Proskauer

The ERISA Litigation Newsletter

April 5, 2010

Editor's Overview

We are pleased to announce that Proskauer's Employee Benefits, Executive Compensation & ERISA Litigation Practice Center will now be contributing articles on a regular basis to Bloomberg Law Reports®—Employee Benefits. This biweekly law report is available to subscribers of Bloomberg Law® (www.bloomberglaw.com). In addition, Proskauer will continue to provide clients and friends of the Firm with our monthly ERISA Litigation Newsletter, which will often reprint the same articles.

We begin this month with a review of published employer stock drop decisions in the first quarter of 2010. As the article reports, there has no been no shortage of decisions. Ten are described in the article and three others were issued too late to be included. Two of these decisions, *Crocker v. KV Pharmaceutical Co.*, 2010 U.S. Dist. LEXIS 28116 (E.D. Mo. Mar. 24, 2010) and *In re ING Groep, N.V. ERISA Litigation*, No. 09 Civ. 400 (N.D. Ga. Mar. 31, 2010) dismissed plaintiffs' fiduciary breach claims on a motion to dismiss while *Fisher v. JP Morgan Chase & Co.*, No. 03 Civ. 3252 (S.D.N.Y. Mar. 31, 2010) dismissed plaintiffs' claims on a motion for judgment on the pleadings.

The second article uses the recent decision in *Hartsfield, Titus & Donnelly, LLC v. The Loomis Company*, 2010 WL 596466 (D.N.J. Feb. 17, 2010) as a vehicle for a discussion about disputes between ERISA plan sponsors and their third-party administrators over alleged overpayments of health benefit claims.

As always, be sure to review the section on *Rulings, Filings and Settlements of Interest*.

Employer Stock Drop Litigation . . . And the Beat Goes On[1]

By Myron D. Rumeld & Russell L. Hirschhorn

As we reported last November in Proskauer's ERISA Litigation Newsletter, the global economic crisis has resulted in a substantial uptick in employer "stock drop" litigation, *i.e.*, suits resulting from losses in the value of company stock held in 401(k) plans. There has been a corresponding increase in the number of reported decisions in these cases — nearly two dozen in 2009 — and there is no indication that this jurisprudential surge is over. During the first three months of 2010 alone, there have been ten reported decisions.

Whether the increased volume of reported decisions will lead to more certainty in the state of the law remains to be seen. The new decisions do suggest that courts are at least getting more comfortable with applying the new pleadings standards set forth in the U.S. Supreme Court's decisions in *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544 (2007) and *Ashcroft v. Iqbal*, 129 S. Ct. 1937 (2009), which require plaintiffs to plead a "plausible" claim to survive a motion to dismiss. Many courts are refusing to allow stock drop suits to proceed to discovery where the plaintiffs cannot allege facts that "raise a right to relief above the speculative level." Thus, there have been an increased number of rulings dismissing one or both of the two principal claims of fiduciary breach in these cases: (i) maintaining the employer stock fund at a time when it was allegedly imprudent to do so (the prudence claim); and (ii) making material misrepresentations or failing to disclose material information about the employer stock (the disclosure claim). Still, the courts' treatment of these claims remains unsettled.

First Quarter 2010 Reported Decisions

Prudence Claims

Several of the trends that began to take shape in 2009 have continued in 2010. Of the ten decisions rendered thus far this year, six courts have dismissed plaintiffs' prudence claim on a motion to dismiss. Of the four that have allowed plaintiffs to proceed to discovery on their prudence claims, two did so because the plan document did not require an employer stock investment option, while two appear to be unpersuaded by prior rulings from the Third, Fifth and Seventh Circuit Courts of Appeals that affirmed the dismissal of plaintiffs' prudence claims.

Four courts dismissed claims for failure to plead facts rebutting the presumption of prudence that most courts have applied in employer stock drop litigation, based on the seminal decision in *Moench v. Robertson*, 62 F.3d 553 (3d Cir. 1995). In *In re Lehman Brothers Securities and ERISA Litig.*, 2010 WL 354937 (S.D.N.Y. Feb. 2010), the court acknowledged that Lehman's collapse must have been "imminent" some time prior to the company's bankruptcy filing in September 2008, but held that the complaint failed "to allege facts that permit a determination of when Lehman's financial condition reached that point." In *Gearren v. The McGraw-Hill Companies, Inc. & Sullivan v. The McGraw-Hill Companies, Inc.*, 2010 WL 532315 (S.D.N.Y. Feb. 10, 2010), the court held that plaintiffs' allegations of a 64% drop in share price did not amount to the sort of "catastrophic decline" necessary to rebut the *Moench* presumption of prudence.

In *Herrera v. Wyeth*, No. 08 Civ. 4688 (S.D.N.Y. Mar. 16, 2010) and *Wright v. Medtronic, Inc.*, No. 09 Civ. 443 (D. Minn. Mar. 17, 2010), the courts applied the *Moench* presumption, and dismissed plaintiffs' prudence claims for failure to plead facts that could overcome the presumption, even though the applicable plan documents did not expressly require the maintenance of the employer stock fund. The *Wyeth* court determined that "[f]rom the references to the Stock Fund found throughout the plan agreements, it [was] clear that the agreements presuppose[d] the existence of the Stock Fund." The *Medtronic* court reasoned that ERISA § 404(a)(2), 29 U.S.C. § 1104(a)(2), which exempts all eligible individual account plans from the duty to diversify, applied whether or not a particular plan provided the fiduciary discretion to eliminate the company stock fund. By contrast, in *Patten v. The Northern Trust Co.*, 2010 WL 894050 (N.D. Ill. Mar. 9, 2010), and *In re Hartford Financial Services Group, Inc.*, 2010 WL 135186 (D. Conn. Jan. 13, 2010), the courts denied defendants' motions to dismiss, concluding that the *Moench* presumption should not be applied where the plan document did not require the company stock fund.

Two courts dismissed prudence claims even without the benefit of the Moench presumption. In *Harris v. Amgen, Inc.*, 2010 WL 744123 (C.D. Cal. Mar. 2, 2010), the court observed that the Ninth Circuit had not yet adopted the Moench presumption, but concluded that, whether analyzed under the Moench presumption or general fiduciary prudence considerations, plaintiffs failed to allege that Amgen was in a "seriously deteriorating financial condition or was on the 'brink of collapse," and that plaintiffs had failed to sufficiently allege that offering the Amgen stock fund was imprudent. In *Kenney v. State Street Corp.*, 2010 WL 938333 (D. Mass. Mar. 15, 2010), the court held that plaintiff's conclusory allegations were not sufficient to withstand dismissal of their prudence claims.

Finally, the courts in *In re Regions Morgan Keegan ERISA Litig.*, 2010 WL 809950 (W.D. Tenn. Mar. 9, 2010) and *Jones v. MEMC Electronic Material*, Inc., No. 08 Civ. 1991 (E.D. Mo. Mar. 17, 2010) denied defendants' motion to dismiss plaintiffs' prudence claim. In *Regions Morgan Keegan*, the court concluded that a determination of whether the *Moench* presumption was applicable is not appropriate on a motion to dismiss. In so ruling, the court relied on district court decisions from 2004 and 2006 and failed to even acknowledge Circuit Court rulings holding to the contrary. In *MEMC Electronic Material*, the court held, without precedent, that even if the *Moench* presumption applied, plaintiffs need not plead facts showing an "imminent collapse" in order to overcome the presumption. Rather it is sufficient for plaintiffs to plead that they "challenge the prudence and loyalty exhibited by [d]efendants."

Disclosure Claims

The courts also appear to be more willing to dismiss plaintiffs' disclosure claims, but they have not been uniform in their approach to doing so. The *Lehman*, *McGraw-Hill* and *Wyeth* courtsall concluded that the mere incorporation of securities filings into summary plan descriptions that allegedly contained misrepresentations did not support a fiduciary breach claim. According to the *Lehman* court, "emerging case law makes clear that those who prepare SEC filings do not become ERISA fiduciaries through those acts" and the fact that the summary plan description incorporated by reference SEC filings does not alter that conclusion. But in *Regions Morgan Keegan*, the court denied defendants' motion to dismiss because it believed that if ERISA fiduciaries are liable for making misrepresentations in plan documents then they also should be prohibited from incorporating into plan documents SEC filings that make material misrepresentations about the company.

The *McGraw-Hill*, *Northern Trust* and *Amgen* courts ruled that plan fiduciaries do not have an affirmative obligation to disclose information pertaining to the company's financial condition or about the company's performance to participants and thus dismissed plaintiffs' disclosure claims.

Two other courts dismissed disclosure claims on grounds not commonly seen in employer stock drop litigation on a motion to dismiss: in *Medtronic*, because the alleged misrepresentation or nondisclosure was not material; and in *State Street*, because, with respect to all but one of the alleged misrepresentations, the statements about the stock were true or were not actionable because they were subjective. The *MEMC Electronic Material* court, however, denied defendants' motion to dismiss the disclosure claim, concluding that the question of whether the information or nondisclosure of information was material should not be resolved on a motion to dismiss.

Proskauer's Perspective

Although some trends can be discerned from the increased volume of decisions, there is still no unanimity on the key issues, such as: (i) whether failure to plead facts to overcome the *Moench* presumption will lead to dismissal of prudence claims at the motion to dismiss stage; and (ii) whether the mere incorporation of securities filings, or affirmative nondisclosures, are insufficient to sustain disclosure claims.

In the Second Circuit, clarity on these and some other important issues may emerge from the appeal in *In re Citigroup ERISA Litigation*, which has attracted the attention of the Department of Labor and other public interest organizations. The Circuit Court will address in that case: (i) whether a plan sponsor may so "hardwire" the plan document as to remove all fiduciary discretion over the company stock fund, as the district court found; and, alternatively, (ii) whether claims can be dismissed for failure to plead facts sufficient to rebut the *Moench* presumption and, if so, under what circumstances.

One would hope that there will eventually emerge standards that will prevent employer stock drop lawsuits from proceeding to costly discovery, and anxiety-provoking class certification, based merely on a drop in the price of company stock and conclusory assertions that those responsible for the plan may have known more than the public about the condition of the company's finances. ERISA should not serve as a vehicle for doubling up on, or enhancing, the recoveries available under the securities laws, unless there is a plausible basis to believe that the elements of an independent fiduciary breach claim can be established.

Stay tuned . . . there is no doubt that 2010 will be another exciting — and, hopefully, illuminating — year for employer stock drop litigation.

Analysis of Recent Case Involving Suit against Third-Party Administrator for Breach of Fiduciary Duty in Making Overpayments on Health Benefit Claims[2]

By Robert W. Rachal and Michael D. Spencer

In recent years, and as medical costs have generally continued to rise, disputes have increased between ERISA plan sponsors and their third-party administrators (TPAs) over alleged overpayments of health benefit claims. A cottage industry has also arisen that proposes to audit claims to find alleged overpayments of health benefits, in some cases on a contingency fee basis. The resulting lawsuits typically involve claims by a plan sponsor that its TPA breached its ERISA fiduciary duties by systemically overpaying medical claims or by approving payment of medical claims not authorized under the plan. *See, e.g., Autonation v. United Healthcare*, 423 F. Supp.2d 1265 (S.D. Fla. 2006); *W.E. Aubuchon Co., Inc. v. BeneFirst, LLC*, 661 F. Supp.2d 37 (D. Mass. 2009). In these cases, the TPA may attempt to rely on the services agreement executed with the plan sponsor to argue that it is not an ERISA fiduciary, and therefore is not subject to ERISA. However, courts will look beyond the terms of the agreement to determine whether the TPA was, in fact, an ERISA fiduciary by virtue of the responsibilities it assumed. *E.g., Briscoe v. Preferred Health Plan, Inc*., 578 F.3d 481 (6th Cir. 2009) (finding TPA primarily responsible for processing claims was an ERISA fiduciary to the extent it exercised control over plan assets).

Hartsfield, Titus & Donnelly, LLC v. The Loomis Company, 2010 WL 596466 (D.N.J. Feb. 17, 2010) exemplifies this employee benefits trend. In this case, decided last month, the United States District Court for the District of New Jersey granted summary judgment in favor of a plan sponsor that alleged that its TPA breached its ERISA fiduciary duties by overpaying on infertility and mental health benefit claims.

The Hartfield Case

Hartfield was the sponsor of the ERISA welfare benefit plan providing the benefits at issue, and Hartfield retained Loomis as its TPA for this plan. Pursuant to the TPA agreement between the parties, Loomis was required to review claims submitted under the plan to determine whether payment should be made on such claims. The plan provided, in pertinent part, that plan participants had a $10,000 cap on infertility treatments and a lifetime maximum cap of $35,000 for substance abuse treatment.

After Hartfield conducted an audit of its health claims, it learned that Loomis had made payments to two employees in excess of the $10,000 cap on infertility claims, and to one employee in excess of the $35,000 cap on substance abuse claims. Hartfield then notified Loomis of these overpayments, which Loomis did not deny making, and sought reimbursement from Loomis. Loomis advised Hartfield that it preferred to seek to recover the overpayments from either the employees whose claims were overpaid, or from the medical providers who received the payments. However, Hartfield balked at the idea of Loomis contacting its employees, and the parties could not agree on how the overpayments should have been recovered. Hartfield thereafter filed suit against Loomis, alleging violations of ERISA fiduciary duties and state law claims for breach of contract and breach of the implied covenant of fair dealing.

At the close of discovery, Hartfield moved for summary judgment on its ERISA claim, arguing that Loomis breached its fiduciary duties by admittedly overpaying claims in contravention of the terms of the plan. Loomis admitted it made the overpayments, but argued instead that it was not an ERISA fiduciary under the terms of the parties' TPA agreement. The court rejected this argument and found that Loomis was a "functional fiduciary" because it used its authority to decide and make payment on the health claims, notwithstanding the language contained in the parties' TPA agreement. The court further relied on ERISA § 410(a), 29 U.S.C. § 1110(a), to find that Loomis could not contract away fiduciary status, holding the "contractual language in which [Loomis] states it shall not be a named fiduciary . . . [is] legally void."

Loomis further argued that, assuming it was an ERISA fiduciary, it did not breach its fiduciary duties because it did not act in "bad faith" in overpaying the claims at issue. The court rejected this argument, finding that "bad faith" is not a requisite element of an ERISA breach of fiduciary duty claim. The court held that negligence was sufficient, and that Loomis was negligent in processing the claims at issue because it admitted that the claims were improperly paid and did "not dispute the clarity of the plan language nor d[id] it argue that it misunderstood the nature of its responsibilities." Based on the undisputed facts that Loomis overpaid on the three specific claims at issue, the court held that Loomis failed to satisfy ERISA's prudent person standard.

Finally, Loomis made a separate argument – unrelated to its fiduciary status – that Hartfield could not recover monetary relief under ERISA § 502(a)(2), 29 U.S.C. § 1132(a)(2), because it was seeking to recover a benefit that had been paid on behalf of the plan participants. The court rejected this argument, finding that Hartfield was seeking, on behalf of the plan, to recover plan assets improperly paid out as benefits. In light of this, the court reasoned that this constituted a loss to the plan recoverable under ERISA § 502(a)(2).

Proskauer's Perspective

Though the court in *Hartfield* rejected the TPA's arguments and found that it breached its ERISA fiduciary duties by overpaying on a discrete number of claims, there may be additional defenses and issues that need to be considered when evaluating these types of "erroneous payment" claims. First, fiduciary duties attach only to discretionary administrative functions, not ministerial errors. *E.g.*, *Harris Trust & Savings Bank v. John Hancock Mutual Life Ins. Co.*, 302 F.3d 18, 28 (2d Cir. 2002) (fiduciary duties limited to when and to the extent exercising discretion to perform a fiduciary function); 29 C.F.R. § 2509.75-8 (FR-16 Q & A) (same). Thus, fiduciary liability arguably does not attach to ministerial errors made in claims processing. "The power to err, as when a clerical employee types an erroneous code onto a computer screen, is not the kind of discretionary authority which turns an administrator into a fiduciary." *IT Corporation v. General American Life Ins. Co.*, 107 F.3d 1415, 1421 (9th Cir. 1997); see also 29 C.F.R. § 2509.75-8 (D-2 Q&A) (illustrating ministerial tasks involved in processing benefit claims).

Second, when a TPA does exercise discretionary fiduciary authority in setting up and overseeing claims processing, the TPA can argue it is entitled to rely on those performing the ministerial functions of processing the claims, absent reason to doubt the competence, integrity or responsibility of such persons. *See* 29 C.F.R. § 2509.75-8 (FR-11 Q & A); *Christensen v. Qwest Pension Plan*, 462 F.3d 913, 917-18 (8th Cir. 2006) (applying DOL regulation to conclude that erroneous statements were not fiduciary breaches absent proof that fiduciary failed to exercise ordinary care in selecting and monitoring actuary who ran the system). This moves the fiduciary focus to what appears to be the proper questions in these contexts, which is not whether an error was made (no complex benefit claim system can purport to be error-free) but rather what were the training and systems put in place to monitor and to minimize claims processing errors.

Third, when TPAs are exercising fiduciary discretion to decide whether certain claims are covered by the plan, a TPA can argue with some force that it is entitled to exercise that discretion on behalf of participants in close cases to pay their benefits. Plans must be administered with an “eye single” to the interests of the participants and beneficiaries. *E.g., Donovan v. Bierwirth*, 680 F.2d 263, 271 (2d Cir. 1982); ERISA § 404(a)(1)(a), 29 U.S.C. § 1104(a)(1)(a) (fiduciary must administer the plan “solely in the interests of participants and beneficiaries”). Thus, when making discretionary benefit determinations, the TPA “owes a special duty of loyalty to the plan beneficiaries.” *Metropolitan Life Ins. Co. v. Glenn*, 128 S. Ct. 2343, 2347 (2008). And in exercising that discretion, TPAs can argue they must be free from concern that liability may be later imposed for paying participants’ benefits on close calls, as such would create an improper financial incentive to deny those close claims. Cf., *e.g.*, Glenn, 128 S. Ct. at 2348 (holding that financial incentives to deny claims creates a conflict of interest for the fiduciary).

In conclusion, the *Hartfield* case involved uncomplicated facts and an apparent admission by the TPA that it acted negligently in paying health benefit claims in excess of the plan terms. Other cases, however, may involve more nuance to determine (1) whether the conduct at issue was fiduciary (versus ministerial) in nature and (2) whether the TPA breached (or met) its fiduciary duties in exercising its discretion in establishing and overseeing the claims processing system. Given the continuing rise of health care costs and plan sponsors’ desires to control those costs, it is likely that disputes and possible litigation will continue to arise between plan sponsors and their TPAs based on alleged systemic or individual claims processing errors.

Rulings, Filings and Settlements of Interest

- In *In re Guidant Corp. ERISA Litig.,* No. 05-CV-01009 (S.D. Ind. Mar. 18, 2010), plaintiffs filed a motion for preliminary approval of a settlement that will provide them with $7 million to resolve their employer stock-drop claims.
- In *Sheward v. Bechtel Jacobs Company LLC*, 2010 U.S. Dist. LEXIS 19696 (E.D. Tenn. Mar. 4, 2010), a district court dismissed plaintiff’s claim that defendants breached their fiduciary duty by miscalculating his pension benefit and then recouping nearly $125,000 in overpayments. In so ruling, the court concluded that the employee who calculated plaintiff's pension amount and communicated it to him was not acting as a fiduciary of the plan.

- In *Thompson v. Retirement Plan for Employees of S.C. Johnson & Sons, Inc.*, 2010 WL 697237 (E.D. Wis. Feb. 25, 2010), the court certified a class pursuant to Fed. R. Civ. P. 23(b)(2) for plaintiffs' claim that their benefits had been miscalculated. Defendants argued that plaintiffs' requested relief (applying 8.95% interest to lump sum calculations for all participants for all class years) created intra-class conflicts because the fixed rate would advantage some participants and disadvantage others, depending on the prevailing rate at the time each challenged lump sum was calculated. The court rejected defendants' argument, concluding that plaintiffs' claim concerned the uniform underpayment of benefits and that issues regarding the proper rate for the lump sums should be addressed during summary judgment. In addition, the court rejected defendants' argument regarding the inadequacy of one of the named plaintiffs, finding that a general release and waiver was not sufficient to bar his service as class representative. Finally, to avoid statute of limitations concerns, the court created several subclasses based on the date of the challenged lump sum payments.
- In *Gillespie v. CUNA Mutual Group Long Term Disability Plan et al.,* No. 09-CV-120 (S.D.W. Va. Mar. 18, 2010), CUNA moved to dismiss plaintiff's claim on the grounds that it was barred under the statute of limitations set forth in the plan's SPD, which required participants to initiate legal action within three years from the date on which "proof of claim" was required. In denying the motion, the court held that the provision in the SPD was unenforceable because ERISA does not permit plans to start the clock on a claimant's cause of action before the claimant may file suit. The court reasoned that if "the clock starts running at the time proof of claim is required rather than at the time when plaintiff has exhausted her administrative remedies, 'benefit plans would have the incentive to delay the resolution of their participants' claims, because every day the plan took for its decision-making would be one day less that a claimant would have to review the plan's final decision, decide whether to challenge it in court, and prepare for a civil action if need be.'"
- In *Gordon v. America's Collectibles Network, Inc.*, 2010 U.S. Dist. LEXIS 20497 (E.D. Tenn. Mar. 8, 2010), plaintiff claimed that America's Collectibles Network, Inc. ("ACN") violated ERISA § 510 by terminating him to avoid paying health care costs attributable to his cancer diagnosis. The court granted ACN's motion to dismiss and held that plaintiff did not establish a prima facie claim under Section 510 because he did not allege, other than in conclusory fashion, that ACN engaged in the allegedly prohibited conduct with a "specific intent to violate ERISA." In so ruling, the court stated that, under *Iqbal*, Rule 8 "does not unlock the doors of discovery for a plaintiff armed with nothing more than conclusions."
- In *Stephens v. U.S. Airways Group*, 2010 WL 958068 (D.D.C. Mar. 17, 2010), retired airline pilots sued the Pension Benefit Guaranty Corporation as successor-in-interest

to the plan, claiming that the plan violated ERISA by:
(i) not paying lump sum benefits on their benefit commencement dates; and (ii) not paying interest for the 45-day period between their benefit commencement dates and the dates on which the lump sum benefits were actually paid to plaintiffs. In granting the PBGC's motion for summary judgment, the court determined that the plan documents did not require U.S. Airways to pay lump sum benefits to plaintiffs on their benefit commencement dates or to pay the interest they requested.

- In *Jobe v. Medical Life Ins. Co.*, 2010 WL 986642 (8th Cir. Mar, 19, 2010), the Eighth Circuit held that a SPD does not trump a plan document where the SPD purports to confer on the plan administrator discretionary authority to resolve claims, while the plan document did not. The Circuit therefore remanded the case to the district court for de novo review.

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