Strafford

presents

ERISA Class Action Trends: Trial and Settlement Strategies

Leveraging the New Developments in Stock Drop, Cash Balance Plan, Fiduciary Duty, Plan Administration and Fee Cases

A Live 90-Minute Teleconference/Webinar with Interactive Q&A

Today's panel features:
Ian H. Morrison, Partner, **Seyfarth Shaw**, Chicago
Neil A. Capobianco, Partner, **Seyfarth Shaw**, New York
Linda J. Haynes, Partner, **Seyfarth Shaw,** Chicago

Wednesday, March 17, 2010

The conference begins at:

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

You can access the audio portion of the conference on the telephone or by using your computer's speakers.
Please refer to the dial in/ log in instructions emailed to registrations.

For CLE purposes, please let us know how many people are listening at your location by

- closing the notification box
- and typing in the chat box your company name and the number of attendees.
- Then click the blue icon beside the box to send.

SEYFARTH ATTORNEYS SHAW LLP

ERISA Class Action Trends

March 17, 2010

Ian H. Morrison
Neil Capobianco
Linda J. Haynes
Seyfarth Shaw LLP

Breadth. Depth. **Results.**

Program Overview

- ERISA Class Action Trends
  - 401(k) plan fees litigation
  - ERISA "Stock Drop" cases
  - Cash balance plan litigation
  - Emerging claims relating to plan administration
- Litigation strategies
  - Motions to dismiss
  - Class certification
  - Settlement
- Key strategies for fiduciary risk management

 © 2010 Seyfarth Shaw LLP

ERISA Class Action Trends

 © 2010 Seyfarth Shaw LLP

Plan Fees Litigation

- A brief history
  - Before 2006, only a handful of cases had been filed, focused on conflicts of interest (proprietary funds, and focused on allegations of divided loyalties)
  - September 2006, Schlichter, Bogard & Denton of St. Louis files numerous suits against large 401(k) Plan sponsors
  - Several similar cases filed by other law firms
  - Cases have also been brought against insurance companies that offer services to smaller plans
  - A handful suits have been filed relating to 403(b) plans

Breadth. Depth. **Results.**

The Core Claims – Beyond “Fees”

- Fees are too high for administrative services (mainly recordkeeping)
  - per capita fees are excessive
  - asset-based fees are inherently too high
- Plan alleged to have improperly allowed service providers to retain revenue sharing
- Company stock fund administration
  - Cash “buffers” diluted returns
  - Claims have morphed into allegation about holding cash in excess of plan guidelines, that plans sponsored by same employer were treated inconsistently, and that a unitized structure was improperly favors “day traders” over “buy-and-hold” investors

© 2010 Seyfarth Shaw LLP

The Core Claims – Beyond "Fees"

- Investment fund structures attacked, including allegations that
  - Large plans shouldn't use retail mutual funds
  - Adopting a family of funds is imprudent
  - Active management is improper because in the aggregate it does not outperform passive management
  - Fees paid to mutual funds sponsored by an affiliate of the plan sponsor are a prohibited transaction
- Plans allegedly should have pursued other revenue streams
  - Float (interest on money going into or out of the plan)
  - Foreign exchange
  - Securities lending
- Plan disclosures of fees and expenses allegedly inadequate
  - dollar cost not disclosed
  - revenue sharing and other practices affecting total costs not disclosed

 © 2010 Seyfarth Shaw LLP

Breadth. Depth. **Results.**

Key Defenses

- ERISA 404(c)
  - The statute provides that if a defined contribution plan participant exercises control over the assets in his account, no fiduciary is liable "for any loss, or by reason of any breach, which results from such participant's exercise of control over the assets in his account." Courts disagree over whether this applies to selection of available investment options.
- Statute of Limitations
  - Fees were disclosed triggering three-year limitations period under ERISA Section 413
  - Claims existed more than six years before suit was filed and thus are barred under the alternative six-year limitations period
  - No evidence/allegations of fraud or concealment to toll the statute of limitations
  - claims accrue at the time of the contested decision and therefore any claim regarding a fee structure or practice established 3/6 years before filing suit is time-barred.
- Plan disclosures were adequate and complied with all ERISA requirements
- Fiduciaries prudently considered their options and made reasonable choices – fiduciaries do not have to pick the lowest cost provider

 © 2010 Seyfarth Shaw LLP

Breadth. Depth. **Results.**

The Scorecard

- Outright dismissals
  - *Hecker v. Deere & Co.*, 556 F.3d 575 (7th Cir. 2009) (Rule 12(b)(6) dismissal affirmed because allegation of excessive fee was implausible and alternatively based on ERISA Section 404(c))
  - *Loomis v. Exelon Corp.,* 1:06-cv-04900 (N.D. Ill. filed 9/11/06) (motion to dismiss granted based upon Hecker)
  - *Young v. Gen. Motors Inv. Mgmt. Corp.,* 550 F. Supp. 2d 416 (S.D.N.Y. 2008), aff'd No. 08-1532-cv(L), 08-1534-cv(con), 2009 WL 1230350 (2d Cir. May 6, 2009) (finding to be untimely a claim that defendants breached their fiduciary duties by allowing a 401(k) plan to invest in certain mutual funds with allegedly excessive fees because plaintiffs had all the information necessary to bring their claims well over three years before they filed suit)

 © 2010 Seyfarth Shaw LLP

Breadth. Depth. **Results.**

The Scorecard

- *In re Honda of Am. Mfg, Inc. ERISA Litig.,* 2:08-cv-01059 GLF-TPK (S.D. Ohio filed 11/10/08) (dismissed for reasons tracking the *Hecker* rationale)
- *But see Braden v. Wal-Mart*, 2009 U.S. App. LEXIS 25810 (8th Cir. Nov. 25, 2009) (district court dismissed because based on failure of complaint to allege facts showing imprudence; Eighth Circuit reversed saying complaint adequately alleged imprudent conduct warranting discovery)

• Full Summary Judgments

- *George v. Kraft Foods Global, Inc.,* Case No. 07-CV-1713 (N.D. Ill. Jan. 27, 2010) (claims relating to compensation of record keeper, unitized stock fund, and float retained by trustee; no issue of fact found as to the prudence of the fiduciaries' conduct)
- *Taylor v. United Tech.,* No. 06-cv-1494, 2009 WL 535779, at *8-10 (D. Conn. Mar. 3, 2009) summarily aff'd 2d Cir. 12/1/09 (summary judgment for defendants on claims regarding stock fund, revenue sharing, recordkeeping fees, and disclosure)

 © 2010 Seyfarth Shaw LLP

Breadth. Depth. **Results.**

The Scorecard

- Partial Summary Judgment
  - *Kanawi v. Bechtel Corp.,* 590 F. Supp. 2d 1213 (N.D. Cal. 2008), appeal docketed, No. 08-16980 (Sep. 8, 2008) (motion granted based on statute of limitations and the fact that for most periods, the plan paid no fees; denied as to periods when the plan paid fees to affiliated investment provider)
  - *Tibble v. Consolidated Edison*, 2:07-cv-05359-SVW-AGR (C.D. Cal. filed 8/16/07) (rejecting certain prohibited transaction, revenue sharing, stock fund, and stable value fund claims; denying motion as to prohibited transaction claims regarding float and whether desire to generate revenue sharing tainted fund selection)
  - *Abbott v. Lockheed Martin Corp.,* 3:06-cv-00701 (S.D. Ill. filed 9/11/06) (claims outside the scope of the complaint dismissed, only conduct within six years before filing of the complaint can be challenged, excessive fee, stock fund, and stable value claims survived).

 © 2010 Seyfarth Shaw LLP

The Scorecard

- Settlements
  - *Mehling v. New York Life Insurance Co.,* No. 99-CV-05417 (E.D. Pa. Mar. 5, 2008) $14 million settlement ($9.8 million of which was split between two 401(k) plans)
  - *Martin v. Caterpillar Inc., et al.,* No. Case No. 07-1009 JBM/JAG (C.D. Ill. Filed Sept. 11, 2006) (claims relating to offering mutual funds sponsored by an affiliate of the plan sponsor; $16.5 million monetary payment and certain affirmative relief proposed, motion for preliminary approval pending)

 © 2010 Seyfarth Shaw LLP

The Scorecard

- *Phones Plus Inc. v. Hartford Life Ins. Co.*, D. Conn., No. 3:06-cv-1835 (AVC), motion filed 2/11/10
  - Claim alleged that Hartford received improper revenue sharing from mutual funds offered to plans for which Hartford was a service provider
  - $13.8 Million settlement fund, to be shared by a class of plans that used Hartford as service provided
  - Structural changes including enhanced disclosures and removal of requirements to invest in particular mutual funds)

Breadth. Depth. **Results.**

The Scorecard

- Trials
  - *Dupree v. Prudential Ins. Co.,* 2007 WL 2263892 (S.D.Fla. 2006) (defense verdict after trial on claims regarding excessive fees paid to affiliated investment managers).
  - *Tussey v. ABB*, 2:06-cv-04305-NKL (W.D. Mo. filed 12/29/06) (awaiting decision)
  - *Tibble v. Consolidated Edison*, 2:07-cv-05359-SVW-AGR (C.D. Cal. filed 8/16/07) (C.D. Cal. Oct. 2010) (awaiting decision)

 © 2010 Seyfarth Shaw LLP

Stock Drop Update

- ERISA imposes duties of:
  - Loyalty
  - Prudence
  - Diversification
  - Following Plan Documents (insofar as consistent with ERISA)
- However, for stock plans:
  - "the diversification requirement and the prudence requirement (only to the extent that it requires diversification) is **not** violated by acquisition or holding of qualifying employer securities."

-ERISA 404(a)(2)

 © 2010 Seyfarth Shaw LLP

Breadth. Depth. **Results.**

Stock Drop Update – Claims and Defenses

- "Stock drop" cases typically allege that fiduciaries imprudently selected stock of the sponsoring employer as an investment option for participants in a 401(k) plan or ESOP and that the plan was harmed when the stock price fell.
- Some cases allege that Company stock became imprudent at some point in time, giving rise to a duty to divest the Plan of Company stock at that point.
- Some cases have held the exemption operates as near impenetrable shield:
  - "an EIAP fiduciary's decision to purchase or hold the employer's securities is exempt from the duty to diversify and the related duty of prudence insofar as it concerns asset diversification." *Kirschbaum v. Reliant Energy, Inc.,* 526 F.3d 243, 248 (5th Cir. 2008).

 © 2010 Seyfarth Shaw LLP

Breadth. Depth. **Results.**

Stock Drop Update – Claims and Defenses

- In the 7th Circuit, it is recognized that "if ESOPs had to be diversified they would fail in their purpose of encouraging employees' ownership of their employer's stock." *Steinman v. Hicks*, 352 F.3d 1101, 1103 (7th Cir. 2003).
- However, "there are some situations in which the duty of prudence could require diversification of an ESOP's holdings." *Pugh v. Tribune Co.,* 521 F.3d 686, 699 (7th Cir. 2008).

 © 2010 Seyfarth Shaw LLP

Stock Drop Update – Claims and Defenses

- Under the presumption of prudence, fiduciaries are presumed to have acted prudently by holding company stock in an ERISA plan that required them to do so.
- *Moench v. Robertson*, 62 F.3d 553, 571 (3d Cir. 1995)
- Plaintiff may rebut the presumption of prudence only by showing that:
  - "owing to circumstances not known to the settlor and not anticipated by him [the making of such investment] would defeat or substantially impair the accomplishment of the purposes of the trust."

  Moench, 62 F.3d at 571.

 © 2010 Seyfarth Shaw LLP

Breadth. Depth. **Results.**

Stock Drop Update – Claims and Defenses

- ERISA fiduciaries are not required to be clairvoyant.
  - In determining whether a fiduciary acted prudently in continuing to offer company stock as an investment option, "the focus of the inquiry is how the fiduciary acted, not whether his investments succeeded or failed."

Kirschbaum, 526 F.3d at 253.

 © 2010 Seyfarth Shaw LLP

Breadth. Depth. **Results.**

Stock Drop Update – Key Decisions

- *Wright v. Oregon Metallurgical Corp.,* 360 F.3d 1090, 1096, 1098 (9th Cir. 2004) (ill-fated merger, reverse stock split, and 75% drop in stock price were insufficient to rebut *Moench* presumption of prudence).
- *Kuper v. Iovenko*, 66 F.3d 1447, 1451, 1459 (6th Cir. 1995) (company-wide financial woes and 80% drop in stock price insufficient).
- *In re McKesson HBOC, Inc. ERISA Lit.,* 391 F. Supp. 2d 812, 830-33 (N.D. Cal. 2005) (declining to apply Moench, but concluding widespread accounting violations, restated revenues for 3 years, and 75% drop in stock price were insufficient to rebut presumption in any event).

 © 2010 Seyfarth Shaw LLP

Breadth. Depth. **Results.**

Stock Drop Update – Recent Developments

- *In re Lehman Brothers ERISA Lit.*, No. 08 Civ. 5598 (S.D.N.Y. Feb. 2, 2010) – ERISA stock drop class action arising from Sept. 15, 2008 collapse of Lehman Brothers dismissed.
  - Directors appointed compensation committee members, but no allegation of breach as to selection of members.
  - S.V.P. of H.R. not alleged to know any facts had access to or knowledge of Lehman's financial condition.
  - Must face "imminent collapse" or "sufficiently dire situation" to justify discontinuing stock option.

 © 2010 Seyfarth Shaw LLP

Stock Drop Update – Recent Developments

- *In re Citigroup ERISA Lit.,* No. 07 Civ. 9790 (S.D.N.Y. Aug. 31, 2009) – ERISA stock drop suit based on Citigroup's exposure to subprime mortgage losses dismissed.
  - Citigroup's 401(k) Plans mandated that Company stock be offered as an investment option, thus fiduciaries had no discretion to eliminate stock from the plan.
  - Stock plans are "not intended to guarantee retiree benefits," but instead are designed to give employees an ownership interest in their employers.
  - Plan administration committee not shown to have any knowledge of company's subprime exposure.
  - DOL Associate Solicitor Timothy Hauser criticized ruling saying duties of loyalty and prudence still apply and cannot be overridden by mandatory plan term.

 © 2010 Seyfarth Shaw LLP

Lessons Learned From Stock Drop Cases

- Lessons learned:
  - Either don't allow Company stock to be a retirement investment option or make sure Company has good fiduciary liability coverage.
  - If Company stock will be an option, "hardwire" it into the plan.
  - To avoid conflict of interest claims, appoint as fiduciaries competent managers who do **not** have non-public information about Company's financial condition or prospects (i.e., not the CFO, COO, or CEO).
  - Stress the importance of diversification of investments at every opportunity (e.g., have diversification statement on each participant statement).
  - If adverse financial conditions occur, consider appointing an independent fiduciary to assess prudence of continued Company stock offering.

 © 2010 Seyfarth Shaw LLP

Cash Balance Issues

- What is a Cash Balance Plan?
  - Defined Benefit Plan that looks like a defined contribution plan
  - Each participant has a “notional account”
  - Account grows based on pay and interest credits during employment and interest credits thereafter
  - Participant who leaves employment before retirement may take a lump sum distribution

 © 2010 Seyfarth Shaw LLP

What is a Cash Balance Plan?

- The "Whipsaw"
  - Plaintiffs claimed that lump sum had to be the "actuarial equivalent" of the normal retirement benefit
  - Courts held that this must be calculated by:
    - Projecting forward participant's cash balance to Normal Retirement Age; and
    - Discounting back to current date using statutorily-required discount rate.
  - May result in lump sum entitlement <u>greater</u> than participant's cash balance
  - Litigation resulted in significant, and likely unintended, liabilities for many employers

 © 2010 Seyfarth Shaw LLP

Breadth. Depth. **Results.**

Current Issues In Cash Balance Litigation

- Claims that where plan has a variable interest crediting formula, the Plan must use "reasonable assumptions" to project cash balance forward to Normal Retirement Age.
  - Plaintiff's counsel can challenge assumptions used to determine Normal Retirement Age benefit as unreasonable
  - Computations typically require a certified actuary to calculate proper benefit
- Are pre-retirement mortality discounts allowed. *Stewart v. AT&T Inc.*, No. 09-50381 (5th Cir. Nov. 17, 2009) (unpublished decision affirming plan administrator's decision to use such a discount in lump sum calculation).
- Determining cash balance "opening account." *Sunder v. U.S. Bancorp Pension Plan*, 586 F.3d 593 (8th Cir. 2009) (plan not required to use IRC Section 417(e) rate to determine value of prior plan benefit).

 © 2010 Seyfarth Shaw LLP

Cash Balance Update

- Why have a Cash Balance Plan?
  - Helps participants understand their benefit in current dollars.
  - Able to move retirement monies to a new employer or IRA without penalty and without waiting until Normal Retirement Age.
  - Has more predictable funding requirements than a traditional Defined Benefit Plan.
  - As traditional Defined Benefit Plans have been hit with “tsunami” funding requirements of PPA, conversion to cash balance design has provided some relief.

 © 2010 Seyfarth Shaw LLP

Cash Balance Update

- Cash Balance Plans Risk Management
  - Age discrimination lawsuits
  - Conversion may require 204(h) notice if it results in significant decrease in the rate of future accruals
  - Allegedly incorrect lump sum determinations
  - Funding may prove difficult, especially if significant reduction in force requires payouts for numerous participants
  - IRS resistance to plans has delayed determination letter requests

 © 2010 Seyfarth Shaw LLP

Other Plan Administration Suits

- Stable Value Funds
  - Historically perceived as preserving capital and providing a guaranteed rate of return but recent market unrest has called that perception into question
  - Current issues facing Stable Value Funds
    - *Divergence of market and book values*
    - *Tight wrap contract provider market*
    - *Declining crediting rates*
    - *Deviation from advertised investment policy*

 © 2010 Seyfarth Shaw LLP

Breadth. Depth. **Results.**

Other Plan Administration Suits

- Stable Value/Bond Fund Litigation
  - *In re State Street Bank and Trust Co. ERISA Litigation*, No. 07-cv-8488 (S.D.N.Y., filed October 17, 2007) – allegations that conservative bond funds were actually investing in risky mortgage backed securities – motion for preliminary approval of $90 Million settlement.
  - *Fishman Haygood Phelps Walmsley, Willis & Swanson v. State Street Corporation, State Street Bank and Trust Co., State Street Bank Trust Co. of New Hampshire and State Street Global Advisors*, 09-cv-10533 (D.Mass. filed April 7, 2009)
    - Plaintiffs allege State Street imprudently invested plan funds in risky mortgage-backed securities
    - Breach of fiduciary duty (prudence, loyalty, prohibited transaction)

 © 2010 Seyfarth Shaw LLP

Securities Lending

- What is Securities Lending
  - The plan lends its securities to a borrower
  - The borrower pays the plan for the loan and posts collateral
  - The plan agrees to repay the collateral and plus portion of investment returns
  - The plan invests the collateral in a portfolio designed to generate the returns
- Current issues raised by securities lending
  - Instead of generating return, practice may have generated a loss
  - Some pooled investments are restricting the ability to exit because of exposure to illiquid assets such mortgage-backed securities and Lehman paper
  - Allegations concerning parameters for lending and investment guidelines for investing collateral
  - Allegations that the lending agents did not disclose how the collateral would be invested

 © 2010 Seyfarth Shaw LLP

Breadth. Depth. **Results.**

ERISA Securities Lending Cases

- *BP Corporation North America Inc. Savings Plan Investment Oversight Committee and Investment Committee v. Northern Trust Investments, N.A. and the Northern Trust Company*, No. 08-cv-06029 (N.D. Ill., filed 10/28/08)
  - Preliminary injunction denied 12/16/08, 45 EBC 2072.
  - Court dismissed (2/10/10) counterclaim for contribution and indemnity, finding that *Russell* overruled prior Seventh Circuit precedent seeming to allow such claims
- *Joseph L. Diebold, Jr. on behalf of ExxonMobil Savings Plan v. Northern Trust Investments, N.A. and the Northern Trust Company*, No. 09-cv-01934 (S.D. Ill. Filed 3/30/09)
  - Consolidated with the BP case
- *Firefighters' Retirement System v. Northern Trust Investments, N.A. and the Northern Trust Company*, N.D. Ill., Filed 11/17/09)
  - motion to consolidate with BP pending

 © 2010 Seyfarth Shaw LLP

ERISA Securities Lending Cases

- *FEDEX Corporation and FEDEX Corporation Employees' Pension Plan v. Northern Trust Investments, N.A. and the Northern Trust Company*, No. 08-cv-02827 (W.D. Tenn. Filed 12/1/08)
  - Court refused to dismiss counterclaim for contribution and indemnity. 48 EBC 1769 (Jan 25, 2010)
- *Lockheed Martin Investment Management Company v. Northern Trust Investments, N.A. and the Northern Trust Company*, No. 09-cv-01649 (D.Md. Filed 6/23/09)
  - Motion to dismiss certain state law claims as preempted pending
- *Bd. Of Trustees of the Iron Workers' Local No. 25 Pension Fund, et. al. v. Comerica Bank*, 5:10-cv-10206 (E.D. Mich. filed 1/15/2010)
  - Case in initial stages of litigation

 © 2010 Seyfarth Shaw LLP

Breadth. Depth. **Results.**

ERISA Class Action Litigation Strategies

 © 2010 Seyfarth Shaw LLP

Litigation Strategies – Motions to Dismiss

- *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544 (2007) (7-2) (Stevens & Ginsburg dissenting)
  - Complaint must provide "grounds" of "entitlement to relief" = "more than labels and conclusions, and a formulaic recitation of the elements of a cause of action will not do."
  - Courts are not bound to accept as true legal conclusions couched as factual allegations.
  - Factual allegations must be enough to raise a right of relief above the speculative level – *i.e.*, must be plausible, not merely possible.

 © 2010 Seyfarth Shaw LLP

Breadth. Depth. **Results.**

Litigation Strategies – Motions to Dismiss

- *Ashcroft v. Iqbal*, 129 S. Ct. 1937 (May 18, 2009) (5-4) (Stevens, Souter, Ginsburg & Breyer dissenting)
  - Rule 8 "demands more than an unadorned, the-defendant-unlawfully-harmed-me accusation."
  - "Nor does a complaint suffice if it tenders naked assertions devoid of further factual enhancement."
  - "Facial plausibility" requires pleading "factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged."
  - "Threadbare recitals of the elements of a cause of action, supported by mere conclusory statements, do not suffice."

 © 2010 Seyfarth Shaw LLP

Breadth. Depth. **Results.**

Litigation Strategies – Motions to Dismiss

- *Ashcroft v. Iqbal*, 129 S. Ct. 1937 (May 18, 2009) (5-4) (Stevens, Souter, Ginsburg & Breyer dissenting)
  - Rule 8 “does not unlock the doors of discovery for a plaintiff armed with nothing more than conclusions.”
  - “Where the well-pleaded facts do not permit the court to infer more than the mere possibility of misconduct, the complaint has alleged-but it has not ‘shown’-that the pleader is entitled to relief.”
  - Conclusions “are not entitled to the assumption of truth.”
  - “While legal conclusions can provide the framework of a complaint, they must be supported by factual allegations.”

 © 2010 Seyfarth Shaw LLP

Litigation Strategies – Motions to Dismiss

- What ERISA allegations might be challenged under *Twombly/Iqbal*?
  - Defendants A, B, and C were fiduciaries of the Plan because they had discretionary authority or control over plan assets or plan administration.
  - Defendants breached their fiduciary duties of prudence, loyalty, skill, care, diversification, and disclosure. *But does the complaint provide sufficient, plausible factual enhancement as to how*?
  - Defendants' breach caused a cognizable loss to the Plan. *How so*? *Is it plausible*? *Is loss attributable to something else like unforeseen market conditions*?

 © 2010 Seyfarth Shaw LLP

Litigation Strategies – Motions to Dismiss

- *Example: Defendants coerced Plaintiffs into investing in Company stock*.
- Motion to dismiss challenges:
  - Neither Plaintiff specifically alleges that he was coerced based on a specific statement or threat made by one of the individual Defendants.
  - No allegation as to when such statement or threat occurred.
  - Neither Plaintiff alleges how he was specifically injured as a result.

Result: Court agrees coercion allegations are lacking in specificity and allows leave to replead if counsel can do so consistent with FRCP. Plaintiffs don't replead.

 © 2010 Seyfarth Shaw LLP

Emerging Issues -- Standing

- Standing requires that Plaintiff – even in a class action – plead that the Named Plaintiff was adversely affected by some act or omission of the Defendant.
  - ERISA breach of fiduciary duty can only be asserted by a participant, beneficiary, fiduciary, or the Secretary.
  - While some ERISA cases previously held that a cashed out participant does not have standing, this issue has been resolved in favor of the former participants.
  - Need to ask in each case whether the participant was harmed by the practice at issue and whether he has standing to represent all of the plaintiffs he seeks to represent.

 © 2010 Seyfarth Shaw LLP

Class Certification Strategies & Defenses

- Rule 23
  - Must satisfy all four Rule 23(a) requirements and fit within one subsection of Rule 23(b)
  - Rule 23(a)
    - *Numerosity* –class must be so numerous that joinder is impracticable
    - *Commonality* – questions of law and fact common to the proposed class
    - *Typicality* –claims or defenses of the representative parties must be typical of the claims and defenses of putative class members
    - *Adequacy Of Representation* – The representative plaintiffs and their counsel capable of fairly and adequately protecting the interests of the class

 © 2010 Seyfarth Shaw LLP

Rule 23(b)(1)

- Certification would create risk of
  - (A) inconsistent or varying adjudications with respect to individual class members that would establish incompatible standards of conduct for the party opposing the class; or
  - (B) adjudications with respect to individual class members that, as a practical matter, would be dispositive of the interests of the other members not parties to the individual adjudications or would substantially impair or impede their ability to protect their interests.
- Subsection (A) focuses on whether separate actions by or against individual class members would risk establishing incompatible standards of conduct for the defendant party opposing the class, and that subsection (B) focuses on whether, as a practical matter, such an action would be dispositive of the interests of nonparty class members, or substantially impair or impede their ability to protect their interests. *Amchem Prods. Inc. v. Windsor*, 521 U.S. 591, 614 (1997)

 © 2010 Seyfarth Shaw LLP

Rule 23(b)(1)

- Rule 23(b)(1)(A) is a common vehicle for certification in ERISA cases:
  - "When raising a plan-wide claim, a plaintiff is pursuing a claim on behalf of the *entire* plan, which necessarily includes discrete accounts within the Plan. Accordingly, if a court entertaining an individual account claim were to reach a different conclusion from a court entertaining a plan-wide claim, the fiduciaries would be left with incompatible orders concerning the same account. For example, if Stanford were successful in his plan-wide claim, but "Participant A" were unsuccessful when raising the same claims in an individual account action, one court order would require defendants to reimburse Participant A while another court order would foreclose such recovery. Such competing orders lead to incompatible standards of conduct for the defendants." *Stanford v. Foamex L.P.,* No. 07-4225, 2009 WL 3075390, at *15 (E.D. Pa. Sept. 24, 2009) (emphasis in original); *see also Jones v. NovaStar Fin. Inc.*, 257 F.R.D. 181, 193-94 (W.D. Mo. 2009)

 © 2010 Seyfarth Shaw LLP

Rule 23(b)(1)

- Rule 23(b)(1)(B) can also be used in ERISA class actions
- The Advisory Committee Notes: Suggesting that the rule applies "to an action which charges a breach of trust by [a] . . . fiduciary similarly affecting the members of a large class of security holders or other beneficiaries, and which requires an accounting or like measures to restore the subject of the trust."
- 23(b)(1)(B) "takes in situations where the judgment in a nonclass action by or against an individual member of the class, while not technically concluding the other members, might do so as a practical matter." *Ortiz v. Fibreboard Corp.*, 527 U.S. 815, 833 (1999).
- *Grabek v. Northrop Grumman Corp.*, No. 07-56448, 2009 WL 2870075, at *1 (9th Cir. Sep. 8, 2009) (401(k) fees case should be certified under 23(b)(1)(B))

 © 2010 Seyfarth Shaw LLP

Breadth. Depth. **Results.**

Rule 23(b)(2)

- The party opposing the class "has acted or refused to act on grounds generally applicable to the class, thereby making appropriate final injunctive relief or corresponding declaratory relief with respect to the class as a whole."
- Rule 23(b)(2) restricted to cases where the primary relief sought is injunctive or declaratory in nature
- Rule 23(b)(2) does not extend to cases in which the appropriate final relief relates exclusively or predominantly to money damages
- Binding order on all class members without guarantees of personal notice and the opportunity to opt-out of the suit

 © 2010 Seyfarth Shaw LLP

Breadth. Depth. **Results.**

Rule 23(b)(3)

- Rule 23(b)(3) Requirements
  - ► two additional requirements:
    - – *[1] common questions must predominate over any questions affecting only individual members; and*
    - – *[2] class resolution must be superior to other available methods for the fair and efficient adjudication of the controversy.*
  - ► Rule 23(b)(3) applies to cases where the primary relief sought is money damages.
  - ► Each class member is entitled as a matter of due process to personal notice and an opportunity to opt-out of the class action.

 © 2010 Seyfarth Shaw LLP

Rule 23(b)(3)

- Rule 23(b)(3) generally is not appropriate in ERISA cases
  - No claims for money damages
  - To the extent damages are involved, they are highly individualized, defeating the “predominance requirement”
- *Piazza v. EBSCO Industries, Inc.*, 273 F.3d 1341, 1353 (11th Cir. 2001) (court should not have certified ERISA Section 502(a)(2) claim pursuant to Rule 23(b)(3) instead of Rule 23(b)(1))

 © 2010 Seyfarth Shaw LLP

Defenses to Class Certification

- Individualized Defenses Defeat Certification
  - *In Re Schering-Plough ERISA Litigation*, 2009 U.S. App. LEXIS 27930 (3d Cir. Dec. 21, 2009) (named plaintiff had signed a release and covenant not to sue. The court found that the release might render the named plaintiff inadequate to represent the class and remanded the case for further review).
  - *Lingis v. Motorola*, No. 03-5044 (N.D. Ill. Sept 28, 2008) (release signers excluded from class).
  - Certification can be defeated if claims would require proof as to individual communications. *Fletcher v. ZLB Behring*, 39 EBC 1650 (N.D. Ill. 2006).
- Class conflicts
  - *Abbott v. Lockheed Martin Corp.*, No. 06-cv-0701-MJR, 46 EBC 1925 (S.D. Ill. April 3, 2009) (refusing to certify class as to stock fund claims in "401(k) fee" case because class could not contain both those who benefited and who were harmed by the alleged breach)
  - *Langbecker v. Electronic Data Systems Corp.*, 476 F.3d 299 (5th Cir. 2007) (remanding class certification order in stock drop case for further consideration of intra-class conflicts and issues related to ERISA 404(c).

 © 2010 Seyfarth Shaw LLP

Breadth. Depth. **Results.**

Defenses to Class Certification

- Rule 23(b) defenses
  - Often possible to argue that no subsection of Rule 23(b) applies
    - Rule 23(b)(1) – parse the subsections
    - Rule 23(b)(2) – are damages claimed? Are they incidental to equitable relief or are they the whole show?
    - 23(b)(3) predominance/superiority issues
  - *In Re First American Corp. ERISA Litigation*, 258 F.R.D. 610 (C.D. Cal. 2009)
    - plaintiffs suing under ERISA Section 502(a)(2) have individual claims, inappropriate for certification under Rule 23(b)(1) or b(2).
    - Court relies on *LaRue*, which had held that a 401(k) participant may bring a claim seeking relief on behalf of the plan, where only his account has been harmed. Each class member has an individual claim for monetary relief.
    - The district court later certified under Rule 23(b)(3), however.

 © 2010 Seyfarth Shaw LLP

Breadth. Depth. **Results.**

ERISA Class Action Settlements

- Major Settlements of 2009-2010
  - *In Re State Street* (S.D.N.Y.) - $89.75 million (claims regarding risky and undisclosed investment strategy in bond funds)
  - *In Re Merrill Lynch* (S.D.N.Y.) - $75 million (stock drop)
  - *Overby v. Tyco* (D.N.H.) - $70.5 million (stock drop)
  - *Alvidres v. Countrywide Financial* (C.D. Cal.) - $55 million (stock drop)
  - *In Re Xerox* (D. Conn.) - $51 million (stock drop)
  - *Chao v. AA Capital* (N.D. Ill.) - $50 million (inappropriate investments)
  - *In Re U.S. Sugar Corp.* (S.D. Fla.) - $15.9 million (ESOP claims)
  - *Phones Plus Inc. v. Hartford Life Ins. Co.* - $13.8 million (fees claims)

 © 2010 Seyfarth Shaw LLP

Settlement Strategies/Considerations

- Historically, many cases settled after ruling on the motion to dismiss
- More cases heading to trial or summary judgment
- Discovery costs
- Affirmative relief/plan changes
- Mediation (court ordered and private)

 © 2010 Seyfarth Shaw LLP

Fiduciary Practices to Minimize Litigation Risk

 © 2010 Seyfarth Shaw LLP

Breadth. Depth. **Results.**

Consistent & Careful Oversight of Plans

- Fiduciary Prudence -- A fiduciary must use the level of care that a prudent person knowledgeable about such matters would use in the same situation (ERISA §404(a)(1)(B))
  - DOL Guidance: The fiduciary should "appropriately consider" all the facts and circumstances that apply (DOL Reg. §2550.404a-2(b))
  - Procedural Prudence: A fiduciary's conduct is evaluated primarily by the process used to make the decision rather than the results of the decision

© 2010 Seyfarth Shaw LLP

Consistent & Careful Oversight of Plans

- What is Procedural Prudence?
  - identify factors relevant to decision-making process
  - identify necessary fact-finding steps and background information
  - identify required expertise and knowledge needed; when necessary, consult with outside experts
    - investment advisor, accountant, actuary, legal counsel
  - evaluate relevant criteria
  - document the evaluation and decision

 © 2010 Seyfarth Shaw LLP

Consistent & Careful Oversight of Plans

- George v. Kraft Foods Global, Inc., Case No. 07-CV-1713 (N.D. Ill. Jan. 27, 2010)
  - Reinforces importance of fiduciary process
    - A "reasoned decision making process"
  - Reinforces importance of making a decision
  - Reinforces importance of documenting both

 © 2010 Seyfarth Shaw LLP

Breadth. Depth. **Results.**

Keeping Up With Changes in Investment Marketplace

- To satisfy the prudence standard, a fiduciary should have a basic understanding of the plan’s investments
- Changes in the investment marketplace may trigger a need to gather information, consult with experts and possibly reevaluate existing investments
  - As a result of the market meltdown, many fiduciaries gathered additional information, reevaluated existing investment and/or reevaluated investment guidelines for investments
    - Bond Funds: Reviewed exposure to asset-backed and mortgage-backed securities
    - Stable Value Funds: Reviewed wrap providers and investment guidelines for fixed income portfolios
    - Securities Lending: Reviewed the associated risks, returns and costs

 © 2010 Seyfarth Shaw LLP

Keeping Up With Changes in Provider Marketplace

- Fiduciary should be aware of changes in the provider marketplace
  - Fee Structure: Fee structures can change over time
    - Historically, a per account charge was very common
    - Now it is very common to pay recordkeeping fees with revenue sharing
    - Recently, however, some shift away from using revenue sharing
  - Amount Paid: As the plan changes (e.g., demographics and assets), the amount of fees paid may need to be re-examined
    - As plan size increases may be eligible for more favorable (cheaper) share classes in mutual funds or other cheaper investment structures (e.g., collective investment trust)

 © 2010 Seyfarth Shaw LLP

Keeping Up With Changes in Law

- Legislation concerning fee disclosures
  - Variety of bills in Congress
  - All are slightly different but common themes are more requirements concerning information that must be disclosed
    - To participants
    - From service providers
- DOL regulations regarding arrangements with certain service providers. The proposed regulations included a requirement that the terms of the contract must require the service provider to disclose certain information in writing (Proposed DOL Regulation §2550.408b-2)
  - Whether the service provider has any material financial, referral or other arrangement with a money manager, broker, other client, other plan service provider that creates or may create a conflict of interest for the service provider
  - Whether the service provider will be able to affect its own compensation or fees from whatever source without the prior approval of an independent fiduciary (e.g., incentive, performance-based, float or other contingent compensation)
  - Whether the service provider has any policies or procedures that address actual or potential conflicts of interest

 © 2010 Seyfarth Shaw LLP

Breadth. Depth. **Results.**

Participant Communications
ERISA Section 404(c)

- To receive ERISA 404(c) protection –
  - Plan must be designed to comply with 404(c)
  - Participant must actually exercise control over investment of account
- Under 404(c) regulations, fiduciaries must provide the participant with access to sufficient information so the participant can make an informed decision (DOL Regulation §2550.404c-1)
  - Some information should automatically be provided to participants
  - Some information must be provided upon request by a participant
- The following information should be provided to participants
  - An explanation that the Plan is intended to be a Section 404(c) plan and that fiduciaries are not liable for losses that result from the participant's investment instructions
  - A description of the available investment options, and a general description of each option's investment objectives and risk and return characteristics
  - The identity of any designated investment managers
  - A description of any transaction fees and expenses assessed in connection with the purchase or sale of interests in the investment options

 © 2010 Seyfarth Shaw LLP

Breadth. Depth. **Results.**

Participant Communications
ERISA Section 404(c)

- Participants should be provided with a prospectus or summary prospectus before or immediately after the participant makes his first investment in a mutual fund
- Certain information should be available upon request. Participant communications should tell participants how to request information
  - Description of the annual operating expenses of each investment fund (i.e., investment management fees, administrative fees, transaction costs), such expenses as a percentage of the investment fund's average net assets
  - Copies of prospectuses, financial statements and reports, and other materials relating to the investment fund, to the extent they have been provided to the Plan
  - For investment funds that are not mutual funds, a list of the assets in the investment fund's portfolio, the value of each asset (or the percentage of the fund it represents)
  - The value of the shares or units in the investment funds, as well as the past and current investment performance
  - The value of the shares or units in the investment funds held in the participant's account

 © 2010 Seyfarth Shaw LLP

Breadth. Depth. **Results.**

Participant Communications
QDIA

- Qualified Default Investment Alternative (“QDIA”) -- Provides protections similar to ERISA Section 404(c) for investing participants accounts in a QDIA when the participant does not make an election (ERISA §404(c)(5) and DOL Regulation §2550.404c-5)
  - DOL regulations require a notice to each participant defaulted into the QDIA at least 30 days before the first investment in the QDIA and an annual notice to each participant defaulted into the QDIA at least 30 days before the beginning of each Plan year
  - Those notices include:
    - A description of the circumstances under which investments will be defaulted into the QDIA
    - A description of the QDIA, including a description of the investment objectives, risk and return characteristics (if applicable), and fees and expenses attendant to the investment alternative
    - A description of the right to direct the investment of assets defaulted in the QDIA into any other investment alternative under the plan, including a description of any applicable restrictions, fees, or expenses in connection with such transfer
    - An explanation of where the participants and beneficiaries can obtain investment information concerning the other investment alternatives available under the plan

 © 2010 Seyfarth Shaw LLP

Participant Communications

- Given the importance of the 404(c) and QDIA protections
  - ▶ Periodically review participant communications to confirm continued compliance
  - ▶ Consider the methods used to deliver these communications
    - DOL guidance concerning electronic delivery of participant communications is from the late 1990s (DOL Regulation §2520.104b-1(c))
    - Under that guidance, posting information on a website is not sufficient – should be pushed out to participants
- When reviewing participant communications concerning investment options, use common sense
  - ▶ Fine line to walk between enough information and too much information
  - ▶ Do participants have sufficient information to understand at high level what they are invested in?

© 2010 Seyfarth Shaw LLP

QUESTIONS?

 © 2010 Seyfarth Shaw LLP