



# **EVALUATING SERVICE PROVIDERS:** *Shareholder Litigation Firms & Proxy Voting Services*

**11<sup>th</sup> Annual PAPERS Forum**

**Harrisburg Hilton Hotel**

**Thursday, May 21, 2015 – 9:00 – 9:45 am**

**Jonathan R. Davidson, Esquire**  
**Kessler Topaz Meltzer & Check, LLP**



# Introduction

- Shareholder Litigation Counsel
- Portfolio Monitoring
  - Fiduciary Duty
  - Asset Allocation
  - Reporting & Services
- Non-U.S. Jurisdiction Litigation
  - Current Landscape
- Importance of Proper Claims Administration
  - Do You Really Have a Handle on This?
- Best Practices for Evaluating Shareholder Litigation Firms
- Proxy Voting & Services



# Qualitative Review of Shareholder Litigation Counsel

- What kind of firm have you retained to represent you in a case?
  - Case Selection – Conservative or Aggressive?
  - Case Range – securities class action; shareholder derivative and takeover litigation; opt-outs/direct actions
  - Experience of firm: lead plaintiff appointment process and in-case representation
  - Results – Quick settlement? Trial?
  - Reputation with the courts, defense bar and corporations



# Portfolio Monitoring

- According to Cornerstone research, an average of 191 securities class actions are filed each year in the U.S.
  - Figure does not include Derivative, M&A, and non-U.S. cases.
- A growing number of pension plans in the United States have embraced portfolio monitoring (often retaining multiple firms).
- Fiduciary obligation to take part in a case: NO.
- Fiduciary obligation to monitoring actions/collect pro-rata share of settlement proceeds: YES.
- Critical for public pension funds to have proper systems in place to track and manager cases impacting their portfolios.



# Portfolio Monitoring

## □ Asset Allocation for Public Funds

### ■ U.S. Equities

- NCPERS 2014 Study – 34% (Target Allocation: 32%)

### ■ International Equities

- NCPERS 2014 Study – 19% (Target Allocation: 19%)



# Portfolio Monitoring

- What types of reports should you be getting?
- New Case Summaries
  - each time a new securities class action is filed where your fund has a financial interest.
  - provides LP deadline (or registration deadline for non-U.S. cases), class period, jurisdiction/judge, case overview, strengths/weaknesses, your losses, estimated class-wide damages.



# Portfolio Monitoring

## MEMORANDUM

*Privileged Attorney Client Communication*

TO: ABC Employees' Retirement System  
FROM:  
RE: Bank of America Class Action  
DATE: February 14, 2011

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The following is a case summary regarding the securities class action litigation filed against Bank of America ("BofA" or the "Company") (Ticker: NYSE: BAC):

Date case filed: February 2, 2011  
Lead Plaintiff Deadline: April 4, 2011  
Class Period: January 20, 2010 – October 19, 2010  
Jurisdiction: United States District Court, Southern District of New York  
Judge: The Honorable William H. Pauley  
Potential Sub-classes: NONE

Losses Suffered by ABC Employees' Retirement System: **(\$92,591.02)**

Initial Estimate of Class Damages: \$3.9 Billion

Recommendation: Remain a passive class member.

### The Case against Bank of America:

The Complaint charges BofA and certain of its officers and directors with violations of the Securities Exchange Act of 1934. BofA is a bank holding company and a financial holding company.

The Complaint alleges that during the Class Period, defendants issued materially false and misleading statements regarding the Company's business. Defendants concealed defects in the recording of mortgages and improprieties with respect to the preparation of foreclosure paperwork that harmed BofA's investors when BofA had to temporarily discontinue foreclosures and admit to the problems it was experiencing. For much of the Class Period, defendants also concealed that BofA had previously engaged in a practice known as "dollar rolling," wherein it omitted billions of dollars in debt from its balance sheet reported to the public. As a result of defendants' false statements, BofA's stock traded at artificially inflated prices during the Class Period, reaching a high of \$19.48 per share on April 15, 2010.



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# Portfolio Monitoring

## □ Quarterly Reports

- outlining all settled, dismissed, ongoing and new litigation for the quarter.
- also include details on non-U.S. case monitoring (where applicable).



# Portfolio Monitoring

## SETTLED LITIGATION

## Quarterly Report

The following is an update of the portfolio monitoring services provided by \_\_\_\_\_ for ABC Employees' Retirement System. The cases listed below include both settled and ongoing securities class actions in which ABC Employees' Retirement System had transactions during the relevant class period. If you have any questions regarding this report please contact \_\_\_\_\_.

## SETTLED LITIGATION

*The custodian for ABC Employees' Retirement System has confirmed that it is responsible for submitting proof of claim forms for all settlements in which ABC Employees' Retirement System is eligible. \_\_\_\_\_ has conducted an audit of the claims filed for ABC Employees' Retirement System with filing deadlines that occurred this Quarter.*

*Based on a review of ABC Employees' Retirement System's transaction history, \_\_\_\_\_ has confirmed that this list is inclusive of all settlements for which ABC Employees' Retirement System is eligible to file. This list also contains eligible settlements for which new claims did not need to be submitted because ABC Employees' Retirement System previously filed overlapping transactions in a related settlement.*

SETTLEMENT	CLAIMS DEADLINE	CLASS PERIOD	TOTAL SETTLEMENT
American International Group, Inc. (2004)	1/23/2012	10/28/99 - 4/1/05	\$725,000,000
MBIA, Inc.	2/9/2012	7/02/07 - 4/7/08	\$68,000,000
Medicis Pharmaceutical Co.	2/18/2012	10/30/03 - 9/23/08	\$18,000,000
Nortel Networks Corporation (SEC)	3/16/2012	10/24/00 - 4/27/04	\$35,500,000



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# Portfolio Monitoring/Case Evaluation

## □ Research Memoranda

- when considering active involvement in a case.
- in-depth memorandum to allow the Board to make an informed decision about how best to proceed.



# Portfolio Monitoring/Case Evaluation

## MEMORANDUM

### PRIVILEGED ATTORNEY CLIENT COMMUNICATION AND ATTORNEY WORK PRODUCT

TO: ABC Employees' Retirement System

FROM: \_\_\_\_\_

DATE: January 26, 2012

RE: BNY Mellon Corp. Securities Litigation Research Memorandum

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### EXECUTIVE SUMMARY

*Losses Suffered by ABC Employees' Retirement System: \$11,283,344.83*

We are writing to advise you of a potential securities fraud class action lawsuit we have been investigating against The Bank of New York Mellon Corp. ("BNY Mellon" or the "Company") and its executives for issuing false and misleading statements and omitting material information regarding the Company's use of fraudulent practices to artificially increase foreign currency exchange ("FX") revenue between February 28, 2008 and August 11, 2011 (the "Class Period").

Details about the Company's deceptive practices began surfacing in January of this year after two whistleblower (or *qui tam*) lawsuits against BNY Mellon were unsealed.<sup>1</sup> The lawsuits were filed on behalf of state pension funds located in Virginia and Florida who retained the Company as a trustee to manage fund accounts. Since the actions were unsealed, three state attorneys general (Virginia, Florida and New York) have filed their own actions against BNY Mellon. On August 11, 2011, the Virginia Attorney General filed a complaint in intervention that cited to internal BNY Mellon emails where employees discussed the impact to the Bank's profitability if clients were provided with greater transparency when trading FX. The emails generally concluded that profitability diminished as transparency increased. A few weeks later, after the markets closed on October 4, 2011, the New York AG Action,<sup>2</sup> filed an action seeking



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# Portfolio Monitoring

## □ Online Access

- Make sure all trustees, administrator, counsel, etc. have access to reporting in one centralized location.
- Trustees receive email notifications when new material is added to fund's account.
- No client transaction data kept online.



# Portfolio Monitoring

Welcome, ABC Employees' Retirement System | [Home](#) | [Change Username](#) | [Change Password](#) | [Logout](#)  
 Institution: ABC Employees' Retirement System

(Use dropdown box on the right to change institution)

Newly Posted	Posted ▼	
Filed Claims Status Chart		11-16-2012
Sample Audit Report		11-16-2012
Fortis (Belgium) Client Research Memorandum		11-01-2012
Agnico Eagle-Mines (Canada) Client Research Memorandum		11-01-2012
Weatherford - Amended Complaint		09-13-2012
<a href="#">More...</a>		

Quarterly Reports	Posted	Quarter End Date ▼
First Quarter 2012 Quarterly Report	06-06-2012	03-31-2012

Case Summaries	Posted	Lead Plaintiff Deadline ▼
Sino-Forest Corporation (Canada) Case Summary	04-30-2012	04-30-2012
BNY Mellon Client Research Memorandum	06-06-2011	02-13-2012
Agnico Eagle-Mines (Canada) Client Research Memorandum	11-01-2012	02-07-2012
Fortis (Belgium) Client Research Memorandum	11-01-2012	03-31-2011
Johnson & Johnson Case Summary	06-06-2011	11-22-2010
<a href="#">More...</a>		

Lead Plaintiff	Posted	
Weatherford - Amended Complaint		09-13-2012
Lead Plaintiff Deadlines for Newly Filed Securities Class Actions		09-13-2012
Sunpower - Consolidating Related Actions, Appointing Lead Plaintiff & Approving Selection of Lead Counsel		06-06-2011
Sunpower - Scheduling Order		06-06-2011

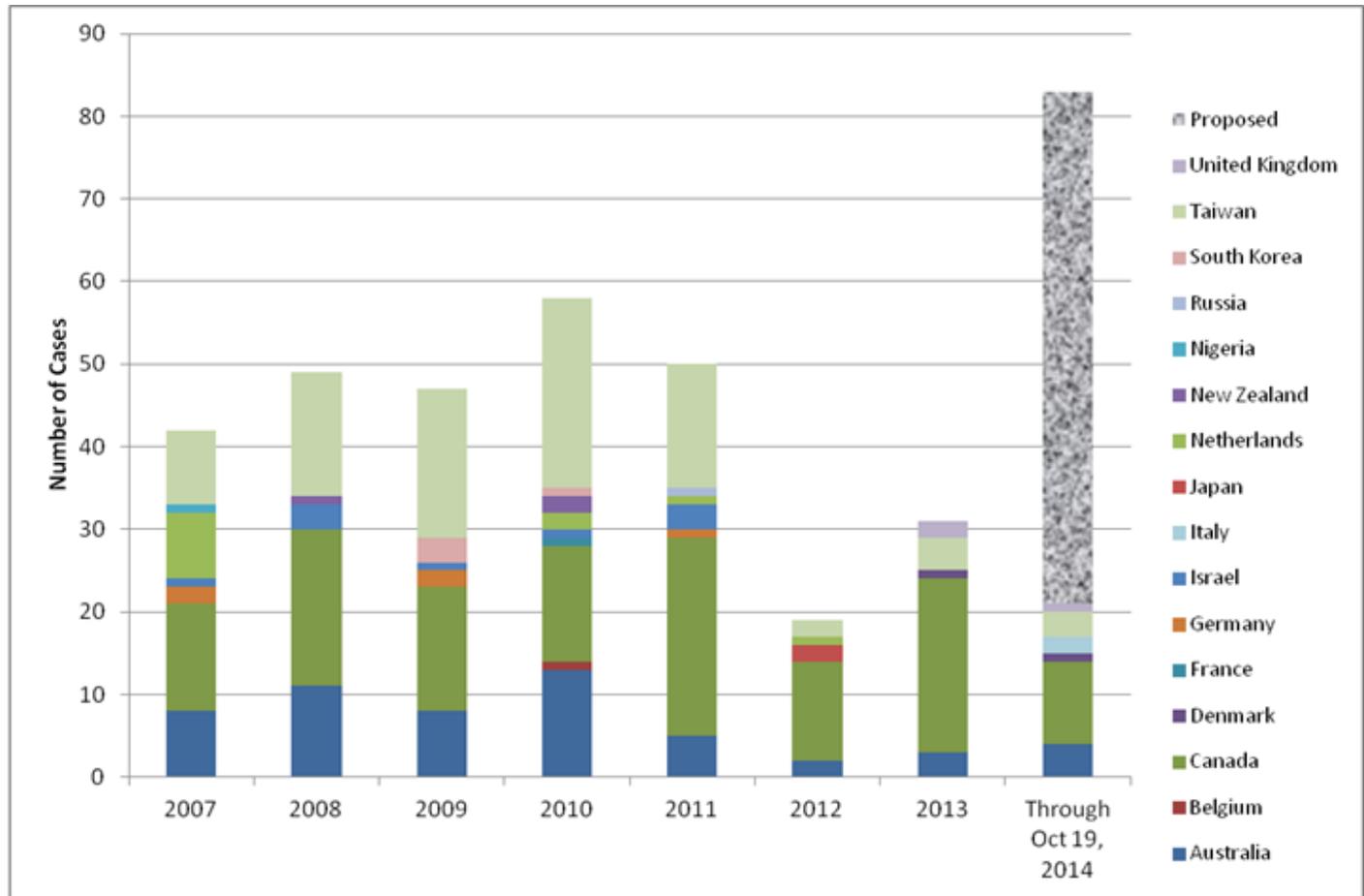
Settlements	Date Posted	
Filed Claims Status Chart	11-16-2012	11-16-2012
Sample Audit Report	11-16-2012	11-16-2012



# Increasing Non-U.S. Litigation/ Importance of Monitoring

- The Supreme Court ruled in *Morrison v. National Australia Bank* (2010) that the Securities Exchange Act of 1934 only applies to transactions on domestic exchanges and domestic transactions in other securities.
- More and more countries are adding class action mechanisms and private causes of action for securities fraud violations.
- Currently more than 100 actions are pending in 13 countries around the world.
- The number and size of the cases have increased.
- We are not aware of any custodians that provide advice on non-U.S. cases or that will ever file claims in cases that settle outside the U.S. This is very important considering the size of many of these cases.

# Non-U.S. Securities Fraud Actions On The Rise





# Global Settlement Estimates

- According to the GOAL Group, settlements in securities class actions outside the U.S. are estimated to reach USD \$8.3 Billion annually by 2020.
- If the rates of non-participation are the same as in the U.S., the GOAL Group estimates that \$2.02 billion will be left on the table each year.

Company Domiciled/Quoted	Predicted Annual Class Action Settlements 2020
	U.S. \$ billions
<b>South &amp; Central America</b>	USD \$ 0.620 bn
Includes: Argentina, Brazil, Chile, Colombia, Mexico and Peru	
<b>Canada</b>	USD \$ 0.542 bn
<b>Asia - Pacific (minus China)</b>	USD \$ 3.435 bn
Includes: Australia, India, Indonesia, Japan, Korea, Malaysia, Philippines, Singapore, Sri Lanka, Taiwan and Thailand	
<b>Europe</b>	USD \$ 3.288 bn
Includes: Austria, Belgium, Cyprus, Eire, France, Germany, Greece, Hungary, Italy, Luxembourg, Malta, Netherlands, Poland, Portugal, Russia, Scandinavia, Slovenia, Spain, Switzerland, Turkey and UK	
<b>Africa</b>	USD \$ 0.258 bn
Includes: Egypt, Morocco and South Africa	
<b>Middle East</b>	USD \$ 0.150 bn
Includes: Israel, Jordan and Saudi Arabia	
<b>Total World (minus China)</b>	USD \$ 8.293 bn



# Challenges with Non-U.S. Cases

1. Need to register by a prescribed deadline - often before the case has been filed and before all information is available.
2. Risk involved in participating in the litigation.
  - Loser pay models.
  - Limited or lack of contingency fee arrangements in most jurisdictions.
  - Necessity of litigation funders or insurance.
3. Other challenges: Hiring foreign counsel; Travel/staff time; Difficulty in enforcing a judgment; Less developed securities laws; Unknown variables (judges, general operation of the legal system, etc.)
4. Prudent to have a law firm actively involved in litigating and monitoring non-U.S. cases to help public funds deal with these complex issues



# Claims Administration

- Public pension funds must fulfill their fiduciary duty by working to retrieve money rightly owed to their pensioners from securities class action settlements.
- In past 8 years both mutual fund managers and brokerage houses have been sued by shareholders for breach of fiduciary duty for alleged failure to file proof of claim forms.
- Courts have not addressed issue of whether an institutional investor has a fiduciary duty to file claim forms, though many have opined there is a legal duty to do so.



# Claims Administration

- Statistical Data: 2005 independent academic study found that only 28% of institutional investors filed claim forms.
- From 2005-2014 there were 1121 securities class action settlements totaling over \$69 billion in proceeds.
- Institutional investors' failure to file produces a windfall for those that do.
- NYCERS recovered almost \$20 million from 2007-2008 in class action settlement money; LACERA recovered over \$40 million since formalizing securities litigation monitoring policy/procedure.



# Claims Administration

## □ Some Reasons Institutions Fail to File:

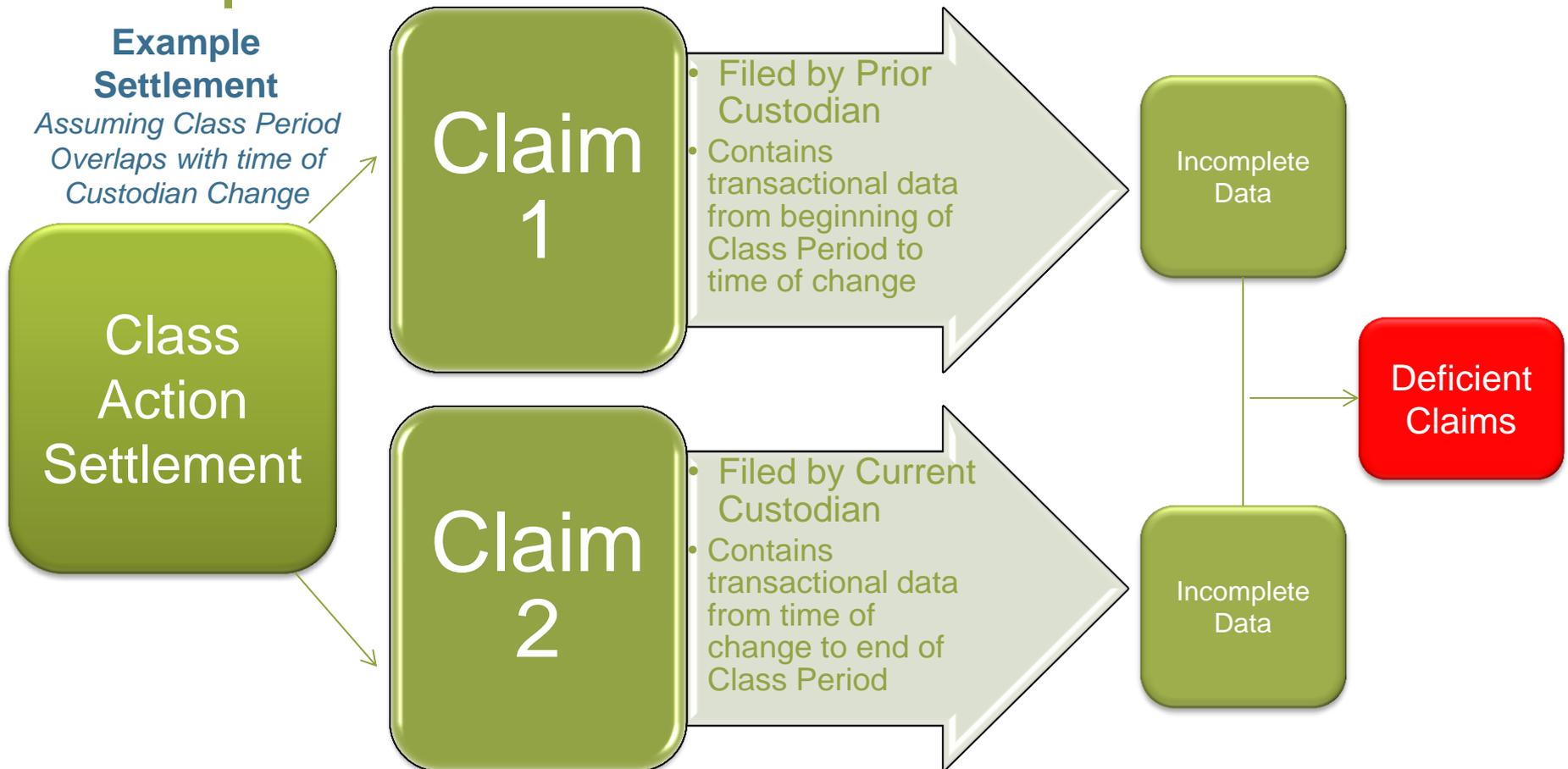
- Assuming someone is already taking care of it.
- Not receiving the settlement notice.
- The perception that the cost associated with filing the proof of claim is greater than any potential recovery.
- The difficulty institutions have in securing and maintaining access to historical data needed to file claims (long class periods, **changes in custodian**).
- General confusion with the forms and the securities.



# Claims Administration

- What Can be Done?: Put a system in place to make sure all claims are identified and filed. Options include:
  - utilize internal staff.
  - negotiate with a custodian to perform this service.
  - hire a third-party claims advisory service.
  - engage external securities litigation counsel.

# Deficient Claims Due to Custodial Changes





## Example Claim:

# Citigroup, Inc. (Settled Q2 – 2013 -- \$590 Million)

(CP: 2/26/07 – 7/17/08)

### Separate Claim Recovery Custodian A & Custodian B

Custodian A delivered all shares to Custodian B; Potentially ineligible for a recovery as a separate claim

CUSTODIAN	TRANS CODE	TRADE DATE	QUANT.	PRICE PER SHARE
A	HOLDINGS	2/26/2007	42,700	0.0000
A	BUY	4/13/2007	10,500	50.3611
A	SELL	5/17/2007	(1,700)	49.8580
A	DELIVERED	7/2/2007	(51,500)	0.0000
A	HOLDINGS	7/17/2008	0	0.0000

**Potential Total Recovery:**  
**\$0.00**

*Custodian A Files for first half of CP and deliver's shares out to Custodian B, who files for remainder of CP*

Custodian B received shares from Custodian A; Potentially ineligible for a recovery as a separate claim

CUSTODIAN	TRANS CODE	TRADE DATE	QUANT.	PRICE PER SHARE
B	HOLDINGS	2/26/2007	0	0.0000
B	RECEIVED	7/2/2007	51,500	0.0000
B	SELL	7/24/2007	51,500	35.5068
B	HOLDINGS	7/17/2008	0	0.0000

**Potential Total Recovery:**  
**\$0.00**

### Combined Claim Recovery

Claim including all Class Period data will result in eligibility for a recovery:

CUSTODIAN	TRANS CODE	TRADE DATE	QUANTITY	PRICE PER SHARE
A	HOLDINGS	2/26/2007	42,700	0.0000
A	BUY	4/13/2007	10,500	50.3611
A	SELL	5/17/2007	(1,700)	49.8580
A	DELIVERED	7/2/2007	(51,500)	0.0000
B	RECEIVED	7/2/2007	51,500	0.0000
B	SELL	7/24/2007	(51,500)	35.5068
B	HOLDINGS	7/17/2008	0	0.0000

Total Recovery based on the Plan of Allocation

**Potential Total Recovery:**  
**\$11,914.00**



# Claims Administration

- What types of reports should you be getting (no matter who is filing for you)?
- Claims Settlement Chart
  - Periodically updated to provide your fund with a proper accounting of all claims filed, and all proceeds recovered from securities class action settlements.
    - Be able to tell your members how much money you have gotten back.



# Claims Auditing

- Audit of Custodian Bank or other Third- Party filer.
- Historical Audit (2 year).
- Quarterly Audit going forward.
- Make sure nothing missed; hold custodian or other third party accountable.
- Work with claims administrator to get in a late filing if needed.

# Issues with Custodian Reports



## Custodian A

Class Action Details for  
ABC Employees Retirement Fund

Q4 2014 (10/01/14 to 12/31/14)

During the period indicated above, the following class actions have been filed for ABC Employees Retirement Fund:

- Private Equity Litigation / Bain Capital

ABC Employees Retirement Fund received the following payments during the period indicated above for class action settlements:

Settlement Name	Amount Received
AIG Litigation	\$1,284.24
AIG Litigation	\$2,581.69
Broadcom Ernst & Young Litigation	\$462.13
Pharmacia Litigation	\$261.44
Citigroup Litigation	\$4,481.95
Thornburg Mortgage Litigation	\$92.94

# Issues with Custodian Reports (Continued)



## Custodian A

Class Action Details for  
Q4 2014 (10/01/14 to 12/31/14)

Please note: This list reflects all class actions received or filed by Custodian A during Q4 2014 for those clients who were eligible to file. This list is NOT account specific.

Please see separate report for class actions filed on behalf of your fund/plan.

- Johnson & Johnson
- Focus Media II
- Affymax
- Weatherford International
- Fushi Copperweld
- Velti Plc
- Hansen Natural
- New Oriental Education & Technology I
- New Oriental Education & Technology II
- Synovus Financial
- Anadarko Petroleum
- Private Equity Litigation /Bain Captial
- Bank of America
- State Street Corp.



# Best Practices for Evaluating Shareholder Litigation Firms

- **From shareholder litigation firms:**
  - **Require detailed reporting (case summaries, quarterly reports).**
  - **Require periodic attendance at Board meetings.**
  - **When in a case, stay involved and keep firm accountable**
- **As with any service provider to your fund, periodic review of them, and the marketplace, is prudent**
  - **Issue a Request for Proposal (RFP)**
    - **Spend time crafting RFP so you get the answers you want -- not what a firm wants to tell you**
    - **Require in-person interviews**



# Summary

- It is essential to ensure that a proper system is in place to actively track and manage securities class action claims **EVERYWHERE**.
  - If your fund has retained a firm or firms, make sure they provide comprehensive service.
- Get a better handle on the claims administration process and audit the filings of whomever is doing the work for your fund.
- If change custodian: **MAKE SURE** to insert language related to old transaction data for claims filing purposes in new agreement.
- Keep your shareholder litigation firms accountable.
- The goal, as with each area of your fund's affairs, is to have the best people working for you.



# Proxy Voting

- Proxy voting season is upon us
  - April 15 to end of June: most of America's largest publicly traded corporations hold their annual meetings to vote on company business—as well as on various proposals introduced by shareholders, which appear on proxy ballots under regulations promulgated by the SEC.
- The U.S. DOL declared proxy votes to be plan assets
  - “The fiduciary obligations of prudence and loyalty to plan participants and beneficiaries require the responsible fiduciary to vote proxies on issues that may affect the economic value of the plan's investment.....”
  - Responsibility of voting proxies lies with the plan trustee unless the power to manage has been delegated to an investment manager. If power to manage is delegated to investment manager, investment manager has power to vote proxies (unless that power was reserved).
- NYC Comptroller (2014 Shareowner Initiatives Report):
  - “proxy voting and shareowner initiatives programs actively promote sound corporate governance, responsible executive compensation and sustainable business practices at portfolio companies in order to protect and enhance the long-term value of the funds' investments.”



# Proxy Voting Services

- How public pension funds vote:
  - Many have implemented proxy voting policy to guide internal investment staff, investment managers, proxy service advisors
  - Vote themselves (PMRS, larger public funds)
    - use Proxy Voting Platform of ISS, Glass Lewis, etc. and vote using the guidelines the fund has chosen
    - or just buy their research on: mergers & acquisitions, boards of directors, pay for performance, say on pay (for advisory votes on executive compensation), ESG issues, auditor issues, shareholder proposals
  - Use a service but retain ability to vote on certain issues
    - Ohio Schools – use ISS (give ISS customized voting guidelines, but SERS' internal Proxy Committee asked that issues relating to human rights and lobbying be directed to SERS' staff for consideration on a case-by-case basis.
  - Delegate authority to investment managers to vote in accordance with certain agreed upon guidelines (include in investment manager agreement)



# Proxy Voting

- Collaboration among peers – Council of Institutional Investors
  - Large investors working together on shareholder initiatives
  - Most active funds in putting forward shareholder proposals:
    - New York City Comptrollers Office, NYSCRF, North Carolina, Connecticut, CalPERS and CalSTRS
  - Some major pension funds post their proxy votes in advance (call for more to do so after annual meetings)
- AFL-CIO puts out Annual Investment Manager Scorecard
  - see how investment managers voted (vs. AFL-CIO guidelines)
- Investors paying more attention to proxy voting than ever and not voting in lock-step with proxy advisors
  - In 2012, ISS recommended opposing 8.7% of the directors nominated at companies while recommending support for the other 91.3%
  - In contrast, CalSTRS voted to oppose 36% of 17,764 nominees for director to corporate boards; State of Wisconsin Investment Board voted against 24.6% of 7,583 nominees; Florida SBA voted to oppose 16.8% of 15,968 nominees.



# Prominent Issue in 2015: Shareholder Proxy Access

- Proxy access generally provides shareholders that meet certain requirements (minimum stock ownership thresholds – 3%/3-year) the opportunity to nominate directors to a company’s board and include those nominees in the company’s proxy materials without proxy contest.
- An estimated 100 shareholder proposals relating to proxy access have been submitted to U.S. companies so far this proxy season.
  - The New York City Comptroller alone, on behalf of the City’s pension funds, has filed 75 proxy access shareholder proposals.
- Companies will not be able to rely on SEC Rule 14a-8(i)(9) no-action relief to exclude proxy access shareholder proposals this season, as they have in seasons past (5%/5-year).
  - After Chair Mary Jo White called for a review, SEC’s Division of Corporation Finance announced it would not express any views on the application of this rule and subsequently reversed a December 2014 no-action letter granting relief to Whole Foods Market, Inc. (which initially said Whole Foods could exclude a proxy access shareholder proposal due to its direct conflict with a management proposal on same topic).



# DuPont Proxy Vote 2015

- Last year, Trian asked for a single board seat but DuPont refused. Now Trian has launched a proxy battle.
  - Trian put forward 4 Board candidates
    - Trian: these candidates will help ensure the company delivers results after failing to live up to its promises.
    - DuPont: open to a Trian-nominated representative but not to Nelson Peltz because he would be fixated on creating a “shadow management team” to drive a dramatic breakup the board has already rejected.
  - ISS is backing 2 of the 4 Trian candidates: Nelson Peltz and John Myers.
    - ISS bases its decisions in such situations on two questions:
      - whether an activist has made the case that change is warranted;
      - and, if yes, whether or not the dissident is better placed than the current board to drive such change.
    - ISS: “The real risk seems less that one wily shareholder nominee outfoxes eight incumbents than that the right issues are never fully aired.”
    - Dupont: ISS reached the “wrong conclusion” and is “ignoring the success of our transformative strategy and the value-destructive nature of Trian’s breakup agenda.”



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# Questions & Thank You!

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