

## **Filing Proofs of Claim: Recovering Money Rightly Owed to Pensioners**

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Trustees can easily overlook an important way to retrieve money rightly owed to their funds and enable them to continue to fulfill their fiduciary duty to plan members: by properly filing proofs of claim in securities class action settlements.

Investors may be surprised to learn their funds regularly leave money on the table in securities class action settlements. Researchers have found that a surprisingly low percentage of institutional investors actually file claims, which annually produce billions in cash to be distributed to defrauded investors. Failure to collect part of a settlement can lead to lawsuits for those responsible for filing these claim forms.

For instance, in January 2005, more than 40 mutual fund managers, including Merrill Lynch & Co. Inc., the Vanguard Group Inc., Janus Capital Group Inc. and American Funds, were sued by shareholders alleging that the funds breached their fiduciary duty by failing to collect as much as \$2 billion in class action settlement payouts. These cases were all resolved in 2006 and marked the first time the courts were asked to rule, en masse, on this narrow issue within securities litigation.

Similarly, in November 2009 a suit was filed against several Wachovia and Wells Fargo entities, in their brokerage capacity as nominal owners of client securities, regarding a 2001 class action brought on behalf of purchases of securities issued by Asia Pulp & Paper Co. Ltd. ("APP"). That case settled in 2006 for \$46 million, and in May 2007 a distribution was made to investors that had filed claims.

As with most securities, the majority of APP investors held their securities in *street name*—or the name of a nominee, typically a bank, broker or custodian. The court overseeing the APP litigation ordered these nominee (record, but not beneficial owner) purchasers to either notify their clients of their eligibility to participate in the APP recovery or to provide the claims administrator with a list of those clients so the claims administrator could contact them directly.

The complaint alleged that Wachovia and Wells Fargo failed to do so and, as a result, their clients were not informed of the APP settlement, did not submit claim forms and thus did not collect their pro-rata share of the settlement. This case is still pending in the U.S. District Court, Northern District of California.

While the courts have yet to address whether trustees have a fiduciary duty to file claim forms for their funds, several academics have weighed in on this issue. Most notably, in their 2005 seminal study, James D. Cox and Randall S. Thomas argued that institutional investors indeed have a legal duty to file claims in securities fraud class action settlements.<sup>1</sup>

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<sup>1</sup> Cox, James D. and Thomas, Randall S., Letting Billions Slip Through Your Fingers: Empirical Evidence and Legal Implications of the Failure of Financial Institutions to Participate in Securities Class Action Settlements (December 2004). Stanford Law Review, Vol. 58, p.411, 2005; Vanderbilt Law and Economics Research Paper No. 06-09; Duke Law School Public Law & legal Theory Paper No. 107.

Cox and Thomas derived this view from the *Caremark Derivative Litigation*, where the Delaware Chancery Court ruled that a board of directors had a duty to monitor whether the corporation was operating within the boundaries of the law to accomplish its purposes. Specifically, Chancellor William T. Allen wrote that directors had a duty to make a good faith judgment that the corporation's information will come to its attention in a timely manner as a matter of ordinary operations. If a corporation failed to make this good faith judgment, a corporation could be liable for losses caused by non-compliance with applicable legal standards.<sup>2</sup>

Under the *Caremark* standard, one may easily conclude that institutional investors, such as public pension funds and Taft-Hartley funds, could face the possibility of litigation for breach of their duty of care if they are not diligently following securities class actions, filing their claim forms, and recovering money from settlements.

As Cox and Thomas asserted, "institutions cannot abandon without reason a claim to recover funds in a securities fraud class action settlement."<sup>3</sup> Even if, within fiduciary context, "an institution decided not to file a claim on the basis of comparing the costs to submit the claim with the expected award from the settlement, we would generally expect this to be a one-sided calculation in favor of filing for any actively trading institution."<sup>4</sup>

### **Statistical Data**

Cox and Thomas found in 2005 that only 28% of institutional investors surveyed actually filed claims in class action settlements. This percentage seemed surprisingly low at that time, considering that in 2004, securities fraud class action settlements produced \$5.45 billion in cash to be distributed to defrauded investors. Cox and Thomas suggested that institutional investors annually were leaving from \$1 billion to \$2 billion in unclaimed settlement money on the table.

Since that study, from 2005 through 2009, 518 securities class action settlements have yielded over \$42 billion in settlement proceeds for distribution to investors. Given these numbers and the current economic climate, it seems counterintuitive at best that pension funds would fail to return these monies to their respective coffers.

Furthermore, institutional investors' failure to file claim forms also leads to a financial windfall for those fiduciaries that do file in a timely manner. Since settlements are distributed on a pro-rata basis, the investors that file claims can be awarded additional money. And the amounts being recovered by responsible fiduciaries are far from insignificant. For example, the New York City Employees' Retirement System (NYCERS) estimates that it recovered almost \$20 million from 2007-2008 in class action settlement proceeds.

### **Why Institutions Fail to File Proofs of Claim**

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<sup>2</sup> Id. at 24.

<sup>3</sup> Id. at 23.

<sup>4</sup> Id.

There are several reasons why institutions are failing to file proof of claim forms in securities class action settlements, including:

- \*A general lack of monitoring by the management of institutions.
- \*Not receiving the settlement notice (unaware of the settlement).
- \*The perception that the cost associated with filing the proof of claim is greater than any potential recovery.
- \*Simply not filing on time or failing to correct errors causing the form to be rejected.
- \*Submitting duplicative filings (multiple filings are rejected by the claims administrator).

Perhaps the biggest reason is the difficulty institutions have in securing and maintaining access to historical data needed to file claims. Given that class periods for securities class actions can span a period of ten years by the time a settlement is announced, it is incumbent upon institutions to keep historical transaction records or be able to rely on third-party providers to compile old data when it is time to file proofs of claim. This task is made more difficult when an institution changes custodian. Typically, the former custodian does not transfer historical records. Therefore, it is the responsibility of the institutional investor to ensure that its old custodian will still file for all actions in which it has the records to perfect and submit a claim, or ensure that the old custodian is contractually required to transfer the fund's records to the new custodian at the end of the business relationship.

Securities class actions themselves continue to cause confusion with regard to claims filing. It is common for there to be multiple types of securities covered by class actions and, subsequently, class action settlements. Beyond typical stock and bond securities, many class actions involve exotic debt securities and multiple tranches of preferred securities. It has become increasingly more important—and more challenging—to locate each type of security within a portfolio.

### **What Can be Done?**

It is hard to believe that institutional investors, as fiduciaries, aren't more vigilant with how their portfolios are affected by corporate fraud and misbehavior. The challenge for most institutional investors is to establish a system to effectively monitor their investment portfolios with an eye toward making informed decisions on whether, and how best, to actively pursue any financial losses, including the diligent filing of proof of claim forms when there is a recovery in securities class action settlements.

Technology has greatly enhanced this exercise. The transfer of electronic data is relatively easy and, once completed, proper and effective portfolio monitoring can be accomplished. There are many options for plans to monitor their investment portfolios, including using internal staff, negotiating with a custodian to perform this important service, hiring a third-party claims advisory service and engaging external securities litigation counsel.

As they weigh these options, institutional investors need to consider their goals carefully. Regardless of which option is chosen, institutional investors should put procedures in place for receiving alerts when securities class action recoveries become available and submitting timely completed claim forms. This process should also include a mechanism for tracking submitted claims to ensure that any mistakes on the forms are corrected and all entitled monies are received.

A number of academics have recommended several best practices to help institutional investors implement loss recovery procedures to participate in class action settlements when they are an eligible class member. These include:

- \*The need for access to historical data should be addressed at the outset of the relationship with the custodian bank, preferably in the contract, to allow a third party to retrieve the data down the road and file the claim on behalf of the institution. (Note: The custodian may insist on inserting a pre-negotiated fee structure for this access. However, it is better to negotiate this fee at the outset of the relationship (stronger bargaining position) than at the end of it).

- \*Designate one individual or entity to file proof of claim forms.

- \*Complete and file timely proof of claim forms with all supporting documentary evidence with the settlement administrator.

- \*Monitor filed claims through their processing and the ultimate receipt of money.

- \*Know where settlement proceeds should be deposited.

- \*Require custodians or other filing parties to properly account for settlement payments when received. This protects trustees should they ever be questioned by their members as to how much the fund has recovered from class action settlements.

- \*Cox and Thomas call for the establishment of a centralized information clearinghouse and to standardize trading documentation and claims forms.

## **Conclusion**

The failure of many institutional investors to submit claims in settled securities class actions is a problem on several levels, and the money they would likely recover is by no means insignificant. But even if a fund is able to recover only enough settlement proceeds in a given year to pay for a portion of one member's pension benefit, isn't this a worthwhile pursuit?

As of the fourth quarter of 2010, approximately \$25 billion in class action settlements and Securities and Exchange Commission civil penalties were awaiting disbursement to investors. Trustees should ask if their pension fund will be taking part in some of those recoveries and find out if they have missed out on any settlements in the past.

From both an economic and fiduciary standpoint, institutional investors need to be certain they are recouping every dollar owed to their funds from securities class action settlements. Given the confluence of issues facing pension plans, it is essential, now more than ever, to ensure that a proper system is in place to actively track and manage class action claims. Implementing such a system is a wise safe harbor that allows trustees to fulfill their fiduciary obligations, fend off potential litigation and, most importantly, recover money rightly owed to their pensioners.