Important considerations in deciding whether to opt out of securities class actions

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Securities class actions serve a vital role in policing corporate wrongdoing and enabling defrauded investors to recover their losses. In some instances, investors may elect to "opt-out" of a pending securities class action to pursue their claims directly.

Deciding whether and when to opt out of a securities class action requires careful thought and analysis. In most circumstances, there is neither a benefit nor a need to opt out. However, unique situations may warrant consideration of whether to opt out. For example, an investor may have out-sized damages, claims not covered by the class case, or concerns about the prosecution of the class action. In these rare instances, investors may be well advised to consider opting out of the pending securities class action to pursue their claims directly.

Investors evaluating whether to opt out should weigh both the pros and cons of doing so. There are many factors to consider — practical, financial, and legal. Upon opting out, investors may forever forfeit their rights to participate in the class action, including the ability to share in any settlement or judgment. They also may be subject to discovery obligations beyond those of an absent class member. Meanwhile, an opt-out plaintiff's lawsuit — if not timely filed and correctly prosecuted — may result in no recovery at all.

Issues to consider include the following:

1) **Timeliness of potential claims**. Investors considering whether to opt out must first determine whether they have timely claims to assert through a direct action. The statute of repose for Securities Act claims is three years, meaning that investors' claims expire if not brought within three years of defendants' last culpable act or omission.

For Exchange Act claims, the statute of repose is five years. In the 2017 decision *CalPERS v. ANZ Securities, Inc.,* the Supreme Court held that the pendency of a class action does not toll the Securities Act's statute of repose. A small minority of courts also has suggested that investors might forfeit the benefit of class-action tolling for even statutes of limitation if they file their opt-out lawsuits prior to an order granting or denying class certification.

Determining whether an investor's opt-out claims would be timely requires a thorough analysis of the trades in the subject securities, the timing of the alleged misstatements and disclosures, and the applicable law. The consequences of an error may be significant.

Over the years, district courts have dismissed as untimely a number of cases filed by opt-out plaintiffs, finding that these investors filed their actions too late. Unless successful on appeal, these investors are likely to recover nothing through their opt-out actions—and it may be too late for them to participate in any class action settlement. Accordingly, it is critical that investors consult with experienced opt-out counsel early and, if they decide to opt out, promptly secure a tolling agreement with defendants, intervene in the ongoing class case, or file their opt-out action.

2) **Potential recoverable damages.** Before opting out, investors must carefully assess whether it makes economic sense to do so. To that end, investors should calculate the amount of both their maximum and likely recoverable damages through an opt-out action. This is not always a simple exercise. The investor should ensure that its counsel retains an expert qualified to analyze its trading records and assess its potential damages under the relevant securities laws.

For many claims, the damages expert will need to conduct an event study to determine whether the stock price declines at issue were both statistically significant and attributable to disclosures relating to the alleged fraud (as opposed to unrelated news or market forces). The damages expert will also need to analyze the investor's damages using both the last-in-first-out (LIFO) and first-in-first-out (FIFO) matching methodologies, which may produce markedly different damage calculations.

Careful consideration should also be given to the impact of the Private Securities Litigation Reform Act's "bounce-back" provision, which may limit recoverable damages under the Exchange Act if the company's stock price rebounded within 90 days of the corrective disclosure.

3) **Availability of uncovered claims.** Investors evaluating whether to opt-out of a class case to pursue a direct action should determine whether they have valuable claims that were not asserted by the lead plaintiff in the securities class action — i.e., "uncovered claims."

The lead plaintiff in a securities class action might not have standing to pursue all claims on all relevant securities or, for strategic reasons, might not have asserted all available claims. These can include claims on purchases made outside the scope of

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the class period alleged by the Lead Plaintiff, claims arising from securities not covered in the class action, or losses arising from corrective disclosures that are not addressed in the class action complaint. For example, in the *ARCP* class action that settled in 2020, numerous sophisticated investors opted out of the class action and pursued claims not asserted by the lead plaintiff in the class action, including high-value claims for damages on their swap securities. These investors would have recovered nothing on their swap securities had they not brought their direct actions.

Likewise, in the *BP* class action arising from the Deepwater Horizon oil spill, numerous institutional investors opted out of the pending class action to pursue claims on securities they purchased on foreign stock exchanges. The court found that investors could not pursue claims under the federal securities laws based on these foreign-exchange purchases following the Supreme Court's 2010 seminal decision in *Morrison v. National Australia Bank Ltd.* Investors could, however, pursue claims under English common law to recover their losses. The *BP* court found, however, that English common law claims require individualized proof of reliance and, for this reason, were unfit for class treatment and could only be brought through direct actions. Accordingly, had these investors not decided to pursue their claims through direct actions, they would have recovered nothing — leaving good money on the table.

4) **Individualized evidence.** Investors also should consider whether they have unique evidence that will help or harm a potential opt-out action. For example, active investors or their investment managers may have read and relied upon the company's misleading financials or spoken directly with the defendant-corporation during the relevant period. Such evidence may provide grounds to assert claims typically not available in the class-action context, including claims under Section 18 of the Exchange Act and direct-reliance claims under state laws.

Conversely, investors may have discoverable evidence in their files that is potentially harmful to an opt-out case, including internal communications showing that they did not rely upon the alleged misrepresentations when making their investment decisions.

Institutional investors evaluating whether to opt out should speak with the analysts and portfolio managers who made the relevant investment decisions to get a full understanding on any individualized evidence before filing an opt-out action.

5) **Defendants' ability-to-pay.** In addition to evaluating the case merits, investors considering an opt-out should analyze the defendants' financial condition. If the defendants lack the financial ability to fund a meaningful opt-out settlement or judgment, the investor should reconsider devoting the time and energy necessary to pursue such a claim.

In some instances, however, defendants are unable to pay a meaningful portion of the class-wide damages, but are able to fully satisfy a judgment in an opt-out case. In these unique circumstances, an opt-out action might present an attractive option.

Balancing the factors

Before deciding whether to opt out, investors should balance all practical, financial, and legal factors. An opt-out action might make good sense in unique circumstances: it may produce a more meaningful and faster recovery.

Opt-out actions are not without risk, however, and investors rarely have the time or resources to monitor all court dockets and determine whether they have valuable opt-out claims to pursue. Investors with substantial holdings may wish to consider retaining portfolio monitoring counsel to identify potential opt-out opportunities and to discuss any unique risks and benefits involved.

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