



# CRA Insights: Financial Markets

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## Securities litigation settlement costs if large shareholders opt out

A recent [New York Times](#) article highlighted large asset managers, such as BlackRock, that are becoming more active on corporate governance issues.<sup>1</sup> These large asset managers control considerable portions of many other firms' stocks. The increase in their level of activity raises questions related to the potential impacts of these large institutional holders becoming more active in securities litigation.

BlackRock, for example, was one of several large asset managers that opted out of the Tyco securities litigation. Many other large institutions have already pursued litigation related to mortgage-backed securities on their own and may have developed a level of expertise that eases the transition to filing individual actions in other types of securities lawsuits. Charles Schwab & Co., for example, filed an individual action against MBS issuers and followed up with an individual action against LIBOR panel banks. In this issue of *CRA Insights: Financial Markets*, we present anecdotal information on settlements that large institutions have obtained in individual actions (IA) and compare them to the estimates of the amount that the institutions would have recovered as part of the class. Recoveries for IA plaintiffs have been significantly higher than for class participants. The levels of recoveries applied to the holdings of large asset managers imply significantly higher settlement costs for defendants in securities litigation if these institutions decide to opt out on a regular basis.

Settlement outcomes of IA claimants are not always publicized. Therefore, we examine a few illustrative examples with sufficient public information and use these to draw inferences regarding the implications for settlement costs if large institutions decide to opt out of class action litigations more frequently.

The class claimants in the Qwest securities litigation obtained \$445 million in settlement. As Table 1 shows, on a per-share basis, the IA plaintiffs obtained recoveries that were many multiples of those obtained by class participants.<sup>2</sup>

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<sup>1</sup> "The Giant of Shareholders, Quietly Stirring," *The New York Times*, May 18, 2013.

<sup>2</sup> This settlement amount is not limited to claims by shareholders, but the portion attributable to bonds and options is no more than 6% of the total amount. The settlement amount is composed of contributions from the company, its auditor, and individual defendants. There were additional IA plaintiffs in the Qwest securities litigation, but as sufficient information is not available, they are not included in Table 1.

Table 1: Qwest securities litigation

|  | Max. shares held during class period (million) | Settlement (\$ million) | Recovery per share | Multiple of class recovery rate |
|--|--|-------------------------|--------------------|---------------------------------|
| CalSTRS  | 4.7  | \$47                    | \$9.9              | 36.9x                           |
| Teacher Retirement System of Texas             | 5.9  | \$62                    | \$10.5             | 39.1x                           |
| Public Employees' Retirement Association of CO | 1.7  | \$16                    | \$9.3              | 34.7x                           |
| New York State Common Retirement System        | 5.8  | \$51                    | \$8.8              | 32.8x                           |
| <b>Class</b>                                   | 1,661  | <b>\$445</b>            | \$0.3              |                                 |

The class in the AOL/Time Warner securities litigation obtained a settlement of \$2.5 billion. Table 2 lists the recovery rates obtained by four IA plaintiffs and the class.<sup>3</sup>

Table 2: AOL/Time Warner securities litigation

|   | Max. shares held during class period (million) | Settlement (\$ million) | Recovery per share | Multiple of class recovery rate |
|---|--|-------------------------|--------------------|---------------------------------|
| CalSTRS                                 | 14.9   | \$105                   | \$7.1              | 11.9x                           |
| CalPERS                                 | 21.0   | \$118                   | \$5.6              | 9.5x                            |
| Regents of the University of California | 17.1   | \$246                   | \$14.4             | 24.4x                           |
| PERS Ohio                               | 10.4   | \$144                   | \$13.9             | 23.5x                           |
| <b>Class</b>                            | 4,233  | <b>\$2,500</b>          | \$0.6              |                                 |

<sup>3</sup> These settlement amounts are not limited to claims by shareholders. The class settlement amount is composed of \$2.4 billion from the company and \$100 million from its auditor, and it excludes the company's \$150 million settlement with the Department of Justice. There were additional IA plaintiffs in the AOL/Time Warner securities litigation, but as sufficient information is not available, they are not included in Table 2.

In the Tyco securities litigation, the class received a settlement of \$3.2 billion, while IA plaintiff New Jersey Division of Investment received \$73.25 million.<sup>4</sup>

Table 3: TYCO securities litigation

|                                   | Max. shares held during class period (million) | Settlement (\$ million) | Recovery per share | Multiple of class recovery rate |
|-----------------------------------|--|-------------------------|--------------------|---------------------------------|
| New Jersey Division of Investment | 1.8  | \$73                    | \$40.4             | 6.3x                            |
| Class                             | 498  | <b>\$3,200</b>          | \$6.4              |                                 |

The estimates of IA plaintiff recovery as a multiple of class recovery that we present in the tables above are imprecise because we do not have the detailed trading records needed to precisely estimate the multiple. However, plaintiffs' own estimates are also many multiples of those of the class—e.g., in the Qwest securities litigation, CalSTRS reported that it was able to recover approximately 30 times what it would have received in the class action, and CalPERS estimated its recovery in the AOL/Time Warner securities litigation at 17 times what it would have recovered as part of the class.<sup>5</sup> Often, IA plaintiffs report that they were able to recover a large fraction of their loss—e.g., in the AOL/Time Warner securities litigation, CalSTRS reported that it recovered \$105 million on “damage ... of approximately \$135 million,”<sup>6</sup> and CalPERS reported a recovery of \$118 million on investment losses of \$250 million.<sup>7</sup>

These examples show that opting out of a class may considerably increase the recovery in certain securities litigation. However, opting out is not without risks, as it involves bearing the costs of filing and pursuing litigation, the publicizing of potentially embarrassing internal analysis and communications, and the risk that the claims may be dismissed due to specific individual issues.<sup>8</sup>

It is likely that the settlements detailed above are instances where the recoveries were significantly above the norm. Inclusion of matters where IA were dismissed or where IA plaintiffs recovered amounts comparable to the class would bring the average recovery multiple for IA down. The levels of differentials in recoveries shown above are also unlikely to persist if large numbers of investors, particularly those with significant holdings, opt out and pursue IA.

<sup>4</sup> The class settlement amount is not limited to claims by shareholders, but the portion attributable to bonds and options is estimated at 9% of the total amount. The class settlement is composed of \$2,975 million from the company and two officers and \$225 million from the company's auditor. The settlement with the listed IA claimant is only for stocks. There were additional IA plaintiffs in the Tyco securities litigation, but as sufficient information is not available, they are not included in Table 3.

<sup>5</sup> CalPERS press releases dated January 31, 2007 and March 14, 2007.

<sup>6</sup> CalSTRS press release dated February 7, 2007.

<sup>7</sup> CalPERS press release dated March 14, 2007 and *New York Times* article dated July 19, 2003.

<sup>8</sup> This risk of dismissal due to specific individual issues is exemplified by the *GAMCO v. Vivendi* (03-5911 and 09-7962) matters and by the claims by the IA plaintiffs in M&A litigation against Aspen Technology.

However, the large stock holdings of institutions like BlackRock, Fidelity, Vanguard, or Putnam may also lower the cost hurdle. For example, within equities, BlackRock is reportedly the largest shareholder in a fifth of US firms. Furthermore, instances where a single plaintiff law firm files suit on behalf of a large number of institutions (as happened in the case of WorldCom securities litigation) may lower the costs that each of the IA plaintiffs has to bear. Costs can also be limited by sharing them with the class, e.g., through a consolidated discovery process.<sup>9</sup>

Certain institutions, particularly those that sponsor index funds and passive ETFs, may be particularly well-suited to opting out and filing IA because their investment strategy is predicated on market efficiency, allowing the institution to argue fraud on the market doctrine. On the other hand, large institutions may contain both actively-managed and passively-managed funds, which can potentially create disadvantageous discovery situations for those institutions regarding their reliance on market prices or exposure of their trading strategies.

Each investor that opts out of a class action creates the possibility of that investor pursuing claims outside of the federal court system. This may be one cause of the increased recoveries documented above. As a result, a decision by large institutions to systematically opt out of class actions is likely to be expensive for defendants in securities matters. For example, applying the minimum 6x settlement multiple in the tables above to the five firms mentioned as the largest shareholders throughout the Bear Stearns securities litigation would have approximately doubled the cost of its 2012 settlement to \$592 million from \$295 million. The added settlement cost to defendants will be greatest where these institutions hold the greatest percentage of shares. It may also spur defendants to increase the sizes of their class settlements to reduce the likelihood of plaintiffs opting out.

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<sup>9</sup> IA plaintiffs may also be able to keep recovery multiples high by judiciously choosing securities class actions to opt out of, such as matters where plaintiffs have strong liability arguments against deep-pocketed defendants and where the class action has survived motion to dismiss and class certification or is in the process of being settled.

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