

# Navigating Alternatives to Securities Fraud Class Actions: State Law and Opt-out Litigation

*Remarks of Jeffrey Paul Mahoney\**

I. THE COUNCIL OF INSTITUTIONAL INVESTORS .....	460
II. THE IMPORTANCE OF SECURITIES FRAUD CLASS ACTIONS .....	462
III. TRENDS IN SECURITIES LITIGATION .....	463

Good afternoon everyone. Thank you for inviting me to participate on this panel.<sup>1</sup>

Before I begin, in the interest of full disclosure, I want to warn you that, by education and training, I am an accountant as well as a lawyer. And because I have worked closely with both throughout my career, I am not infrequently asked about the differences between accountants and lawyers. And what I have observed over the years is that the single biggest difference between accountants and lawyers is that lawyers *know* that they can be boring. In light of that observation, I am going to be very brief in my remarks this afternoon and touch on just three related topics.

---

\* General Counsel, Council of Institutional Investors (“Council”) and adjunct professor, Washington College of Law, American University. A.A., Delta College; B.B.A, University of Michigan; J.D., University of North Carolina. Jeff Mahoney joined the Council as general counsel in 2006. His responsibilities include advocating the Council’s membership-approved policies before standard setters, regulators, members of Congress, and other policy makers. Prior to joining the Council, he was counsel to the chairman of the Financial Accounting Standards Board (“FASB”). From 1996–2006, he advised FASB and its parent entity, the Financial Accounting Foundation, on a variety of research, technical, and administrative matters, and was primarily responsible for FASB’s Washington, D.C. liaison activities. Prior to joining FASB, Mahoney was a corporate securities lawyer at Morgan, Lewis & Bockius LLP; a law clerk to the Honorable James G. Exum Jr., Chief Justice of the North Carolina Supreme Court; and an auditor at Arthur Andersen LLP. He was the initial co-chair of FASB’s Investors Technical Advisory Committee, and is a former member of the International Financial Reporting Standards Advisory Council, chair of the Investor Rights Committee of the Corporation, Finance, and Securities Law Section of the District of Columbia Bar, and a member of the Public Company Accounting Oversight Board’s Standing Advisory Group and Pricing Sources Task Force. Mahoney is currently a member of the Nasdaq Listing Qualifications Hearing Panel.

1. The Institute for Investor Protection Conference, entitled “The New Landscape of Securities Fraud Class Actions” was held at Loyola University Chicago School of Law on October 24, 2014.

First, I provide a brief description of the general members of the Council of Institutional Investors (“Council”), whom I represent. Second, I describe why Council members believe securities fraud class actions are important to their funds. And third, I discuss two trends that, in recent years, appear to have influenced some of our members into conferring greater consideration to opting out of federal securities fraud class action litigation or otherwise pursuing state law claims as an alternative to federal class actions.

### I. THE COUNCIL OF INSTITUTIONAL INVESTORS

The Council of Institutional Investors is a nonpartisan, nonprofit membership organization that serves as the voice for strong shareowner rights and protections and effective corporate governance standards for U.S. companies.<sup>2</sup> We were founded in 1985 by leaders of twenty-one largely public pension funds.<sup>3</sup> Those founders had different views on many issues, but they agreed on a few basic principles.

They agreed on the principle that investors and the markets benefit when corporate boards provide robust and effective oversight of management, when directors are accountable to owners, and when rules and regulations provide adequate protections to investors and ensure that important information is promptly and transparently provided to the marketplace.<sup>4</sup> They also agreed on the principle that investors’ voices can be more powerful and effective when they come together as a single constituency, rather than as individual funds.<sup>5</sup>

And finally, the founders agreed on the principle that one size doesn’t necessarily fit all when it comes to institutional investors and corporate governance and shareowner rights.<sup>6</sup> This last principle has led the Council to focus its resources on “big tent” issues where there is broad agreement and support among our member funds.

Almost thirty years later, the aforementioned principles remain the foundation of the Council, its mission, and its activities. Today, our general or voting members are composed of more than 120 corporate, public, and union employee benefit plans—foundations and endowments with more than \$3 trillion in assets under management.<sup>7</sup>

---

2. *About Us*, COUNCIL OF INSTITUTIONAL INVESTORS, [http://www.cii.org/about\\_us](http://www.cii.org/about_us) (last visited Mar. 24, 2015).

3. *Id.*

4. *See id.* (describing the founders’ goals of oversight and accountability).

5. *Id.*

6. *Policies on Other Issues*, COUNCIL OF INSTITUTIONAL INVESTORS, [http://www.cii.org/policies\\_other\\_issues](http://www.cii.org/policies_other_issues) (last visited Mar. 24, 2015).

7. *See Members*, COUNCIL OF INSTITUTIONAL INVESTORS, <http://www.cii.org/members> (last

Those members are quite diverse.

More than half of our general members are public pension funds.<sup>8</sup> The remaining members are split fairly evenly between union and corporate funds, with a sprinkling of endowments and foundations.<sup>9</sup>

Our general members also come in all sizes, from just over \$100 million in assets to more than \$100 billion in assets, and with the Council's median-sized voting member having about \$6 billion in assets under management.

While Council members are diverse, they share a few important characteristics. Members have a very significant stake in the U.S. capital markets with the average member fund investing more than fifty percent of their total portfolio in stocks and bonds of U.S. public companies.<sup>10</sup> In addition, members are in the market for the long-term. As most member funds are employee benefit plans, they have long-term obligations matched by long-term investment horizons. And because of the heavy use of passive investment strategies, members are often "locked in" to the companies in which they invest for as long as those companies remain part of an investable index.

More specifically, and on average, Council members passively manage more than forty percent of their U.S. stock portfolio and around fifteen percent of their U.S. fixed income portfolio.<sup>11</sup> And as long-term, passive investors, our members cannot simply exercise the "Wall Street Walk" and sell their securities whenever they are unhappy with the company in which they are invested.<sup>12</sup>

Finally, and perhaps most importantly for this panel discussion, our

---

visited Mar. 24, 2015) (describing the three types of members: General Members, Educational Sustainers, and Honorary International Participants).

8. See *General Members*, COUNCIL OF INSTITUTIONAL INVESTORS, [http://www.cii.org/general\\_members](http://www.cii.org/general_members) (last visited Mar. 24, 2015) (providing the names of members on the Board of Directors, including those who represent various public pension funds).

9. *Members*, *supra* note 7.

10. COUNCIL OF INSTITUTIONAL INVESTORS, *ASSET ALLOCATION SURVEY 2011*, at 4 (2011) ("The Traditional asset classes of domestic stocks and bonds have consistently represented a majority of total assets surveyed.")

11. *Id.* at 9; see Brief Amici Curiae of the Council of Institutional Investors et al. in Support of Respondent at 15–17, *Halliburton Co. v. Erica P. John Fund (Halliburton II)*, 134 S. Ct. 2398 (2014) (No. 13-317) (explaining that investors, especially those that are largest and most sophisticated, utilize passive investment management strategies to govern substantial amounts of assets).

12. See, e.g., COUNCIL OF INSTITUTIONAL INVESTORS, *CII INVESTOR-COMPANY ROUNDTABLE, THE SHAREHOLDER PROPOSAL PROCESS 2 (2014)* (explaining that many members of the Council are often unable to sell their shares when they are dissatisfied because of their sizable ownership stake of portfolio companies and their commitment to passive investment strategies.).

member funds are fiduciaries, and, as such, they are subject to legal standards regarding their duties to fund beneficiaries.<sup>13</sup> Those duties may arise from federal, state, and local rules.<sup>14</sup>

## II. THE IMPORTANCE OF SECURITIES FRAUD CLASS ACTIONS

In interpreting the applicable fiduciary duty standards, our member funds generally agree that they are required, at a minimum, to passively monitor securities litigation activity relevant to their funds' holdings and to pursue recoveries when the securities litigation results in settlements or judgments awarded to securities holders.<sup>15</sup> Those members generally believe that awards that are a result of securities fraud settlements or judgments are in effect fund assets, and as fiduciaries, they are required to recapture those lost assets on behalf of the fund's beneficiaries.<sup>16</sup>

A small, but not insignificant, minority of our member funds take a more aggressive approach to securities litigation by actively considering whether it would be in the best interest of the beneficiaries of their funds to serve as a lead plaintiff in securities fraud class actions.<sup>17</sup> As many of you know, the lead plaintiff in U.S. federal securities class actions is the court-appointed representative of the class charged with selecting and retaining lead counsel and managing the subsequent legal proceedings, primarily by overseeing and monitoring the case's progress and the efforts of lead counsel.<sup>18</sup> In that regard, some of those member funds have adopted specific internal guidelines to evaluate whether, and under what circumstances, their fund should pursue lead plaintiff status.<sup>19</sup>

For example, one public pension fund's guidelines include three criteria.<sup>20</sup> First, "What is the likelihood of [the fund] increasing its net recovery or capturing other added value by acting as lead plaintiff?"<sup>21</sup>

Second, "Are there non-monetary remedies of special importance to [the fund], such as corporate governance reforms, which other potential

---

13. See COUNCIL OF INSTITUTIONAL INVESTORS, SECURITIES LITIGATION, EVERYTHING YOU EVER WANTED TO KNOW BUT WERE AFRAID TO ASK 3 (2012) (describing the fiduciary obligations of pension funds).

14. *Id.*

15. *Id.* at 4.

16. *Id.*

17. *Id.*

18. *Id.* at 13.

19. *Id.*

20. See *id.* at 4 (describing the securities litigation policy of the Commonwealth of Pennsylvania Public School Employees' Retirement Board).

21. *Id.*

lead plaintiffs may not pursue?”<sup>22</sup> As an aside, many Council members believe that securities litigation offers a potential tool for imposing corporate governance reforms that may better ensure that U.S. corporations and their agents have a governance structure and practices going forward that are better aligned with our members’ interest in enhancing long-term shareowner value.

And third, “Are there specific reasons why [the fund] should not seek lead plaintiff status . . . ?”<sup>23</sup> Such reasons may include the fact that estimated damages do not meet the fund’s monetary threshold for participation, or that the venue for the class action is impractical or non-sympathetic to the fund or the class generally.<sup>24</sup>

On the flip side, as fiduciaries, our members generally acknowledge and understand that securities litigation can be very harmful to their funds and beneficiaries if the claims pursued are frivolous. Frivolous securities claims obviously waste corporate assets and divert management attention away from the goal of long-term value creation for shareowners.<sup>25</sup>

### III. TRENDS IN SECURITIES LITIGATION

For the minority of our fund members who are active rather than passive participants in securities fraud class actions, opt-outs are not uncommon.<sup>26</sup> The decision is generally based on a case-by-case analysis involving the careful consideration of a range of factors, including the type and number of claims, the level or lack of control over the litigation, the venue, the choice of outside counsel, the ability to achieve corporate governance reforms, and the amount of the estimated loss.<sup>27</sup> In some cases, this last consideration—the size of the fund’s losses—may prove to be the most important.

In general, it appears that the more material the amount of the estimated claim or damage is to the fund’s assets under management, the more likely the fund will conclude that overall benefits of opting out

---

22. *Id.*

23. *Id.*

24. *Id.*

25. *Id.* at 3.

26. *See, e.g.*, Interview with Amir Rosen, Principal, Cornerstone Research, and Christopher Harris, Partner, Latham & Watkins (Dec. 9, 2013), *available at* <http://www.metrocorpounsel.com/articles/26578/opt-out-cases-securities-class-action-settlements> (noting that pension funds, asset management companies, hedge funds, etc., were found to be among those entities most likely to opt out).

27. *See* SECURITIES LITIGATION: EVERYTHING YOU EVER WANTED TO KNOW BUT WERE AFRAID TO ASK, *supra* note 13, at 16–17 (listing the six factors that pension funds may wish to consider before reaching an opt-out determination).

exceed the costs to the fund, including the costs for extra time and resources often associated with pursuing an opt-out action.

Interest in opting out by member funds has likely been influenced by some of the recent high-profile pension fund opt-outs that appear to have been quite successful. For example, several of our New York City pension fund members opted out of the WorldCom class action settlement (the second largest in history at nearly \$6.2 billion).<sup>28</sup> The opt-out settlement for those funds was estimated to be three times more than they would have recovered if they had participated in the class.<sup>29</sup>

Similarly, in the AOL Time Warner securities fraud class action, the California Public Employees' Retirement System ("CalPERS"), which is a Council member, opted out.<sup>30</sup> CalPERS ultimately recovered \$117.7 million on claimed losses of \$129 million, a ninety percent recovery rate.<sup>31</sup> CalPERS's general counsel described the recovery as: "approximately 17 times what we would have recovered if we stayed in the class."<sup>32</sup>

Also during the same general time period, another Council member—the California State Teachers' Retirement System ("CalSTRS")—opted out of the Qwest securities fraud litigation.<sup>33</sup> CalSTRS recovered thirty times more in its opt-out action than it would have otherwise recovered.<sup>34</sup>

More recently, on May 5, 2014, CalPERS announced a \$12.75 million settlement with Ernst & Young ("E&Y") with respect to CalPERS claims arising out of purchases of Lehman stocks and bonds prior to the collapse of Lehman Brothers in 2008.<sup>35</sup> In its press release, CalPERS indicated that the E&Y recovery was "far larger than the recovery CalPERS would have obtained had it remained in the class

---

28. Keith R. Dutilleul & Joseph T. Kelleher, Morrison, IndyMac, and Halliburton: *The Changing Landscape of Securities Fraud Class Actions and What It Means for Mutual Funds*, PRACTICAL COMPLIANCE & RISK MGMT. FOR THE SEC. INDUS., May–June 2014, at 8.

29. *Id.* (quoting Kevin M. LaCroix, *Opt-Outs: A Worrisome Trend in Securities Class Action Litigation*, INSIGHTS, Apr. 2007, at 3, available at [http://clients.oakbridgeins.com/newsletters/Arril\\_Opt-OutsAWorrisomeTrendinSecuritiesClassActionLitigation.pdf](http://clients.oakbridgeins.com/newsletters/Arril_Opt-OutsAWorrisomeTrendinSecuritiesClassActionLitigation.pdf)).

30. *Id.*

31. *Id.* at 9.

32. *Id.* (citing Gilbert Chan, *CalPERS' Time Strategy Pays Off: The State Pension Fund Gets \$117.7 Million After Opting Out of Class Action Against Media Giant*, SACRAMENTO BEE, Mar. 15, 2007).

33. *Id.*

34. *Id.*

35. Press Release, CalPERS, CalPERS Achieves \$12.75M Recovery from Ernst & Young LLP (May 5, 2014), available at <http://www.calpers.ca.gov/index.jsp?bc=/about/newsroom/news/ernst-young.xml>.

action.”<sup>36</sup> The release also stated that the “amount paid by E&Y to CalPERS was equal to almost 13 percent of the total amount E&Y paid to settle with the entire class that CalPERS opted out of . . . .”<sup>37</sup>

Interest in opting out by member funds likely has also been influenced by the new landscape for federal securities class actions that is the title of this conference.<sup>38</sup> I believe it is fair to say that in recent years the federal courts, led by the United States Supreme Court, have generally made it more, rather than less, difficult for our members and other investors to pursue securities fraud class actions in federal courts.<sup>39</sup> One example of this anti-investor trend is the 2010 Supreme Court decision in *Morrison v. National Australia Bank Ltd.*<sup>40</sup>

As many of you are aware, the application of the Court’s decision in *Morrison* by the lower courts has significantly narrowed the boundaries of securities class actions brought by our members by often foreclosing their right to recover under the federal securities laws for stock bought on foreign exchanges.<sup>41</sup> In 2013 we surveyed our members about the impact of the decision on their funds.<sup>42</sup>

The survey revealed that, as a result of the *Morrison* decision, sixty-nine percent of our members were “changing or considering changing their litigation strategies and policies.”<sup>43</sup> While many of those changes focused on general members developing or modifying criteria and strategies for participation in foreign litigation, a few members indicated that they may place a greater focus on bringing securities fraud claims under state law.<sup>44</sup> This view is also represented in our most recent membership publication entitled *Top 10 Considerations for*

36. *Id.*

37. *Id.*

38. See Dutil & Kelleher, *supra* note 28, at 9 (describing how the law governing securities fraud class actions has continued to shift against the interests of investor plaintiffs).

39. See *id.* at 6–8 (detailing recent federal court cases and their effect on the pursuit of securities fraud litigation by investors).

40. *Morrison v. Nat’l Austl. Bank Ltd.*, 561 U.S. 247 (2010). See generally CHRISTIAN J. WARD ET AL., COUNCIL OF INSTITUTIONAL INVESTORS, *MORRISON V. NATIONAL AUSTRALIA BANK, THE IMPACT ON INSTITUTIONAL INVESTORS 1* (2012) (describing how the *Morrison* decision strips institutional investors of significant protections previously afforded under the federal securities laws).

41. See Brief Amici Curiae of the Council of Institutional Investors et al. in Support of Respondent, *supra* note 11, at 17–18 (“[A]fter the Court’s decision in *Morrison v. National Australia Bank Ltd.*, domestic equities and bonds form the principal classes of assets for which recovery can be had under Rule 10b-5 and that trade in conditions that could trigger the fraud-on-the-market presumption.”).

42. COUNCIL OF INSTITUTIONAL INVESTORS, A SURVEY OF *MORRISON*’S IMPACT ON CII MEMBERS 1 (2013).

43. *Id.* at 7.

44. *Id.*

*Institutional Investors When Participating in Foreign Securities Litigation.*<sup>45</sup> That paper indicates that member funds are being advised as best practice to examine the feasibility of pursuing state law alternatives for recovery in those cases.<sup>46</sup> More specifically, and as described in the paper, some of the questions that member funds are or should be evaluating in the case of foreign securities fraud litigation include: whether the facts support an action “under common law fraud, other tort or consumer laws, or state blue sky statutes”; whether a “choice of law analysis supports the application of state law claims to the facts presented”; and, “whether the claim would be barred by statutory or procedural issues, such as SLUSA, *forum non conveniens*, or lack of personal or subject matter jurisdiction.”<sup>47</sup>

There is little doubt that the *Morrison* decision and the success of some high profile state law opt-outs by institutional investors have contributed to the new landscape of securities fraud actions. There is also little doubt that my ten minutes have expired and as a lawyer, *I know I can be boring*, so let me end my remarks by thanking you for your time and attention.

---

45. COUNCIL OF INSTITUTIONAL INVESTORS, PARTICIPATING IN FOREIGN SECURITIES FRAUD LITIGATION, TOP 10 CONSIDERATIONS FOR INSTITUTIONAL INVESTORS 2–3 (2014).

46. *Id.* at 2.

47. *Id.* at 2–3.