Best Practices For Protecting Securities Fraud Recoveries From Expiring Under The Statute Of Repose

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The U.S. Supreme Court recently delivered a shot across the bow of the investment community. In *California Public Employees' Retirement System v. ANZ Securities* (June 26, 2017), the Court overturned four decades of precedent and held that the filing of a class action does **not** "toll" or satisfy the statute of repose governing class members' individual claims for recovery of damages under the federal securities laws. Now, under *ANZ Securities*, the statute of repose serves as an **absolute time bar** to individual class members' institution of new, individual actions.

It is therefore critical that institutional investors diligently monitor pending securities class actions and take proactive steps to protect valuable individual claims from expiring under the statute of repose in order to fulfill their fiduciary duty of protecting and preserving fund assets and recoveries. As the dissenting opinion in *ANZ Securities* warns: "Any class member with a material stake … including every fiduciary who must safeguard investor assets, will have strong cause to file a protective claim, in a separate complaint or in a motion to intervene, before the [repose] period expires." This article provides institutional investors and their counsel with the best fiduciary practices for protecting valuable securities fraud recoveries under the new *ANZ Securities* framework.

Securities Fraud Recovery 101

While stock fraud has long been a blight on our nation's capital markets, securities class actions have proven to be a potent recovery vehicle for the investment community. Through waves of corporate scandals, securities class actions have proved their mettle. In the last 20 years, securities class actions have recovered nearly $100 billion for defrauded investors. Last year alone, the top 12 securities class action settlements achieved total recoveries of more than $5.4 billion, the largest aggregate settlement fund from the top settlements in any single year. Two of these settlements exceeded $1 billion, each the product of more than a decade of hard-fought litigation.

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Alongside securities class actions, individual "opt-out" actions have emerged as a highly effective recovery option. In certain circumstances, pursuing direct actions offers significant advantages to institutional investors over passive participation in class actions, including preserving their individual claims for recovery, strategic control over the prosecution of their own claims, the ability to pursue powerful claims not available in the class case and covering a wider range of securities, and the potential for quicker recovery of substantially larger sums. Furthermore, in cases in which the proposed class action is not certified by a court as a class action, or is dismissed on legal grounds unrelated to the merits, direct actions can serve as the sole vehicle for the recovery of securities fraud damages.

The New *ANZ Securities* Framework

Under the *American Pipe* "class action tolling" rule, the filing of a class action traditionally suspended applicable limitations periods for all would-be class members' individual claims until class certification was denied or the case settled. For decades, the *American Pipe* tolling rule was faithfully applied to both time periods for filing suits to recover damages under the federal securities laws: the statute of limitations, a relatively short period that starts when investors discover or should have discovered the securities law violation; and the statute of repose, a longer period that starts when the violation occurred.

This broad application of the class action tolling rule made great practical sense and allowed investors to benefit from a "wait and see" approach to securities fraud recovery. Investors could remain passive, receive a notice of settlement or certification of a class action, and then decide whether to remain in the class or opt out to pursue a more substantial recovery of their losses. Investors were also protected if the court declined to certify the case for class action treatment, or if the class action failed on technical grounds unrelated to the merits. It was important for many reasons, but principally because (1) the majority of securities class actions do not reach a court decision on class certification until after the repose period has expired; (2) the majority of securities class actions do not settle until after the repose period has expired; and (3) the class action tolling doctrine serves one of the class action device's *raisons d'être* — concentrating like claims in a single representative proceeding and avoiding splintered litigation and a morass of protective filings.

After the Supreme Court's decision in *ANZ Securities* in June 2017, investors cannot rely on a securities class action to toll the statute of repose governing their individual claims. In *ANZ Securities*, a sharply divided court held that the class action tolling rule applies only to the Securities Act's statute of limitations and <u>not</u> to its statute of repose. Courts quickly extended *ANZ Securities* to apply to Section 10(b) of the Exchange Act and U.S. Securities and Exchange Commission Rule 10b-5, the core anti-fraud provisions of the federal securities laws and the cornerstone of securities fraud litigation.

Although *ANZ Securities* overturns decades of established law and policy, the decision provides much-needed clarity and resolves a recent circuit court split that had divided lower federal courts across the country. It also provides a clear directive to institutional investors and their fiduciaries to implement practices and procedures to ensure that valuable securities recoveries are not lost to the statute of repose. As the dissent in *ANZ Securities* warns: "Because critical stages of securities class actions, including the class-certification decision, often occur years after the filing of a class complaint, the risk is high that class members failing to file a protective claim will be saddled with inadequate representation or an inadequate judgement."

Best Practices Post-*ANZ Securities*

To put an investor in a superior position to make timely and informed decisions under the new *ANZ Securities* framework, we strongly recommend that fiduciaries for institutional investors implement the following best practices.

1. ***Identify Cases in Which the Investor Has a Significant Financial Interest.*** There are over 600 pending securities class actions, excluding merger objection cases. However, because most cases are relatively small — the median securities class settlement is about $8 million — we recommend that an investor apply an efficient two-step process to determine which cases are large enough to potentially justify individual litigation. For the vast majority of institutional investors, securities class actions involving less than $500 million in classwide damages will seldom implicate an individual return large enough to justify individual litigation. Thus, an investor should first isolate cases exceeding an appropriate threshold of aggregate, classwide damages, and then analyze its financial interest in this subset of cases to determine which cases warrant consideration for potential individual action. Importantly, while institutional investors can typically retain an outside securities litigation law firm on a contingency fee basis, the legal fees and litigation expenses are ultimately borne by the individual litigant (or group of litigants) and reimbursed from any settlement proceeds. By comparison, in a class action, the legal fees and expenses are spread over the entire class.

2. ***Evaluate the Cases on Their Legal Merits.*** For cases in which an investor's financial interest is sufficiently large to potentially warrant individual litigation, the next step is to evaluate the cases on their legal merits. This be can be difficult; of the roughly 600 pending securities class actions, approximately two-thirds remain at the pleading stage and have not been tested with a motion to dismiss. Again, we recommend a prudent approach: look for telltale indicators of misconduct, such as admissions of wrongdoing, government investigations, enforcement actions, and fines; internal investigations, executive terminations, and whistleblower complaints; financial restatements and accounting irregularities; unusual and suspicious insider selling; and critical reports by securities analysts and others in the financial media. Further, outside law firms often conduct in-depth investigations that involve interviews with former employees of the subject company, its customers and competitors, and other potential fact witnesses to drill down on the allegations of securities fraud.

3. ***Identify Deadlines and Develop Recovery Strategies.*** Having identified meritorious cases in which it has a sizeable financial stake, an investor is now in a position to develop a tailored recovery plan. Because abstract filing deadlines may have little or no relevance to an investor's *individual* damages claims — among other things, statute of repose deadlines are tied to when an investor made its investment — it is critical to pinpoint the deadlines pertinent to an investor's own claims for recovery. An investor should cross-reference the purchases or acquisitions that underlie its claims against the dates of the alleged misstatements, consider the full scope of claims available to the investor and any unique limitations, and have the resulting set of deadlines checked and verified by an experienced securities litigation attorney.

4. ***Carefully Monitor the Cases.*** With a recovery plan and relevant filing deadlines in hand, the investor should closely monitor its cases of interest for significant developments. The most critical pretrial stages are the motion to dismiss stage, which will determine the contours of the case, and class certification, which will result in a court-ordered opt-out deadline. Investors should also stay apprised of other case developments that may affect their legal rights for recovery — such as other dispositive motions, attacks on expert testimony, and attempts to disqualify class representatives. As Justice Ruth Bader Ginsburg's dissenting opinion in *ANZ Securities* recognized, "Defendants will have an incentive to slow walk discovery and other precertification proceedings so the clock will run on potential opt outs."

5. ***Be Poised to Take Prompt Action***. As important case developments occur or filing deadlines approach, an investor must be ready to take prompt action to protect its legal rights. To this end, investors should retain outside securities litigation counsel well before the first relevant limitations or repose deadline, and obtain its advice on the most strategic type of filing or, in contrast, whether to secure a tolling agreement with the potential defendants. If a strategic filing is the more prudent course, outside counsel should advise on whether to file a comprehensive opt-out action complaint that asserts not only those claims covered in the class case, but additional viable and valuable claims that can *only* be asserted in a direct action or that have been omitted or excluded from the class case. Further, the investor can consider the option of joining with other prominent institutional investors in a direct action which can alleviate the litigation expenses and add prominence to the individual litigation.

Without question, the Supreme Court's decision in *ANZ Securities* significantly narrows the time frame for investors to assert individual claims for recovery of damages under the federal securities laws, and imposes significant burdens, costs, and fiduciary obligations on institutional investors to protect valuable securities claims from expiring. By adopting these best practices, institutional investors can ensure they are in a position to fulfill their fiduciary duties by making timely and informed decisions to protect valuable securities recoveries from expiring under the statute of repose.

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DISCLOSURE: In support of CalPERS and on behalf of 75 institutional investors with over $4 trillion in assets under management, Bernstein Litowitz coordinated an institutional investor amicus brief before the Supreme Court in the ANZ Securities *case.*