gains wash out 
losses across all investors. It is tautological. But critics mis-characterize this tautology by 
asserting that for any given diversified shareholder, her gains will offset her losses. This 
conclusion does not logically follow from the predicate. Indeed, all stock trading is also a zero-
sum game, total gains are exactly equal to total losses.\(^9\) Nonetheless, who would contend that 
this necessarily means that each investor’s gains must equal his losses.

Notwithstanding this clarification that gains from securities fraud wash out losses overall (but 
not necessarily for each diversified investor), after accounting for transaction costs (of litigation), 
the game is no longer a zero sum. That is, gains from securities fraud to all investors minus 
losses from securities fraud for all investors minus litigations costs is a negative number. 
Consequently, because of the high transaction costs of litigation, critics contend that settlements 
in securities litigation result in a highly inefficient “pocket-shifting” wealth transfer.

\(^9\)“Trading is zero-sum game because the combined gains and losses of buyers and sellers always 
sum to zero. If a buyer profits from a trade, the seller loses the opportunity to profit by the same 
amount. Likewise if a buyer loses from a trade, the seller avoids an identical loss.” LARRY 
HARRIS, TRADING AND EXCHANGES: MARKET MICROSTRUCTURE FOR PRACTITIONERS, 176 
If the purpose of the securities laws was solely to transfer wealth from one group to another, then significant transaction costs of litigation could result in an inefficient wealth transfer. The determination of whether securities damages remedies result in economic inefficiency, however, must be assessed by weighing the transaction costs of litigation not only against the benefits of providing compensation to injured parties, but also weighed against the benefits of providing market discipline or deterrents to potential wrongdoers.

The direct out-of-pocket injury to shareholders is arguably only one part of the total costs to society from securities fraud. Economic theory suggests that financial markets that lack adequate discipline against securities fraud are characterized by higher costs of capital than disciplined financial markets. Empirical evidence is consistent with theory. La Porta, Lopez-de-Silanes, Shleifer, and Vishney (1998) report that the U.S. enforcement in protecting shareholders is among the toughest in the world. The same researchers also report that the average market capitalization for U.S. markets far exceeded that of all of the other 48 countries examined. Therefore, despite the stringent securities laws and their enforcement in the U.S., companies overwhelming have listed in the U.S. versus other countries.

Consequently, eliminating penalties for committing securities fraud under the pretext that diversified investors are already protected creates what economists call “negative externalities.”

Negative externalities arise when the someone’s action has an negative effect on others for which

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11 Id. at 1147 tbl.7
action he or she is not properly penalized. When no one penalizes people for the costs they impose on others, they tend to do more bad acts than what would be socially desirable.

Thus, a failure to penalize for securities fraud will tend to undermine the trust and confidence in the securities markets and thereby increase the cost of capital for all U.S. listed firms. Professor Coffee correctly points out that:

...clearly the cumulative effect impact of Enron, WorldCom and a host of other scandals in the 2000 to 2002 era made stockholders wary, chilled the initial public offering market, and caused investors to demand a higher return based on the perceived higher risks – in short, the cost of capital rose.\(^{12}\)

The critical implication from Professor Coffee’s assessment is that any increase in the expected return required by investors from eliminating or reducing penalties for securities fraud are not diversifiable because it would affect the market overall. That is, an investor cannot diversify away the higher market risk, which is precisely the externality created by eliminating penalties for committing securities fraud. Therefore, eliminating penalties for committing securities fraud under the pretext that diversified investors are already protected is incorrect.

Moreover, Professor Coffee also concludes that:

[w]hen the cost of capital rises, the economy as a whole suffers, as Gross National Product declines or stagnates, and unemployment may increase. As a result, not only investors, but also citizens throughout society experience a loss.\textsuperscript{13}

Thus adequate portfolio diversification does not eliminate the deadweight loss to society caused by securities fraud.

\textit{Critics’ Argument: Lack of Deterrent}

The fourth argument related to circularity – and the most important – has to do with the deterrent effect from securities laws. In essence all circularity arguments ultimately lead to the question of deterrents.

Critics argue that damages paid in securities class actions are an insufficient deterrent to securities fraud because damages are generally paid by shareholders as opposed to being paid by the managers or agents of shareholders who actually perpetrated the fraud.

\textsuperscript{13} Coffee, \textit{id.}
The deterrent effect in securities class action is based on the system of enterprise liability, in which the company is sued over the fraud perpetrated by its managers. Enterprise liability, as simply explained by the Nobel Prize winning economist Gary Becker, is that: “[d]irectors of companies that pay large fines for crimes committed by their officials have an incentive to fire them or force them to clean up their act.”14 This is the basis of the corporate governance within publicly traded firms. The market disciplines the principal and the principal in turns disciplines the agent.

Although managers are often named as individual defendants, it is the enterprise (or shareholders) that generally pays the majority of settlements in securities litigation.

When managers’ actions cause a loss of shareholder value (poor earnings performance, bad acquisition, etc.), the board can impose costs on the managers for their actions. One of the costs imposed is firing the manager. This is the hallmark of good corporate governance.

Critics do not contend that there is a general failure of corporate governance in public firms. It is widely accepted that firm-level monitoring and control can be less costly than direct monitoring by regulators, etc. Indeed, even the most vocal critics of securities class actions concede that scholarly analysis generally supports an emphasis on enterprise liability to optimally deter value-

decreasing behavior by agents. Rather, the critics assert that this corporate governance mechanism does not work when the loss of shareholder value results from securities fraud. Other than anecdotal evidence from selected securities cases, critics cite as the prime evidence of this failure a theoretical problem referred to as the “final-period” problem. The final-period problem has been defined as follows:

“Final-period” problems classically arise as the corporation approaches bankruptcy or as the manager faces the prospect of job loss. The more the manager expects ouster, the more that the manager’s incentives are no longer aligned with those of the shareholders, and the manager cannot be easily deterred by future private sanctions or reputational loss.

As it applies to securities fraud, critics contend that the final-period problem manifests itself under circumstances for which “managers’ reputational and long-term pecuniary interests are already in jeopardy, making their long-term contractual interests (express or implied) and their

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16 There is also anecdotal evidence that contradicts critics’ arguments. A number of executives are serving jail time and have had to give back their “ill-gotten gains” from securities fraud.


concern about the company’s status or capital marketplace reputation less compelling.”\textsuperscript{19}

Consequently, “[m]anagement, [in these circumstances] thus lies to buy time (or other forms of cover) during which some turnaround in fortunes might occur, or at least to retain their income and perquisites for a bit longer.”\textsuperscript{20}

Surprisingly absent from the critics’ argument, however, are citations to empirical evidence to support critics’ theoretical proposition of the final-period problem. Indeed, one author who is critical of securities class actions admitted (at least as of 1996) that available data does not prove that the securities class action system is defective. But, despite the lack of supporting data, that author expressed the opinion that he “found it hard to believe that it [securities class action system] isn’t [broken].”\textsuperscript{21} In large measure, this criticism appears to be more accepted by the critics as a matter of faith rather than one based on objective facts.

If these circumstances that give rise to the final-period problem presented themselves in the majority of securities fraud cases, then one should observe no measurable effect on the firing of managers in response to their complicity in securities fraud, holding all else the same. There have been several research papers that have attempted to study this topic. At best, the published research on this topic is mixed. Two published studies infer that perpetrators of securities fraud

\textsuperscript{19} Langevoort, \textit{id} at 654.

\textsuperscript{20} Langevoort, \textit{id}.

\textsuperscript{21} Langevoort, \textit{supra} note 15 at 650.
are more likely to lose their jobs all else the same and two other published studies reach opposite conclusions.\textsuperscript{22}

A recently published research paper that states reliance on more precise data than used in previous research concludes that 93.4\% of all employees cited by the SEC or DOJ as responsible parties for financial reporting violations lose there jobs.\textsuperscript{23} The paper states that “[t]he likelihood of dismissal is positively related to board independence, the ownership of large blockholders and others insiders.... The evidence, however, belies such sentiment [that culpable managers get away with fraud]. Managers who are caught misrepresenting their companies’ financial statements typically lose their jobs and substantial personal wealth through their ownership stakes in the firm.”. This implies that firms’ internal governance plays a significant role in disciplining managers who impose costs on shareholders by getting caught cooking the books.\textsuperscript{24} This recent empirical finding is not consistent with the final-period problem hypothesis, at least as it is generally applied to financial fraud that reaches the level of an SEC or DOJ investigation.


\textsuperscript{24} Id at 213.
Consequently, this empirical findings casts some doubt on the validity of accepting, on pure faith, that critics’ final-period problem is pervasive and is an explanation for the purported lack of deterents in private securities litigation.\textsuperscript{25}

Indeed it is curious that the most vocal critics of the lack of deterents in existing securities laws come not from shareholders but rather from managers (who are ostensibly protecting shareholders interests) and political groups (e.g., U.S. Chamber of Commerce) representing the “business community.”\textsuperscript{26} There is a surprising absence of complaints from the very parties that would directly “pay” for the lack of deterents in securities laws – investors. Where are the shareholder activists groups that represent investors in many corporate governance matters? I have visited several web pages for such organizations and found no comparable criticism of the lack of deterrent effect in existing securities laws.\textsuperscript{27} The complaints coming from the “business community” is a bit like the fox complaining to the farmer that he should tear down his fence

\textsuperscript{25} I note that although the damages remedy under SEC or DOJ litigation is the same out-of-pocket measure of damages levied under a system of enterprise liability as in private securities litigation, there can be additional costs imposed on managers by regulators that include fines and non-monetary sanctions. This may limit general inferences from this study to private securities litigation.

\textsuperscript{26} \textit{E.g. Securities Class Action Litigation: The Problem, Its Impact, and the Path to Reform} (U.S. Chamber Inst. for Legal Reform, 2008), http://www.instituteforlegalreform.com/about/index.cfm. The U.S. Chamber Institute for Legal Reform is an affiliate of the U.S. Chamber of Commerce “representing the nation's business community.”

because it is too costly for the farmer to maintain and does not stop the foxes from getting into the chicken coup anyhow.

_Critics’ Proposals for Change_

Can some mechanism other than private class actions provide a reasonable level of deterrence?

Some have advocated replacing private class actions with heightened legislated rules and greater SEC oversight. These alternatives are arguably less efficient. For example, the high costs of Sarbanes-Oxley compliance has been discussed as the source of capital flowing from U.S. public markets to U.S. private markets and to foreign financial markets. One prime reason is that the high costs of compliance are imposed on the innocent as well as the perpetrators of corporate fraud. This can create inefficiencies and may have actually increased the cost of raising public capital, as opposed to reducing the cost as once hoped. In contrast, securities class action targets the alleged wrongdoer, not all companies universally.

Others have argued that damages based on out of pocket losses to investors as a remedy for securities fraud and non-disclosure in the aftermarket are not optimal and should, at minimum, be reduced to a multiple of the gains received by defendants from the fraud.\(^{28}\) In their 1991 book, Easterbrook and Fischel discuss the economics of non-optimal damages and conclude that if damages are excessive, then it would lead to a costly, inefficient supply of information to

investors. Specifically, the authors conclude that excessive damages would lead to “silence” from companies, which would result in other actors like investment bankers and advisors producing more information. Information generated by these actors is likely to be more expensive and less accurate than that produced by the firm itself, which is the essence of the information inefficiency.

The authors’ conclusion that “excessive” damages would create “silence” is based on logical economic analysis. It follows from this economic logic that if damages have been excessive, then we should perceive the kind of silence or lack of disclosure from companies that would be consistent with this theory. Despite the fact that this book was published in 1991, the critics have not cited to any empirical research that supports the hypothesis that information supplied by companies has been curtailed because of damages remedies.

The lack of such empirical evidence may be explained by another theory advanced by Easterbrook and Fischel. The authors suggest that if Rule 10b-5’s “scienter” requirement filters out cases such that only those cases involving the most egregious acts survive, then there is no longer as much concern about whether damages remedies provide optimal deterrence. That is, “[t]he interaction of the scienter requirement with the damages rule should get rid of excessive (or, what is the same thing, inaccurate) enforcement.”

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29 Id at 339.

30 Id at 333-34.
Finally, critics have argued for a dollar cap on damages from securities fraud. Economics teaches us that if a price cap is binding it will result in greater demand than what would be economical for society. If, on the other hand, existing damages have little or no effect to deter fraud, then a capping such a cost that has no effect on the economic equilibrium to deter fraud.

Conclusion

Evidently what sets damages from securities class actions apart from damages for other types corporate wrongdoing is that all recipients of damages awards have been at sometime or other shareholders of the company paying the damages. While this observation is true, it does not necessarily advance the ball for the critics. Pointing out characteristics that are peculiar to securities class action litigation without providing an economic analysis as to why these peculiarities are uneconomic is not persuasive. Thus, the circularity critics generally tie the winners and losers circularity argument with other arguments related to investor diversification.

Critics have over-reached on arguments that shareholders with diversified portfolios are unaffected by financial fraud (even before any transaction costs). The diversification axiom does not imply that investors are no longer concerned with choosing between stocks based upon company-specific criteria. The upshot of the diversification axiom is that whatever stocks are chosen should be part of a well-diversified portfolio, but it does not follow from finance theory that financial fraud is irrelevant to diversified investors.

31 Langevoort *supra* note 15 at 639-664.
In addition, critics contention that institutional shareholders are benefitted more than individual shareholders because of greater diversification is flawed. There has been no empirical evidence that non-institutional shareholders are less diversified than institutions. To the contrary, commonly cited sources indicate that non-institutional investors hold well diversified portfolios within the vast number of mutual funds available. Moreover, if critics truly believe that there are many non-diversified individual investors, then efforts would be better spent at improving the education of these investors on the benefits of diversification rather than using this alleged widespread value-decreasing investment policy to advance changes in enforcing securities laws. Indeed the direct losses from holding an undiversified portfolio far outweigh the potential effect on these purported undiversified shareholders from being a “loser” in a securities fraud case.

In a related argument, critics contend that because of the high transaction costs of litigation, the wealth transfer from “loser” shareholders to “winner” shareholders is economically inefficient. This conclusion presumes that the only reason for the current damages remedy is compensate shareholders who were harmed by the fraud. The determination of whether securities damages remedies result in economic inefficiency, however, must be assessed by weighing the transaction costs of litigation not only against the benefits of providing compensation to injured parties, but also weighed against the benefits of providing market discipline or deterrents to potential wrongdoers. A failure to penalize for securities fraud will tend to undermine the trust and confidence in the securities markets and thereby increase the cost of capital for all U.S. listed firms. Furthermore, portfolio diversification cannot diversify away the deadweight loss to society that results increased costs of capital from securities fraud.
The central issue then for virtually all circularity arguments is whether the damages formula for securities fraud deters fraud. If, the current penalties under the U.S. securities laws do not deter fraud, then critics are correct that the damages remedy is merely an inefficient wealth transfer between groups of shareholders. Critics, however, have failed to demonstrate that current damage remedies do not deter fraud. The critics assert that the corporate governance mechanism under a system of enterprise liability does not work when the loss of shareholder value results from securities fraud. Other than anecdotal evidence from selected securities cases, critics cite as the prime evidence of this failure a theoretical problem referred to as the “final-period” problem, which suggests that managers who commit fraud are little concerned with results of being caught because fraud is their last chance at keeping their jobs.

Surprisingly absent from the critics’ argument, however, is empirical evidence to support critics’ theoretical proposition of the final-period problem. If these circumstances that give rise to the final-period problem presented themselves in the majority of securities fraud cases, then one should observe no measurable effect on the firing of managers in response to their complicity in securities fraud, holding all else the same.

There have been several research papers that have attempted to study this topic. At best, the published research on this topic is mixed. A recent research paper, which states reliance on more precise data than used in previous research, concludes that 93.6% of all employees cited by the SEC or DOJ as responsible parties for financial reporting violations lose their jobs.
The empirical findings casts doubt on the validity of accepting, on pure faith, that the critics’ final-period problem is pervasive and is an explanation for the purported lack of deterrents in private securities litigation.

Indeed it is curious that the most vocal critics of the lack of deterrents in existing securities laws come not from shareholders but rather from managers (who are ostensibly protecting shareholders interests) and political groups (i.e., U.S. Chamber of Commerce) representing the “business community.” There is a surprising absence of outrage from the very parties that would directly “pay” for the lack of deterrents in securities laws – investors. Where are the shareholder activists groups that represent investors in many corporate governance matters? The complaints coming from the “business community” is a bit like the fox complaining to the farmer that he should tear down his fence because it is too costly to maintain and does not stop the foxes from getting into the chicken coup anyhow. Methinks thou dost protest too much.
References


**Securities Class Action Litigation: The Problem, Its Impact, and the Path to Reform** (U.S. Chamber Inst. for Legal Reform, 2008).
