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Factors affecting variations in securities class action claims rates

The claims rate represents the ratio of total approved claims as a percentage of damages estimated by plaintiffs for those claims. In a world with perfect information and automatic claim submissions, the claims rate should be 100%. In reality, however, damages computations rely on imperfect information and assumptions regarding purchases and sales of securities by investors and some investors do not file claims, and the ratio consequently varies widely across securities litigation matters. Looking at claims rates significantly below or above 100% can provide an understanding of the uncertainties surrounding damages estimation and settlement distribution in securities class actions.

The variation in the claims rate is the result of two factors. The first source of variation is that the denominator is an estimate of damages produced using a trading model.[1] Such trading models rely on assumptions that fill the gaps created by limited data on investors' holdings over time. In most cases, there is no information at all on individual retail investors' holdings, and institutional holdings are typically reported only quarterly in aggregate form. Trading models vary in their assumptions about investors' trading patterns and in their methods for calculating damages.[2] Thus, estimates of damages can be higher or lower than actual damages that would be computed using detailed records of holdings prior to the class period and purchases and sales during the class period. The claims rate will be below 100% if a too-high estimate of damages is used, and it can be above 100% if the estimate of damages is too low.

Note that, as we show below, the use of trading models to estimate damages allows some discretion on the part of plaintiffs and their experts because the selection of the trading model can influence estimates of maximum or expected class-wide damages. Plaintiffs' incentives at different stages of

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1 Plaintiffs often use a simple "80/20" model which assumes that 80% of securities are held by investors who account for 20% of the trading volume each day and the other 20% of the securities are held by investors who account for 80% of the trading volume each day. Many more complex and sophisticated trading models have been used over time, e.g., ones that explicitly separate out the shares held by institutional holders.

2 For example, damages calculations can depend on whether sales are matched to buys on a first-in-first-out (FIFO) or last-in-first-out (LIFO) basis and whether damages are capped by trading losses or by the 90-day lookback rule under 10(b)-5.

litigation may factor into such estimates. At the damages stage, plaintiffs have an incentive to demand as high an amount of damages as is plausible given the facts of the case. In filings to obtain approval of the settlement, plaintiffs may have an incentive to show damages at the lower end of the range so that the percentage of damages recovered seems high and may help to convince the judge to approve the settlement and to convince class members to accept the settlement so that defendants' "blow" provisions are not triggered.[3] Independent third parties observe only the damages estimates set out in settlement briefs and not the full range of estimates put forth by plaintiffs over the course of the litigation, what model was used, or what assumptions were made to estimate damages.

Sometimes the damages estimates provided by plaintiffs may vary not just because of alternative trading models, but because of alternative assumptions regarding case outcomes. For example, a plaintiffs' brief in support of class settlement might present damages scenarios reflecting defendants' prevailing on one or more disputed areas of the case. Because the claims process measures investor losses using a plan of allocation following plaintiffs' position, claimed losses can far exceed an estimate of damages based on defendants' positions.

The second source of variation in claims rates is that not all eligible investors file claims. For example, investors may neglect to submit claims, intentionally not submit claims because they believe the expected settlement amount is not worth the time and effort of doing so, or lack sufficient documentation to substantiate their claims. The second factor alone will result in a claims rate that is lower than 100%. In combination, the factors can result in claims rates that are above or below 100%. In the following sections we discuss cases that illuminate the factors driving claims rates.

Examples with high claims rates

In some cases, a very high claims rate may simply be due to plaintiffs' disclosures focusing on the low end of a range of estimated damages. For example, *Great Lakes Dredge & Dock Corp.* featured $15.9 million of approved claims compared to $12.9 million of estimated damages (claims rate of 123%). However, plaintiffs' brief in support of class settlement noted that the damages might be "as low as $12.9 million," indicating that the damages estimate could have been significantly higher.[4] The claims rate would have been lower than 100% if the high end of plaintiffs' damages in *Great Lakes* were only 25% higher than the low end. It is not unusual for the high end of damages estimates to be dramatically more than the low end of the range. For example, in the *Tangoe Inc.* matter (discussed below), plaintiffs estimated the high end of the range of damages of $12 million, 140% higher than the $5 million low end of the range.

The *Bank of New York Mellon* matter is notable for a claims rate of 232%. The approved claims totaled $2.3 billion though damages were estimated as $1.0 billion. As a result, the recovery rate (i.e., settlement amount as a percentage of damages) for class members was only 8% (180/2,300) rather than the 18% (180/1,000) recovery rate (before fees and expenses) that plaintiffs presented at the time of settlement approval.[5] BNY Mellon stock was widely held by institutions—at least 75% of shares

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3 "Blow" provisions in the settlement agreement allow defendants to cancel the settlement if an insufficient number of class members opt to accept the settlement payment and release defendants from further liability.

4 Plaintiffs do not provide any upper bound to the range of their damage estimates. Lead Plaintiff's Memorandum in Support of Motion for Final Approval of Class Action Settlement, Class Certification, and Approval of Plan of Allocation, in In re Great Lakes Dredge & Dock Corporate Securities Litigation, August 28, 2015, p. 5.

5 Memorandum of Law in Support of Lead Plaintiffs' Motion for Final Approval of Class Action Settlement and Plan of Allocation, in In re Bank of New York Mellon Corp. Forex Transactions Litigation, September 15, 2015, p. 18.

outstanding during the class period were held by institutions.[6] On the basis of the stock price inflation in plaintiffs' plan of allocation and publicly available data on institutional holdings, it is possible to put a lower bound on damages related to institutions at over $1.5 billion.[7] Given that institutional claims would be higher than this lower bound and the, up to 25% of, shares held by retail investors would contribute even more to total claims, plaintiffs' damages estimates relied on either a flawed model or assumptions that did not fully take into account available data.

Turning to the *Tangoe, Inc.* matter, the range of damages estimates from plaintiffs resulted in a claims rate between 111% and 267%. Notably, however, plaintiffs stated that damages were "likely closer to the low end" of the range of $5 million to $12 million, meaning that the claims rate would be near the high end (267%).[8] When computed at the upper end of estimated damages ($12 million), the claims rate declines to 111%. There was significant trading in Tangoe's shares between the initial disclosure event implied by the plan of allocation and the end of the class period, caused in part by significant events including an agreement for Tangoe to be acquired. Because the vast majority of recognized losses under the plan of allocation derived from the first disclosure event ($0.59 per share) rather than the end of the class period ($0.02), any misestimation of damages would come from trading model assumptions regarding the first disclosure event. During the time between disclosure events, Tangoe's share price first trended upward for several months and then declined in the final months of the class period. Plaintiffs' models could have overestimated the degree to which damages shares were purchased just before the first disclosure, only to be sold at higher share prices after that disclosure (with associated out-of-pocket caps on damages).

The *Vista Outdoor* matter, with a claims rate of 172%, has notable parallels to the *Tangoe* matter. Vista's institutional ownership of shares was very high: over 90% through the class period and, at some points in time, over 100% as a result of institutions holding shares created through short interest.[9] The *Vista Outdoor* matter is also notable for having two subclasses, one for common stock shares and one for bonds. Although bonds represented a small fraction of claims, they could be a source of estimation error in plaintiffs' damages estimates because less data on ownership of bonds are typically available (and, for unregistered bonds, the same is true of data on trading).[10] Bonds also tend to be owned and traded by institutions, who are more likely than retail investors to submit claims.[11]

Examples with Section 11 claims

One factor that could affect claims rates is whether the settlement involves Section 11 claims. Investors who purchase in securities offerings might find it more difficult to prove their claims—for example, a monthly brokerage statement might not suffice if it does not indicate that a purchase was

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6 Based on data from Refinitiv.

7 The lower bound is based on the increase in shareholdings for each institution during the class period multiplied by the maximum stock price inflation (where the increase is measured from the minimum holdings during the class period to the holdings at the end of the class period). This lower bound ignores any damages related to retail investors.

8 Memorandum of Law in Support of Lead Plaintiff's Unopposed Motion for Preliminary Approval of Class Action Settlement, in In re Tangoe, Inc., Securities Litigation, October 3, 2017, p. 19.

9 Based on data from Refinitiv.

10 FINRA's Trade Reporting and Compliance Engine (TRACE) tracks trading in registered corporate fixed income securities; trading information on unregistered securities may be more limited.

11 S. Çelik, G. Demirtaş and M. Isaksson, "Corporate Bond Market Trends, Emerging Risks and Monetary Policy," *OECD Capital Market Series* (Paris 2020), oecd.org/corporate/Corporate-Bond-Market-Trends-Emerging-Risks-and-Monetary-Policy.htm, p. 21.

made in a particular securities offering. On the other hand, a securities offering might be allocated disproportionately to institutional investors, who have fiduciary obligations to submit claims and tend to maintain records adequate for proof of claims.

One way to assess the effect of Section 11 is to examine a case such as the *Scottish Re Group* matter, which had separate settlements for Rule 10(b) and Section 11 claims, each of which applied to both common and preferred shares. Although the Section 11 settlement fund was only about 9% of the combined Section 11 and 10(b) settlements ($3.5 million and $34.0 million, respectively, totaling $37.5 million), it was about 39% of the approved claims ($106 million and $274 million for Section 11 and 10(b) claims, respectively, totaling $380 million).[12] The Section 11 claims rate of 166.7% was double the 79.7% 10(b) claims rate. The higher claims rate may relate to the inclusion of preferred shares in the Section 11 claims, as the plan of allocation noted that all preferred stock investors were considered eligible for Section 11 without further proof.[13]

The *Citigroup Bonds* matter, which involved only Section 11 claims, had a relatively high claims rate of 158.8% (approved claims of $4.7 billion versus estimated damages of $3.0 billion).[14] It is not surprising that there was a high claims rate for this case because the large size of the settlement ($750 million) created an economic incentive to submit claims and because bond investors are likely to skew more toward institutional investors, for whom records are available for proofs of claim. It is notable, though, that plaintiffs underestimated maximum damages by such a wide margin. One possible explanation is that plaintiffs misestimated the turnover and trading patterns in the bonds. For example, plaintiffs' damages expert pointed out that most bonds recovered quickly, reducing the likely damages in the case (Section 11 claims are limited by actual sale price, or, the higher of the actual sale price and the price on the lawsuit date).[15] However, if the bond investors who purchased during the class period were forced to sell for any reason (e.g., liquidity) at the market bottom and before the end of the class period, then the price recovery would be applied only to investors with minimal damages. Investors who held the bonds over the large price drops would suffer most of the damages and would have valid claims. In that case, the typical proportional trading model assumptions used in damages computations would cause damages to be underestimated.

Note that Section 11 cases do not all have high claims rates. In the *GT Solar International* matter (2008), the class comprised only purchasers in the stock's initial public offering and purchasers the next day.[16] The case ultimately had a claims rate of 79% (approved claims of $47.9 million versus

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[12] Plaintiffs estimated that if all class members submitted their claims, the 10(b) settlement would provide 9.9% recovery of recognized losses before fees and expenses, while the Section 11 settlement would provide only 5.5% recovery.

[13] Additional Section 11 claims derive from a secondary offering of common stock, requiring proof by the claimant that shares were purchased in the offering and not on the secondary market.

[14] Declaration of Stephen J. Cirami in Support of Bond Plaintiffs' Motion for Approval of Distribution Plan, in In re Citigroup Inc. Bond Litigation, July 18, 2014, p. 20; Memorandum of Law in Support of Bond Plaintiffs' Motion for Final Approval of Class Action Settlement and Plan of Allocation, in In re Citigroup Inc. Bond Litigation, June 7, 2013, p. 21.

[15] For example, investors who continued to hold the bonds through March 18, 2013, the date of the settlement, were to have a 90% discount applied to their claim to reflect the post date of suit recovery in the bond prices. Memorandum of Law in Support of Bond Plaintiffs' Motion for Final Approval of Class Action Settlement and Plan of Allocation, in In re Citigroup Inc. Bond Litigation, June 7, 2013, fn. 17.

[16] Proof of Claim and Release, in GT Solar International, Inc., p. 1.

estimated damages of $60.6 million).[17] Any claims rate below 100% is related either to investors failing to submit valid claims or plaintiffs misestimating damages due to a lack of information regarding the timing of individual class members selling their eligible shares and the prices at which they sold.

Example with multiple claims rates for the same underlying class period

Two settlements that BP entered into relating to alleged misstatements and omissions following the April 20, 2010 Deepwater Horizon explosion illustrate the degree of variation in the claims rate. Both settlements allowed investors who purchased shares between April 26, 2010, and May 28, 2010, to file claims. Both settlement notices indicated that the FIFO method would be used to match sales to purchases. Eligible claims were estimated at $2 billion by the SEC's Fair Fund administrator and at less than $437.5 million by the expert for the class-action plaintiffs—a five-fold difference in the damages estimate over the same period. Claims totaling $474 million were filed with the SEC Fair Fund administrator and claims totaling $130 million were filed in the class action—a 3.6-fold difference in claim submissions. The resulting claims rate was 24% for the Securities and Exchange Commmission (SEC) Fair Fund and 30% for the class action.[18]

This raises an interesting set of questions: (i) why do we see a low claims rate across the two matters although the eligible claimants are the same (investors who purchased BP American Depositary Shares (ADS) between April 26 and May 28, 2010)?; (ii) why do we see such a large difference in the eligible claims, which are based on filings by claimants?; and (iii) why are the estimated damages so different?

The low claims rates, 24% and 30% in the two matters, are surprising particularly because investors could submit claims in both matters using substantially the same documentation.[19] Investors could expect to receive approximately 25% of their losses based on a $525 million settlement amount and $2 billion damages estimate in the SEC Fair Fund process. However, since only 25% of the $2 billion damages amount was claimed (i.e., roughly $500 million in damages was claimed against a settlement fund of $500 million), then investors were paid 100% of their claim amount.[20] For investors who purchased ADS on April 26, 27, and 28, 2010, this would be $14.34 per ADS if they did not sell any ADS during the class period.[21] Investors in the class action could also expect large payouts. Plaintiffs' settlement notice indicated that investors who purchased ADS before May 4, 2010, would receive $0.97 per ADS, and based on the claims rate of 30% these investors likely received $3.23 per share.[22]

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[17] Exhibit A: Report of the Settlement Administrator, in GT Solar International, Inc., p. 2; Memorandum of Law in Support of Lead Plaintiff's Motion for Final Approval of the Settlement and Plan of Allocation, in GT Solar International, Inc., August 26, 2011, p. 8.

[18] Declaration of Eric Schachter on Behalf of A.B. Data, Ltd., in Support of Class Representatives' Motion for Authorization to Distribute Net Settlement Fund, In re BP p.l.c. Securities Litigation, November 7, 2018, p. 15; Lead Plaintiffs' Unopposed Motion for Preliminary Approval of Class Action Settlement and Approval of Notice to the Settlement Class, In re BP p.l.c. Securities Litigation, September 15, 2016, p. 9; Declaration of Brendan J. Manfreda, BP P.L.C., April 22, 2020, p. 2; Memorandum of Law in Support of Plaintiff Securities and Exchange Commission's Motion for an Order Approving a Distribution Plan for the Fair Fund, BP P.L.C., December 17, 2015, p. 4.

[19] Ibid.

[20] Declaration of Brendan J. Manfreda, BP p.l.c., April 22, 2020, p. 3.

[21] Plan of Allocation, in In re BP p.l.c. Securities Litigation, November 4, 2016, p. 40; Distribution Plan, BP p.l.c., February 3, 2016, p. 20.

[22] Notice of Proposed Settlement of Class Action, Final Approval Hearing, and Motion for Attorneys' Fees and Reimbursement of Litigation Expenses, in In re BP p.l.c. Securities Litigation, November 14, 2017, p. 2.

The low institutional ownership of BP ADS during the class period—38%—is one potential explanation for the low claims rate.

As noted above, investors who purchased ADS between April 26 and May 28, 2010, were eligible to file claims in both matters, with sales to be matched to purchases using the FIFO method.[23] However, there were significant differences in the way the size of the claims was determined that explain some of the difference. The SEC Fair Fund process used a simple inflation ribbon that started at $14.34 on April 26, 2010, and declined to zero on May 27, 2010, in five steps.[24] The class action used a more complex inflation ribbon that started at $7.93 on April 26, 2010.[25] The first two declines in the inflation ribbon coincided with the declines in the SEC Fair Fund inflation ribbon, but the behavior of the two ribbons diverged beginning May 4, 2010, when the class-action inflation ribbon rose again. The class-action plaintiffs used the more complex inflation ribbon to allocate settlement dollars to investors who purchased shares between April 26, 2010, and May 3, 2010, who were viewed as having stronger claims in the litigation.[26] In addition, the inflation band in the class action extended beyond the class period and the claims were limited by the 90-day lookback rule.[27] All four factors—the lower initial inflation, the more complex inflation ribbon, the extension of the ribbon beyond the end of the class period, and the use of the 90-day lookback rule—would contribute to lowering the eligible claims and damages estimate in the class action. However, the SEC Fair Fund claim computation used an offset for gains from inflation on sales of pre-class–period shares that would limit the ability of investors who purchased and sold shares during the class period to make claims.

Differences in the trading model and assumptions used may also have contributed to the large difference in damage estimates. The effects of the large number of ADS outstanding (more than 886 million), high trading volume, and the short class period (one month) would be amplified by differences in the trading model and assumptions used resulting in the large difference between the two damages estimates. The class-action plaintiff estimated that 149.7 million ADS—17% of the 886 million outstanding ADS—were damaged in the six trading days from April 26 to May 3, 2010, and 275.7 million ADS—31%—were damaged during the period from May 4 to May 28, 2010. The SEC Fair Fund administrator did not provide information on the estimates of damaged ADS.

Conclusion

Claims rates are of interest to parties to the settlement process. Average claims rates, which are well below 100%, suggest either that plaintiffs' class-wide damages estimates are too high or that many eligible class members do not submit claims. These average rates, however, obscure significant variation. Case-specific factors such as institutional ownership and the timing and extent of trading volume can significantly affect the accuracy of aggregate damages estimates. Understanding the assumptions behind such estimates and the magnitude of uncertainty about them is important when considering such estimates as part of settlement discussions.

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[23] Plan of Allocation, in In re BP p.l.c. Securities Litigation, November 4, 2016, p. 40; Distribution Plan, BP P.L.C., February 3, 2016, p. 20.

[24] Distribution Plan, BP p.l.c., February 3, 2016, p. 21.

[25] Plan of Allocation, in In re BP p.l.c. Securities Litigation, November 4, 2016, p. 43.

[26] *Id.* at p. 39.

[27] *Id.* at p. 41.

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