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Defined Benefit Plan Litigation: Emerging Strategies to Challenge Pension Plan Investments

Avoiding and Defending Breach of Fiduciary Duty Claims for Pension Investment and Other DB Plan Decisions

TUESDAY, AUGUST 16, 2011

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

Today's faculty features:

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Strafford Teleconference
August 16, 2011

Defined Benefit Plan Litigation

James O. Fleckner

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Pension Plans

- **Defined Contribution Plans**
  - Fixed contribution; benefit is variable and depends on factors such as amounts invested, earnings (loss), fees
  - Employee bears investment risk
  - Examples: 401(k), ESOPs, 403(b)

- **Defined Benefit Plans**
  - Benefit is fixed by the terms of the plan
  - Employer bears investment risk

Constitutional Standing

Sprint Commc'ns Co. v. APCC Servs., Inc., 554 U.S. 269 (2008)

- "irreducible constitutional minimum" requirements:
  - "an injury in fact (i.e., a 'concrete and particularized' invasion of a 'legally protected interest');
  - causation (i.e., a 'fairly traceable' connection between the alleged injury in fact and the alleged conduct of the defendant); and
  - redressability (i.e., it is 'likely' and not 'merely speculative' that the plaintiff's injury will be remedied by the relief plaintiff seeks in bringing suit)."
- Burden on plaintiff

Defined Benefit Cases

Harley v. Minn. Mining And Mfg. Co., 284 F.3d 901 (8th Cir. 2002)

- Claims:
  - failing to adequately investigate and monitor plan investment in a hedge fund
  - failing to discover and remedy a prohibited transaction involving the fund advisor's compensation
- DB plan "with a substantial surplus"
- District court held that plan suffered no loss

Defined Benefit Cases

Harley v. Minn. Mining And Mfg. Co., 284 F.3d 901 (8th Cir. 2002)

- Eighth Circuit affirmed, but on narrower grounds
- Rejected the "no loss to plan" rationale
- Loss of surplus is a plan loss, but not a loss to the participant; the plan sponsor is liable to fund the plan and benefits:
  - "the limits on judicial power imposed by Article III counsel against permitting participants or beneficiaries who have suffered *no* injury in fact from suing to enforce ERISA fiduciary duties on behalf of the Plan." 284 F.3d at 906 (emphasis added).
  - "[t]he primary purpose of [ERISA] is the protection of individual pension rights." 284 F.3d at 907 (quoting H.R. REP. No. 93-533 (1974), *reprinted in* 1974 U.S.C.C.A.N. 4639, 4639).

Defined Benefit Cases

Harley v. Minn. Mining And Mfg. Co., 284 F.3d 901 (8th Cir. 2002)

- Dismissal proper where "the Plan's surplus was sufficiently large that the [] investment loss did not cause actual injury to plaintiffs' interests in the Plan." 284 F.3d at 907
- Surplus is not an affirmative defense
- Plaintiffs must show "an actual injury *to themselves."*
  - Court found that "Plaintiffs have no evidence that the Plan will terminate in the foreseeable future." 284 F.3d at 908

Defined Benefit Cases

McCullough v. AEGON USA, Inc., 585 F.3d 1082 (8th Cir. 2009)

- Claims:
  - causing DB plan to pay excessive fees, and
  - committing prohibited transactions by investing in funds offered by affiliates of the sponsor
- The plan was "substantially overfunded"
- Affirms dismissal, following *Harley*

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Palmason v. Weyerhaeuser: A New Trend in Defined Benefit ERISA Litigation?

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Weyerhauser Case

- *Palmason v. Weyerhaeuser*, No. 2:11-cv-00695 RSL
- U.S. District Court – Western Dist. of Washington at Seattle
- Complaint filed by Plaintiffs on April 25, 2011.
- Motion to Dismiss filed by Defendants on July 12, 2011.
- Amended complaint filed on August 2, 2011.

Parties

- Plaintiff participated in a defined benefit retirement plan offered by Weyerhauser – one of two pension plans participating in a master trust.
- Defendants are –
  - Sponsor
  - Weyerhaeuser Asset Management (INHAM)
  - Morgan Stanley
  - Northwater Capital Management, Inc.
  - Members of the plan's Investment Committee

Plaintiff's Claims

- Allege that plan experienced a loss of approximately $2.4 BB in 2008 (41%) by reason of the defendants' violations of ERISA (caused the plan to go from an overfunded to underfunded status).
  - Sponsor and Committee members breached fiduciary duty in formation of investment policy.
  - INHAM and outside managers breached fiduciary duty for failing to properly implement the investment policy and failing to prudently invest plan assets.
  - Sponsor and Committee members failed to properly monitor INHAM and outside managers.
  - All defendants breached duties as co-fiduciaries.

Relief Requested by Plaintiff

- Class certification
- ERISA § 409 – liability to plan for losses by reason of ERISA violations.
- ERISA § 502(a)(2) – participant has right to bring action on behalf of plan under ERISA § 409.
- Attorney's fees

Plaintiff's Allegations

- Alleges violations of –
  - Exclusive purpose – ERISA § 404(a)(1)(A)
  - Prudence – ERISA § 404(a)(1)(B)
  - Diversification – ERISA § 404(a)(1)(C)
- In 2000, adopted an "alpha" investment strategy that resulted in large weighting of the trust's assets in "alternative investment funds" ("AIVs")
  - 84% (53% hedge funds & 24% in private equity)
- States that the plan invested in over 330 AIVs including hedge funds, private equity funds, and real estate.

Plaintiff's Allegations

- In essence, alleges that investment in AIVs, as an asset class, are generally not appropriate under ERISA (and certainly not in large numbers or in heavy weightings) – points to Government Accountability Office (GAO) (GAO-08-692).
- All things "wrong" with AIVs-

Limits on liquidity	Hard to monitor
Valuation issues	Investment risks
Operational risks	Lack of government oversight
Fees	Use of leverage
Increased monitoring effort	

- GAO Report states that average hedge fund allocation in 2007 was 4% and private equity funds was 5% (GAO cited study).

Plaintiff's Allegations

- Investment policy was not followed – significantly underperformed target benchmark.
- Points to prior relationship between MSDW advisers and sponsor.
- Use of "alpha" strategy was mechanism to make corporate financials look better rather than produce appropriate investment returns.
  - Even though plan was overfunded by $2.1 BB in 2007, defendants "continued this aggressive, risky, and costly investment strategy…"
- Implication is that once plan was overfunded, less risky strategy should have been implemented.

Plaintiff's Allegations

- ERISA Violations Caused
  - Assets of all employer pension plans (including plans not subject to the litigation) went from $2.8 BB overfunded in 2007 to $450 MM underfunded in 2008 according to SEC filings.
  - Employer made cash loans to plan in order to provide adequate liquidity for plan operations.
  - In the amended complaint, raises potential Code § 436 restriction issues, level of PBGC protection, & Weyerhaeuser's financial condition.

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Defendant's Motion to Dismiss FRCP 12(b)(1) & 12(b)(6)

- Facts in support of motion:
  - Weyerhaeuser has a market cap of $11BB and with net earnings of $1.28 BB in 2010.
  - The pension plans are defined benefit plans pursuant to which participants are promised a benefit and the sponsor bears the risk of investment performance.
  - The trust's investment policy has been in place for over 26 years – annual rate of return of 15.3% (S & P achieved 10.6% over same period & average for defined benefit plans over same period approx. 9.3%).
  - Per the plans' form 5500s, the plans were more than 100% funded (i.e., the actuarial value of the plans' assets exceeded the present value of the plans' benefit obligations).

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Defendant's Motion to Dismiss FRCP 12(b)(1) & 12(b)(6)

- Legal arguments in support of motion:
  - ERISA provides for an investment process and does not mandate types of investments – flexibility.
    - The type of plan makes a difference.
  - Investment risk solely borne by employer – participants have a limited interest in the underlying assets.
  - Plaintiff lacks standing -
    - Claim of loss speculative - Participant is not yet eligible to receive benefits (early or normal retirement).
    - Plan was overfunded by ERISA standards – points to prior decisions in which participant does not have standing to recover losses to pension surplus.
    - Prudence standard met via meeting ERISA's minimum funding standards.

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Defendant's Motion to Dismiss FRCP 12(b)(1) & 12(b)(6)

- Claim for imprudent investments fails (*Twombly*).
  - Vague and conclusory allegations.
  - Unable to point to one or more investments being imprudent – rather, challenges use of AIVs in general.
  - Ignores long term nature of pension plan investments – cannot simply look at short period of time (particularly when MANY investments in MANY asset categories performed poorly).

What does all of this Mean?

- Do plan fiduciaries need to avoid investments in AIVs? What is the appropriate limit on the number of (or weighting of) AIVs?
- In the event of a significant loss during a short period of time, has the plan suffered any damages? Does the plans funded status at that time make a difference?
- At what point does ERISA provide for an actionable claim in the event imprudent investments result in a loss to a defined benefit plan? How does the employer's viability as a going concern impact that determination?
- What can fiduciaries do to protect themselves?

CIGNA Corp. v. Amara: A Watershed Event in Complex ERISA Litigation

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CIGNA Corp. v. Amara: Presentation Overview

- *CIGNA Corp. v. Amara*, Case No. 09-804 (S. Ct. May 16, 2011)
- Background of the Case
- The Supreme Court's Decision
  - A Summary Plan Description ("SPD") is not a contract
  - ERISA § 502(a)(1)(B) v. § 502(a)(3)
  - Equitable relief under ERISA § 502(a)(3)
- Implications for communication claims
- Implications for ERISA class actions

Factual Background

- Named Plaintiff Amara filed class action of current or former employees of defendant CIGNA Corp. ("CIGNA")
- Lawsuit stems from CIGNA amending the CIGNA Pension Plan (the "Plan") from a traditional defined benefit formula to a cash balance formula in 1988 and the communications both before and after the conversion
- Case centers on the alleged "wear-away" period and whether the communications related thereto sufficiently apprised participants of the potential for "wear-away"
- "Wear-away": period of time when the starting balance in the cash balance account could be worth less than the value of the frozen defined benefit
- Greater-of: Plan provided that participants would receive the greater of their frozen defined benefit or their cash balance benefit

Factual Background (cont'd)

- Claims alleged: age discrimination, backloading, non-forfeiture, faulty SPD, deficient 204(h) notice, and breach of fiduciary duty
- Heart of the dispute stems from communication claims:
  - SPD
  - ERISA § 204(h) Notice
  - SMM
  - Breach of fiduciary duty claim
- Plaintiffs allege that these "faulty" communications did not disclose sufficiently to participants the "greater-of" formula and that participants believed that they were receiving the frozen traditional defined benefit *plus* his cash balance benefits ("A+B")

Procedural History: District Court

- Class certified of approximately 27,000 participants
- Bench trial conducted
- Following bench trial, court held no liability as to:
  - Age discrimination claim
  - Backloading claim
  - Non-forfeiture rules

Procedural History: District Court (cont'd)

- Liability as to: § 204(h) notice and SPDs
  - Failed to adequately disclose the "wear-away" phenomenon to participants
  - Led participants to believe earning A+B rather than A or B
- In so ruling, the district court determined that the Plaintiffs need not demonstrate on an individual basis that they were detrimentally harmed by the SPD deficiency, but rather that it was sufficient that they show that they were "likely harmed"
- The court made no participant-by-participant showing of injury

Procedural History: District Court (cont'd)

- Court held that any potential remedy available only under SPD claim and not Section 204(h) notice and SMM claims
- Remedy: Each participant receives the benefit that the SPD purported to offer – the frozen traditional defined benefit *plus* his cash balance benefits ("A+B")
- Court awarded such relief for the SPD violation under ERISA § 502(a)(1)(B)
- Court doubted that the relief awarded was permissible under ERISA § 502(a)(3)

Procedural History: Second Circuit

- Summary Opinion Issued
- Adopted District Court's Opinion
- Both Parties Sought Certiorari

Procedural History: Certiorari Granted

- Whether a participant who claims to have been victimized by a faulty plan communication must demonstrate that:
  - he/she detrimentally relied on that communication;
  - will be afforded relief based on a showing of "likely prejudice," a substantially less onerous standard that has been applied in various contexts in the Second Circuit; OR
  - need make no showing at all, based on the theory that a statutory violation automatically entitles the participant to relief.
- Court held in abeyance Plaintiffs' writ for certiorari as to relief available for § 204(h) notice and SMM violations
- Oral argument heard on November 30, 2010

Summary of Supreme Court's Holding May 16, 2011 & May 23, 2011

- 8-0 Opinion
- J. Scalia, J. Thomas filed concurring opinion
- Vacated and remanded back to district court
- SPD not a binding contract
- Relief under 502(a)(3) not (a)(1)(B)
- "Likely Prejudice" not the standard
- May 23, 2011 granted Plaintiffs' certiorari request and vacated district court's opinion as to relief permitted for 204(h) notice and SMM violations

Supreme Court Opinion: SPD & ERISA § 502(a)(1)(B)

- Whether a SPD is binding contract that can usurp the actual plan
  - Supreme Court: No
  - SPD is meant to be a summary of the plan, not the plan itself
  - ERISA mandates that plan and SPD are meant to serve different roles, governed by different rules, and drafted by separate entities
- ERISA § 502(a)(1)(B): participant can bring an action to "enforce the terms" of the plan
- Because a SPD cannot be the plan, Supreme Court held district court erred in ordering relief under ERISA § 502(a)(1)(B) rather than ERISA § 502(a)(3)

Supreme Court Opinion: ERISA § 502(a)(3)

- ERISA § 502(a)(3): participant may bring an action for "appropriate equitable relief"
- Previously interpreted as no monetary relief
- Dicta suggesting monetary relief/damages possible
- Court implies that district court's remedy may be appropriate under ERISA § 502(a)(3)
- 3 Forms:
  - Estoppel
  - Surcharge
  - Reformation

Supreme Court Opinion: Likely Harm/Prejudice Rejected

- No automatic requirement of "detrimental reliance"
- Estoppel
  - Detrimental reliance
  - "defendant's statement 'in truth, influenced the conduct of' the plaintiff, causing prejudice"
- Reformation
  - Reform contracts to reflect mutual understanding of contracting parties where "fraudulent suppression, omission, or insertions…materially"…affected the substance of the contact
- Surcharge
  - Make whole following a trustee's breach of trust
  - Showing of actual harmed by preponderance of the evidence

Implications for Communication Claims

- Plaintiff bears burden of proof
- Actual harm but not detrimental reliance
- Reformation claims v. surcharge claims?
- Individualized showing v. group harm?

Implications for Class Certification

- Less likely to certify class if individualized showing of harm required
- “Harm”: element of claim or element of relief?
- Relevance of Wal-Mart decision

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