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Recent Lawsuits Against Mutual Funds, Investment Advisors And Related Parties Allege Failure To File Proofs Of Claims In Securities Class Action Settlements

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Overview

Dozens of class action lawsuits have been filed in the last several weeks against mutual funds and related parties asserting that the funds failed to file proofs of claims and as a result failed to collect money from settlements of securities class action lawsuits. This recent spate of lawsuits, noted in an article in *The New York Times*,[1] may have originated with a 2002 law review article[2] estimating that only about one-third of institutional investors eligible to file claims for a portion of settlement proceeds actually do so. The article estimated that, in the aggregate, institutional investors may leave more than $1 billion in settlement proceeds unclaimed each year.

We are aware of at least 39 actions that have been filed in jurisdictions across the country, including the Southern District of New York, the Central and Northern Districts of California, the Eastern District of Pennsylvania, the Northern District of Illinois, the District of Massachusetts, the Northern District of Texas and the District of Colorado. These actions are concentrated in the Northeast, with 16 of the 39 lawsuits filed in New York, eight in Massachusetts and three in Pennsylvania. The plaintiffs' law firms behind these actions include prominent asbestos class action law firms in Texas and New York and a securities class action law firm in Arkansas. The complaints name mutual fund companies, individual directors or trustees of the funds, and investment advisors and sub-advisors.

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Allegations

The complaints are virtually identical. Each alleges that the fund has held shares of companies that have settled securities class action lawsuits in the past four years, but the fund failed to submit a proof of claim to collect settlement proceeds to which the fund and the fund's investors are entitled. The complaints list more than 130 recent securities class action settlements. Plaintiffs allege five causes of action and seek monetary damages, disgorgement of fees and compensation, punitive damages and attorney's fees:

- Count I asserts a cause of action for breach of fiduciary duty against all named defendants.
- Count II asserts a cause of action for negligence against all named defendants for their alleged failure to act in a reasonable manner to protect and maximize each individual's investment in the funds.
- Count III asserts a cause of action for breach of fiduciary duty under Section 36(a) of the Investment Company Act of 1940 (ICA), 15 U.S.C. §80a-35(a), against all named defendants.
- Count IV asserts a cause of action for breach of fiduciary duty under Section 36(b) of the ICA, 15 U.S.C. §80a-35(b), against the investment advisor defendants and their affiliates and against the fund parent companies.
- Count V asserts a cause of action under Section 47(b) of the ICA, 15 U.S.C. §80a-46(b), against the advisor defendants and fund parent companies. This count seeks to void all advisory agreements and return all fees or other consideration earned during the class period.

Legal Defenses And Other Issues

There are a number of legal and factual issues that defendants and other interested parties should explore. These issues include the following:

- ***Plaintiffs may not have standing to assert direct claims***. Claims asserting a breach of common law fiduciary duty and a private right of action under Section 36(a) of the ICA may, in some cases, only be brought derivatively (on behalf of the mutual fund) rather than directly (on behalf of the individual investor plaintiff).
- ***A private right of action may not be available under Section 36(a)***. Section 36(a) of the ICA does not expressly provide a private right of action, applying by its terms only to actions by the SEC. Though a number of courts have permitted private plaintiffs to sue under Section 36(a), the Supreme Court has never recognized a private right of action under this provision, and courts are increasingly reluctant to imply private rights of action under the securities laws.
- ***Plaintiffs may not have alleged a violation of Section 36(a).*** Section 36(a) of the ICA allows suit against advisory boards, investment advisors, depositors and underwriters for "a breach of fiduciary duty involving personal misconduct." The allegations of inaction in the complaints may not rise to this standard of culpability.
- ***Section 36(b) may not apply.*** Section 36(b) of the ICA creates a fiduciary duty on the part of fund advisors "with respect to the receipt of compensation for services." To state a claim under this provision, courts generally require allegations that fees charged by the advisor are excessive or that fees were obtained in violation of a fiduciary duty.
- ***Section 47(b) may not provide a separate cause of action.*** While Count V asserts a cause of action under Section 47(b) of the ICA, this section appears to provide a remedy only (principally for rescission), not a separate cause of action.
- ***Defendants may not have breached the standard of care in the industry.*** The breach of fiduciary duty and negligence allegations in the complaints may not state a viable claim for which relief may be granted. If there is no uniform practice within the mutual fund industry with regard to submitting proofs of claim, or if it is more common than not that proofs of claim are not filed by mutual funds, then this practice may not constitute a breach of prevailing standards of care. It is also possible that the costs of administering claims in some instances may outweigh likely returns, which could justify not filing proofs of claim.
- ***Exculpatory charter provisions may shield individual defendants.*** The majority of state corporation codes permit a corporation to limit or eliminate the liability of its directors for breaches of their duty of care. Many corporations invoke this protection by including exculpatory charter provisions in their articles of incorporation. States may similarly permit trustees to limit their liability under exculpatory clauses in the trust instrument. However, these provisions generally protect only directors or trustees, and only for breaches of state law fiduciary duties.
- ***Statutes of limitations.*** The purported class periods in the complaints span four years. Some of these claims may be time-barred under applicable statutes of limitations. Courts have generally required plaintiffs to bring claims under Section 36(a) of the ICA within three years of the violation or within one year of receiving notice of the violation, whichever is earlier. Recovery of management fees under Section 36(b) generally is limited to one year prior to the institution of the action. Finally, statutes of limitations for state common law claims of breach of fiduciary duty and negligence vary from state to state and may be less than four years.
- ***Insurance and indemnification.*** Named defendants should carefully consider their rights and obligations under applicable indemnity agreements with other parties and potential parties. Defendants should also evaluate the availability of coverage under insurance policies and possible exclusions. Finally, each party should take care to give appropriate notice to any third parties that may have duties to indemnify or defend.
- ***Plaintiffs may have their facts wrong.*** In many cases, the allegations in the complaints may simply be inaccurate, and defendants should conduct their own investigations of the facts. Mutual funds may not have held the relevant securities, may not have received notice of the settlements or may have filed proofs of claims.

Defendants should also determine whether there are procedures or policies in place with regard to receiving, processing and filing proofs of claims. Investment advisory agreements, sub-advisory agreements, custodial agreements, fund organization documents, prospectuses or other documents may contain provisions governing the responsibilities of the various parties in this regard.

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[1] *Jonathan Glater, "Suits Contend Mutual Funds Fail To Collect In Settlements,"* The New York Times, *January 19, 2005 at C1.*

[2] *James D. Cox & Randall S. Thomas, "Leaving Money On The Table: Do Institutional Investors Fail To File Claims In Securities Class Actions?" 80* Wash. U. L. Q. *541 (2002).*

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