ERISA LITIGATION UPDATE

An informational newsletter from Goodwin Procter's ERISA Litigation Practice

GOODWIN PROCTER'S ERISA LITIGATION TEAM

Wilfred J. Benoit, Jr.
Deborah S. Birnbach
John J. Cleary
Daniel P. Condon
James S. Dittmar
Alison V. Douglass
Anthony M. Feeherry
James O. Fleckner
Robert M. Hale
Michael K. Isenman
James W. Nagle
Brian E. Pastuszenski
Stephen D. Poss
Brenda R. Sharton
Bradford J. Smith

CONTACT US

In this Issue:

- *Why an ERISA Litigation Newsletter?*
- *Recent Victories for Defendants in 401(k) Excessive Fees Litigation*
- *Financial Downturn Leads to Upswing in ERISA "Stock Drop" Lawsuits*
- *Upcoming Conferences*

Why an ERISA Litigation Newsletter?

Those in the investment community have seen first-hand the increasing migration of savings into plans designed to fund retirement. Statistics from the ICI tell the story. Over the last three decades, the percentage of household assets invested in retirement accounts as opposed to other forms of savings has risen 150%, from 14% of all wealth to 35%.[1] While there continues to be a significant public policy debate as to the appropriate form of retirement savings vehicles – and the current state of the economy and transition to a new administration have led to renewed interest in this debate[2] – employer-sponsored retirement plans continue to dominate the landscape. Throughout much of the post-war 20th century, the primary employer-provided retirement benefit took the form of a defined benefit ("DB") plan that guaranteed a certain level of retirement income for participating employees. Increasingly, employers have moved to 401(k)-style defined contribution ("DC") plans, under which the actual benefit available depends on the amount contributed and any net investment gain or loss.[3] In the current economic situation, the effects have been widely felt. By one account, over a trillion dollars in wealth was lost in DC plans as a result of the 2008 market decline alone.[4]

Against that backdrop, the tremendous rise in litigation under the Employee Retirement Income Security Act of 1974, as amended ("ERISA") – which governs private employer sponsored benefit plans, including retirement plans – that began when the tech bubble burst in 2001 has continued unabated. Indeed, the growing economic troubles of the current economic crisis, coupled with the increased concentration of wealth in private employer sponsored retirement plans, has accelerated the trend. The cases brought with respect to these employee benefit plans challenge conduct in ways that touch upon a wide range of legal disciplines, including securities, employee-employer relations, trust law and tax. As the U.S. Supreme Court has recognized, ERISA itself is a "comprehensive and reticulated" statute.[5] These cases often raise complex issues that require increasing specialization to litigate.

Because of the importance of litigation developments under ERISA to those who sponsor or provide products and services to employee benefit plans, and the high stakes in many of these cases, Goodwin Procter is instituting this ERISA Litigation Update newsletter to keep our clients up-to-date regarding developments in this rapidly evolving area of law. For suggestions for future topics, and for any additional comments, please contact any of the attorneys listed.

Recent Victories for Defendants in 401(k) Excessive Fees Litigation

Over the last few years there has been a wave of ERISA class actions in which plaintiffs have asserted breach of fiduciary duty and prohibited transaction claims against employers that sponsor 401(k) plans, plan named fiduciaries and, in some instances, plan service providers. These cases, filed on behalf of classes of participants or plan fiduciaries, have challenged long-standing customs and business practices in the financial services and retirement plan servicing industries. Among the targets of the plaintiffs' bar in these cases are the investment options that are offered to retirement plans and the fee structures and revenue sharing practices that have traditionally funded plan administration. Plaintiffs have alleged that defendants – which often include investment providers and plan recordkeepers – have charged excessive administrative fees and failed to disclose fee arrangements to sponsors and participants. Some cases also challenge the investment management fees charged by mutual funds offered to investors through retirement plans. These cases have forced the named fiduciaries of retirement plans to defend the process through which service providers and investment options are selected for plans, as well as the substantive prudence of those selections. Service providers have been required to defend the products and pricing they offer in the competitive investment management and retirement plan servicing markets. Over two dozen suits have been filed the last few years, many of which survived early challenges to the pleadings, where courts ruled that claims could be brought and go forward to trial.

As these cases gain attention against the backdrop of the current economic crisis and recent Department of Labor initiatives to address disclosure of retirement plan fees, the last several months have seen a number of victories for defendants. Most significantly, the U.S. Court of Appeals for the Seventh Circuit last month affirmed dismissal of the complaint in *Hecker v. Deere & Co.*, Nos. 07-3605 & 08-1224, 2009 WL 331285 (7th Cir. Feb. 12, 2009). In this first appellate decision in the wave of participant-filed suits challenging 401(k) plan fees, the *Hecker* plaintiffs' ERISA breach of fiduciary duty claims against the employer sponsoring the plan and two of its service providers were dismissed in June 2007 by the U.S. District Court for the Western District of Wisconsin, as reported in greater detail in our July 3, 2007 Financial Services Alert. On February 12, 2009, the Seventh Circuit affirmed dismissal on the grounds that the employer had breached no fiduciary duty based on the alleged failure to disclose revenue sharing between service providers, and that it had not acted imprudently in selecting investment funds for the plans, as reported in greater detail in our February 17, 2009 Financial Services Alert. The court also affirmed dismissal of the claims against the two service provider defendants, finding that neither possessed relevant fiduciary authority such that either could be liable under ERISA for disclosing revenue sharing practices or choosing investment options. In rejecting the plaintiffs' core allegations that the funds in the plans charged excessively high fees, the court relied heavily on the fact that mutual fund fees are set in a competitive market and that the plans at issue offered funds with a wide range of fees, including 2,500 funds that were accessible through a brokerage window. The plaintiffs have filed a petition with the Seventh Circuit for rehearing by the panel and rehearing en banc; the Department of Labor, which had filed an amicus brief prior to the recent decision, filed a second amicus brief on March 19, 2009 seeking panel rehearing and two other amici briefs were filed seeking panel rehearing and rehearing en banc, one by certain non-profit organizations led by AARP and the second by a group of five law professors.

Defendants in other suits have also obtained dismissal on the pleadings in recent months. In September, the District of Massachusetts dismissed the complaint in *Columbia Air Servs.*

Inc. v. Fidelity Management Trust Co., No. 07-11344, 2008 WL 4457861 (D. Mass. Sept. 30, 2008). One of a handful of suits filed not by a plan participant but by a plan fiduciary purporting to represent a class of fiduciaries of all plans serviced by the same provider, the complaint in *Columbia Air* challenged the fees and revenue sharing payments received by the plan's directed trustee and recordkeeper. The court dismissed the suit, finding that the plaintiff failed to allege facts that the defendant acted as a fiduciary of the plan with respect to its contractual compensation and receipt of revenue sharing payments from fees collected from affiliated mutual funds.

In October, the Western District of Missouri granted defendants' motion to dismiss in *Braden v. Wal-Mart Stores, Inc.*, No. 08-03109 (W.D. Mo. Oct. 28, 2008). The *Braden* complaint asserted claims against the plan's employer-sponsor and the plan's named fiduciaries, alleging, among other things, excessive and undisclosed fees and imprudent selection of the plan's mutual fund options, which included 10 retail class funds, most of which were actively managed. The court dismissed the plaintiff's claims based on alleged excessive fees and undisclosed revenue sharing practices. The court found no allegations to support the claim that the defendants had failed to investigate the funds selected for the plan, and ruled that the defendants were under no duty to disclose revenue sharing agreements. This case is currently on appeal to the Eighth Circuit.

While many of the dozens of excessive fees cases filed since 2006 have survived the motion to dismiss stage, defendants have also recently obtained victories at later stages in the litigations. In *Kanawi v. Bechtel Corp.*, No. 06-05566 (N.D. Ca. Nov. 3, 2008), the defendants obtained a full victory with respect to the plaintiffs' excessive fees claim when the court held that the evidence did not support a determination that the fees paid by the plan were "patently unreasonable," or that the defendants abrogated their duties in reviewing the performance of the funds. Declining to second-guess the defendants' business judgment or to rely solely on hindsight, the court noted that "the test of prudence is one of conduct and not performance." With respect to the plaintiffs' claim that the defendants engaged in prohibited transactions by retaining an investment manager and service provider that lacked independence, the court dismissed that claim to the extent that the challenged fees were paid by the employer and plan sponsor, and not out of plan assets, leaving only the plaintiffs' claim with respect to a four-month period during which the fees were paid from plan assets. Following the order, the parties reached a settlement of the only remaining claim. A settlement agreement was signed earlier this month, pending final court approval.

The defendants in *Taylor v. United Tech. Corp. et al.*, No. 06-1494, 2009 WL 535779 (D. Conn. March 3, 2009), also obtained summary judgment on the eve of trial on similar claims of imprudent investment selection and excessive and undisclosed fees. The court rejected the plaintiffs' challenge to the plan's use of actively managed mutual funds, noting that in some instances the plan's active funds outperformed their index benchmarks, and that in any event the defendant fiduciary's fund selection process included appropriate consideration of the fees and returns of the selected funds. The court also rejected the plaintiffs' excessive fees claim, where the plaintiffs failed to proffer evidence to show that the plan's service provider received compensation that was "materially unreasonable" or "beyond the market rate." Judgment was entered for defendants on March 6, 2009.

Significant motions are pending in a number of other suits, with decisions expected in the next few months. Trial dates have also been set for a number of cases for 2009, and at least some remaining cases that survive these motions are likely to be tried this year.

Financial Downturn Leads to Upswing in ERISA "Stock Drop" Lawsuits

One by-product of the recent economic downturn in the financial services sector has been an increase in so-called "stock drop" cases filed by the plaintiffs' bar against financial services companies. These class action lawsuits challenge investments in employer stock held in 401(k) plans, employee stock ownership plans ("ESOPs") and other defined contribution retirement plans sponsored by financial services companies for their employees. Often the commencement of such an ERISA lawsuit will follow the filing of a complaint on behalf of investors generally, based on alleged securities laws violations by the financial services company. Although ERISA stock drop cases present special challenges for defendants that can make them more difficult to defend than a corresponding securities law case, some plan sponsors have taken certain steps in hope of reducing the risk of potential liability in this area.

While this increased focus of the ERISA plaintiffs' bar on financial services companies is relatively recent, stock drop cases against plan sponsors facing economic difficulties have been common since the 1990s. Although they may include many counts, ERISA stock drop complaints generally rely on two broad types of allegations. First, plaintiffs typically argue that plan fiduciaries breached their duties of prudence and loyalty under ERISA by investing plan assets in employer stock or offering it as an option for participants to invest in under the plan at a time when the employer was encountering significant financial problems. Second, plaintiffs often allege that plan fiduciaries breached their duties by failing to disclose to plan participants information regarding the company's financial condition that would be material to the participants' decision whether to invest in employer stock under the plan. The named defendants in these cases may include not only the plan sponsor but also employees who are members of the plan's investment committee, and officers and directors of the plan sponsor.

Plaintiffs' attorneys may view an ERISA stock drop action as easier to litigate than a case brought under the securities laws. For example, they argue that the heightened pleading standards of the Private Securities Litigation Reform Act and Federal Rule of Civil Procedure 9(b) (relating to fraud claims) should not apply in ERISA stock drop cases. Further, they contend that the fiduciary standards of care under ERISA, including the duties of prudence and loyalty, are more stringent than those imposed on an issuer under the securities laws. In light of these advantages from the perspective of plaintiffs' attorneys, a financial services company that sponsors a plan with significant investments in employer stock is at risk of being the target of an ERISA lawsuit whenever its stock price declines substantially.

Some plan sponsors have taken steps that they believe may reduce this litigation risk. For example, some plan sponsors – hoping to counter arguments that plan investments in employer stock may involve a conflict of interest – have appointed an independent, professional investment manager to determine, on an ongoing basis, whether their plan should continue to invest in employer stock. Other plan sponsors have made an effort to review carefully the provisions of their plan documents concerning investment in employer stock to ensure they are providing appropriate protection. In this regard, a number of courts have held that there is a rebuttable presumption that a fiduciary's continued investment in employer stock is prudent when it is required by the terms of the applicable plan documents.

While some plan sponsors have succeeded in obtaining dismissal of ERISA stock drop cases at an early stage, others have been unsuccessful. Often, the outcome of a motion to dismiss will turn on the details alleged in the complaint and the particular court's view of ERISA's role in the employer stock context. For example, last month a federal district court in Ohio dismissed a complaint challenging the decision to continue making employer stock available as an investment alternative under a 401(k) plan, where the plan sponsor (a bank) had allegedly become subject to substantial exposure for subprime loans, the employer stock price had declined 65%, and the plan's employer stock fund had lost over $100 million. See *In re Huntington Bancshares Inc.* ERISA Litigation, Case No. 2:08-cv-0165 (S.D. Oh. Feb. 9, 2009). The court in *Huntington Bancshares* concluded that these allegations – and the plaintiff's references to general difficulties in the U.S. mortgage market – did not raise the type of "red flag" that would have required investigation into the prudence of retaining employer stock as an investment option, as "ERISA was simply not intended to be a shield from the sometimes volatile financial markets."

In contrast, in December 2008 a federal district court in Michigan refused to dismiss a stock drop complaint against Ford Motor Company, emphasizing that the complaint included specific allegations asserting that the company had been mismanaged in a manner that made its stock too risky to be a plan investment. See *In re Ford Motor Company ERISA Litigation*, Case No. 06-11718 (E.D. Mi. Dec 22, 2008). In the *Ford Motor* court's view, the plaintiffs could overcome the presumption that an employer stock investment is prudent by demonstrating that holding the stock had become so risky that no prudent fiduciary would invest any plan assets in it, taking into account not only the stock's price in the market but also the risk tolerance of plan participants. In the court's view, a standard that focused solely on the market, and not on participants' risk tolerance, would "demote the ERISA duty of prudence from being 'the highest known to the law' . . . to being largely illusory." The contrast in the outcomes in *Huntington Bancshares* and *Ford Motor* reflects not only a difference in the specificity of allegations in the complaints, but also difference in the courts' perspectives on the role of ERISA fiduciary duties in the employer stock context.

As more decisions in these cases are expected in the coming months, it may become possible to determine whether courts will develop a more consistent view of a fiduciary's obligations when a plan's investment in employer stock drops in value.

Upcoming Conferences

ERISA Class Action Lawsuits on the Rise
Date: April 7, 2009
Location: Teleconference
Jamie Fleckner will serve as a faculty member for this Strafford Publications teleconference, which will review current ERISA class action trends, litigation and settlement strategies for ERISA class action claims, and best practices for fiduciaries to avoid and reduce ERISA litigation.

ALI-ABA Annual Conference on Insurance and Financial Services Litigation
Date: July 9-10, 2009
Location: Langham Hotel, Boston, MA
Jamie Fleckner will be presenting at this ALI-ABA conference on ERISA litigation. This annual conference covers the latest developments and trends in litigation involving the insurance and financial services industries. A faculty of experts focuses on changes affecting the marketing, sale and administration of financial and insurance products,

Goodwin Procter's
ERISA LITIGATION PRACTICE

including annuities, life insurance, variable products, retirement plan contracts, mutual funds, health insurance, disability insurance, long term care and other consumer and commercial financial and insurance products.

ERISA Litigation – The Evolving Landscape and the Fiduciary Quagmire
Date: September 17, 2009
Location: MCLE Conference Center, Boston, MA
This MCLE seminar will offer practical solutions to the litigation problems plaintiffs and defendants face in ERISA-related cases. It will provide information and commentary on cutting-edge issues in employee benefits law to keep attendees up-to-date on recent developments. **Jamie Fleckner** will serve as a faculty member for this seminar and will present on a panel discussing current trends in ERISA litigation.

---

[1] *See* Investment Company Institute, The U.S. Retirement Market, Third Quarter 2008, February 2009 ("Retirement Market") (last visited March 16, 2009), Figure 3.

[2] For example, in February 2009, the House Education and Labor Committee, chaired by Rep. George Miller (D-CA), began a series of hearings entitled "Strengthening Worker Retirement Security," with the following commentary about the nature of its deliberations: "In light of the current financial crisis, on Tuesday, February 24, the House Education and Labor Committee will begin a series of hearings to explore the shortcomings of our nation's retirement system and look at solutions to ensure that Americans can enjoy a safe and secure retirement after a lifetime of hard work." (last visited March 16, 2009).

[3] According to one source, in 1985, $813 billion was invested in private DB plans, as compared to $509 billion in DC plans; by 2008, the numbers reversed, with over $4 trillion invested in private DC plans and $2.26 trillion in private DB plans. *See* Retirement Market, Figure A1. *See also* EBRI Databook on Employee Benefits, Ch. 10 "Aggregate Trends in Defined Benefit and Defined Contribution Retirement Plan Sponsorship, Participation, and Vesting" (Updated January 2009) (last visited March 16, 2009), Chart 10.1 and accompanying tables and data.

[4] *See* Alicia H. Munnell and Dan Muldoon, "Are Retirement Savings Too Exposed To Market Risk?" October 2008, Center for Retirement Research at Boston College, Number 8-16.

[5] *Nachman v. Pension Ben. Guaranty Corp.*, 446 U.S. 359, 361 (1980) (Stevens, J.). A Westlaw search on March 16, 2009 identified 251 cases that have quoted this language.

Boston
Hong Kong
London
Los Angeles
New York
San Diego
San Francisco
Silicon Valley
Washington, D.C.

This publication, which may be considered advertising under the ethical rules of certain jurisdictions, is provided with the understanding that it does not constitute the rendering of legal advice or other professional advice by Goodwin Procter LLP or its attorneys. Additionally, the foregoing discussion does not constitute tax advice. Any discussion of tax matters contained in this publication is not intended or written to be used, and cannot be used, for the purpose of avoiding penalties under the Internal Revenue Code or promoting, marketing, or recommending to another party any transaction or matter.
© 2009 Goodwin Procter LLP. All rights reserved.