

# Fiduciary duties of a hedge fund that are often neglected

BY RANDALL H. STEINMEYER

Oftentimes a hedge fund with large losses in a stock as a result of fraud or misrepresentation will ask what its fiduciary duties are with regard to such losses, and in particular ask if it can or should 'actively' participate in the case. In such circumstances, there are a variety of matters to be considered, including maximising the recovery to the class, and thus to the fund; ensuring the fund receives its fair share of the settlement proceeds; minimising the risk of the company committing fraud again; and the fiduciary duties to pursue such a claim. Absent taking an active role, a fund limits its ability to influence the outcome and perhaps minimises rather than maximises its recovery.

A fund manager is a trustee of the assets it holds for the benefit of the fund's investors. As

such, it is under a duty to maximise the financial interest in claims it holds for the benefit of its investors. Some state officials view the lawsuits as their duty to be publicly accountable to fund-holders and to try to recover losses in cases where they believe fraud occurred, and this thinking should be applicable to public as well as private institutions managing other people's money.

Regardless of the jurisdiction, it is black letter law that "a trustee has a duty to investigate relevant facts, to explore alternative courses of action and, if in the best interests to pursue claims". As a fiduciary, fund managers have a fiduciary responsibility to consider the merits of participating in the litigation. Failure to investigate a valid claim may breach the fund's

fiduciary responsibilities to its investors and may expose them to liability. As stated by one federal court, it may not only be prudent to initiate litigation, but also a breach of fiduciary duty to not pursue a valid claim.

A fiduciary has a duty to "take reasonable steps to realise on claims that are property of the trust, including claims in tort". When a tort is committed against a fiduciary, the trustee has a duty to take reasonable steps to compel the tortfeasor to redress the injury. Moreover, fiduciary (i.e., a hedge fund manager) cannot properly abandon claims affecting the trust property unless it reasonably appears that a suit would be futile or the expense of the litigation or the character of the claim would make it reasonable not to bring suit. In 1998, the United States ▶▶

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Secretary of Labor stated:

*"[A] fiduciary may have a duty to serve as lead plaintiff where no single individual has sufficient interest or resources to serve in such capacity or where, as a large stakeholder, the fiduciary has an interest in assuring that an alternate class representative with a less substantial stake in the outcome does not unduly compromise the interests of the class in settlement, fail to vigorously prosecute the actions, or fail to protect the interests of the class vis a*

*vis its attorneys."*

The lesson here is twofold: First, if the your fund takes a large loss in a security associated with fraud (and the shares trade on a US Exchange where the fund can engage counsel without incurring a scintilla of risk or costs and pursue a class action) ask the fund manager what the fund is doing to recover the losses. If you're the fund manager, make sure you have an answer. Avail yourself of your rights by associating with one of the 20 or so firms in

the US that practice exclusively in the area of shareholder class actions and open a dialogue. This way, when the next Enron, Worldcom, Parmalat or Lehman hammers your fund, a simple phone call to US counsel will not only protect you by demonstrating you're attempting to comply with your fiduciary duties, but enhance your returns as well. ■

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