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Key Considerations For Litigation Settlement Trustees

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With billions of dollars at stake, successfully administering a complicated mass tort or class action litigation settlement requires trustees to operate flexibly and adaptably, and provide full accountability to stakeholders.

Mass tort and class action litigation makes headlines when high- profile, multibillion-dollar settlements and awards are announced. In recent memory, cases involving tobacco, oil spills, medical devices, pharmaceuticals, and accounting and securities fraud have garnered worldwide media attention.

Today, mass tort issues involving prescription opioids, climate change and "forever chemicals" are increasingly gaining public awareness. But what happens after the media spotlight turns elsewhere? What about the work that follows after the issues are agreed upon, the court approves a settlement with a monetary award and hundreds or even thousands of claims must be administered?

The complex work that arises post-settlement rarely garners public attention, but it is critically important. One of the most essential elements to ensure a successful post-settlement outcome is the establishment and administration of an effective, comprehensive settlement trust fund or funds.

A settlement trust acts as a separate legal entity that implements the terms of the settlement. It holds, invests and distributes funds deposited by the defendants for the benefit of beneficiaries. The settlement trust is structured and managed by an independent trustee, oftentimes chosen by the plaintiffs in consultation with the defendants and approved by the court.

It is essential that the settlement trust be optimized for effectiveness and efficiency. The trustee must pay attention to beneficiary requirements and be ready to address unexpected events that might require operational changes.
In this article, we will describe some of the core functions and considerations that a trustee must focus on when administering settlement trust, using our experience administering trusts formed under the Volkswagen AG diesel emissions settlement as an example.

What are the key functions of a trustee?

Effective trust administration necessitates that litigants work closely with a trustee to design an ideal framework that will optimize the experience for the beneficiaries, while enhancing opportunities for the monies to achieve desired goals. A trustee must successfully accomplish the following tasks.

The trustee must efficiently disburse funds to potentially hundreds or even thousands of beneficiaries, and only for approved purposes.

Typically, each beneficiary provides direction to the trustee, through procedures established in consultation with the beneficiaries and enforced by the trustee.

Mechanics for distribution must be precisely identified — and since funds may only be released for purposes defined in the settlement, the trustee must work with the beneficiaries to create a process for vetting and settling claims, ensuring adherence to the process.

The trustee must maintain effective custody and safekeeping of trust assets.

The trustee must minimize trust administrative expenses, ensure liquidity so funds can be disbursed quickly to beneficiaries upon receipt of direction and claims processing, and maximize investment earnings subject to investment parameters defined in the trust agreement.

The trustee should have trust powers and controls in place to establish and operate dedicated trusts, and ensure availability of all funds for their established purpose.

The trustee must mitigate risk through insurance and innovative contractual provisions.

The trustee must work to minimize operational and credit risk for beneficiaries. Together, they should plan for the unexpected over the life of a trust, including "black swan" events that can negatively impact assets available to settle claims.

These can be market or legal events that are undefinable and impossible to foresee. The trustee should work with beneficiaries to develop creative ways to cost-effectively insulate the trust so it can navigate through the unknown without hampering its ability to fully settle claims.

The trustee must manage investments while balancing risk mitigation, the safety of the corpus, liquidity and yield.

The trustee must have clearly defined investment parameters, while working to preserve and grow assets and ensure ready availability for claims settlements and disbursements. In addition, the investment approach should mitigate interest rate risk, so the value of assets is not negatively impacted by any rate changes.

While the trustee should pursue yield in order to augment assets available for the beneficiaries and to efficiently operate the trust, the safety of the corpus is paramount. The pursuit of yield must be secondary to the liquidity and credit worthiness of the investments.

The trustee must manage legal and tax considerations.

The trustee must ensure that the trust is established and functions in a manner that is consistent with the law, which at times can be nuanced and complicated. In addition, tax considerations can have an impact on the defendant, while affecting the beneficiaries in different ways.

Therefore, it is essential that the trustee work closely and effectively with beneficiaries and tax professionals to understand the tax implications, and when necessary, engage the Internal Revenue Service for clarity and private letter rulings.

The trustee must maintain internal verification and auditing standards.

The trustee must provide complete transparency in trust operations, to ensure and reinforce confidence in its ability to execute its mandate. Consistent and strict adherence to operating policies and a high standard of execution are critical. The trust should engage a third-party accounting firm to validate financials and lack of operational risk.

Collaboration with beneficiaries is paramount — as is recognizing that different sets of beneficiaries likely will have their unique requirements. Optimizing these requirements while also safeguarding trust assets and effectively administering trust payments is the hallmark of a successful trustee. Importantly, the trustee must listen, adapt and create solutions to address beneficiary needs — not only during the development of the trust, but throughout its life.

In 2016, global automaker Volkswagen entered into a series of civil and criminal settlements to resolve allegations that it manipulated its diesel engines for eight years to defeat emissions tests.[1] According to the terms of one settlement, Volkswagen agreed to finance $2.9 billion for environmental mitigation efforts to reduce emissions of nitrogen oxides, gases proven to contribute to global warming.

In the spring of 2017, our team at Wilmington Trust was assigned the work of administering two environmental mitigation trusts funded with this money, the beneficiaries of which span all 50 U.S. states, two territories and 568 federally recognized Indian tribes. As of Dec. 31, 2020, the Volkswagen trusts had disbursed $537 million as directed by 47 beneficiary states, and nearly $35 million to 68 tribes.

On the Volkswagen settlement, we were tasked with implementing a trust designed, ultimately, to alleviate environmental damage wrought by the emissions scandal. With hundreds of plaintiffs, the litigation drew global attention. This required a solution for administering and paying billions of dollars to the beneficiaries in a manner that was fully transparent, with no margin for error.

An important element of the settlement agreement was the establishment of two trusts: one for the U.S. states and territories, and one for the tribes.[2] This allowed for tailoring our administrative duties to the specific needs of each of the beneficiary groups.

A particularly challenging detail was the use of qualified settlement funds, or QSFs, also known as 468B settlement funds. We worked with legal and tax professionals, as well as the beneficiaries, toward the goal of effectuating the trusts and a mutually beneficial QSF tax strategy. The team worked closely with trust tax counsel to pursue a private letter ruling from the Internal Revenue Service and win the consent of the court to establish QSFs.

The QSF structure offers significant benefits. Notably, investment returns earned on the corpus of the trust are tax exempt within the state trust structure, as determined by the IRS. In the Volkswagen case, an ancillary benefit was that Volkswagen's monetary contribution to the settlement was deemed tax-deductible.

QSFs are frequently mandated by court-ordered settlements because they are tax-efficient and facilitate dispute resolution. In many cases, funds can be transferred to a QSF as established by the trustee, and are then immediately deductible by the settling defendant, without constituting income to the beneficiaries until the funds are distributed by the QSF.

Additionally, QSFs allow the time necessary for trustees to work with beneficiaries in complex settlements to ensure procedures for vetting claims and payment mechanics are clearly defined and established, while ensuring the funds from the settlor are secure.

A trustee should always inquire as to whether the court-ordered settlement has mandated a QSF, and when clarity is needed, proactively work with all parties to the settlement to ensure the QSF is established effectively.

A final element of the Volkswagen settlement structure was establishing the two trusts as Delaware statutory trusts. This strategy gave the stakeholders multiple advantages, including limiting liability to the trust and its assets, and the creation of a legal entity, among other actions, to hold settlement proceeds and execute the requirements of the settlement.

These examples illustrate that a settlement as initially approved does not always ideally effectuate the desired goals of the parties when it is implemented in accordance with its original terms. This is when it is truly critical that the trustee work with the beneficiaries to craft solutions and seek approvals to ensure the trust operates as intended.

How can the trustee streamline the process of producing the desired results?

One of the key performance indicators of a settlement trust is its ability to repeatably and sustainably disburse monies to facilitate results. In the past, some of these structures have been criticized for being ineffective, either because they fail to meet the needs of the beneficiaries or because the overhead expenses are excessive, resulting in a disproportionate amount of funds being paid to the trust administrators.[3]

Complex settlement trusts should be designed with a focus on ensuring that settlement dollars flow quickly and easily to the beneficiaries, for the intended objectives of the trust. The structure must provide for the ability to address unanticipated issues, and must be clearly designed with transparent terms and conditions. This facilitates efficient interactions by and between the beneficiaries and the trustee regarding funds disbursement.
For example, some states have miscellaneous receipts statutes that preclude the direct disbursement of monies to mitigation or remediation programs. The design of trust language should consider any such restrictions to ensure that beneficiaries maximize the full benefit of the settlement agreement.

In working on the Volkswagen settlement trust, it was determined that the most effective approach was to have a lead agency designated for each beneficiary, through which monies are disbursed for the intended purpose of meeting the emissions mitigation projects identified by the settlement. In California, for example, that agency is the California Air Resources Board.

Individual organizations apply to the lead agency in their respective jurisdiction for funding for projects that will replace diesel-powered equipment with new equipment that is more environmentally friendly. There are 10 specific types of replacement/repower projects that are eligible for funding, ranging from airport ground equipment to shorepower sources used for oceangoing vessels.

In this situation, a trustee/fiduciary is not responsible for ascertaining the worthiness or potentially positive impact of any proposed project. Rather, it is responsible for ensuring each application meets all criteria for an eligible project, as mandated by the trust agreement, and that the application is supported by all necessary information and documentation.

If an application is incomplete, the trustee works with the applicant to bring it up to standard. It is up to the beneficiaries themselves to verify that they have used their funds in accordance with the terms of their trust and to report on their use of the funds to the public.

To enhance transparency and accountability in the Volkswagen settlement, we designed and implemented an accessible public-facing website[4] that tracks all funding requests, with approvals, denials and modifications.

As part of our reporting responsibilities as trustee, we produce semiannual and annual reports, which are independently audited, showing the status of all projects and pertinent financial data — funds expended, interest earned, etc. — down to the penny. And the trust is reviewed semiannually, and audited annually, by an independent public accounting firm.

How can a trustee help make operations as cost-effective as possible?

In any mass tort or class action litigation settlement process, minimizing administrative costs is crucial to maximizing the eventual payouts to the beneficiaries. It is a best practice to establish a fixed cost structure for paying expenses, in that the trustee budgets for all costs as a fixed percentage of the assets in the trusts.

These expenses can include various costs for necessary professional services, among them legal, tax, accounting, auditing, insurance and trustee fees. It is also important to account for the costs of technology, such as websites and secure file-sharing and collaboration solutions.

By applying a fixed cost structure, stakeholders are shielded from the surprise of unanticipated expenses or cost overruns. It is essential that there be full transparency of costs for all constituents, which is achieved by publishing all expense data in the public domain.
In the Volkswagen case, our team held in-depth discussions with the plaintiffs and beneficiaries with the goal of ensuring that there would be sufficient funds, informed by internal budgeting. The team jointly agreed to set an administrative cap of 3% of the assets in the trust.

This rate remains consistent throughout the court-ordered 10-year lifespan of the trusts. However, with our legal, tax and insurance partners, we also developed contingency planning for managing expenses in case of a black swan event that could negatively affect the assets in the trusts — up to and including the point of insolvency.

To ensure transparency, all invoices from service providers, including for trustee fees, are published publicly — e.g., via a public-facing website — for review and comment.

In administering this type of trust, it is also important that trustees track the beneficiaries' administrative expenses and ensure that information, too, is publicly available. For example, in the Volkswagen settlement, a beneficiary can spend up to 15% of a specific allocation for an approved emissions mitigation project on administrative overhead.

Final Thoughts

Today's legal, regulatory and tax environment is complex. The trustee for a mass tort or class action litigation settlement must work collaboratively to bridge the dialogue between court, the settlors and the beneficiaries.

In so doing, the trustee is imbued with the responsibility to see the settlement through, ensuring that funds are quickly, efficiently and accurately disbursed, consistent with the terms of the court-mandated agreement. An effective trustee must serve not simply as a fiduciary, but also ensure that the monetary awards are disbursed as intended under the stated goals of the trust.

In the Volkswagen case, the goal was to alleviate the damage caused by the defendants' noncompliance with environmental law to the greatest extent possible. With careful planning and close collaboration, a trustee can work with all parties to extend the benefits of the settlement to as many qualified beneficiaries as possible in the most effective and cost- efficient way for all concerned.

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Disclosure: The authors and their firm administer the Volkswagen diesel emissions settlement trusts that are discussed in this article.

[1] https://www.atlasevhub.com/.
[2] https://www.vwenvironmentalmitigationtrust.com/.
[3] See, for example, https://www.tobaccofreekids.org/assets/content/what_we_do/state_local_issues/settlement/FY2019/2018_State_Report.pdf.

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