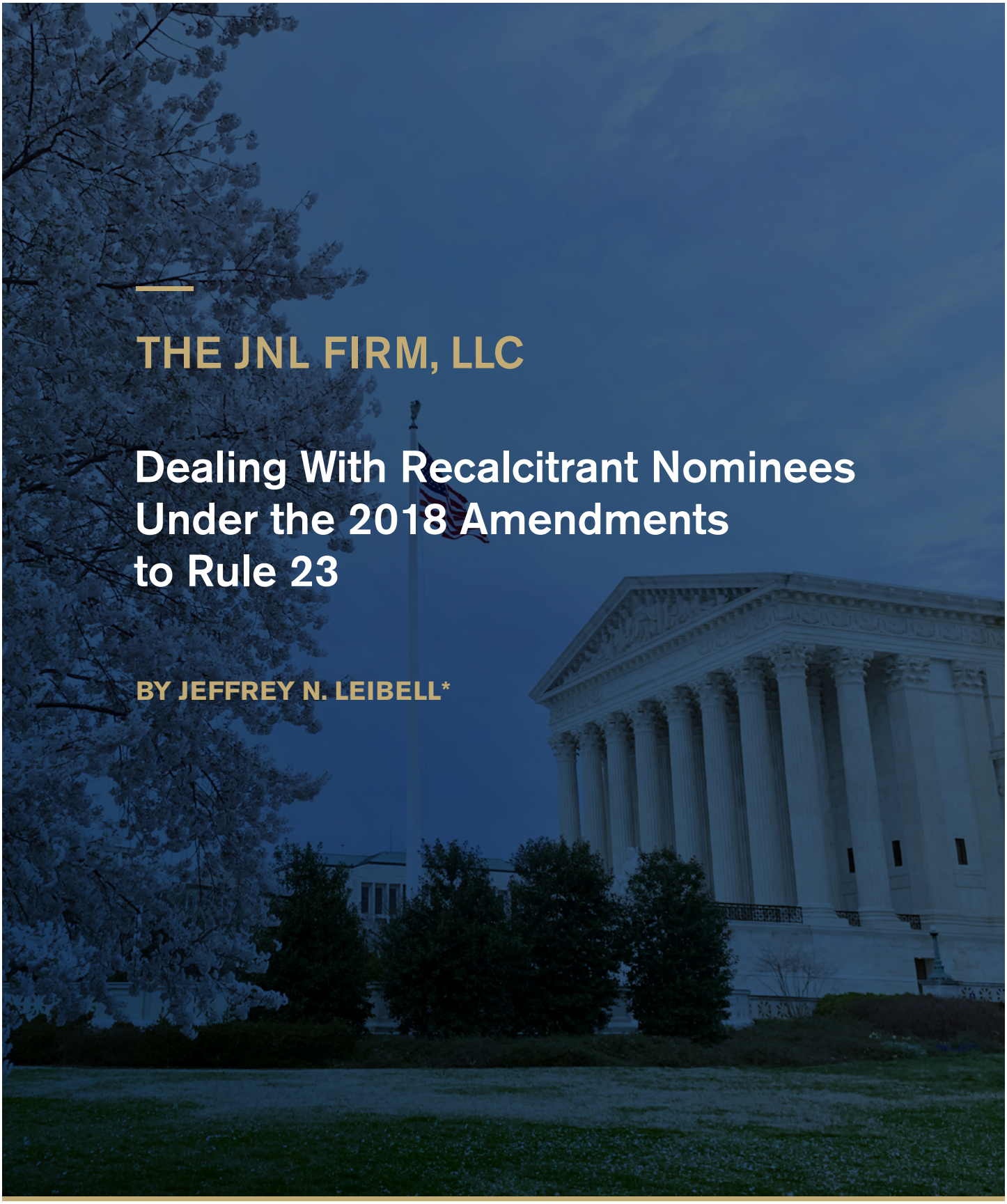

THE JNL FIRM, LLC

Dealing With Recalcitrant Nominees Under the 2018 Amendments to Rule 23

BY JEFFREY N. LEIBELL*

THE JNL FIRM, LLC
Class Action Settlement Management
80 Baker Hill Road
Great Neck, New York 11023

Jeffrey N. Leibell
jeff@jnlfirm.com
516.652.2040
www.jnlfirm.com

Summary

Recalcitrant nominees – brokerages, custodians and other entities that, although they trade and hold securities for their clients, do not timely or at all send to them settlement notices for securities class actions – have long plagued the efficient administration of those settlements. Prior to the 2018 amendments to Rule 23 (the "2018 Amendments"), the obstacles created by recalcitrant nominees concerned whether, because their clients were not provided with notice of a settlement, due process required by Rule 23 was provided to the class. In almost all cases, courts found that due process had been satisfied. But that was prior to the effectiveness of the 2018 Amendments. Now, with heightened focus on class member participation and recovery, recalcitrant nominees' disservice to their own clients may delay or jeopardize settlements for entire classes.

Introduction

Because "much of the value of a [class action] settlement lies in the ability to make funds available promptly,"[1] a primary goal of every distribution is to get the recovery into the hands of class members as soon as possible.[2] The best way to do that is to maintain the objection, request for exclusion and proof of claim schedule approved by the court. But that effort has been and continues to be hindered by recalcitrant nominees that do not comply with court orders to provide to their clients notice of securities class action settlements: Because most securities owners trade and hold in "street name," notice to those beneficial owners is a crucial element of due process. Accordingly, courts require that, within a specified number of days of their receipt of a settlement notice, nominees comply with simple notice obligations for which they could seek reimbursement from the settlement fund. Unfortunately, however, many nominees either do not send the notice at all or so delay their compliance that their clients do not receive the notice and thus are not made aware of their rights until after opt out and objection deadlines – and, sometimes, claim filing deadlines – have passed. Most often, though not always, affected putative class members have not been permitted to opt out after the deadline for doing so—even when they received the notice after that deadline,[3] or to object after the fairness hearing; courts have, however, extended for those beneficial owners claim filing deadlines. Of course, those latter extensions are relevant only if the affected class members eventually learn of their right to file a claim to recover from the settlements. With the 2018 Amendments' heightened focus on class member participation – Rule 23(e)(2)(C)(ii) now makes "the effectiveness of any proposed method of distributing relief to the class, including the method of processing class-member claims" a mandatory consideration in a court's fair, reasonable and adequate examination – recalcitrant nominees are no longer a mere inconvenience. Rather, their dilatory conduct may impact whether a securities class action settlement is approved and, if so, when distributions to class members and attorneys' fee payments will occur.

Background

As anyone with experience with the settlement of securities class actions knows, the overwhelming majority of class members, to facilitate efficient trading and recordkeeping, trade and hold their securities in "street name."[4] Those beneficial owners – that is, the clients of the nominee-record owners – *are* the putative class members entitled to notice, and only the nominees know their identities and addresses and, therefore, are the only ones able to provide the "best notice practicable" required by due process and Rule 23.[5] To effect the required notice, therefore, nominees must provide to their clients the court-approved notice of settlement. Accordingly, notices sent to nominees include a court-ordered process like the ordered by the court in *DeJulius*:

> "With the 2018 Amendments' heightened focus on class member participation, … recalcitrant nominees are no longer a mere inconvenience."

> In order to address this problem, the district court in the instant case issued special procedures for nominees who held shares on behalf of their clients during the class period. If a particular shareholder reflected in Sprint's records was a nominee, that entity had two options. The nominee could provide Gilardi with a list of names and addresses of its clients who were the beneficial owners of the Sprint shares. Gilardi would then forward individual notice packets to each investor. Alternatively, the nominee could simply request the appropriate number of notice packets from Gilardi and then forward the notices itself to the actual owners. Any costs associated with the mailing would be reimbursed from the settlement fund. In any event, the nominee was required to complete this process within ten days of receiving the initial notice package from Gilardi.[6]

Unfortunately, however, many nominees either ignore entirely their obligations or comply so dilatorily that their clients do not receive notice until after deadlines have passed for objection and exclusion, and, in some cases, even claim filing.[7]

Courts that have had to address recalcitrant nominees have done so when beneficial owners or class counsel have brought their failures to the courts' attention either as deadlines were approaching or after they had passed.[8] And when they did address them, most held that, even though beneficial owners did not timely receive notice, due process – which requires only the best notice practicable, not actual notice – was satisfied.[9] The issue, as framed by those courts, is "whether the class as a whole had notice adequate to flush out whatever objections might reasonably be raised to the settlement."[10] Accordingly, the schedules for the courts' fairness determinations almost always remained

intact. But, as described in the next paragraph, a cautionary tale is provided by the events concerning the recalcitrant nominee in the *In re Bisys Securities Litigation*.[11]

In *Bisys*, in which one nominee failed to comply with the customary notice obligations ordered by the court,[12] class counsel and the claims administrator, without alerting the court or seeking its approval, mailed to all affected beneficial owners notice packets that were accompanied by a notification that advised that the lapsed claim deadline set forth in the notice packet would be extended. The court, upon learning from an affected beneficial owner that the court's authority had been usurped, convened a hearing, considered the imposition of sanctions, ordered a supplemental notice to be disseminated to the affected beneficial owners, and determined that they "should be given the opportunity to participate in, opt out of, or object to the Settlement to the same extent as other Members of the Settlement Class."[13] The extension of the opt out and objection deadlines necessarily delayed the fairness hearing schedule and carried with them the potential for additional delays and, depending upon the volume and character of any new exclusion requests and objections that may have been filed, risk to the settlement itself. Similarly, the extension of the claim filing deadline delayed the timing of any distribution. And all of that was caused by the failure of just one nominee to provide notice to beneficial owners.

The Impact of the 2018 Amendments

Prior to the 2018 Amendments, the harm caused by recalcitrant nominees ranged from inconvenience to delay, with the overwhelming result trending toward the former, with courts focusing on the rights of class members that recalcitrant nominees identified late—that is, little to no consideration was given to affected beneficial owners of nominees that ignored entirely their court-ordered notice obligations.[14] And even when delays occurred so that the rights of late-identified putative class members could be addressed, those delays most often affected only the claim submission deadline and, therefore, the distribution of net settlement funds. There was little or no effect on a courts' consideration of a settlement's fairness, and, with the proliferation in securities class action settlements of court-approved quick pay provisions, there was little impact on the payment of attorneys' fees.[15] But the 2018 Amendments' heightened focus on class member participation may complicate this paradigm.

> "[M]any nominees either ignore entirely their obligations or comply so dilatorily that their clients do not receive notice until after deadlines have passed for objection and exclusion, and, in some cases, even claim filing."

While including in the settlement recovery as many class members as possible without unduly delaying the distribution always has been a primary goal,[16] the 2018 Amendments turn that goal into a formal consideration in courts' determinations of the fairness, reasonableness and adequacy of proposed settlements.[17] The Rule 23 Advisory Committee stated, for example, that

> [t]he relief that the settlement is expected to provide to class members is a central concern. Measuring the proposed relief may require evaluation of any proposed claims process; directing that the parties report back to the court about actual claims experience may be important.[18]

That Committee also advised that "[o]ften it will be important for the court to scrutinize the method of claims processing to ensure that it facilitates filing legitimate claims."[19] Accordingly, a proactive approach to recalcitrant nominees, as described in the next section, is the best way under the 2018 Amendments to protect the viability of securities class action settlements and to enhance the likelihood of timely judicial approval of them, of class counsel's requests for attorneys' fees, and of motions to distribute net settlement funds. Otherwise, courts may follow the *Bisys* example, which, if a court determines that, by the time of the fairness hearing, adequate class member participation has not occurred, would subject securities class action settlement approvals to unwarranted delays—and perhaps jeopardize those settlements altogether, and may delay the payment of attorneys' fees.[20]

> [Recalcitrant nominees'] dilatory conduct may impact whether a securities class action settlement is approved and, if so, when distributions to class members and attorneys' fee payments will occur."

Potential Solutions

One way proactively to address the recalcitrant nominee issue, as articulated in *Peil*, is to not entirely rely on nominees to comply with court-ordered notice obligations.[21] As that court held, "counsel for the class has primary responsibility for ensuring compliance with the notice procedure."[22] The *Peil* court continued:

> The notice dispute in this case rests on plaintiff's misconception of his pivotal role in notifying possible class members. Plaintiff's notice program must entail something more than pro forma gestures amounting to superficial compliance with constitutional and statutory notice requirements. ... As a court officer and a fiduciary to absent class members,

> class counsel is obligated to ensure that the nominees receive proper notice and that the nominees either identify beneficial purchasers or agree to notify these purchasers. In this respect, plaintiff's program fails on every count.

[N]eglecting to aggressively and systematically pursue recalcitrant nominees fails to satisfy the goal of individual notice.[23]

With these obligations in mind—and given the enhanced focus that the 2018 Amendments place on class member participation, class counsel may want to consider more than sending notices to nominees and waiting for those nominees to fail to respond to them. For example, class counsel may, as was ordered in *Peil*, consider issuing subpoenas duces tecum to those nominees that, in class counsel's opinion and that of the claims administrator, which maintains and updates lists of nominees and works with them on a regular basis, are likely to account for the lion's share of beneficial owners of the securities that are the subject of the class action, especially those nominees that, in past settlements, did not comply with court-ordered notice obligations:

> "[C]lass counsel may … consider issuing subpoenas duces tecum, [or] consider serving on those nominees preliminary approval motions."

> If after these efforts [to address confidentiality and financial issues raised by nominees], any nominees are still unwilling to identify or notify beneficial purchasers for purposes of this class action, *plaintiff shall issue subpoena duces tecum to recalcitrant nominees*. Issuing a subpoena seeking the identity of class members falls within this court's power under [Rule 23](d) "to order one of the parties to perform the tasks necessary to send notice." Brokerage houses receiving a subpoena will be compelled to provide plaintiff with the relevant records and shall receive appropriate reimbursement for their efforts. If any nominees refuse to identify the beneficial purchasers they may be subject to the court's contempt power.[24]

A similar approach would be to consider serving on those nominees preliminary approval motions; in that way, the motions and, specifically, the notice obligations on nominees contained in them, would not be ex parte such that failing to comply with them would carry with it consequences similar to those for failing to abide by a properly issued and served subpoena.[25] If issuing subpoenas or serving preliminary approval motions, even to a limited number of nominees believed by the claims administrator likely to be both material and recalcitrant, is considered by class counsel to be too drastic a process to implement prior to nominee noncompliance, class counsel may wait, with the risks of delay attendant to that choice, until after the deadline for nominee compliance has passed

– usually ten days to two weeks from the date on which the notice is mailed to them – and then issue the subpoenas necessary to assure that a substantial proportion of beneficial owners receive notice and, as a result, increase the likelihood of sufficient class member participation in recoveries.

Should class counsel decide not to be proactive and then, just before or any time after the court-imposed deadlines for exclusion requests, for objections or for claim submission, learn about recalcitrant nominees, an approach that is less likely than the one taken in *Bisys* to incur judicial recriminations was applied in *In re Teva Securities Litigation*.[26] There, class counsel timely filed a status report that, in addition to informing the court about the status of the notice program, advised of late nominee compliance, and provided the following solution: The claims administrator would send to the affected beneficial owners the existing notice and proof of claim together with a "buck slip" that, to avoid confusion, to protect their rights, and to enhance the likelihood of their participation in the settlement recovery, provided to those beneficial owners the following explanation and information:

> "[O]nly the nominees know their identities and addresses and, therefore, are the only ones able to provide the "best notice practicable" required by due process and Rule 23."

> You are receiving this Notice pursuant to the Court's order in *In re Teva Securities Litigation*, No. 3:17-cv-00558 (SRU). Because your broker or nominee only recently responded to the Court's order, you may receive this Notice after the deadlines to submit a claim, request exclusion from the Settlement Class, or object to the settlement.
>
> **While the deadline for submitting a claim in this action is May 17, 2022, you should submit a claim as promptly as possible, even if it is after the May 17, 2022 deadline.** The Claims Administrator will continue to process claims received or postmarked after May 17, 2022 until such time as the receipt and processing of new late claims will impact decisions on disbursements.
>
> **If you wish to request exclusion or object to the settlement, you should do so as promptly as possible, even if it is after the May 2, 2022 exclusion deadline and May 12, 2022 objection deadline, so that your request or objection can be considered by the Court at the Settlement Hearing on June 2, 2022, at 10:00 a.m.**[27]

* * * * *

It always is in the best interests of the class to maintain the fairness consideration schedule approved by the court, while, only if necessary, extending solely for those class members affected by recalcitrant nominees, the claim filing deadline. But recalcitrant nominees are not going away any time soon. And based on my experience, many of them, because they consider customary court-ordered notice obligations to be ex parte, will not comply with them. Class counsel, if they want to take reasonable steps designed to maintain fairness hearing and distribution schedules, to protect the rights of beneficial owners, and to enhance class member participation in the recoveries provided by securities class action settlements, should consider the approaches described above, as well as others, that address the longstanding recalcitrant nominee issue.

Notes

* Jeffrey N. Leibell is the principal of The JNL Firm, LLC, a consulting firm that provides class action settlement management services, and is the Chief Legal & Financial Officer of Financial Recovery Services, LLC ("FRS"), a leading class action claims management consulting firm. Prior to joining FRS, Mr. Leibell was Vice President, Class Action Services at The Garden City Group, Inc., a prominent class action settlement administrator, and, before that, he was the partner at Bernstein Litowitz Berger & Grossmann LLP, a preeminent plaintiff-side class action law firm, responsible for negotiating and documenting the terms of, developing the allocation plans for, and overseeing the administrations of, over $16.4 billion in class action recoveries.

1 *In re Citigroup Inc. Sec. Litig.*, Nos. 09 MD 2070 & 07 Civ. 9901, 2014 WL 2445714, at *2 (S.D.N.Y. May 30, 2014) (quoting *In re Agent Orange Prod. Liab. Litig.*, 611 F. Supp. 1386, 1406 (E.D.N.Y. 1985) (Weinstein, J.); *see id.* at *1 ("The Court concludes that ... the class members should receive their recovery as expeditiously as possible.").

2 *See, e.g.*, *In re LIBOR-Based Fin. Instr. Antitrust Litig.*, 327 F.R.D. 483, 496 (S.D.N.Y. 2018) ("The goal of any distribution method is to get as much of the available damages remedy to class members as possible and in as simple and expedient a manner as possible.") (quoting 4 William B. Rubenstein, Newberg on Class Actions ("Newberg") §12:15 (5th ed.) (Westlaw 2018); *accord Krakauer v. Dish Network, LLC*, Case No. 1:14-CV-333, 2017 WL 3206324, at *7 (M.D.N.C. July 27, 2017) (citing Newberg §12.15 (5th ed. 2017)).

3 Courts have left open the possibility that those beneficial owners could seek redress in a collateral proceeding. *See, e.g., DeJulius v. New England Health Care Emp. Pen. Fund*, 429 F.3d 935, 945 n.12 (10th Cir. 2005) ("We expressly left open the possibility of individual class members bringing a due process claim based on lack of individual notice in a collateral effort to challenge the binding effect of the settlement as to them.") (quoting *Torrisi v. Tucson Elec. Power Co.*, 8 F.3d 1370, 1375 (9th Cir.1993) (quoting *In re Integra Realty Res., Inc.*, 262 F.3d 1089, 1111 & n.18 (10th Cir. 2001))).

4 *See, e.g., DeJulius* 429 F.3d at 939 ("[M]any of the shareholders reflected in Sprint records were brokerage houses and it was thus likely that these entities held the shares only as 'nominees' while the entities' clients held the beneficial title to the shares, also known as holding shares in 'street name.'") (citing and quoting 940 S.E.C. Comm'n, *The Street Name Study* 1 (1976), *reprinted in* Robert W. Hamilton & Jonathan R. Macey, *Cases and Materials on Corporations Including Partnerships and Limited Liability Companies* 674 (8th ed. 2003)); *id.* at 940 ("The primary benefit of this practice is to permit beneficial owners easily and quickly to transfer ownership of their shares without meeting the issuer's often cumbersome requirements, such as endorsing the back of the stock certificate.").

5 *See, e.g.*, *Eisen v. Carlisle and Jacquelin*, 417 U.S. 156, 173 (1974) ("*Eisen IV*") ("[T]he court is required to direct to class members 'the best notice practicable under the circumstances including individual notice to all members who can be identified through reasonable effort.'"). As the *Eisen IV* Court stated:

> The Advisory Committee's Note to Rule 23 reinforces this conclusion. [It] described subdivision (c)(2) as "not merely discretionary" and added that the "mandatory notice pursuant to subdivision (c)(2) ... is designed to fulfill requirements of due process to which the class action procedure is of course subject." The Committee explicated its incorporation of due process standards by citation to *Mullane v. Central Hanover Bank & Trust Co.*, 339 U.S. 306, 70 S. Ct. 652, 94 L.Ed. 865 (1950), and like cases.

Id. at 173-74.

6 429 F.3d at 940.

7 *See, e.g., DeJulius*, 429 F.3d at 940 ("[A]n additional 89,426 notice packages were sent out sometime before December 3, 2003, one day after the deadline for opt-out/objection deadline and nearly two weeks prior to the settlement hearing."); *Silber v. Mabon*, 18 F.3d 1449, 1454 (9th Cir. 1994) (Although opt out deadline passed before approximately 17% of the class members who held their securities in street name received notice from their nominees, due process was satisfied because best notice practicable, not actual notice, is all that due process requires.); *In re Johnson & Johnson Deriv. Litig.*, 900 F. Supp.2d 467, 486 (D.N.J. 2012) ("[A] few shareholders complained to the Court that they did not receive notice until after the deadline for objections had passed. ... [T]he late-noticed shareholders were individual shareholders whose shares were held in a street name, most likely that of a brokerage house."); *Peil v. National Semiconductor Corp.*, No. 77-4244, 1986 WL 11699, at *5 (E.D. Pa. Oct. 16, 1986) ("Notice to nominees is especially ineffective in this case because many nominees have failed to respond and many others have declined to cooperate for various reasons.").

8 *See, e.g.*, note 7, *supra* and cases cited therein.

9 *See, e.g., DeJulius*, 429 F.3d at 944 ("[T]his due process right does not require actual notice to each party intended to be bound by the adjudication of a representative action.") (citing, *inter alia*, *Mullane*, 339 U.S. at 313-14); *accord Torrisi v. Tucson Elec. Power Co.*, 8 F.3d 1370, 1373 (9th Cir.1993) ("[T]he question before us today is not whether some individual shareholders got adequate notice, but whether the class as a whole had notice adequate to flush out whatever objections might reasonably be raised to the settlement.").

10 *Johnson & Johnson*, 900 F. Supp.2d at 486 (quoting *In re Intel Corp. Deriv. Litig.*, No. 09-867, 2010 WL 2955178, at *2 (D. Del. July 22, 2010) (quoting *Fidel v. Farley*, 534 F.3d 508, 514 (6th Cir. 2008) (quoting *Torrisi*, 8 F.3d at 1375))).

11 No. 04 Civ. 3840 (S.D.N.Y.).

12 *See Bisys*, No. 04 Civ. 3840, Order Am. Settle. & Prov'g Supp. Notice, Doc. No. 167-2 (May 16, 2008), *as amended by* Order, Doc. No. 168 (May 20, 2008).

13 *Id.*; *accord Johnson & Johnson*, 900 F. Supp.2d at 486 ("Nevertheless, out of an abundance of caution, I extended the deadline for objections and directed J & J to provide notice of the extended deadline to those shareholders who received late notice."). The *Bisys* court ordered the cost of the supplemental notice to be borne by the claims administrator, the nominee and one class counsel firm. *See* Doc. No. 166, Ltr. to Court (May 14, 2008); so ordered, May 15, 2008.

14 Because only the nominees can determine whether any of their clients beneficially owned a security at issue in the settlement of a securities class action, class counsel and claims administrators are wholly dependent on those nominees to comply with their court-ordered notice obligations. Nominees' failures to do so—that is, either to provide to the claims administrator their names and addresses or to request from the claims administrator sufficient notices so that the nominee could forward them to their clients, leaves courts, class counsel and claims administrators in the unenviable position of determining whether non-responding nominees failed to respond solely because they did not locate among their clients any putative class members. *Accord, e.g.*, *Vieth v. Jubelirer*, 541 U.S. 267, 311 (2004) (Kennedy, J., concurring in the judgement) ("This is a difficult proposition to establish, for proving a negative is a challenge in any context.").

15 *See* Jeffrey N. Leibell, *Under Amended Rule 23, Effective Settlement Management Is Not Just a Good Idea, It's the Law* (cited as "*Settlement Management*"), available at www.JNLFirm.com.

16 *See id.*

17 *See id.*

18 Fed. R. Civ. P. 23 Adv. Comm. Notes 2018 Amend., Subd. (e)(2) &¶¶ (C) & (D).

19 *Id.*

20 *See Settlement Management.*

21 As the *Peil* court put it, "[r]eliance on a nominee's duty to forward notice to his client fails to constitute notice reasonably calculated to reach class members. ... I find it unlikely that these nominees would nevertheless notify class members based only on vague notions of agency and fiduciary duty." 1986 WL 11699, at *5 (citations omitted); *see id.* at 1 ("[N]otice to nominees, standing alone, fails to satisfy plaintiff's statutory and constitutional obligation to use reasonable efforts to individually notify identifiable class members.").

22 1986 WL 11699, at *4 (citations omitted).

23 *Id.* (citations omitted).

24 *Peil*, 1986 WL 11699, at *6 (citations omitted).

25 *Cf. In re Penn Central Sec. Litig.*, 560 F.2d 1138, 1140 (3d Cir. 1977).

26 No. 3:17-cv-00558 (D. Conn.).

27 Status Rpt. Re Notice of Class Settle., Doc. No. 955, at ¶7 (p.3) (May 4, 2022) (emphasis in original).