

US Securities Class Actions: A Guide to the Initial Stages

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Being named as a defendant in a securities class action can give rise to uncertainty and distress. This guide discusses what you can expect during the early stages of the action, the immediate steps that you need to take, and where external counsel can assist.

What to Expect

- **Announcement of an “Investigation”** – Often, before the commencement of an action, a company will encounter a press release from a law firm specializing in securities class actions that it is “investigating” potential claims against the company. These announcements are not indicative of an actual investigation, but rather are plaintiff-side law firm advertisements for shareholders with standing to bring a claim. In the US there is an entrepreneurial Plaintiffs bar that monitors the market for statistically significant stock drops, and then typically comes up with a theory of “fraud” to explain the stock movement. Although such investigation announcements typically are a pre-cursor of a complaint, sometimes no complaint is filed and they are not necessary to commence a claim.
- **The Original Complaint and Copy-Cat Complaints** – The Original Complaint is sometimes followed by virtually identical complaints (known as “copy-cat complaints”). These initial complaints will typically be consolidated into one action (the exception being when certain claims are brought in federal court and others in state court). The Original Complaint is typically drafted hastily and does not contain much detail because plaintiffs know that the operative complaint will not be filed until after the lead plaintiff and lead counsel are selected. Your outside legal counsel will negotiate with the plaintiffs’ firms for an adjournment of a response to initial complaints until after the lead plaintiff is appointed and a Consolidated Complaint is filed.
- **Lead Plaintiff Selection Process** – The original plaintiff must file a “notice” announcing the class action in a national publication within 20 days of filing the complaint (and normally does so simultaneously with the filing of the Original Complaint). Within 60 days of this notice, any member of the purported class may move the Court to serve as lead plaintiff. The Court then appoints a lead plaintiff (or a group of lead plaintiffs) who select the lead counsel. Defendants do not participate in this process.
- **Consolidated Complaint** – The lead plaintiff will file a Consolidated Complaint. The Consolidated Complaint contains more detail than the initial complaints, and may include statements from current and former employees acting as “Confidential Witnesses,” as well as internal reports. The Consolidated Complaint may also cite to publicly-available materials such as analyst reports and press reports.
- **Motion to Dismiss** – After a Consolidated Complaint is filed, Defendants typically will make a motion to dismiss it. There is a statutory stay of plaintiffs’ right to obtain documents or testimony from the defendants pending a motion to dismiss. To grant a motion to dismiss, however, the court must conclude that plaintiffs have not stated a claim assuming the truth of the complaint’s allegations. Although each case is different and must be evaluated on its own merits, approximately half of all motions to dismiss are granted.

Immediate Action Items

- **Notify Insurance Carrier** – The company needs to provide timely notice of the claims to its insurance carrier, and review coverage limits and exclusions under its D&O insurance policy. External counsel can assist the company with this review.
- **Document Preservation** – The company is required to preserve documents relevant to the case and should develop a document preservation plan as soon as possible. This plan includes issuing a litigation hold to the relevant personnel over the applicable timeframe and across all data sources. The company should also suspend document retention policies that would otherwise delete relevant information. The destruction of documents after a case has been commenced or a company has notice of a case can lead to very severe sanctions against a company or individuals, including in extreme cases, adverse inferences or the directing of a verdict against the company.
- **Informal Initial Internal Check** – The company should conduct an internal investigation during the period between the filing of the original complaint and the Consolidated Complaint to assess the merits of plaintiffs' claims. The company may also consider reaching out to former employees whom it believes the plaintiffs' counsel may contact for information. It is advisable to involve external counsel in this initial check.
- **Dealing with the Press** – The company should designate a point person to whom employees should refer any media inquiries. It is highly recommended that the company work with external counsel on media strategy, and, to the extent appropriate, crisis management.

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