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Morgan Lewis
C O U N S E L O R S A T L A W

Role Of Advisers In Client Class Action Claims

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Role Of Advisers In Client Class Action Claims

- What to do about class actions, settlements and related proofs of claim?
- Recent class action complaints against mutual funds and their investment advisers
- Recent inquiries by OCIE
- Desirability for advisers to clarify what role they do – or do not – play in these matters

Class Action Lawsuits on Class Actions Settlements

- Alleged that fund advisers violated their fiduciary duties by failing to file class action claims
- “By virtue of their position as investment advisors to the Funds, the Investment Advisor Defendants directly owed fund investors a fiduciary duty to act in their best interests
- “By failing to submit Proof of Claim forms, Defendants breached the fiduciary duty and standard of care
- Of the 44 funds and firms targeted, at least 22 have had their cases voluntarily dismissed because the complaints were based on bad facts

OCIE Enters the Fray

- OCIE Asks:
 - Advisor’s process to identify situations in which clients may be eligible to participate in a class action and receive any benefits, including factors considered in deciding whether to participate
 - Written policies and procedures for the foregoing as well as the process for participating, filing proofs of claim, etc.
 - The number of class action recoveries for the past two years in which the adviser’s clients participated and the total amount of their recoveries, as well as the number of class action lawsuits for which clients were eligible but the adviser elected not to participate
- Admonition: Adviser should “consider” implementing written policies and procedures relating to clients’ participation in class action lawsuits . . . “we are bringing the issue to your attention for immediate corrective action.”

Acting on Class Actions Exceeds Typical Responsibility and Authority

- Responsibility rests with client
 - Does not flow down to an adviser by virtue of its appointment or being given discretionary authority
 - Unless such authority is specifically conferred by contract
- Advisory contracts usually don't grant broad power of attorney
 - This includes submissions of proofs of claim in class action settlements that include a full release against the defendants
 - Recent Lead Plaintiff Case
 - Proofs of claim in class action settlements generally state that
 - The form may only be executed by a person with the “authority to bind the person or entity on whose behalf they are acting to the Proof of Claim and Release”
 - “Cannot be established by stockbrokers only demonstrating that they have discretionary authority to trade stock in another’s accounts.”

Professors Cox and Thomas

- Argue just the opposite in their 2002 article
- Their analysis (and the analysis in their forthcoming 2005 article)
 - Seems primarily directed at the in-house managers of institutional investors
 - Does not seek to parse the fine distinctions between the roles of different in-house and outside fiduciaries
- They note in their forthcoming article
 - Majority of institutional investors surveyed relied on their bank custodians – not their investment advisers – to process and file proofs of claim
 - Remaining institutional investors surveyed had in-house departments, outside vendors or attorneys involved in the process

Contrast DOL Position

- DOL has taken stance that a pension plan’s “fiduciaries” of all types are responsible to determine whether the plan should serve as lead plaintiff in litigation
 - This position does not mean that this responsibility flows with the appointment of an investment manager down to an adviser responsible for making investment decisions for a plan’s account
 - The DOL has in other contexts made clear what responsibilities flow from a plan fiduciary to an investment manager, most notably in the proxy voting area

Good reason why not

- Class actions should be treated differently than proxy voting
 - Voting of proxies on a company's management or other shareholder initiatives may have a direct bearing on the investment merits of a particular security
 - Issues of whether a client participates in the class action and the submission of proofs of claim do not, however, affect the analysis of whether an investment in a given security is prudent
 - Nor would an adviser's judgment or expertise about a security or its investment merits have any bearing on a decision by a plan fiduciary to participate in a class action or submit a proof of claim

Exceeds Current Abilities

- Advisers do not have the requisite expertise to advise clients on participation in class actions, but would have to
 - Subscribe to litigation monitoring services
 - Engage outside lawyers to assist in evaluating potential claims
- The decision of whether to participate in a class action may involve facts beyond the scope of the adviser's dealings with the client
 - Opt Out

Best Practices

- Disclose practice either way
- If an adviser undertakes to act on class action claims, specify the terms in a contract that
 - Confers legal authority to submit proofs of claim on behalf of the client
 - Obligates the client and its legal counsel to provide information and be reasonably available to consult
 - Addresses fees, expenses and the standard of liability that will apply to the adviser's services
 - Disclaims advisor's obligation to provide legal services
 - Enables the adviser to “bump” back to the client any matter the adviser deems appropriate

Best Practices

- If an adviser does not undertake to act on class action claims, adviser may wish to
 - Confirm who is undertaking this responsibility for the client
 - Receive client direction on whether the adviser should transmit copies of class action notices it receives to that person
- Consider the extent to which the handling of class action claims should be reflected in its policies and procedures
- If an adviser undertakes to provide class action claim services, it should review its insurance policies to ensure these activities are appropriately covered