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Harnessing Antitrust Laws, Investors Deal Blow to Bank Collusion in Market for Stock Lending

Plaintiffs in an antitrust lawsuit accusing a handful of prime broker banks of colluding to keep prices in the stock loan market artificially high have received initial approval for a settlement requiring the banks to pay nearly $500 million in cash and make reforms that should reduce the chances of collusion in the future.

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Harnessing Antitrust Laws, Investors Deal Blow to Bank Collusion in Market for Stock Lending

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Plaintiffs in an antitrust lawsuit accusing a handful of prime broker banks of colluding to keep prices in the stock loan market artificially high have received initial approval for a settlement requiring the banks to pay nearly $500 million in cash and make reforms that should reduce the chances of collusion in the future.

On September 1, 2023, the Hon. Katherine Polk Failla of the United States District Court for the Southern District of New York granted preliminary approval of plaintiffs' class action settlement with four Defendant banks—Morgan Stanley, Goldman Sachs, UBS, and JP Morgan—and with EquiLend, the securities lending trading platform Defendants control. According to Plaintiffs, the Defendant banks conspired through EquiLend since at least 2009 to keep markets opaque and thwart modernization, thereby keeping prices artificially high.

Counting the $499 million cash component of the latest settlement, Plaintiffs have now recovered $580 million from Defendants, pending final approval. An $81 million settlement with Credit Suisse received preliminary approval last year.

COUNTING THE $499 MILLION CASH COMPONENT OF THE LATEST SETTLEMENT, PLAINTIFFS HAVE NOW RECOVERED $580 MILLION FROM DEFENDANTS, PENDING FINAL APPROVAL.

Filed in 2017, *Iowa Public Employees' Retirement System, et al. v. Bank of America Corp. et al.* is led by five institutional investors, including four public pension funds, represented by Cohen Milstein and its co-counsel. The Plaintiffs—Iowa Public Employees' Retirement System, Los Angeles County Employees Retirement Association, Orange County Employees Retirement System, Sonoma County Employees' Retirement Association, and Torus Capital LLC—asserted that the banks' actions to preserve their market dominance violated federal antitrust laws, causing market participants financial harm. The Plaintiffs sought financial damages and improvements to the system.

The $1.7 trillion stock loan market is a critical component of global securities markets, facilitating activities like short selling and hedging while providing a stream of income to beneficial owners who lend out their securities. By temporarily lending stocks to another entity, typically for a fee, long-term investors who hold large amounts of publicly traded securities can generate additional income for their portfolios. The borrowing entities, in turn, are able to borrow stocks they need to enable short sales and hedging strategies.

PLAINTIFFS BELIEVE THAT THE EQUITABLE RELIEF THEY DESIGNED AND NEGOTIATED FOR WILL HELP ALIGN EQUILEND TO THE BEST PRACTICES AND GUIDELINES.

But, as alleged in the complaint, the institutional investors who lend and borrow stocks believe that, for years, they were forced to use an inefficient, antiquated, and opaque over-the-counter trading platform which forced market participants to use defendant Prime Brokers as middlemen to match buyers and sellers for a fee, which Defendants allegedly conspired to keep the market frozen in its inefficient state to preserve their collective market control and dominance and charge higher transactional fees.

In their complaint, Plaintiffs allege that since at least 2009, the six Defendant banks routinely took steps together to block the development of competitive exchange platforms in the stock loan market, like AQS (in the United States) and SL-x (in Europe)—exchanges that would have reduced trading costs for both stock lenders and borrowers. For example, the Complaint alleged that when the banks learned that Bank of New York (BONY) was using AQS for stock loan transactions, Goldman Sachs threatened to return billions in collateral and never do business with BONY again. BONY promptly abandoned its plans. Various Defendants took similar steps with well-known hedge funds, too—SAC Capital, Renaissance Capital, and others—telling them they would not connect them to AQS, and, if they did not like it, they could take their business elsewhere.

In 2001, the six prime broker banks, together with four others, created EquiLend, a securities lending platform and dealer consortium purportedly created to enhance market efficiencies in the stock loan market. The board of directors of EquiLend consisted of a representative from each Defendant bank, something that plaintiffs allege helped them control and protect their profits in the stock loan market.

The Complaint alleged that through EquiLend, the banks could collectively agreed not support any exchange that would permit borrowers and lenders to trade directly with each other in a modern all-to-all market.

In the Complaint, Plaintiffs contend that in 2016 alone these six banks skimmed approximately 60% of the $9.15 billion in stock lending revenue, despite performing a service for which they bear virtually no risk. Any other arrangement would have substantially reduced the need for their services, and the premiums that they charged would have been untenable.

The Complaint alleges that after boycotting securities lending participants who participated on other platforms—AQS in the US and SL-x in Europe—the banks either purchased the intellectual property underlying those exchanges (SL-x) or the exchange itself (AQS), effectively shelving the efforts to improve stock lending for investors. The purchase of AQS by bank-controlled EquiLend—the last piece of the conspiratorial puzzle because it gave the banks complete control over all gateways to central clearing in the US—even had a secret code name at Morgan Stanley: Project Gateway.

After years of painstaking and costly discovery, in February 2022, Credit Suisse became the first of the six banks to settle. Morgan Stanley, Goldman Sachs, UBS, JP Morgan, and EquiLend followed suit in September 2023.

While the settling Defendants have denied any wrongdoing and say reforms are unnecessary, Plaintiffs believe that the equitable relief they designed and negotiated for will help align EquiLend to the best practices and guidelines for anti-cartel and collaborations among competitors.

These reforms include:

- Mandatory rotation of outside antitrust counsel and EquiLend board members;
- Limitations on who can access commercially sensitive information; and
- A robust compliance, training, and monitoring program at EquiLend.

At least one industry observer is cautiously optimistic about the settlement's injunctive relief. In a recent article, financial investor publication *Pensions & Investments* said that the terms of the settlement "may bring the first bit of transparency to stock lending." The article noted, however, that many of the case documents that could shed further light on the inner workings of stock loan market remain under judicial seal.

Cohen Milstein and co-counsel continue to pursue the case against Bank of America, the only remaining Defendant bank. ■

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REPORT: SHAREHOLDER SUITS ABROAD GRAVITATE TOWARD LOW-RISK COUNTRIES WITH STRONG TRACK RECORDS

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ONE SETTLEMENT CLAIM FILING SERVICE SAID THE NUMBER INVESTOR RECOVERY ACTIONS INITIATED OUTSIDE THE US HELD STEADY DURING THE FIRST HALF OF 2023, BUT WERE FOCUSED ON FEWER JURISDICTIONS. A SECOND PROVIDER ADVISED CLIENTS TO LOOK CLOSELY AT HIGH ADVERSE RISKS IN CERTAIN COUNTRIES.

Even as avenues for consumers to pursue group litigation abroad expand, activity in shareholder lawsuits outside the United States has grown more narrowly focused on jurisdictions with lower adverse risks and better histories of recovery, according to recent publications by service providers.

While the number of non-US shareholder actions filed in the first half of this year held steady, "litigation funders have changed their geographic focus, investing more resources in countries perceived as lower risk with more expedited legal proceedings and away from countries where previously filed suits have been slower and more challenging than expected," Financial Recovery Technology (FRT), a global class action recovery service, wrote in its *Mid-Year 2023 in Review*.

According to FRT, 25 recovery actions were initiated outside the US from January through June, nearly on track to match the 52 cases filed in 2022. The 2023 cases were filed across six jurisdictions, however, compared with 11 countries in 2022. Both totals include opt-in actions, where affected investors are required to register as parties relatively early in the proceedings, as well as opt-out actions, where (like in US federal class actions) affected shareholders can wait until a case is decided to file a settlement claim.

The review found that countries with opt-out actions, such as Australia and the Netherlands, were seeing an uptick in new matters, while Germany, Brazil, and other jurisdictions where prior cases have become bogged down have seen fewer new filings. Risk calculations were also driving institutional investors' decisions on whether to register for cases, FRT said, adding that, so far in 2023 it has seen "the greatest client participation in passive [opt-out] countries including Australia and the Netherlands."

ISS Securities Class Action Services (SCAS), another settlement-claims-filing service, also underscored the importance

LAW FIRMS THAT ADVISE CORPORATIONS ON RISK APPEAR DIVIDED ABOUT THE DANGER THE RISE OF GROUP LITIGATION IN THE EU AND UK POSES TO THEIR CLIENTS. ONE FIRM CALLED THE GROWTH "EXPONENTIAL" AND A "KEY CORPORATE RISK." ACCORDING TO ANOTHER, "THIS FEAR IS NOT JUSTIFIED."

of assessing adverse cost risks in overseas litigation, even when third-party litigation funders take out "after the event" (ATE) insurance—policies designed to kick in if a court orders plaintiffs to pay defendants' costs.

"[E]ven with litigation funding and ATE insurance, there is still a risk that participating investors could be left footing some of the bill," SCAS wrote in a September 2023 white paper, *Participating in Securities Collective Actions Outside the US: Are Adverse Costs Worth the Risk?* In one English High Court case where the judge found for defendants in 2019 (*Lloyds/ HBOS*), defendants claimed more than £30 million in legal costs, £9 million more than that funder's ATE insurance cap.

The white paper highlighted the risk of paying adverse costs in five countries, saying risks were lowest in Australia, the Netherlands, and Japan and highest in the United Kingdom and Brazil. Despite such generalizations, the paper's authors said investors need to rely on a "thorough, objective case and jurisdictional analysis" to make decisions on whether to participate in non-US litigation.

"Unfortunately, there is no universal approach to handling adverse costs across multiple jurisdictions," they wrote. "The adverse cost risk is highly context-specific based on the jurisdiction, the particular case, and the terms offered by the funder."

If new cases and participant registrations are concentrated in a handful of lower-risk countries, the EU and the UK, at least, continue to expand their own legal mechanisms for collective redress. Depending on the commentator, this process is either leading to an explosion of "US-style" class actions or a more measured, European model.

"The growth of group litigation in the UK and Europe over recent years has been exponential, and its significance to businesses as a key corporate risk will only continue to increase," the law firm Jones Day wrote in an October 2023 client booklet, *The Rise of US-Style Class Actions in the UK and Europe*.

In the UK, for example, Jones Day said 13 new claims were brought in 2022 under the collective proceedings order introduced in 2015, double the number in 2021. The authors attributed the rise to a "confluence" of factors: "an upswing in the third-party litigation funding market, increasingly sophisticated and experienced claimant law firms, and liberalised group claim procedures."

Still, the UK has been a bit of a bumpy road for case organizers and funders. Most recently, the UK's Supreme Court ruled that litigation funding agreements that provide funders a share of damages should be defined as "damages-based agreements," meaning that they are unenforceable unless comply with a strict set of regulations that, among other things, limit the percentage to 10 percent—and completely unenforceable for opt-out proceedings before

the Competition Appeal Tribunal. In the wake of this agreement, funders are working to revamp their agreements with registrants.

Unlike the UK, the EU appears to be moving slowly and steadily toward more claimant-friendly "collective redress" procedures. The European Commission's 2018 "New Deal for Consumers" and 2020 "Representative Actions Directive" required the EU's 27 member states to put in place a collective action mechanism for consumers in a range of sectors, including data protection, financial services, travel and tourism, energy, and communications. These cases can be filed by "qualified entities"—typically consumer groups registered in at least one of the EU countries—that represent a minimum number of claimants.

While adoption has been slow enough to prompt the European Commission to send "formal notice" in January to member countries who had failed to change their laws to conform, at least 10 countries have now complied with the directive, with all but a few in the process of doing so.

On September 29, 2023, Germany became the latest EU member country to approve a law transposing the Representative Actions Directive. Expected to take effect by the end of October, the new law expands protections for consumers in German courts, where previous collective actions provided only declaratory and injunctive relief. Also under the new law, consumers will have until three weeks after the end of oral proceedings to register their claim, when they will have a better idea of the case's chances for success.

That said, the German parliament estimates that only 15 cases a year will be brought under the new law. Bird & Bird attorney Susanne Lutz says that is because of features in the final law that favor defendants. For one thing, at least 50 impacted consumers need to group together to commence an action. For another, litigation funding fees are capped at 10% of the "economic benefit resulting from the redress action" and contractual arrangements must be disclosed. In addition, the law dropped a proposal to include disclosure obligations for relevant documents. And finally, claimants can still be found liable for adverse costs, though the €300,000 cap is less than originally proposed.

"Many companies feared the introduction of a 'class action' based on the US model; however, this fear is not justified," she wrote, adding that representative actions brought under the law "should not be able to be utilized as a business model for purely profit-making purposes." ■

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CAN YOU COMMIT SECURITIES FRAUD BY TWEETING AN EMOJI? ONE COURT SAYS 👍 YES YOU CAN.

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"A fraudster may not escape liability simply because he used an emoji."

JUDGE TREVOR MCFADDEN

Can you commit securities fraud by tweeting an emoji? One court confirmed that you can in an important recent decision from the District Court for the District of Columbia.

In *Bed Bath & Beyond Corporation Securities Litigation*,[1] Judge Trevor McFadden held that the plaintiffs had adequately alleged multiple securities fraud, insider trading, and market manipulation claims against Ryan Cohen.

Defendant Cohen is an entrepreneur-turned-investor who founded the online pet store Chewy and sold it for more than $3 billion. Most recently, Cohen became an investor in so-called "meme stocks." These stocks are popular among retail investors who gather online on Twitter (now known as "X") and Reddit, often using memes and emojis to discuss their trades (thus the moniker "meme stock"). Meme stock traders are known for buying and selling stocks of companies that most traditional investors either ignore or short (that is, bet that the price will fall rather than rise).

Cohen entered the meme stock fray in 2020 by buying a large stake in GameStop, the struggling brick-and-mortar video game retailer. After buying his stake in GameStop, Cohen made multiple business recommendations and soon selected several directors of its board. GameStop had been popular with meme stock investors, but when they found out about Cohen's involvement, GameStop's stock soared by more than 40%. Cohen's popularity rose and he was soon viewed as the leader of meme stock investors, with media outlets naming him the "meme stock king."

Cohen followed the same playbook with the struggling retailer Bed Bath & Beyond. In early 2022, Cohen bought a 9% stake in the company and, as with GameStop, made public business recommendations and picked several members of Bed Bath & Beyond's board. Cohen's main proposal for Bed Bath & Beyond

[1] Cohen Milstein filed the first amended complaint in the case and currently serves as Liaison Counsel to the proposed class.

DEFENDANT COHEN CLAIMED THAT EMOJIS CAN NEVER BE ACTIONABLE BECAUSE THEY HAVE NO DEFINED MEANING.

was that the company should sell its one bright spot, its subsidiary buybuy BABY, which sells items for babies and children. As with GameStop, Bed Bath & Beyond's stock price rose and became a popular meme stock, despite the company's well-known struggles.

But by August 2022, Bed Bath & Beyond's leadership had decided against selling buybuy BABY. Instead, the company planned to use the subsidiary as collateral to borrow more money, an agreement finalized in late August 2022. At the same time, Bed Bath had announced more bad news, firing 20% of its workforce and closing 150 stores.

But before all that became public, Plaintiffs allege, Cohen hatched a plan to profit from his huge investment in Bed Bath & Beyond. As alleged in their complaint, starting in early August 2022, Cohen made three moves designed to drive Bed Bath & Beyond's stock price higher so that Cohen could sell his stake at a profit.

First, Cohen tweeted an emoji. On August 12, 2022, CNBC.com tweeted a negative story about Bed Bath & Beyond accompanied by a picture of a woman pushing a shopping cart in one of the Company's stores. Cohen fired back with a tweet saying, "At least her cart is full," which he capped with an emoji of a "smiley moon."

Many meme stock investors interpreted Cohen's smiley moon emoji to mean "to the moon" or "take it to the moon," a phrase that meme stock investors commonly use when they are predicting a stock price to increase. The complaint alleges that Cohen used the tweet to tell his thousands of meme stock investor followers that Bed Bath's stock was about to rise and that they should either buy or hold their positions. And they appeared to act on his tip. Bed Bath's stock price soared.

Four days later, Cohen filed a Schedule 13D document with the SEC stating that he had not recently sold any Bed Bath Stock. If Cohen had any concrete plans to sell his stock, he was legally required to disclose those plans on his Schedule 13D, but Cohen mentioned no such plans. Meme stock investors saw this as even more evidence that Cohen remained enthusiastic about Bed Bath's growth prospects and its stock price continued to rise.

Finally, later that same day, Cohen filed a Form 144 with the SEC, which outlined his potential plan to sell his stock. But at that time, Cohen could file his Form 144 on paper via email, so his Form 144 was not immediately made public.

Meanwhile, over two days, on August 16 and 17, Cohen quietly sold his entire stake in Bed Bath & Beyond for a whopping profit of $68 million. When news finally broke that Cohen had sold off his entire stake, Bed Bath's stock plunged by more than 50% within a few days.

Moving to dismiss the complaint, Cohen claimed that emojis can never be actionable because they have no defined meaning, asserting that there is no way to establish the truth of "a tiny lunar cartoon."[2] Judge McFadden rejected that argument, explaining that emojis are "symbols" that are an "effective way of communicating ideas" and "[e]mojis may be actionable if they communicate an idea that would otherwise be actionable."[3] Judge McFadden put it simply: "A fraudster may not escape liability simply because he used an emoji."[4]

In this case, Judge McFadden explained, the complaint plausibly alleged that the smiley moon tweet relayed Cohen's communication to his followers that Bed Bath & Beyond's stock price was going up and that they should buy or hold.

Judge McFadden rejected most of Cohen's other arguments as well. Cohen argued that the Complaint did not adequately allege "scheme liability" under Section 10(b) of the Exchange Act, claiming that scheme liability claims cannot be based "solely upon misrepresentations or omissions."[5] But Judge McFadden explained the Complaint alleged "a pump and dump scheme that relies on more than just misrepresentations or omissions," including Cohen's delayed filings of two SEC forms.[6] Judge McFadden also refused to dismiss the Plaintiff's insider trading claims under Section 20A and its market manipulation claims under Sections 9(a)(3) and 9(a)(4), providing important precedent for claims that are rarely litigated.

Six weeks after Judge McFadden's decision, *The Wall Street Journal* reported that the SEC was investigating Cohen about his ownership and trades of Bed Bath & Beyond stock, making clear the significance of Cohen's alleged misconduct. ■

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2 *In re Bed Bath & Beyond Securities Litigation*, 1:22-cv-02541, ECF No. 91, at 10 (D.D.C. July 27, 2023).

3 *Id.*

4 *Id.* at 10-11.

5 *Id.* at 22.

6 *Id.*

SECURITIES LITIGATION 101:

SURVIVING DEFENDANTS' MOTIONS TO DISMISS

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As we have written previously, most US stock fraud lawsuits are prosecuted as class actions under two federal securities laws enacted during the Great Depression and significantly amended in the 1990s. In this installment of Securities Litigation 101, we will explore some of the unique burdens imposed on plaintiffs by the Private Securities Litigation Reform Act of 1995 (PSLRA), specifically the heightened pleading standards to overcome defendants' motion to dismiss and the initial discovery stay.

First, some history. The Securities Act of 1933 and the Securities Exchange Act of 1934 sought to eliminate secretive insider trading, stock-price manipulation, fraudulent securities sales, and other brazen behaviors by Wall Street traders that devastated ordinary investors and contributed to the 1929 stock market crash. The laws prohibited issuers of public securities—stocks and bonds—from making false and misleading statements or material omissions in documents they were required to file periodically with the Securities and Exchange Commission.

Decades later, in 1966, revisions to the federal rule governing class actions would lead enterprising lawyers to search for new ways to unleash the power of federal class actions in a variety of areas, including civil rights, consumer protection, unsafe products, antitrust—and eventually securities fraud. Unsurprisingly, not everyone applauded the increasing use of class actions against large corporations. Facing mounting legal, insurance, and settlement costs, big businesses lobbied Congress to curtail what they viewed as frivolous, lawyer-driven nuisance suits. Lawmakers responded to calls for tort reform by passing the PSLRA in 1995.

AMONG THE PSLRA'S NUMEROUS PROVISIONS WAS ONE CONCERNING THE PROCESS KNOWN AS DISCOVERY, THROUGH WHICH PLAINTIFFS' LAWYERS SEEK EVIDENCE FROM DEFENDANTS AND NON-PARTIES TO SUPPORT THEIR SECURITIES FRAUD CLAIMS.

Among the PSLRA's numerous provisions was one concerning the process known as discovery, through which plaintiffs' lawyers seek evidence from defendants and non-parties to support their securities fraud claims. In particular, discovery requests by plaintiffs' lawyers demand that defendants produce internal documents related to the unlawful behavior alleged in the lawsuit. By gaining access to masses of memos, emails, letters, operations reports, and other internal documents, critics argued, shareholders' attorneys could sometimes find incriminating evidence of fraud unrelated to the allegations in their initial complaint. Defendants' advocates argued that discovery therefore could incentivize "fishing expeditions" by plaintiffs' lawyers, who (critics reasoned) could file a flimsy initial complaint, initiate

discovery, and sift through mountains of documents in hopes that something incriminatory would turn up and then file a stronger amended complaint.

The response by Congress was to direct courts to automatically delay, or "stay," discovery when a complaint is filed, lifting the stay only after the judge denies defendants' motion to dismiss, also known as a 12(b)(6) motion. As a result, plaintiffs' attorneys in federal securities cases are now forced to rely on information that is available publicly or gleaned from their own investigations to construct an amended complaint strong enough to survive defendants' motion to dismiss—which, if granted with prejudice, terminates the case. In response, many plaintiffs' law firms retain private investigators, forensic accountants, and even damages experts at the earliest stages of the litigation to provide evidence to bolster their amended complaints and respond to the motion to dismiss.

This process would be difficult enough if plaintiffs in federal securities class actions were subject to the same standards as others for surviving a motion to dismiss. But the PSLRA also heightened pleading standards to make it easier for defendants to convince the court to sustain the motion to dismiss—standards that became even more rigorous after subsequent Supreme Court rulings.

THE PSLRA HEIGHTENED PLEADING STANDARDS TO MAKE IT EASIER FOR DEFENDANTS TO CONVINCE THE COURT TO SUSTAIN THE MOTION TO DISMISS. SUBSEQUENT SUPREME COURT RULINGS RAISED THE BAR EVEN HIGHER.

To survive a motion to dismiss, plaintiffs' complaint, among other things, must allege with particularity:

- Specific instances where defendants made misstatements or omissions of facts they had a duty to disclose about the company, its financial reporting, or its business prospects;
- Evidence that those false or misleading statements or omissions were "material," i.e., might have caused a reasonable investor to change their decision about buying or selling the defendant company's stock;
- Information supporting a "strong inference" that defendants had "scienter"—in other words, that they knew or should have known their behavior was deceptive or that they were extremely reckless; and
- Evidence that the misstatements or omissions cited in the complaint actually harmed investors in the purported class, a concept known as "loss causation."

Owing to these high pleading standards, surviving the motion to dismiss in a securities fraud action requires plaintiffs to amass more evidence to support their allegations than plaintiffs in other types of litigation. Moreover, plaintiffs in securities cases must obtain that information without the aid of internal company documents produced through discovery. For that reason, it is important for potential lead plaintiffs to retain counsel who are adept at investigating securities fraud claims and able to assess the legal merits, risks of dismissal, and potential recoverable damages at the outset of each case. ■

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FIDUCIARY FOCUS

TODAY'S TRUSTEES MAY CHOOSE TO DELEGATE INVESTMENT AUTHORITY PROVIDED THEY SELECT AN APPROPRIATE INVESTMENT MANAGER, ESTABLISH THE SCOPE AND TERMS OF SUCH DELEGATION, AND MONITOR THE INVESTMENT MANAGER'S COMPLIANCE WITH THE AGREED UPON TERMS.

THE RESPONSIBILITIES AND DUTIES OF TRUSTEES WHEN DELEGATING INVESTMENT MANAGEMENT AUTHORITY

A common question for public pension trustees is determining whether or not to delegate their investment authority. For example, if a trustee possesses the knowledge and expertise in investing, is he or she in a better position to make investment decisions compared to delegating such authority to an investment manager? Fortunately, today's trustee may delegate investment authority provided he or she selects an appropriate investment manager, establishes the scope and terms of such delegation, and monitors the investment manager's compliance with the agreed upon terms.

As background, early American law held that trustees could not delegate investment decisions. The Second Restatement of Trusts clearly stated this nondelegation rule: "The trustee is under a duty to the beneficiary not to delegate to others the doing of acts which the trustee can reasonably be required personally to perform." The Second Restatement goes on to state, "A trustee cannot properly delegate to another power to select investments." Even the Second Restatement's commentary discusses an example where a trustee who lacked investment, business, or financial expertise still must perform his or her duty without delegating such duties to an investment expert.

The case for prohibiting trustees from delegating authority was justified during a time trustees were primarily responsible for holding and transferring real property to family members. The management of land required little knowledge or expertise of the trustee. However, over the last half century, financial assets held in trusts have become increasingly complex, requiring the trustee to possess more expertise. As Professor John Langbein of Yale University observes, "[m]anaging a portfolio of marketable securities is as demanding a specialty as stomach surgery or nuclear engineering. There is no more reason to expect the ordinary individual serving as a trustee to possess the requisite investment expertise than to expect ordinary citizens to possess expertise in gastroenterology or atomic science."

The complexity of the financial market and assets set the stage for the Third Restatement of Trusts to reject the Second Restatement trustee's nondelegation rule. In 1992, Section 80 of the Third Restatement integrated the prudent investor rule that resulted in two overarching principles. First, the default rule for trustees replaces delegation for nondelegation. Specifically, the trustee has a duty to personally perform the responsibilities of the trusteeship "*except* as a prudent person of comparable skill might delegate those responsibilities to others [emphasis added]". This means the trustee may indeed "have a duty

THE THIRD RESTATEMENT OF TRUSTS' COMMENTARY STATES THE TRUSTEE SHOULD ACCOUNT FOR MANY FACTORS IN SETTING CONDITIONS FOR INVESTMENT MANAGERS, INCLUDING THE TRUST'S SCALE, THE TRUST'S OPERATIONS, INVESTMENT GOALS, AND INVESTMENT ASSETS.

… to delegate [investment] functions … in such manner as a prudent investor would delegate under the circumstances." Second, based on the official commentary in Third Restatement, a three-part fiduciary inquiry should be applied to the trustee's decision to delegate: (1) whether the trustee prudently selected an investment manager; (2) whether the trustee established the terms for the investment manager, including compensation, duration, and condition; and (3) whether the trustee has arrangements for monitoring or supervising the investment manager. A trustee who carries out and follows this inquiry will also guard against charges of abuse of discretion.

This three-part inquiry, then, provides guidance for public pension fund trustees when delegating such authority to investment manager. First, the trustee should select an investment manager where he or she "exercise[s] reasonable, care, and caution." In some instances, the Third Restatement recommends delegation of investment authority where such investments are complex and specialization. For example, the Third Restatement states that if a trustee considers venture capital investment, the trustee "would have not only authority but a duty to delegate management activities in reasonable fashion" unless the trustee already possesses the requisite knowledge and expertise. Regardless, a trustee must establish an investment process, follow the process, and carefully document the process. It's important to point out that such a process requires a standard of conduct, not the outcome of the investment manager. In other words, a court will not judge the pension plan by the results of their investment decisions, but by the process to reach such decisions.

Second, a trustee should establish terms and conditions for the investment manager. The Third Restatement's commentary states the trustee should account for many factors, including the trust's scale, the trust's operations, investment goals, and investment assets. Such terms and conditions should be clear, unambiguous, and simple as possible. Furthermore, the terms of the delegation should protect beneficiaries against overbroad delegation. As an example, a trustee should not agree to terms with an investment manager that contains a provision that prevents the trust without any legal remedy if reckless mismanagement occurs.

Finally, a trustee should monitor the performance of the investment manager. Such a duty requires conducting an independent evaluation to determine whether the investment should remain included in the plan's portfolio. Last year's Supreme Court *Hughes v. Northwestern* decision is a reminder that trustees should routinely review their investment funds and remove poorly performing funds. In the event a trustee decides to keep an investment manager with higher fees, the plan should again document the process and set out the reasons for doing so. ■

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AWARDS & ACCOLADES

- Seven Cohen Milstein Attorneys Recognized as Super Lawyers & Rising Stars in New York Metro Area – September 22
- Cohen Milstein Again Named Ceiling Smasher in *Law360* Glass Ceiling Report – September 6
- *The Best Lawyers in America* Names Christine E. Webber 2024 Lawyer of the Year – August 21
- *The Best Lawyers in America* Recognizes 17 Cohen Milstein Attorneys – August 21
- American Bar Association Appoints Betsy A. Miller Special Advisor to the Commission on Women in the Profession – August 17
- Five Cohen Milstein Attorneys Named to *Lawdragon* 500 Leading Civil Rights & Plaintiff Employment Lawyers 2023 – August 14
- *Benchmark Litigation* Names Julie Goldsmith Reiser a Top 250 Women in Litigation for 2023 – August 9

UPCOMING EVENTS

- **November 7-10** | State Association of County Retirement Systems Fall Conference, Omni Rancho Las Palmas, Rancho Mirage, CA – Richard Lorant
- **November 18-21** | County Commissioners Association of Pennsylvania Fall Conference, The Hotel Hershey, Hershey, PA – David Maser
- **December 2** | Pennsylvania Society Annual Reception, Hilton Midtown, New York, NY – David Maser and Christina Saler
- **January 22-24** | National Conference on Public Employee Retirement Systems Legislative Conference – Renaissance Hotel, Washington, DC – Richard Lorant

PROFILE

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Kate Nahapetian is a member of the Securities Litigation & Investor Protection practice group. Kate joined the firm in 2020 and serves as Manager of Investor Services, where she is primarily responsible for preparing the monthly portfolio monitoring reports for more than 200 pension fund clients. For this issue of the* Shareholder Advocate, *Kate talked with Editor Christina Saler.

I grew up … in a few places. When I was six years old, my family immigrated to the United States. My father was awarded a Fulbright Fellowship at the Massachusetts Institute of Technology, so my parents, older sister, and I moved to Brookline, Massachusetts, where I learned to love the Celtics! We eventually moved to Wilmington, Delaware, where I spent my middle school and high school years before heading to Washington, D.C. for college.

I went to law school … after working several years first at the Carnegie Endowment for International Peace and on Capitol Hill for then-Senator Joe Biden, followed by a fellowship in Germany. It was in Germany where I first decided I wanted to go to law school. I took classes on human rights and realized that I wanted to pursue a law degree to help people who have been abused.

I began my law career … at Milberg Weiss in San Diego working on consumer class actions and human rights cases. Although I have worked on very different types of cases, there was a common thread in my work—holding actors who abuse their power accountable for harming others. Following a stint at the US Department of Justice managing the congressional relations program for the Community Relations Service, I worked for a human rights advocacy group. It was demanding work often confronting adversaries, including multinational corporations, who were better funded. Wanting to get back to litigation, I was drawn to Cohen Milstein because of the innovative litigation that the firm has taken on to rectify corporate abuses in so many areas—such as human rights, civil rights, consumer, antitrust, and securities violations. As part of the Cohen Milstein team, I know that we are making a difference and strengthening protections for investors.

One of my strengths … is capturing large amounts of data and complex information and synthesizing all of it into a condensed, easy to comprehend format. On a monthly basis, I am providing securities fraud case summaries to more than 200 clients. Because our clients are busy, I need to provide them with concise summaries that still tell the story of the alleged fraud that occurred, so that our clients understand the salient facts and claims in a particular case.

I recently saw in concert … Pink at Nationals Field in Washington D.C. She put on an amazing performance and all through the pouring rain. Not once did her voice falter as she was flying through the air doing aerial acrobatics from one end of the stadium to the other. It was pretty incredible. Her music sends a positive message of acceptance and celebration of our uniqueness. ■

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