

Reproduced with permission from Tax Management Compensation Planning Journal, 40 CPJ 275, 12/07/2012. Copyright © 2012 by The Bureau of National Affairs, Inc. (800-372-1033) <http://www.bna.com>

The Fiduciary Duty to Recover Securities Class Action Settlement Awards Under ERISA

*by Marcia S. Wagner, Esq., and John J. Sohn, Esq.
The Wagner Law Group, and
John Sinclair and Robert I. Adler
Financial Recovery Technologies / Value Recapture
Partners*

Editor's Note: This article is the first in a two-part series of articles that address the retirement plan fiduciary duties under ERISA that may apply to class action settlement awards involving plan assets. This article addresses the steps retirement plan fiduciaries should take to develop a prudent process for investigating and recovering amounts owed to plans in connection with class action settlement awards. The second article, which will be published in the February 2013 issue of the Compensation Planning Journal, will address the additional considerations that should be taken into account by plan fiduciaries when the class action litigation settlement involves a party in interest to the plan, including the DOL's Prohibited Transaction Exemption 2003-39, which provides procedural guidelines for ensuring that a settlement will not be treated as a prohibited transaction under ERISA.

INTRODUCTION AND OVERVIEW

Plan fiduciaries to retirement plans have a duty to safeguard their individual plans' assets in accordance

with the fiduciary standard of care under the Employee Retirement Income Security Act of 1974, as amended (ERISA). This fiduciary duty to preserve the plan's assets extends to any potential legal claims and rights of recovery that the plan may have in its capacity as an investor in securities, including any claims that the plan may have with respect to the proceeds of securities class action settlements.

As the list of corporate and investment scandals continues to grow, such as the highly publicized Enron scandal or Madoff's infamous Ponzi scheme, class action litigation has become more commonplace. Furthermore, the size of many settlements for eligible class members continues to be substantial. Given the prevalence of class action settlements, it is important for plan fiduciaries and their service providers to develop a prudent process for investigating and recovering the amounts owed to plans in connection with their legal claims. Any plan sponsor or fiduciary service provider that breaches its investment-related duties under ERISA for imprudently failing to recover amounts owed to the plan may become subject to significant liability and penalties for its fiduciary breach.

ERISA'S FIDUCIARY DUTY TO RECOVER CLASS ACTION SETTLEMENT AWARDS

There is an overarching duty of "loyalty" under §404(a)(1) of ERISA that requires plan fiduciaries to discharge their duties with respect to the plan solely in the interest of the plan's participants. In addition to imposing a duty of loyalty, this ERISA provision also imposes a duty of "prudence" on all plan fiduciaries, requiring them to act with the care, skill, prudence

and diligence that a prudent man familiar with such matters would exercise under similar circumstances.

The courts have interpreted these broad fiduciary duties as also imposing a “duty to take reasonable steps to realize on claims held in trust,” meaning that plan fiduciaries have a duty to take reasonable steps to recover amounts owed to the plan and its related trust.¹ Accordingly, a plan fiduciary generally has a duty to pursue valuable claims that the plan has against other persons.² Generally, when a plan has a potential claim against another party, the plan fiduciaries have a “duty to investigate the relevant facts, to explore alternative courses of actions and, if in the best interests of the plan participants, to bring suit” or take other legal action.³

A failure to preserve the plan’s claims against a third party, or releasing them without investigating the value or viability of those claims, may constitute a breach of the responsible plan fiduciary’s duties.⁴ In accordance with traditional trust law doctrine, if a plan holds a claim against a third party and the plan’s fiduciary improperly refuses to bring an action, the plan participants may bring a suit against the fiduciary.⁵ These traditional trust law principles are incorporated into ERISA, which clearly allows participants, fiduciaries and the U.S. Department of Labor to initiate lawsuits on behalf of an injured plan against the responsible plan fiduciary.⁶

The fiduciary duties of loyalty and prudence under ERISA do not necessarily require the plan fiduciary responsible for investigating class action settlement awards to pursue every possible claim. If, under the circumstances, it is prudent to refrain from pursuing a claim on behalf of the plan, the responsible fiduciary would not be in breach of its duties. For example, the courts have held that a plan fiduciary did not breach its duty by failing to take steps to enforce a claim to the extent the fiduciary reasonably believed that such action would be futile.⁷ Apathy and ignorance, of course, would not be viewed as valid reasons for failing to file a valuable claim on behalf of the plan. In the absence of reasonable grounds for not filing, a responsible fiduciary’s failure to submit a claim to an administrator in a settled action for proven losses

would undoubtedly result in a breach of the fiduciary’s duties under ERISA.⁸

Pursuing a claim to recover class action settlement monies can be a challenging task, as it typically involves an analysis of the plan’s trading activity with respect to the applicable security. This analysis is customarily necessary to determine claim eligibility as well as the amount of the economic injury sustained by the plan, ultimately determining the amount of the plan’s award. All settlement claims must be timely filed with the claims administrator. If a plan fails to file a settlement claim on a timely basis, the plan effectively abandons its claims and forfeits all rights to the settlement funds.⁹ Because the award recovery process can drag on for multiple years after the initial claim has been filed, it is especially important to monitor the status of the filed claim and to follow up with the claims administrator to ensure the claimant actually receives the amount due. Because of the complexity of the award recovery process, many plans either fail to recover the settlement monies that are owed to them or recover only a portion of what is due.

A failure to recover the plan’s class action settlement award could be viewed as a breach of the responsible plan fiduciary’s duties under ERISA, unless the fiduciary can establish that it was prudent to abstain from filing its claim to the settlement proceeds. The failure to investigate and preserve the plan’s settlement claims would clearly result in a fiduciary breach to the extent pursuing the abandoned claims would have been valuable to the plan.

IDENTIFYING THE RESPONSIBLE PLAN FIDUCIARY

Subject to certain limited exceptions, the assets of retirement plans subject to ERISA must be held in trust by the plan’s trustee or trustees.¹⁰ Generally, the assets of a plan are beneficially owned by the participants, but legal title to the assets are typically held by the plan’s trustee or custodian. If the plan relies on the services of an *institutional trustee*, the applicable

⁸ See also Cox and Thomas, “Leaving Money on the Table: Do Institutional Investors Fail to File Claims in Securities Class Actions?” 80 *Wash. U. L. Q.* 855 (2002).

⁹ In the case of a mandatory or “non-opt out” class action, each class member must make a filing to recover the rightful portion of the settlement monies. In the case of an “opt out” class action, if a class member does not affirmatively notify the court that they are opting out of the class, the class member is deemed to have agreed to participate in the class and no longer has the option of initiating its own lawsuit against the issuer of the applicable security. In either case, if the class member then fails to file a timely claim to any settlement monies, it effectively abandons its claims to such funds.

¹⁰ ERISA §403.

¹ *Donovan v. Bryans*, 566 F. Supp. 1258 (E.D. Pa. 1983). See also *Freund v. Marshall & Ilsley Bank*, 485 F. Supp. 629 (W.D. Wis. 1979).

² *In re Trans-Industries, Inc.*, 419 B.R. 21 (Bankr. E.D. Mich. 2009).

³ *McMahon v. McDowell*, 794 F.2d 100 (3d Cir. 1986).

⁴ *Harris v. Koenig*, 815 F. Supp. 2d 26 (D.D.C. 2011).

⁵ See *McMahon v. McDowell*, above.

⁶ ERISA §502(a).

⁷ *McMahon v. McDowell*, above.

bank or trust company serving as the plan trustee would hold legal title to the plan's assets. In situations in which one or more individuals serve as the plan's trustees, a separate financial institution (e.g., bank, broker-dealer) would typically need to serve as a *custodian* to hold the plan's assets on behalf of the plan and its trustees. In these types of arrangements, the *custodian* would similarly hold legal title to the plan's assets.

When a plan invests in a security that becomes involved in a securities class action lawsuit, it is the plan's institutional trustee or custodian that is legally able to file a claim as the formal owner of the relevant security in order to collect the settlement funds due to the plan. In the case of an institutional trustee with discretionary authority over the plan's assets, this "discretionary" trustee would be the plan fiduciary responsible for taking the reasonable steps necessary to recover these amounts on behalf of the plan.

If the institutional trustee is a "directed" trustee that acts solely at the direction of the plan sponsor, the plan sponsor (or its delegate) would be the fiduciary responsible for investigating the class action settlement and pursuing the reasonable steps necessary to recover the plan's settlement funds with the assistance of the directed trustee. Although the directed trustee in its capacity as the legal owner of the relevant security would need to file the actual claim to the class action settlement funds, the plan sponsor would remain responsible for directing the trustee to take this action on behalf of the plan.

Similarly, in the case of a plan with individuals serving as the plan's trustees and a separate financial institution serving as the plan custodian, the trustees (or their delegate) would typically be responsible for investigating the class action settlement and also directing the custodian to file its claim and to collect the applicable settlement funds.

POTENTIAL LIABILITY FOR FIDUCIARY BREACHES

As discussed above, a plan fiduciary has a duty to pursue valuable claims that the plan has against other persons, including class action settlement claims. If the responsible fiduciary for a plan fails to take reasonable steps to recover the settlement funds in breach of its duties of loyalty and prudence under ERISA, the plan fiduciary's failure to act would be subject to substantial liability and penalties under this federal law.

ERISA §409(a) imposes personal liability on the responsible fiduciary for the losses sustained by the plan (i.e., the recovery amount that was wrongfully abandoned by the plan). Therefore, an institutional trustee with discretion over plan assets, the plan sponsor re-

sponsible for the actions of a directed trustee, or the individual trustees of a plan with an institutional custodian could be subject to personal liability for breaching their respective fiduciary duties under ERISA by failing to take reasonable steps to investigate and to recover the class action settlement proceeds owed to the plan.

Even if they do not have any fiduciary responsibility to initiate an award recovery process, directed trustees and custodians could potentially be held liable in situations in which they knew, or should have known, that the responsible fiduciary's failure to pursue and recover class action settlement claims was in breach of the responsible fiduciary's duties under ERISA. Although the case law is still evolving, a number of courts have held that the non-fiduciaries can also be held liable for knowingly participating in a plan fiduciary's breach of its duties under ERISA.¹¹

Once the breach of a plan fiduciary's duties has been established, the U.S. Department of Labor (DOL) is empowered under §502(l) of ERISA to assess a civil penalty against the fiduciary or any non-fiduciary person that knowingly participates in such breach. The amount of the civil penalty is based on 20% of the applicable amount recovered by the DOL on behalf of the plan. Therefore, in the event of a fiduciary's failure to take reasonable steps to recover funds in breach of its ERISA duties, the DOL would have the power to impose a 20% monetary sanction against the plan fiduciary as well as any directed trustee or custodian that knew or should have known about the fiduciary breach.

STANDARD OF CARE FOR RECOVERING CLASS ACTION SETTLEMENTS

In accordance with the duty of prudence under ERISA, plan fiduciaries must act with the care, skill, prudence and diligence that a prudent man *familiar with such matters* would exercise under similar circumstances. Because this standard of care requires a plan fiduciary to act with the skill that a hypothetical person who is already familiar with the relevant matter would possess, it requires a level of expertise beyond that of a prudent lay person. For this reason, this prudence standard is sometimes referred to as the prudent "expert" standard.

¹¹ See, e.g., *Bombardier Aerospace Employee Welfare Benefit Plan v. Ferrer, Poirot & Wansbrough*, 354 F.3d 348 (5th Cir. 2003); *Rudowski v. Sheet Metal Workers Int'l Ass'n, Local Union No. 24*, 113 F. Supp. 2d 1176 (S.D. Ohio 2000). However, a number of courts have held that a non-fiduciary can only be held liable for knowingly participating in a fiduciary's breach that also involves a prohibited transaction under ERISA. See, e.g., *Mellon Bank v. Levy*, 71 Fed. App'x. 146 (3d Cir. 2003).

The duty of prudence, as interpreted by the courts, generally requires plan fiduciaries to conduct an independent investigation of the merits of any proposed course of action (or inaction) to be taken on behalf of a plan.¹² This standard of care would also, for example, extend to a proposed decision to pursue (or not to pursue) claims for class action settlement monies. In accordance with the “expert” standard of care that is required, the responsible plan fiduciary must conduct this investigation skillfully and with the knowledge of an experienced fiduciary.

This aspect of the prudence standard poses a problem for a large number of plans. In many instances, the responsible plan fiduciary does not have the necessary experience or skill to research and identify all of the potential settlement claims for which the plan would be eligible to recover. As the legal owner of the plan’s investment securities, the plan’s institutional trustee or custodian should receive all the relevant class action notices and settlement notices that are provided to the class members. However, due to administrative errors, the relevant notices may not be properly delivered to the plan’s current trustee or custodian, especially if the plan has recently switched to a new provider of trust or custody services.

Furthermore, if a directed trustee or custodian does not proactively inform the responsible plan fiduciary about the receipt of such notices, the plan fiduciary may remain ignorant of the plan’s potential claims, resulting in the unknowing and unintentional forfeiture of the plan’s settlement awards. It should be noted that even if the trustee or custodian submits an initial filing to the claims administrator, the plan may not receive the full amount to which it is rightfully entitled, if the filing does not contain all of the supporting information necessary to demonstrate the plan’s economic loss in its entirety. The plan may also fail to receive its settlement award if the institutional trustee or custodian fails to follow up with the claims administrator or provide any required follow-up information after the initial filing.

INVESTIGATING AND RECOVERING CLASS ACTION SETTLEMENT AWARDS PRUDENTLY

The courts have held that plan fiduciaries must seek out an independent expert whenever the responsible fiduciary lacks the education, experience or skills to satisfy the prudence standard.¹³ With respect to the recovery of class action settlement monies, the respon-

sible fiduciary should similarly consider seeking out an independent expert if it or the plan’s provider of trust or custody services lacks the necessary experience or skill.

There are a number of firms that specialize in monitoring and recovering class action settlement awards on behalf of investors. In addition to appropriately filing and managing current claims on behalf of plan clients, these firms can also examine the plan’s trading history against recently settled and active class action cases to confirm the eligibility of the plan to pursue additional settlement awards.

As discussed above, the plan’s responsible fiduciary may be an institutional trustee with discretion over plan assets, the plan sponsor responsible for the actions of a directed trustee, or the individual trustees of a plan with an institutional custodian. By engaging a firm specializing in class action settlement recovery services, each of these types of plan fiduciaries would be demonstrating that they have taken reasonable steps to recover the amounts owed to the plan in satisfaction of their fiduciary duties under ERISA. This approach would also insulate these responsible plan fiduciaries from potential liability under ERISA.

Further, providers of directed trustee and custody services should also consider engaging the services of a firm that monitors and recovers class action settlement funds. In addition to enhancing the scope and the quality of the services provided to its plan clients, these services would also insulate these providers from any potential liability under ERISA, potentially arising to the extent that these providers knew or should have known that their plan clients had failed to file their claims for settlement awards, and thus, in breach of their respective fiduciary duties.

CONCLUSION

As part of their duties of loyalty and prudence under ERISA, plan fiduciaries have a duty to take reasonable steps to recover amounts owed to the plan and its related trust. With respect to class action settlement awards, plan fiduciaries have a duty to file the relevant claim unless pursuing such claim would have no value to the plan or if it would otherwise be prudent to abstain from filing. A breach of these fiduciary duties may result in personal liability and penalties for the responsible fiduciary. Additionally, a plan’s directed trustee and custodian may also be subject to potential liability and penalties under ERISA to the extent that they knew or should have known that the responsible plan fiduciary was acting imprudently.

Plan fiduciaries, including plan sponsors and discretionary trustees, should consider engaging a firm specializing in class action settlement recovery services, demonstrating that they have taken reasonable

¹² See, e.g., *Donovan v. Cunningham*, 716 F.2d 1455 (5th Cir. 1983), cert. denied, 469 U.S. 1072 (1984).

¹³ See, e.g., *Liss v. Smith*, 991 F. Supp. 278 (S.D.N.Y. 1998).

steps to recover the amounts owed to the plan in satisfaction of their fiduciary duties under ERISA. Directed trustees and custodians should also consider

engaging such a firm's services to insulate themselves from any potential liability under ERISA.