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To Opt Out or Not to Opt Out: That is the Question

When a class action is filed in the US, investors who qualify to participate have three choices: (1) they can remain in the class and seek to lead or control it by becoming a Lead Plaintiff; (2) they can remain in the class but take no leadership role; or (3) they can opt out of the class and file an individual action against the same defendants being sued in the class action.

All of these options provide an opportunity for institutional investors to help satisfy their fiduciary obligations to their beneficiaries and to use the litigation to demand important corporate governance improvements when engagement is not an option.

Nevertheless, the decision of which course of action to pursue is an important one, particularly for investors with significant holdings in the defendant corporation, as it will determine the level of involvement and influence of the institution throughout the class action proceedings.

Becoming a Lead Plaintiff

European institutional investors during the past several years have been motivated to take an active role in US shareholder litigation by seeking to become the lead plaintiff in these actions.

There are a number of reasons for this activism. Because engagement options in the US are much more limited than in the UK or Europe, some European institutional investors have been motivated to create policy of being active in US litigation as their form of engagement for their US equity portfolio.

Others have not made this distinction and have chosen to play an active role in US litigation precisely because the wrongdoer is a European company. In this situation, the motivation is to ensure that Europeans prosecute actions against local companies.

Under US law, within 60 days after the first case is filed, investors desiring to take a more active role in securities class action litigation can apply to the court to be a Lead Plaintiff.

A Lead Plaintiff in a securities class action is responsible for defining the Class, evaluating the sufficiency of a settlement, overseeing the litigation, and determining the lawyers' fee in the litigation which is subject to court approval.

In addition, the Lead Plaintiff owes a fiduciary duty to the other class members in that it will protect the interests of the class and not just its own well being. When the 60-day deadline expires, the court will look to various characteristics of those investors competing to be Lead Plaintiff and make a determination as to which investor or investors should lead the class action.

When selecting a Lead Plaintiff, courts often consider the size of investors' losses, whether the investors are individuals or institutions, and whether the investor has any potential conflicts with the proposed class.

Participating as a Class Member

If an investor chooses not to take a leadership role in the litigation, or is not chosen by the court to be Lead Plaintiff, it can still participate in the action as a passive member of

the class. Passive participation means proactively claiming a pro rata share of any monies that have already been recovered in a class action by filing claim forms.

In the last five years, over \$37 billion has been made available from securities class action settlements in the US. Yet, a recent study showed that "on average, roughly 28% of eligible institutional investors filed claims in these settlements. In other words, almost three out of four institutional investors are not filing claims for monies that belong to them.

"The average mean loss is very substantial in these cases: almost \$850,000," according to the same authors. Filing claim forms does not obligate any investor to take an active role in any shareholder class action.

Opting Out – Filing an Individual Action

A third option that is being used more and more by institutional investors in recovering monies as a result of securities fraud, in the appropriate situation, is opting out of a class action.

In general, the Lead Plaintiff in a large securities class action has considerable power to help secure significant monetary recoveries and governance enhancements. However, some actions are better suited for an individual action, rather than a class action.

This may be the case when the allegations of corporate wrongdoing are insufficient at the 60-day Lead Plaintiff deadline but are strengthened by subsequent corporate disclosures; when a currently pending class action is being led

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by investors that are unlikely to adequately protect the interests of all members of the class, particularly the interests of foreign investors; or where the investor has suffered a particularly large loss.

There are several reasons why investors may want to “opt-out” or exclude themselves from the class action and bring their own individual action in the US:

First, if the court has already appointed a lead plaintiff in the class litigation, no other investor will be able to influence how much money is recovered for the class and whether appropriate governance reforms are incorporated into any final settlement.

For this reason, any institutional investors who wish to have a greater voice in the results of the litigation may choose to opt out of the class and file their own actions.

Second, investors can sometimes achieve a greater per share recovery by filing their own individual actions, particularly if their losses are substantial or if they are part of a group with a substantial collective loss.

For example, a number of institutional investors opted out of the AOL Time Warner, WorldCom and Qwest class actions, and secured recoveries that far exceeded the per share recoveries obtained on behalf of class members in each of the related class cases.

Although there is no definitive threshold for filing an individual action, an investor’s loss should be large enough to give the investor leverage with the defendants to bring its own claim apart from the class action.

Third, unlike a Lead Plaintiff in a class action, investors who bring individual actions do not assume any fiduciary responsibilities for other investors.

Fourth, there is minimal risk. Opt out actions are usually filed before the same judge who is handling the pending class action.

This is a benefit as the judge has already developed a good understanding of the facts surrounding the fraud and is in a better position to oversee both the class and individual actions. Additionally, settlements reached in individual actions are often kept confidential and are not publicized.

Fifth, the process for opting out is quite simple. US class actions are “opt out” actions, which means that investors are automatically included in the class unless they specifically exclude themselves. Therefore, an investor would merely need to authorize counsel to file an action on its behalf.

Staying Informed

No matter what course of action or level of involvement an investor decides to take with respect to any particular securities class action litigation, it is essential for institutions to monitor the securities in their portfolios and stay informed of settlement proceeds to which they may be entitled.

Indeed, since every lawsuit depends on its own circumstances, the best way for investors to determine whether to opt out or not to opt out of a class action is to make as informed a decision as possible based on the merits of the lawsuit and the institutional investor’s individual situation.



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