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The ERISA Litigation Newsletter

July 2009

Editor's Overview

June brought an interesting array of cases. We begin with two articles that discuss claims brought regarding investments in 401(k) plans. The first article discusses two substantive decisions on "stock drop" claims in which, after the development of factual records, trial in one and summary judgment in the other, the courts ruled for defendants (and kept alive the record that no judgment has been awarded for plaintiffs on a stock drop claim involving a public company). The second article addresses two decisions denying class certification on 401(k) investment claims; in both cases the courts suggested the claims at issue were more appropriately brought as individual ones.

On a related note, we have included an update on proposed legislation that, among other things, seeks to expand fee disclosure requirements for 401(k) plans.

Next, we switch gears to defined benefit plans, and discuss recent rulings that suggest plaintiffs may need to plead and prove an age discriminatory motive to sustain a "rate of accrual" claim under ERISA § 204(b)(1)(H)(i).

We conclude this month's articles by discussing one court's application of the "fiduciary exception" to the attorney-client privilege. The decision illustrates that the likelihood of litigation is not enough to prevent the disclosure of communications between plan fiduciaries and their counsel that are related to plan administration.

And, of course, don't forget about the Rulings, Filings and Settlements of Interest, where we discuss, among other things, the recent denial of panel rehearing in *Hecker v. Deere*, in which the Seventh Circuit reiterated that it purposefully is proceeding cautiously in defining the scope of ERISA § 404(c) protection for fiduciaries.

Judgments for Defendants Continue in Stock Drop Cases

By Nicole Eichberger

In June, the Northern District of Illinois issued two decisions dismissing employer stock drop claims in favor of defendants, one after an eight-day bench trial in *Brieger v. Tellabs, Inc.*, 2009 WL 1565203 (N.D. Ill. June 1, 2009), and the other on summary judgment in *Lingis v. Motorola, Inc.*, 2009 WL 1708097 (N.D. Ill. June 17, 2009). Both decisions continue the trend of judgment for defendants when stock drop claims are decided on the merits.

In *Brieger v. Tellabs*, Tellabs and various individual defendants were sued over the offering of Tellabs common stock as an investment option in Tellabs' Profit Sharing and Savings Plan between December 11, 2000 and July 1, 2003. The plan required the offering of Tellabs stock, which was one of eleven to twelve investment options offered during the class period. Beginning in first quarter 2001, Tellabs, along with other companies in the telecommunications industry, began to experience a market downturn; during the proposed class period, Tellabs stock declined from $63.19 per share to $6.58 per share. Several years later, plaintiffs filed a class action lawsuit alleging various fiduciary breaches, including a breach of the fiduciary duty of prudence and a breach of the fiduciary duty to disclose.

Following a bench trial, the court rendered a verdict in favor of defendants as to all claims. With respect to the imprudent investment claim, the district court held that, regardless of whether the *Moench* "presumption of prudence" applied to the offering of Tellabs stock, plaintiffs failed to prove that it was imprudent to continue offering Tellabs stock as an investment option. Although the district court stated that defendants' procedural prudence in reviewing the Tellabs stock fund could have been better, the absence of any formal consideration of Tellabs stock in committee meetings did not show procedural imprudence in light of the committee members' intimate knowledge of Tellabs, and their continuous discussion of its business and future prospects in other contexts. The court also held that plaintiffs failed to show the investment was substantively imprudent: there was never any real threat of bankruptcy and Tellabs reasonably expected its industry and business to rebound.

On the disclosure claim, the court held that defendants did not make any material misrepresentations or withhold any material information to which plaintiffs were entitled. Rather, the court found that, through the company's intranet site, weekly newsletters, and town hall meetings, employees regularly received information on Tellabs and its business prospects. Finally, the court held that even if plaintiffs had established their claims, the claims would be barred by ERISA § 413's three-year statute of limitations, which commences upon "actual knowledge" of a fiduciary breach. The court determined that the three-year period commenced after the stock price had declined 66%, at which time defendants had issued numerous statements to plan participants and the public about the serious problems facing Tellabs and the telecommunications industry.

In *Lingis v. Motorola*, Motorola and various individual defendants were sued over the offering of Motorola common stock in Motorola's 401(k) plan. In the late 1990s-2001, Motorola entered into several loan agreements with a major telecommunications customer, Telsim, whereby Motorola ended up loaning Telsim approximately $2 billion. On April 30, 2001, Telsim defaulted on the loan agreements, and this was disclosed in May 2001. During the proposed class period of May 2000 to May 2001, Motorola stock lost 50% of its value. Plaintiffs filed suit, claiming that defendants breached their fiduciary duty of prudence and their fiduciary duty to disclose. After discovery was completed, the parties cross-moved for summary judgment.

Prior to issuing its opinion on the merits of plaintiffs' claims, the district court addressed whether ERISA § 404(c) shielded the fiduciaries from liability. The court concluded Section 404(c) applied, and rejected plaintiffs' allegation that the participants did not exercise independent control (a condition for application of Section 404(c)) because defendants allegedly concealed material information with respect to Telsim. The court concluded that Section 404(c)'s disclosure duty is equivalent to that imposed by ERISA generally. And, under ERISA, since there were no misrepresentations made in an ERISA fiduciary capacity (any alleged negligent misrepresentations occurred in SEC filings) the fiduciaries had no duty to issue corrective disclosures. The court then applied Section 404(c) to the prudent investment claim, and held Section 404(c) was satisfied because the plan offered a broad range of investment alternatives in addition to Motorola stock.

The court held that plaintiffs' prudent investment claim also would fail on its merits. Although the court concluded the *Moench* "presumption of prudence" did not apply because the plan did not require Motorola stock to be an investment option, the court found that plaintiffs failed to prove there were extraordinary circumstances warranting the sell-off of Motorola's stock, such as that "Motorola was on the verge of collapse, or that it had an elderly workforce with a substantial interest in less risky investments."

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Tellabs and *Motorola* join the growing line of cases that have rejected plaintiffs' stock drop claims once those claims reach the summary judgment stage or trial. These cases illustrate that courts are not viewing these investments through hindsight, and are not concluding that employer stock must be sold off because of business setbacks, even substantial ones.

District Courts Deny Class Certification on 401(k) Claims

By Stacey Cerrone and Brian Dragon

Two district courts recently denied class certification to participants bringing claims related to investments in 401(k) plans, concluding the proposed classes did not meet *Fed. R. Civ. P.* 23(b) (which requires plaintiffs to establish that that the proposed class meets the requirements of at least one of the types of classes set forth in Rule 23(b)).

In *In re First American Corp.*, 2009 U.S. Dist. LEXIS 53427 (C.D. Cal. June 10, 2009),plaintiffs brought suit under ERISA § 502(a)(2), claiming that defendants breached their fiduciary duties by offering First American stock as a retirement plan option when the stock price was artificially inflated. The claims in First American are similar to those brought in other 401(k) stock drop cases. In deciding class certification, the court first determined that plaintiffs satisfied all of *Fed. R. Civ. P.* 23(a)'s requirements and, in particular, rejected First American's argument that plaintiffs did not satisfy the typicality and adequacy of representation requirements. Defendants argued that no typicality existed because the court would need to analyze whether each participant exercised "independent control" over their participant-directed investments as defined by ERISA § 404(c). The court disagreed, ruling that since Section 404(c) was an affirmative defense, it was not an appropriate basis to deny class certification. The court also held that the named plaintiffs satisfied the adequacy of representation requirement because neither the unsupported speculation of conflicts between class members nor the allegations that named plaintiffs were not sophisticated enough to understand the case were enough to show that named plaintiffs were inadequate representatives.

The court then considered whether a class was appropriate under *Fed. R. Civ. P.* 23(b). The participants sought to certify the class under Rule 23(b)(1)(A), asserting that separate actions would create a risk of inconsistent adjudications among the plan participants, and under *Fed. R. Civ. P.* 23(b)(1)(B), arguing that separate actions "inescapably will alter the substance of rights of others having similar claims." The court declined to certify the class under *Fed. R. Civ. P.* 23(b)(1)(A) because, under Ninth Circuit precedent, class certification is not appropriate under that rule where, as here, plaintiffs primarily sought monetary damages. The court also declined to certify a class under *Fed. R. Civ. P.* 23(b)(1)(B). In so ruling, the court, relying on *LaRue v. DeWolff*, 128 S. Ct. 1020 (2008), held that since the individual members could bring claims on their own behalf under ERISA § 502(a)(2), separate actions would not alter the substance of the rights of others having similar claims. Since plaintiffs did not satisfy *Fed. R. Civ. P.* 23(b) under the grounds they sought to certify a class, the court refused to certify a class.

In *Turner v. Talbert*, 2009 WL 1683297 (M.D. La. June 15, 2009), the district court similarly refused to certify a class of 401(k) plan participants under *Fed. R. Civ. P.* 23(b). In *Turner*, while plaintiffs were participants in a 401(k) Plan, the claims against the fiduciaries were different than in the First American case and the typical 401(k) stock drop cases. Plaintiffs claimed that the 401(k) plan administrator, Pan American, breached its fiduciary duties to the plan when it failed to notify the plaintiffs that their contributions were not being forwarded timely by their employer, and by unilaterally freezing the plan assets. The court first concluded that plaintiffs satisfied the requirements of *Fed. R. Civ. P.* 23 (a): (i) joinder was impracticable; (ii) common issues existed, such as whether Pan American owed a fiduciary duty, the nature and scope of that duty, whether and under what circumstances a freeze of the plan's assets occurred, and the alternative investment options available to plan participants; (iii) despite the necessity of individualized inquiries into each plaintiff's damages, typicality was met because named plaintiffs' claims relied on a single legal theory on whether Pan American owed and breached a fiduciary duty to the members of the plan by freezing plan assets; and (iv) there were no inherent class conflicts because plaintiffs sought certification of a class of participants who were all damaged by the alleged freeze, and presumably would not include participants who would have benefited from Pan American's actions.

The court, however, declined plaintiffs' request for class certification under *Fed. R. Civ. P.* 23(b)(3), which requires that common questions of law or fact predominate over any questions affecting individual members, and that a class action be superior to other methods of adjudication. The court agreed with Pan American that in order to determine if an individual class member was harmed by Pan American's actions, the participants would have to make several individual showings including: participants' individual investment allocations prior to the freeze; that each participant tried to change his or her allocations during the freeze; how each participant tried to change his or her allocations; and that Pan American refused to alter allocations. In so ruling, the court rejected plaintiffs' reliance on cases that had certified classes despite the need for individualized damage determinations because, in those instances, damages were amenable to calculation by mathematical or formulaic calculations, and the plaintiffs in this case had not set forth any damages calculation that would allow the court to do so.

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Turner and *First American* suggest courts are taking a harder look in determining whether class certification requirements are being met on 401(k) claims; simple assertions that claims are being brought "on behalf of the plan" may not be enough.

Legislative Update: House Committee Passes 401(k) Fee Disclosure, Investment Advice and Defined Benefit Plan Funding Relief Bill

By Amy Covert

The House Education and Labor Committee passed a bill, The 401(k) Fair Disclosure and Pension Security Act of 2009 (H.R., 2989) on June 24, 2009, that would amend both ERISA and the Internal Revenue Code with provisions related to 401(k) fee disclosure, investment advice and defined benefit plan funding. The legislation adopted by the Committee would:

- Require 401(k) plan service providers to disclose to plan administrators all fees assessed against a participant's account, with those fees broken down into four categories: administrative fees, investment management fees, transaction fees and other fees;
- Mandate that quarterly statements be provided to participants that detail contributions, earnings, account balances and all fees taken out of their accounts;
- Require 401(k) plans to include at least one low-cost market index fund as an investment option;
- Require service providers to disclose financial relationships so that companies sponsoring 401(k) plans can make sure there are no conflicts of interest;
- Ensure that investment advice offered to participants be based on the workers' needs, not the financial interests of those providing the advice;
- Provide adjustments to pension funding rules to help defined benefit plan sponsors better weather the economic downturn, including by delaying the effective date of regulations mandated under the Pension Protection Act and by giving employers more flexibility in choosing an interest-rate methodology to value pension plan liabilities in 2009 and 2010.

It is not clear yet whether the bill will now be taken up by the Ways and Means Committee or go straight to the full House for consideration.

Recent Rulings Suggest Plaintiffs May Need To Prove Discriminatory Motive To Prevail under ERISA's Rate of Accrual Provision, Section 204(b)(1)(H)(i)

By Robert Rachal

ERISA § 204(b)(1)(H)(i), 29 U.S.C. § 1054(b)(1)(H)(i), prohibits the reduction or cessation of the rate of benefit accrual in defined benefit plans "because of the attainment of any age." A series of rulings by the Seventh, Third, Second, Sixth and Ninth Circuits rejected claims that, since younger workers had more years to accrue interest credits under cash balance pension formulas, those formulas inherently violated Section 204(b)(1)(H)(i). In so ruling, these courts reached the common-sense conclusion that ERISA did not make unlawful the time value of money.

Plaintiffs continue to look for novel ways to assert "rate of accrual" claims, however. Two recent rulings suggest that plaintiffs may need to plead and establish a discriminatory motive to make out such a claim. In *Walker v. Monsanto Co. Pension Plan*, 2009 WL 1651378 (S.D. Ill. June 11, 2009), plaintiffs challenged a plan rule that stopped credits from accruing once the plaintiff turned age 55, arguing that such cessation of accruals was on account of age in violation of Section 204(b)(1)(H)(i). Even though this cessation facially correlated with age, the district court dismissed the claim because it found that plaintiffs failed to prove that the cessation was motivated by age, i.e., by some type of stereotype or inaccurate generalization, citing and applying *Kentucky Retirement System v. EEOC*, 128 S. Ct. 2361 (2008). Rather, the cessation occurred because the credit was meant to reflect and make up for the discount for the early retirement benefit, which was fully subsidized as of age 55.

One week after *Walker*, in *Gross v. FBL Financial Services, Inc.*, 2009 WL 1685684 (U.S. June 18, 2009), the Supreme Court held that the Age Discrimination in Employment Act's ("ADEA") use of the term "because of age" requires proof that age was the "but for" reason for the adverse action:

> The words “because of” mean “by reason of: on account of.” 1 Webster’s Third New International Dictionary 194 (1966); *see also* 1 Oxford English Dictionary 746 (1933) (defining “because of” to mean “By reason *of*, on account *of* “(italics in original)); The Random House Dictionary of the English Language 132 (1966) (defining “because” to mean “by reason; on account”). Thus, the ordinary meaning of the ADEA’s requirement that an employer took adverse action “because of” age is that age was the “reason” that the employer decided to act. . . . To establish a disparate-treatment claim under the plain language of the ADEA, therefore, a plaintiff must prove that age was the “but-for” cause of the employer’s adverse decision.

The ruling in *Gross* calls to mind our July 2008 newsletter, in which we discussed *Kentucky Retirement System v. EEOC*, 128 S. Ct. 2361 (2008), which concluded that a provision of a pension plan on imputing service (which eliminated imputing service for those past the plan’s retirement age of 55) was done because of “pension eligibility,” not age, and thus was not “actually motivated” by age. Although *Gross* and *Kentucky Retirement System* arose under the ADEA, ERISA uses the same “because of” age language that is found in the ADEA. Given the similarity in statutory language, the ruling in *Walker* appears to be applying precedent fairly to conclude “rate of accrual” claims require proof that the accrual was decreased or ceased “because of” age instead of some factor that may correlate with age.

District Court Reminds Plan Fiduciaries That Not All Communications with Counsel Are Privileged

By Russell L. Hirschhorn

In *Redd v. Brotherhood of Maintenance of Way Employees Division of the International Brotherhood of Teamsters*, 2009 WL 1543325 (E.D. Mich. June 2, 2009), the district court addressed whether certain communications between plan fiduciaries and plan counsel were protected by the attorney-client privilege and attorney work product doctrine, or whether such communication should be produced pursuant to the fiduciary exception. The fiduciary exception derives from the principle that when an attorney advises a plan fiduciary about the administration of an employee benefit plan, the attorney’s client is not the fiduciary, but, rather, the trust’s beneficiaries.

The documents at issue were prepared by the plan's attorneys and led to the fiduciaries' decision to recalculate the participants' benefits. Defendants claimed that the fiduciary exception should not apply because the plan's interests and the participant's interests diverged at the time the documents were prepared, since it was likely that the recalculation would lead to litigation. The district court sustained plaintiffs' objections to the magistrate judge's report and concluded that pre-decisional communications between the plan fiduciaries and plan counsel must be produced pursuant to the fiduciary exception. In so ruling, the district court concluded that even if the plan administrator viewed litigation to be likely, this prospect, standing alone, was insufficient to preclude a plan beneficiary's access to pre-decisional communications between a plan administrator and counsel concerning matters of plan administration.

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While it is well established that the fiduciary exception to the attorney-client privilege is applicable to claims brought under ERISA, the intricacies of its application are not so uniformly settled, including situations, such as here, when subsequent litigation may be likely. *Redd* provides a good reminder to plan fiduciaries and their counsel to make it clear at the outset of all communications the purpose for which the communication is being made in order to try and preserve the privileged nature of communications whenever possible. If the plan can successfully demonstrate that the communication in question: (i) was independent of the administrative record; and (ii) was prepared in anticipation of litigation, the plan will more likely be successful in preserving its privileged status.

Rulings, Filings and Settlements of Interest

- In *Pendleton v. Quicktrip Corp.*, 2009 WL 1577172 (8th Cir. 2009), the Eighth Circuit affirmed summary judgment in favor of an employer, concluding that Pendleton failed to establish a prima facie case under ERISA § 510, 29 U.S.C. § 1140. Section 510 prohibits discharging an employee "for the purpose of interfering with the attainment of any right to which such participant may become entitled under the plan." Pendleton alleged that he was terminated to prevent the accrual and receipt of benefits under the company's severance and stock plans. Because Pendleton had been terminated for "gross misconduct" at a staff meeting (he made disparaging remarks about upper management and a fellow employee), the court concluded he could not establish a prima facie case under Section 510, since this misconduct disqualified him from the plan benefits. The court also ruled that the employer was not entitled to attorney's fees because Pendleton did not pursue his claim in bad faith.

In *Hecker v. Deere*, 2009 WL 1797441 (7th Cir. June 24, 2009), the Seventh Circuit denied a petition for panel rehearing and rehearing *en banc* on the 401(k) fee case discussed in our March 2009 Newsletter. In this denial, the panel also responded to an amicus brief filed by the U.S. Secretary of Labor, which asked the court to reconsider its alternative ruling that ERISA § 404(c) shielded the fiduciaries from the claims challenging the fees on the investment options offered to participants. The court noted that the Secretary had "no quibble" with its primary ruling that it was not plausible to deem mutual funds imprudent because they were offered at the same prices that were offered to the general public. On the Section 404(c) issue, the court observed that the Secretary was not due *Chevron* deference on its regulatory preamble, which attempted to create a wholesale exclusion of fund selection from Section 404(c) protection. The court noted that it had purposefully stayed away from a broad ruling on this issue, holding instead that on this complaint (which had attacked retail mutual funds as inherently imprudent), plaintiffs had failed to state a claim. The court also noted it had not blessed a strategy of offering numerous mutual funds as a way to avoid fiduciary responsibility for selecting plan investment options.

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