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NAPPA 2008 Winter Seminar Meetings

Wednesday, February 4 – Thursday, February 5, 2009
Benefits – Fiduciary & Plan Governance
Investment – Tax

Friday, February 6, 2009
Senior Counsel Seminar

The Westin Grand
Washington, DC

Save the Dates

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hold procedures, this rule is irrelevant because data would not be lost during good faith operations.

- “A global auto-purge email process poses a threat,” Moquin said. “On the other hand, the default position of saving all emails is not appropriate. We have begun to address the issue by being more cautious about the classification of emails.”
- “With our document policies in place, there remains a need for manual compliance review,” Deputy General Counsel Tom Petroni of the MERS Legal Department said. “With the incorporation of the automated records management systems, we have the ability and control to declare documents as official ‘records,’ in accordance with our formal records retention policy. In this way, we can reduce or eliminate record retention ‘mistakes’ that inevitably occur with auto-delete functionality.”
- Third-party data storage is another provision that pension organizations will need to address; contract language detailing actions acceptable for pending litigation or e-discovery actions must be clear and understood between both parties. Third-party data stores must comply with the same regulatory requirements of the contracting organization.

Each of these factors plays a role in developing an e-discovery strategy and process. Pension services organizations can follow the e-discovery guidelines proactively to minimize litigation costs, thus ensuring that the focus is on the facts of the case—not the

cost of discovery. Pretrial conferences are good opportunities to present and discuss the existence of electronic information that may be needed during the case and limit the discovery of information that is too burdensome to produce. As always, judges have the final say—so make sure they know that your organization is well prepared to enable collaborative discovery discussions.

About MERS

The Municipal Employees' Retirement System (MERS) is a statewide retirement plan and tax-qualified trust that municipalities may adopt for their employees. MERS offers employee benefit programs: defined benefit, defined contribution and hybrid plans, and group insurance products. MERS serves cities, counties, hospitals, libraries, medical care facilities, road commissions, townships, villages, and similar units of local government. MERS operated under state government from 1945 until 1996, when MERS became an independent non-profit public corporation. MERS members total approximately 700 municipalities and more than 75,000 individual members and retirees. For more information, visit www.mersofmich.com.

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The 7th Circuit Sends a Strong Message: Institutions Must Monitor Securities Class Action Claims

By

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Recently, the Seventh Circuit Court of Appeals sent a strong message to institutional investors: they are expected to have procedures and policies in place to monitor securities class actions in which they have a financial interest and viable claims. In *Larson v. J.P.Morgan Chase & Co.*, Civ. No. 8-1045, 2008 U.S. App. LEXIS 13298 (7th Cir. Jun. 23, 2008), a public pension fund sought to intervene in a securities class action against J.P.Morgan Chase & Co. after being notified of a proposed settlement that failed to include a recovery for certain claims worth several million dollars to the pension fund. The disputed claims were initially part of the class action, but were dismissed during an earlier stage of the litigation.

Even though the federal securities laws and the Private Securities Litigation Reform Act of 1995 (the “PSLRA”) do not provide for potential class members to receive notice when a securities fraud claim is dismissed prior to class certification, the court in

Larson denied the pension fund’s motion to intervene as untimely because it found that the pension fund is a **“sophisticated litigant with a large stake who had no good excuse for failing to seek intervention (or bring its own suit) years ago.”** Larson 2008 U.S. App. 13298, at *14. In reaching its decision, the court assumed that **“[l]arge pension funds have securities lawyers on retainer, and their lawyers would have known about and monitored the progress of the class action whether or not the fund’s trustees did.”** *Id.* at * 7 (emphasis added).

Although not all pension funds and institutional investors have securities lawyers on retainer to monitor their viable claims, the Seventh Circuit’s assumption that the pension fund would be aware of an important development in the pending litigation was not surprising, as most recommended “best practices” and model shareholder litigation policies make clear that institutional investors and fiduciaries should, at the very least, actively monitor on-going

litigation to ensure that they are fulfilling their duty to preserve viable claims, protect assets and recover funds lost as a result of securities fraud. Many of these recommended best practices and policies are published by large and respected organizations, such as the National Association of Pension Funds (UK) (“NAPF”) and the Government Finance Officers Association (US) (“GFOA”). These organizations have made clear the importance of institutional investors and trustees fulfilling their fiduciary duty to protect assets in the securities class action context.

It is now well established that institutions, at minimum, have an affirmative duty to recoup losses resulting from securities fraud, regardless of the origin or jurisdiction of the suit. For example, in its publication, “Securities Litigation – Questions for Trustees,” the NAPF reported, *“it seems self-evident that trustees have a duty to protect the assets in their scheme and that they should therefore at the very least not neglect opportunities to recoup losses.”*¹ Likewise, the published GFOA Recommended Practice, “Developing a Policy to Participate in Securities Litigation Class Actions (2006)(CORBA),” begins, *“Public pension governing bodies (the Board) and chief administrative officers (CAO) have a fiduciary obligation to recover funds lost through investments in public securities as the result of corporate mismanagement and/or fraud.”*² In addition, the U.S. Department of Labor has made clear that a pension fund’s “assets” – which fiduciaries, as defined under the Employee Retirement Income Security Act of 1974, as amended (“ERISA”), have a duty to protect – include not only the securities held by an ERISA plan, but also the rights attached to those securities.³ Indeed, the U.S. Secretary of Labor has repeatedly affirmed that it would be *“a breach of fiduciary duty not to pursue a valid [securities fraud] claim.”*⁴

One reason that organizations have been reaching out to institutions and promoting shareholder litigation policies is the massive amount of money from class action recoveries that has gone unclaimed. Since the Private Securities Litigation Reform Act was passed in 1995, *nearly \$60 billion has been recovered for injured shareholders.* (See chart below.) Nevertheless, *over \$12 billion went unclaimed.*⁵ That number is staggering, considering that most of the money is being left on the table by institutional investors, run by fiduciaries with a duty to collect it. In fact, a recent study found that less than 30 percent of institutions with recoverable losses file the proof of claim forms necessary to collect their settlement proceeds.

Year	Number of Settlements	Total Settlement Dollars
1995	71	\$616,267,860
1996	188	\$970,093,333
1997	155	\$1,290,206,307
1998	154	\$2,487,781,189
1999	157	\$1,821,129,610
2000	192	\$4,603,798,810
2001	179	\$2,511,677,710
2002	170	\$2,067,428,090
2003	114	\$2,527,918,267
2004	112	\$5,521,298,622
2005	99	\$6,711,616,861
2006	169	\$18,419,093,164
2007	238	\$9,430,669,343
Total:	1998	\$58,978,999,166

Source: Institutional Shareholder Services

Those institutions at the forefront of shareholder litigation, that have already developed and implemented litigation policies and procedures, have clearly benefited their constituents. For example, the Los Angeles County Employees Retirement Association (“LACERA”) *has recovered more than \$40 million from shareholder litigation* since formalizing its securities litigation policies and procedures in 2001. With established securities litigation policies and procedures, institutional investors are better able to assess the legal merits, track their viable claims, and review their financial records to determine if it has suffered damage, once it has been alerted to a new action. Not surprisingly, though, given the considerable size and diversity of an institutional portfolio and the limited amount of time an investor has to determine its best course of action before certain options are no longer available, institutional investors have turned to securities lawyers for assistance in monitoring their viable claims – just as presupposed by Judge Posner in his *Larson* decision.

By and large, firms that specialize in shareholder litigation are certain to monitor and evaluate newly filed class actions, and most are willing to provide their assessment to an inquiring investor at no cost, even before being retained to represent them in that action. In fact, many of these firms employ in-house analysts and investigative staff, in addition to attorneys, dedicated to that specific purpose. Moreover, beyond general inquiries, certain shareholder litigation law firms are able to facilitate the process proactively, through active portfolio monitoring.

Typically, portfolio monitoring involves the law firm working in conjunction with an institution’s custodian or investment advisor to track the institution’s investments in public companies. Once a shareholder action is filed, the law firm will run a search against the institution’s portfolio to see if it traded securities of the defendant company during the relevant time period. If so, the law firm will calculate the amount of damages resulting from the alleged wrongdoing and notify the institution. The portfolio monitoring continues throughout the litigation, ensuring that institutions and fiduciaries are aware of the progress of all pending actions. Thus, when a significant event takes place – e.g., the dismissal of claims in *Larson* – the institution is prepared to make an informed and timely decision based on case-specific advice. The amount of effort required by the institution to initiate portfolio monitoring is minimal (and the service is usually provided at no cost), yet the time saved is substantial considering the number of stocks that need monitoring, and that many securities class actions allege wrongdoing that occurred over several years.⁷

In addition, portfolio monitoring can simplify and improve the recovery collection process, which is at the essence of the duty fiduciaries owe their constituents. Each proof of claim form requires evidence of an investor’s holdings and dealings in the damaged securities. With active portfolio monitoring, such information is readily available to the monitoring law firm, making it easy for the law firm to ensure that the claims forms are timely filed. Moreover,

portfolio monitoring allows the law firm to oversee and monitor the proof of claims filings, which will increase the overall efficiency and effectiveness of the recovery collection process.

Historically, fiduciaries have relied solely on their custodians to handle recovery collections. However, noted experts have concluded that such a process “likely includes a good amount of incompleteness . . . [d]espite the admirable and nontrivial efforts of claims administrators to reach possible claimants,” and thus carries significantly increased risk that claims will not be accurately filed and recovered.⁸ Among the causes for such incompleteness is the length of time between the trades involving damaged shares and the notice of the settlement. High turnover within the custodial institutions and the frequency with which institutional investors change custodians and investment advisors may cause important information to “slip through the cracks.” Additionally, former custodians often fail to forward relevant information and trading data to new custodians, and they don’t always maintain adequate records of the trades of former clients. The danger of failing to perfect settlement claims is heightened by the fact that claims administrators often send notice directly to an institution’s custodian – or ex-custodian – rather than to the institution itself, so that the fiduciary remains unaware of the recovery right until it is too late.

These kinds of procedural deficiencies are costing institutions real money. On top of the \$60 billion recovered for injured shareholders since the PSLRA, there is an additional **\$9 billion currently in the “settlement pipeline,”** (which includes settlements that have been agreed upon but funds not yet distributed,) and every indication is that the settlement funds available to harmed investors will continue to mount.

Considering the amount of funds recovered in securities class actions and the increased amount of scrutiny from constituents in this time of economic volatility, it is critically important for institutions to develop and implement shareholder litigation and claims administration policies and procedures; or to revisit existing, potentially outdated policies. Decisions such as *Larson* from the Seventh Circuit make this all the more imperative. With the courts assuming that institutions are comprehensively monitoring their viable claims and making law based on those assumptions, institutional investors have no choice but to monitor their portfolios to preserve viable claims and recover assets lost as a result of securities fraud.

Footnotes

1. “Securities Litigation – Questions for Trustees,” NAPF March, 2007.
2. “GFOA Recommended Practice: Developing a Policy to Participate in Securities Class Actions (2006) (CORBA), approved by the GFOA Executive Board on October 6, 2006.
3. See PTE 2003-99, 68 Fed. Reg. 6953 (February 11, 2003).
4. Secretary of Labor’s Memorandum of Law as *Amicus Curiae* in Support of the Florida State Board of Administration’s Appointment as lead plaintiff in *In re Telxon Corp. Sec. Litig.*, 67 F.Supp.2d 803 (N.D. Ohio, 1999).
5. Taylor, Peter, “Europeans Lose Out On Billions,” *The Business*, 16 February 2008.
6. As estimated in a noteworthy study by leading experts professors James D. Cox and Randall S. Thomas, “Letting Billions Slip Through Your Fingers: Empirical Evidence and Legal Implications of the Failure of Financial Institutions to Participate in Securities Action Settlements.” 58 *Stan. L. Rev.* 411 (2005).
7. Simmons, Laura E., Ryan, Ellen M., “Securities Class Action Settlements: 2006 Review and Analysis,” Cornerstone Research.
8. James D. Cox and Randall S. Thomas, “Letting Billions Slip Through Your Fingers: Empirical Evidence and Legal Implications of the Failure of Financial Institutions to Participate in Securities Action Settlements,” 58 *Stan. L. Rev.* at 429.
9. See Riskmetrics Group, Institutional Shareholders Services, Securities Class Action Service Settlement Pipeline, as of June 1, 2008, as published at <http://www.issproxy.com/iss-governance/scas/index.html>.