Not Shy and Not Retiring: The Supreme Court’s Recent ERISA Decisions Affecting Retirement Plans

INSURANCE AND FINANCIAL SERVICES LITIGATION – WEBINAR SERIES

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Overview

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Dudenhoeffer: Background

- Fifth Third maintains a defined contribution retirement plan for employees
- Plan participants can choose to invest contributions in mutual funds or a company stock fund; the company stock fund portion of the plan is considered an employee stock ownership plan (ESOP)
- Fifth Third’s matching contributions are initially deposited in the ESOP
- Fifth Third’s ESOP invests primarily in Fifth Third common stock
- Fifth Third stock price fell by 74% between July 2007 and September 2009
Dudenhoeffer: Procedural History

- **U.S. District Court**
  - Dismissed the plan participants’ complaint for failure to state a claim
  - Ruling: Where a lawsuit challenges ESOP fiduciaries’ investment decisions, the complaint must overcome the presumption of prudence at the pleading stage that the plan fiduciary’s decision to remain invested in employer securities was reasonable
  - Conclusion: The case does not proceed to the evidentiary stage
Dudenhoeffer: Procedural History

- On Appeal: 6th Circuit Court
  - Reversed District Court’s dismissal of plan participants’ complaint
  - Ruling: Where a lawsuit challenges an ESOP fiduciary’s investment decisions, the plaintiff bears the burden of the presumption of prudence at the evidentiary stage that the plan fiduciaries’ decision to remain invested in employer securities was reasonable
  - Conclusion: The case proceeds to the evidentiary stage
Dudenhoeffer: Circuit Splits

- 2d, 3d, 5th, 7th, 9th and 11th Circuits
  - The Moench Presumption: Presumption of prudence applies at the pleading stage and requires the plaintiff to establish that the employer was “in a dire situation” that was objectively unforeseeable by the settlor. *Moench v. Robertson*, 62 F.3d 553 (3d Cir. 1995)

- 6th Circuit
  - Presumption of prudence applies only at summary judgment and beyond and only requires the plaintiff to establish that “a prudent fiduciary acting under similar circumstances would have made a different investment decision”
Dudenhoeffer: Plan Participants’ Claims

• Fifth Third’s stock
  ▪ Excessively risky
  ▪ Overvalued

• Breach of fiduciary duty
  ▪ Fiduciary knew or should have known about the risk and valuation of Fifth Third’s stock
  ▪ Public news informed the fiduciary about the impending collapse of subprime lending
  ▪ Nonpublic information indicated that officers of Fifth Third made material misstatements about financial prospects of Fifth Third
  ▪ Fiduciary should have sold the ESOP, refrained from purchasing, canceled ESOP option, or disclosed nonpublic information to adjust valuation of stock in financial market
Dudenhoeffer: Decision

• **Holding**
  - Unanimous Court Opinion by Justice Breyer
  - No presumption of prudence applies. “ESOP fiduciaries are subject to the same duty of prudence that applies to ERISA fiduciaries in general, except that they need not diversify the fund’s assets.”
The Court observed that there is obvious tension between fiduciary requirements and the goals of ESOPs under ERISA

- The content of ERISA’s duty of prudence does not vary depending upon the “specific non-pecuniary goal set out in an ERISA plan”
- The duty of prudence supersedes instructions of a plan document
- While Congress was seeking to promote capital growth and stock ownership, it did not intend to relax the duty of prudence applicable to ESOP fiduciaries
**Dudenhoeffer:** Decision

- Potential for conflict arises because ESOP fiduciaries are often company insiders and because suits against insider fiduciaries assert that fiduciaries were imprudent in failing to act on inside information they had about the value of employer stock
  - ERISA’s duty of prudence does not require a fiduciary to violate federal securities laws
  - Courts should consider whether a complaint alleges ERISA-based obligations that may conflict with federal securities laws
  - Courts should also consider whether a complaint alleges alternative conduct by a fiduciary that would do more harm than good to the fund by causing a drop in stock price
Dudenhoeffer: Decision

- An ESOP fiduciary who worries that continuing to purchase company stock may be imprudent “finds himself between a rock and a hard place…”
  - Fiduciaries could be subject to litigation either for continuing to purchase poor-performing company stock or for “missing the opportunity to benefit from good performance”
  - “[C]areful, context-sensitive scrutiny of a complaint’s allegations” can weed out meritless claims more effectively than the presumption of prudence
  - “[T]he content of the duty of prudence turns on the circumstances prevailing at the time the fiduciary acts”
Dudenhoeffer: Decision

- Allegations that a fiduciary should have known from publicly available information alone that publicly traded company stock was over- or undervalued are implausible as a general rule
  - ERISA fiduciaries may prudently rely on a major stock market to provide the best estimate of the value of stocks
  - Special circumstances could make reliance on the market price of a stock imprudent
The Aftermath: Case Law

  - After *Dudenhoeffer* and based on articles from the *Financial Times*, class action plaintiffs try a new amended complaint alleging imprudent continued offering of company stock fund
  - Employer alleged to engage in illegal scheme to conceal material facts about merger target’s improper accounting practices, and points to both press reports and whistleblower allegations that should have resulted in freezing new investments or public disclosure of info to participants
  - Allegations not sufficient to establish “special circumstances”
  - Articles did not establish fraud, and employer has right to investigate whistleblower allegations before going public
  - Plaintiff fails to plausibly allege alternative action defendant could have taken consistent with securities laws
The Aftermath: Case Law

  - Allegedly imprudent to continue offering employer stock as investment option despite significant public information about heavy involvement in risky subprime mortgage market
  - Significant red flags and steady decline of stock price
  - But plaintiffs fail to point to “special circumstances” that would render reliance on market price imprudent
  - Defendant fiduciaries were between the Dudenhoeffer “rock and a hard place” re continuing to invest where the stock price goes down or ceasing to invest as the stock price goes up
  - No material nonpublic information to be disclosed; rather, information re problems well known by beginning of class period
The Aftermath: Case Law

- *Harris v. Amgen, Inc.*, 2015 WL 3372373 (9th Cir. May 26, 2015)
  - Senior officials of Amgen committed the alleged fraud by publishing inaccurate and misleading statements about clinical drug trials
  - Both securities law and ERISA simultaneously violated by conduct of defendants
  - Irrelevant whether Amgen experiencing severe financial difficulties or remains strong company
  - Share price artificially inflated by deliberate fraudulent conduct
  - Special circumstances found to exist
The Aftermath: Case Law

  - Continued investment by ESOP fiduciaries in company stock after it was obvious that company headed for bankruptcy
  - Court focuses on allegations that company’s downward slide was so obvious and unstoppable that, regardless of whether market was “correctly” valuing stock, fiduciaries should have halted or disallowed further investment
  - Fiduciaries allegedly knew or should have known stock was imprudent investment because of dying technology and antiquated products, inability to bring new products to market, cash flow problems, and severe lack of liquidity
  - Fact that market, on any given day, may have provided best estimate of stock value does not, in these alleged facts, reveal whether fiduciary acted prudently in continuing to invest – indeed, should have seen it was a poor long term investment
  - Special circumstances found to exist
The Aftermath: Best Practices

• Plan terms
  ▪ It is clear that mandating employer stock will not result in a presumption of prudence
  ▪ Nevertheless, until the law is more settled, it still may be a good idea to specify the stock investment in the plan document

• Satisfying fiduciary obligations – independent fiduciary
  ▪ Consider use of independent fiduciary
  ▪ Independent fiduciary would have complete discretion to sell company stock fund if maintaining the fund is no longer prudent under ERISA
The Aftermath: Best Practices

• Satisfying fiduciary obligations – company committee
  ▪ Carefully select members of the committee – consider whether including top management might be counter-productive
  ▪ Establish process for evaluating company stock investment option and follow that process, then document following the process

• Communications about company stock
  ▪ Ensure participants are appropriately informed about the risks of holding company stock

• Limits on company stock
  ▪ Consider establishing limits on the percentage of a participant’s total account that can be held in company stock
Remaining Issues: SPD/Prospectus

• **Harris v. Amgen**
  - **Issue**
    - Whether filings with the SEC become actionable ERISA fiduciary communications merely by virtue of their incorporation by reference into plan documents
  - **Facts**
    - Amgen maintains a retirement plan for employees
    - One investment choice within the Amgen plan is the Amgen Common Stock Fund, which only holds Amgen stock
    - Due to failed drug trials and negative news reports, Amgen stock decreased in value by 33%
  - **Complaint**
    - Plan fiduciary knew or should have known that statements contained in SEC filings, which were incorporated by reference into ERISA-mandated summary plan descriptions (SPDs), were materially false and misleading
Remaining Issues: SPD/Prospectus

• *Lanfear, 11th Cir. 2012; Kirschbaum, 5th Cir. 2008*
  ▪ Employers are not acting in their capacity as plan fiduciaries incorporating SEC filings into their company prospectus and giving them to employees

• *Dudenhoeffer, 6th Cir. 2012; In re Citigroup ERISA Litigation, 2d Cir. 2011; Quan, 9th Cir. 2010*
  ▪ “The SPD is a fiduciary communication to plan participants and selecting the information to convey through the SPD is a fiduciary activity”
  ▪ This is the case “whether the fiduciary states information in the SPD itself or incorporates by reference another document containing that information…”
Remaining Issues: SPD/Prospectus

- *Harris v. Amgen*, 9th Circuit 2015
  - Ruling: Incorporating SEC filings into ERISA-mandated plan documents by reference results in fiduciary liability from statements that would not be actionable under the federal securities laws
  - Conclusion: Incorporating SEC filings into an ERISA-mandated SPD creates risk for plan fiduciaries
Remaining Issues: Decision to Eliminate

• *Tatum v. RJR Pension Inv. Comm.*, 761 F.3d 346 (4th Cir. 2014)
  - 14 years after merger, Nabisco spun off RJR
  - RJR’s 401(k) Plan maintained the Nabisco Stock Fund immediately after the spinoff
  - RJR’s plan fiduciary decided to remove Nabisco Stock Fund from the plan shortly after the spinoff
  - Complaint: RJR breached its fiduciary duties of procedural prudence owed to plan participants under ERISA when it liquidated the Nabisco Stock Fund
Remaining Issues: Decision to Eliminate

- *Tatum v. RJR Pension Inv. Comm.*, 761 F.3d 346 (4th Cir. 2014)
  - Ruling: Fiduciary breached duty by removing plan investments on an arbitrary timeline without conducting a thorough investigation
  - Conclusion: Documented procedures and processes are required for plan investment choices
  - Takeaways
    - Burden of proof shifts to defendants to show that a prudent fiduciary would have made the same decision (not just could have)
    - Careful record-keeping and care is required for decisions made regarding changes to plan investments
• Issue:
  ▪ Whether a claim that fiduciaries breached their duty of prudence was barred by the six year statute of limitations when the decision to include the investment funds at issue was more than six years before the complaint was filed.
**Tibble: Background**

- 1999: Edison selects high-cost retail class mutual funds as investment options for its 401(k) plan
- 2002: Edison adds three more retail class mutual funds to its 401(k) plan options
- 2007: Plaintiffs sue Edison for breaching its duty of prudence by offering retail class mutual funds instead of less expensive institutional class funds
  - Using revenue sharing to offset plan administration costs in violation of ERISA §§ 404(a)(1)(D) and 406(b)(3)
  - Including a unitized stock fund, a short-term investment fund, and three retail mutual funds in violation of ERISA § 404(a)(1)(B)
**Tibble: Procedural History**

- **U.S. District Court & Ninth Circuit**
  - **Funds added in 2002:**
    - Court agreed that Edison breached its duty of prudence
    - Edison improperly relied on recommendations of investment consultant
    - Edison did not breach its fiduciary duty by selecting a money market fund that allegedly charged excessive management fees or by failing to negotiate a lower management fee
  - **Funds added in 1999:**
    - No evidence that a prudent fiduciary would have reviewed available share classes and associated fees
    - **Barred by statute of limitations**
  - Ninth Circuit held that there was no change in circumstances that might trigger an obligation to conduct full due diligence review within 6 year period and therefore, outside limitations period
**Tibble:** Plan Participants’ Claims

- **Continuing duty of prudence**
  - Ninth Circuit’s interpretation that ERISA limitations period begins on the date that the funds were added to plan options is inconsistent with fiduciaries’ continued duty of prudence
  - Ninth Circuit’s decision contrary to Second and Seventh Circuits, most district courts, and the Department of Labor position
Tibble: Edison’s Defense

- Petitioners failed to show breach of fiduciary duty during repose period
- Common law trust principles support less intensive reviews after initial selection and monitoring for significant changes in value and risk
- Liability for pre-repose decisions renders right to repose meaningless
Tibble: Solicitor General

- Ninth Circuit erred by failing to recognize that Edison owed a continuing duty of prudence
  - Fiduciaries would have no incentive to monitor and update plan investments
  - Fiduciaries could retain imprudent investment options forever once the investment options have been available for more than six years
Tibble: U.S. Supreme Court Decision

- Unanimous decision written by Justice Breyer
- A plaintiff’s allegation is timely under ERISA § 413 so long as the alleged breach of duty of prudence occurred within six years of the suit
- Ninth Circuit failed to recognize that ERISA’s fiduciary duty is “derived from the common law of trusts”
- “Under trust law, a trustee has a continuing duty to monitor trust investments and remove imprudent ones. This continuing duty exists separate and apart from the trustee’s duty to exercise prudence in selecting investments at the outset”

- Therefore, “so long as alleged breach of the continuing duty occurred within six years of suit, claim is timely”
**Tibble: Remand**

- Case remanded to Ninth Circuit
  - Expressed no view on scope of fiduciary duty in this case
- **But**
  - Held that an ERISA fiduciary must discharge his responsibilities “with the care, skill, prudence, and diligence” that a prudent person “acting in a like capacity and familiar with such matters would use” §1104(a)(1)
  - Ninth Circuit directed to consider whether Edison breached duties within the six year period, and to recognize the importance of analogous trust law
  - Ninth Circuit to also decide whether the petitioners failed to raise the issue of new breaches of the duty of prudence by failing to monitor their investments
**Tibble: Best Practices**

- **Committee structure**
  - Consider separate committee for investments and plan administration
  - May not be desirable for Board members or, in some cases, top management, to be on the committee
  - Keep settlor functions separate

- **Procedural prudence**
  - Periodic meetings
  - Establish and follow investment policy statement
  - Review investment performance, managers, fees
  - Use benchmarking
  - Apply watch list concept and follow through regularly
**Tibble: Best Practices**

- **Procedural prudence (cont.)**
  - Hire advisors when appropriate
    - ERISA 3(21) v. 3(38) fiduciary
  - Fiduciary training
  - Document all of the above
Other Developments: *M&G Polymers USA, LLC v. Tackett*

- Retirees claim expired collective bargaining agreements created a right to lifetime contribution-free healthcare benefits.
- U.S. Supreme Court vacates Sixth Circuit holding that retiree health care benefits are unlikely to be left up to future negotiations:
  - Incompatible with ordinary principles of contract law
  - No presumption in favor of vested retiree benefits
  - No evidence indicating employers and unions in the industry customarily vested retiree benefits
  - Provision limiting duration of the agreement could not be disregarded
- Result is a somewhat lower standard to eliminate retiree health care benefits in some instances.
Other Developments: ERISA Fiduciary Proposal

- Department of Labor is concerned that IRA owners and small plan sponsors are receiving conflicted investment advice
  - Many financial advisors receive commissions and other payments that vary based on the IRA owner’s investment choice
- Proposed regulation in April 2015 expands the definition of “fiduciary” under ERISA to cover almost all advice to IRA owners and small plan sponsors
  - Result would be to prevent many existing compensation practices
  - Proposed new class exemption that allows some compensation practices to continue, but only if satisfy very strict requirements
Questions?

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