

Ruling warns funds to follow class actions

By Blair A. Nicholas and Ian D. Berg

A U.S. Court of Appeals sent a strong message earlier this year to institutional investors that 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 vs. J.P. Morgan Chase & Co.*, the \$40 billion Colorado Public Employees' Retirement Association, Denver, sought to intervene in a securities class action after being notified of a proposed settlement that failed to include a recovery for certain claims worth several million dollars to the pension fund, according to the case in the 7th Circuit U.S. Court of Appeals, Chicago, in June. The disputed claims were initially part of the class action, but were dismissed during an earlier stage of the litigation.

The court, in an opinion written by Judge Richard A. Posner, denied the Colorado pension system'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." In reaching its decision, the ruling stated 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."

Although not all institutional investors have securities lawyers on retainer to monitor their viable claims, the court's assumption 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 ongoing 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.

It is now well established that institutions, at minimum, have a 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 National Association of Pension Funds in the United Kingdom said: "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." Likewise, the U.S.-based Government Finance Officers Association's recommended practice outlined in its publication "Developing a Policy to Participate in Securities Litigation Class Actions," begins: "Public pension governing bodies and chief administrative officers have a fiduciary obligation to recover funds lost through investments in public securities as the result of corporate mismanagement and/or fraud."

Since securities litigation reform was enacted by the federal government in 1995, \$58.9 billion has been recovered through 2007 for injured shareholders, and an additional \$9 billion is now in the "settlement pipeline," which includes settlements that have been agreed upon but funds not yet distributed. Nevertheless, more than \$12 billion went unclaimed. That number is staggering, considering that most of the money is being left on the table by institutions, run by fiduciaries with a duty to collect it. In fact, a recent study found that less than 30% of institutions with recoverable losses file the proof of claim forms necessary to collect their settlement proceeds. (That \$12 billion in unclaimed recoveries is not necessarily "lost" or unclaimed. In most cases, the class-action settlement is structured so that the pool is divided among those investors who do submit claims, so their respective shares would be increased to account for those who don't file a claim.)

As presupposed by the court in the Larson decision, many institutions have indeed turned to securities lawyers to help develop securities litigation policies and to facilitate class-action recoveries. For example, the Los Angeles County Employees Retirement Association, Pasadena, Calif., has recovered more than \$40 million from shareholder litigation since formalizing its securities litigation monitoring policies in 2001.

Typically, portfolio monitoring allows law firms to work in conjunction with custodians and investment advisers to ensure that institutions and fiduciaries are alerted to pending class actions and are kept informed of important events throughout the litigation.

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 make this all the more imperative. With the courts assuming that institutions are comprehensively monitoring their viable claims, institutional investors have no choice but to monitor their portfolios to preserve viable claims and recover assets lost as a result of securities fraud.

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