Selinger: Clients Opting Out of Class Actions

By Christopher Faille, Financial Correspondent
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WHITE PLAINS, N.Y. (HedgeWorld.com)—A name partner at a venerable Westchester County securities law firm said that sophisticated institutional investors in the classes that become the plaintiffs in class-action law suits against corporate malefactors are increasingly inclined to opt out of those actions and seek a better result, through litigation or settlement, on their own.

Neil Selinger of Lowey Dannenberg Bemporad & Selinger recently represented a money manager in litigation against DaimlerChrysler AG. Mr. Selinger said in an interview he isn't sure whether that manager, Glickenhaus & Co. in New York, should be considered a "hedge fund" or not. It's a registered investment adviser with nearly $1 billion in assets under management, and it describes itself as a manager of equity, balanced, and fixed-income portfolios.

Glickenhaus was one of the largest investors in Chrysler when it merged with Daimler-Benz AG in 1998. At the time, the transaction was represented as a "merger of equals," although it became clear soon thereafter that Daimler had effectively acquired Chrysler and was treating it as a subsidiary. Many shareholders believed that the original presentation of the "merger of equals" was a fraudulent attempt to deprive Chrysler shareholders of the "control premium" that owners of an acquisition target generally receive.

Mr. Selinger said that LDB&S represented Glickenhaus in that matter, and that on that law firm's advice, the client opted out of the class action against the merged entity. "Glickenhaus had a relationship with some of the corporate officials involved and they felt that they were lied to, face-to-face," and that they might have grounds for a lawsuit available to them under New York state laws that wouldn't be available to the class as a whole.

Glickenhaus took this advice. Both the class action and the individual lawsuit have since settled. Although the settlement terms are confidential, Mr. Selinger did indicate that his clients had no reason to regret their action.

The View from Academia, and from the Trenches

The opt-out phenomenon hasn't as of yet received a great deal of academic attention. But in 2004 Theodore Eisenberg, Cornell University, and Geoffrey P. Miller, New York University School of Law, coauthored a research paper on the quantity of opt-outs. They concluded that throughout the period they studied, 1992–2003, "the numbers of opt-outs and objections [to class action settlements] were uniformly low and in some cases nearly trivial." On average, less than 1% of class members opt out of such an action, they said.

Mr. Selinger said that he hadn't seen the study and couldn't reply specifically, but that Messrs. Eisenberg's and Miller's conclusions might be misleading, for at least three reasons.

First, the number of members who opt out doesn't equal the percentage of the defendant corporations' equity represented by those who opt out.

Second, the phenomenon has been concentrated mostly in a small number of big-ticket cases such as the DaimlerChrysler controversy or a recent class action against Sidley Austin and KPMG over illegal tax shelters that those two firms—one of lawyers, the other of accountants—both approved. It may be significant in these cases even if swamped quantitatively within the Eisenberg/Miller database.

Third, the opt-out phenomenon has gained momentum in the two years since the publication of that paper.

Another high-profile example is the WorldCom litigation. Mr. Selinger there represented the New York City Pension Funds. In this instance, he was more at liberty to discuss the result than in the DaimlerChrysler matter. He said that he counseled the municipal pension to opt out and as a result “our client recovered 100 cents on the dollar on the recoverable bond debt and 20 cents on the dollar for open-market stock damages, which represents a significant premium on what it would have gotten as a member of the class.”

Defendants in that case included former officers and directors of the telecom giant as well as some of its service providers. The class action lawsuit was filed in the spring of 2002. The city filed its opt-out in October 2002, before the class had been certified, Mr. Selinger noted. Both the class action and the opt-out cases settled in September 2005.

In the broader picture, Mr. Selinger said that the class-action system was clearly broken by the 1990s, when Congress stepped in and sought to fix it with legislation. One of the effects of the reform act was, he said, to energize institutional investors to take a more active role in defense of their rights in cases of apparent securities fraud.

“This new role has unfolded in two stages,” he said. “The first step was that institutions became more likely to become the lead plaintiffs, in the hope of seeing to it that the actions were client-driven, not lawyer-driven. But the second step has been the growth of the opt-out, where activism takes the form of independent litigation.”

CFaille@HedgeWorld.com

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