With Billions At Stake, Class Action Plaintiffs Opt Out
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More than 100 institutional investors recently opted out of a $2.6 billion class action settlement with AOL Time Warner, choosing instead to pursue individual suits against the company. Opting out is becoming more common, as institutional investors with big losses seek to bypass lengthy class action proceedings and win larger settlements.

The plaintiffs that opted out of the Time Warner settlement, including Amalgamated Bank and a fund run by the Service Employees International Union, held around 100 million shares of the company's stock and lost between $220 million and $300 million after the messy merger of AOL and Time Warner.

Plaintiffs lawyer Bill Lerach, of Lerach Coughlin Stoia Geller Rudman & Robbins, argued that the settlement only recovers a small fraction of the amount lost by plaintiffs, and said that those who had opted out of the settlement would seek $3.3 billion in their suit against Time Warner.

The Time Warner opt-out is strikingly similar to the WorldCom class action litigation, in which several New York state pension funds decided to bring their own suit against the fallen telecom giant.

While the class action case netted a $651 million settlement, a judge ordered WorldCom to pay $78.9 million in damages to the five pension funds that benefited city employees, educators, policemen and firefighters.

The funds lost more than $200 million due to their investment in WorldCom. $130 million of the loss was directly attributed to the fraud that took place at the company, according to the complaint.

The WorldCom settlement set an important precedent for institutional investors looking to opt out of class action cases, showing that plaintiffs that had the most to lose may be better off on their own.

But although the promise of huge settlements may be alluring, institutional investors looking to bring their own suits must carefully weigh the pros and cons of opting out.

"If you have a substantial loss, it might give rise to a claim that's different than could be asserted in a class case," said Neil Selinger, an attorney with Lowey, Dannenberg, Bemporad & Selinger. "When you have an opt-out case, you control your destiny. You drive your own litigation; you're at the settlement table."

From a defense perspective, opt-outs further complicate shareholder litigation.

"You're fighting a several front war, and your resources have to be used in two different places, especially if the opt-out is a big institution," said Jeff Rosen, an attorney with Cozen O'Conner. "The opt-out cases could be in a different court; you're faced with twice as much discovery, twice as much litigation. If you settle one individual suit, it's going to set a floor. The other parties are probably not going to settle for less and expenses will continue to climb."

Another case in which plaintiffs that opted-out won big is the Bristol Myers Squibb class action litigation. Four institutional investors filed individual suits against the drug maker over the

company's relationship with ImClone, and in June 2005 the company settled all four cases for $89 million.

The class action suit, settled last February, netted $300 million.

But choosing an individual case over a class action does have its downsides, Selinger said. Rather than simply collecting a check when a settlement is reached, plaintiffs that opt out must commit greater time and energy to the case. This means that funds have to weigh the increased participation against the potential settlement value—sometimes it might not be worth it.

Additionally, opting out is generally an option only exercised by large institutional investors.

"Opting out is not something a mom and pop investor would do," Rosen said. "If you opt out, you've got to have the horses to go for the long haul. A single investor is not about to opt out. He can't even pay the filing fees."

Class action opt-outs are also occasionally driven by other motives, although settlement values surely remain at the forefront of investors' minds.

Some smaller investors have been known to opt out as a matter of principle, said Sarah A. Good, with Howard Rice Nemerovski Canady Falk & Rabkin.

"Other examples of cases involve institutional investors that have opted out of securities fraud class action settlements and filed separate litigation not in federal court (where securities fraud class actions under the Securities Exchange Act of 1934 always are filed) but in state courts under the antifraud provisions of the state blue sky laws and other claims under state law," she said.

But while the number of opt-outs jumped in the wake of big-name scandals like Enron and Tyco, experts say institutional investors—and plaintiffs lawyers—are likely to begin reconsidering, as the potential for profit drops.

"You may see a drop because it has to do with the economics of the lawyers that are involved," Selinger said. "From the self-interest of the attorney, the larger the potential recovery, the larger the fees will be and the more incentive to take the case. In a class action case, potential recovery will be maximized. In order to have the same economic incentive, significant damages must be involved."

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