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ERISA Stock Drop Suits & the 404(c) Safe Harbor Defense

Defending Stock Drop Cases Amid Differing Court Standards

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

Today's panel features:

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ERISA Litigation: Defense of ERISA Stock Drop Cases

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Defense of Stock Drop Actions

- The recent financial crisis has fueled a considerable amount of ERISA stock drop lawsuits.
- The fact pattern in these cases is typically as follows:
 - A publicly-traded company offers participation in a 401(k) plan
 - One of the investment options offered is a company stock fund
 - The company's stock price declines
 - Participants file suit against the company and the plan fiduciaries



The Claims

- Plaintiffs allege that failing to eliminate the company stock fund as an investment option in the plan when they knew or should have known that it was an imprudent investment is a breach of fiduciary duty (the “prudence claim”).
- Plaintiffs also contend that making material misrepresentations or failing to disclose material information about the company that would have alerted plaintiffs that the company stock price was overvalued is a breach of fiduciary duty (the “disclosure claim”).
- Claims frequently target the company, the officers and directors of the Company and members of the plan investment committee.



Defenses to the Prudence Claim

- The best defenses to the prudence claim are available where the plan document strongly and clearly evinces an intent that the company stock fund should be maintained as an investment option.
- There are two potential legal arguments arising from this plan design:
 1. There is no fiduciary responsibility with respect to the company stock fund, and hence no basis for asserting a claim challenging the decision to maintain the fund as an investment option. See *In re Citigroup ERISA Litig.*, 2009 WL 2762708 (S.D.N.Y. Aug. 31, 2009); *In re Wachovia Corp. ERISA Litig.*, No. 09 Civ. 262, 2010 WL 3081359 (W.D.N.C. Aug. 6, 2010).
 2. In light of the plan's design, the plan fiduciaries should be afforded a presumption of prudence with respect to their decision to maintain the company stock fund, which can be rebutted only under extremely limited circumstances, *i.e.*, when the company's financial condition is imperiled. See *Moench v. Robertson*, 62 F.3d 553 (3d Cir. 1995).



Defenses to the Prudence Claim (Contd.)

- Legal argument #1 was recently embraced by two U.S. District Courts, but it is unclear whether these rulings will be affirmed on appeal or widely adopted by courts in other jurisdictions.
- Legal argument #2 has been accepted by the overwhelming majority of courts confronting it, including four U.S. Circuit Courts of Appeals.



The “Hard-Wired” Argument – *In re Citigroup ERISA Litigation*

- A district court in the Southern District of New York dismissed at the pleadings stage a claim for imprudently permitting participant investment in the company stock fund of two Citigroup 401(k) plans because the plans required that the stock fund be permanently maintained as an investment option. *See In re Citigroup ERISA Litig.*, 2009 WL 2762708 (S.D.N.Y. Aug. 31, 2009);
- The two plans at issue provided, in relevant part, that “the Trustee *shall maintain . . .* the Citigroup Common Stock Fund” and the “Citigroup Common Stock Fund *shall be permanently maintained* as an Investment Fund under the Plan.” *See In re Citigroup ERISA Litig.* at *3-4 (emphasis added).



The “Hard-Wired” Argument – *In re Citigroup ERISA Litigation (Contd.)*

- The plans also provided that “[a]ny one or more of such Investment Funds may be eliminated, or new Investment Funds may be made available, at any time by the Investment Committee without consent by any Participant or Employer; *provided, the Citigroup Common Stock Fund shall be permanently maintained as an Investment Fund* under the Plan.” *Id.* (Emphasis added.)
- The court concluded that defendants had no discretion to eliminate or liquidate the company stock fund and thus that there could be no claim for breach of fiduciary duty. *See id.* at *7-9.
- In so ruling, the court rejected plaintiffs’ contention that defendants had discretion with respect to the Citigroup stock fund because the plans stated that the stock fund should invest “primarily,” and not “exclusively” in Citigroup stock. *See id.* at *8-9.



The “Hard-Wired” Argument – *In re Wachovia Corp. ERISA Litigation*

- In *In re Wachovia Corp ERISA Litig.*, plaintiffs asserted claims similar to those claims alleged in *Citigroup*.
- The court in *Wachovia* adopted the reasoning of the *Citigroup* court, holding that “the plan language of [the Wachovia] plans makes clear that none of the Defendants had the discretion to eliminate the Wachovia Stock Fund as an investment option with the plan.” *In re Wachovia Corp ERISA Litig.*, at *9
- The Wachovia Savings Plan provided that the Wachovia Stock Fund “*shall* be made available to Participants for investment.” *Id.*



The “Hard-Wired” Argument

- The *Citigroup* case is currently on appeal to the U.S Court of Appeals for the Second Circuit and has already attracted the attention of the DOL and other interested entities, which have filed amicus briefs.
- The DOL has taken the position that the district court in *Citigroup* erred in concluding that fiduciaries have no duty with respect to an investment in company stock if the plan terms mandate continued investment in company stock.
- The DOL argues that ERISA expressly provides that statutory duties override plan terms inconsistent with ERISA.



The *Moench* Presumption

- *Moench*, 62 F.3d at 571, held that the fiduciaries of ESOPs were entitled to a rebuttable presumption that it was prudent under ERISA to invest the plan's assets in company stock.
- Recognizing that ownership of company stock is “a goal in and of itself” under ERISA, the court reasoned that “by subjecting an ERISA fiduciary’s decision to invest in employer stock to strict judicial scrutiny, we essentially would render meaningless the ERISA provision excepting ESOPs from the duty to diversify.” *Id.* at 570.
- The court thus concluded that it should not “sacrifice the policies behind ESOPs and employee ownership in order to make ESOP fiduciaries virtual guarantors of the financial successes of the [ESOP] plan.” *Id.*



Scope of the *Moench* Presumption

- The principles set forth in *Moench* with respect to ESOP plan trustees have been extended broadly to cover all eligible individual account plans, including 401(k) plans with company stock fund investments, which are similarly exempted from the duty to diversify.
- *Moench* has been accepted by virtually every court to confront it, including four U.S. Circuit Courts of Appeals. See, e.g., *Pugh v. Tribune Co.*, 521 F.3d 686, 700-02 (7th Cir. 2008); *Kirschbaum v. Reliant Energy Inc.*, 526 F.3d 243, 254 (5th Cir. 2008); *Edgar v. Avaya, Inc.*, 503 F.3d 340, 348-49 (3d Cir. 2007); *Kuper v. Iovenko*, 66 F.3d 1447, 1459-60 (6th Cir. 1995); *Steinman v. Hicks*, 352 F. 3d 1101 (7th Cir. 2003); see also *Bunch v. W.R. Grace & Co.*, 555 F.3d 1, 6 (1st Cir. 2009) (citing *Moench* with approval); *In re Syncor ERISA Litig.*, 516 F.3d 1095, 1102 (9th Cir. 2008) (declining to decide whether to adopt the *Moench* presumption of prudence).

Scope of the *Moench* Presumption (Contd.)

- As in *Moench*, in adopting the presumption of prudence, these courts have balanced ERISA's fiduciary responsibilities with the recognition that stock funds invest primarily in company stock as a matter of plan design, and that Congress has not only permitted such practices, but has encouraged them through the removal of the requirement of diversification, removal of the prohibition against self-dealing and favorable tax rules. See, e.g., *Edgar*, 503 F.3d at 347-48; *Pugh*, 521 F.3d at 699-701; *In re Citigroup*, 2009 WL 2762708, at *11; *In re Avon Products*, 2009 WL 848083, at *10 n.22; *In re Bausch & Lomb*, 2008 WL 5234281, at *5; *In re Duke Energy ERISA Litig.*, 281 F. Supp. 2d at 794 n.5; *Steinman v. Hicks*, 252 F. Supp. 2d 746, 759 (C.D. Ill. 2003), *aff'd*, 352 F.3d 1101 (7th Cir. 2003); *Crowley*, 234 F. Supp. 2d at 230.



Rebutting the *Moench* Presumption

- The facts needed to rebut the presumption include facts giving rise to a reasonable belief that the company's viability is in jeopardy. The failure to allege such facts has often led to dismissal of fiduciary breach claims.
 - *Edgar*, 503 F.3d at 348-49 (claims failed to allege a “dire situation”);
 - *Pugh*, 521 F.3d at 700-02 (claims failed to allege company's financial condition warranted plan fiduciaries to override terms of the plan);
 - *In re Avon Products*, 2009 WL 848083, at *10 (company was not “facing such a ruinous financial situation that maintaining the Plan's interest in its common stock was self-evidently financially destructive to the Plan”);
 - *In re Bausch & Lomb*, 2008 WL 5234281, at *6 (claims did not indicate that company's financial situation was “seriously deteriorating”);
 - *In re Duke Energy*, 281 F. Supp. 2d at 793-94 (presumption not overcome absent evidence of an “impending collapse”).

Rebutting the *Moench* Presumption (Contd.)

- The proffer of proof required to rebut the presumption is evident from the numerous cases dismissing prudence claims even where the stock had experienced a huge decline in price. Large declines in stock, standing alone, are not sufficient to sustain a claim of imprudence.
 - *In re Wachovia Corp.*, 2010 WL 3081359, at *14 n.9 (87% drop);
 - *Kuper*, 66 F.3d at 1447, 1451, 1459 (80% drop);
 - *Crowley*, 234 F. Supp. 2d at 227 (80% drop);
 - *Wright v. Metallurgical Corp.*, 360 F.3d 1090, 1096, 1098 (9th Cir. 2004) (75% drop);
 - *In re Duke Energy*, 281 F. Supp. 2d at 795 (55% drop);
 - *In re Lehman Bros.*, 683 F. Supp. 2d at 217 (45% drop);
 - *In re Citigroup*, 2009 WL 2762708, at *18-19 (52% drop);
 - *Kirschbaum*, 526 F.3d at 256 (40% drop);
 - *Wyeth*, 2010 WL 1028163, at *2 (31% drop).



Application of the Presumption at the Pleading Stage

- The courts have not ruled uniformly, however, as to whether the presumption of prudence can be applied as a basis to dismiss complaints at the pleadings stage.
- In part due to the heightened pleading standards set forth in *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544 (2007) and *Ashcroft v. Iqbal*, 129 S. Ct. 1937 (2009), the recent trend appears to be toward an increased willingness by the courts to apply the presumption on a motion to dismiss.
- Two Circuit Courts and numerous district courts that have addressed the issue have applied the presumption on a motion to dismiss. See *Edgar*, 503 F.3d 340; *Pugh*, 521 F.3d 686; *In re Harley Davidson*, 660 F. Supp. 2d at 966-67; *Benitez*, 2009 WL 3166651, at *5-9; *In re Citigroup*, 2009 WL 2762708, at *15-19; *In re Avon Products, Inc.*, 2009 WL 848083, at *10, adopted by, 2009 WL 884687; *In re Bausch & Lomb*, 2008 WL 5234281, at *5; *Steinman*, 252 F. Supp. 2d at 75; *In re Duke Energy*, 281 F. Supp. 2d at 792-95; *Crowley*, 234 F. Supp. 2d at 231; see also *Wright*, 222 F. Supp. 2d at 1233-34.



The DOL's Position With Respect to the *Moench* Presumption

- In its briefs, the DOL has generally taken the position that:
 - The *Moench* presumption of prudence is contrary to ERISA's statutory language;
 - The *Moench* presumption, if applied, should not be applied at the pleadings stage.
 - The *Moench* presumption, if applied, is rebutted if there are allegations that the plan fiduciaries were aware that the stock was overvalued.



The Disclosure Claim

- When making the disclosure claim, Plaintiffs allege that plan fiduciaries failed to notify plan participants of facts and circumstances suggesting that the company stock price was overvalued due to adverse corporate events that were not being properly communicated to the general public.
- The claims are based on authorities recognizing claims under Section 502(a)(3) of ERISA for breaches of fiduciary duty predicated on misrepresentations or alleged failures to disclose material information concerning plan benefits. *See, e.g., Griggs v. E.I. DuPont de Nemours & Co.*, 237 F.3d 371 (4th Cir. 2001) (permitting participant to seek individualized relief under Section 502(a)(3) for alleged fiduciary violation by administrator in providing misleading information on the taxability of benefits); *Chappel v. Laboratory Corp. of Am.*, 232 F.3d 719, 727 (9th Cir. 2000) (permitting participant to seek individualized relief under Section 502(a)(3) for alleged failure to provide adequate information on the plan's arbitration procedure for claims).



The Disclosure Claim (Contd.)

- In stock drop litigations, courts have dismissed ERISA claims alleging breaches of a fiduciary duty to disclose where the challenged statements consisted merely of securities filings and statements made to the market, because the filings and statements were made in a corporate, not an ERISA fiduciary, capacity. See, e.g., *Edgar*, 503 F.3d at 350-51; *In re Citigroup*, 2009 WL 2762708, at *22-24; *DiFelice v. US Airways, Inc.*, 497 F.3d 410, 418-19 (4th Cir. 2007); *Hull v. Policy Mgmt. Sys. Corp.*, No. 00 Civ. 778, 2001 WL 1836286, at *4, 8 (D.S.C. Feb. 9, 2001); *In re Bausch & Lomb*, 2008 WL 5234281, at *7-8; *Crowley*, 234 F. Supp. 2d at 228; *In re WorldCom*, 263 F. Supp. 2d 745, 760 (S.D.N.Y. 2003); *In re Avon Products*, 2009 WL 848083, at *13-14.



The Disclosure Claim (Contd.)

- Plaintiffs have tried to avoid dismissal on these grounds by asserting a claim based on the incorporation into the SPD of allegedly inaccurate securities filings.
- Recently, several courts have concluded that this does not constitute an ERISA claim either. See *Kirschbaum v. Reliant Energy, Inc.*, 526 F.3d 243, 257 (5th Cir. 2008); *In re Avon Prods.*, 2009 WL 848083, at *13-14; *In re Bausch & Lomb*, 2008 WL 5234281, at *7-9. But see, e.g., *In re WorldCom, Inc. ERISA Litig.*, 263 F. Supp. 2d 745, 766 (S.D.N.Y. 2003); *In re First Am. Corp. ERISA Litig.*, No. 07-1357, 2008 WL 5666637, at *6-7 (CD. Cal. July 14, 2008); *In re Goodyear Tire & Rubber Co. ERISA Litig.*, 438 F. Supp. 2d 783, 795 (N.D. Ohio 2006).



The Disclosure Claim (Contd.)

- Courts dismissing such claims have reasoned that the incorporation of the securities filings is merely the result of the federal securities laws mandating that corporate sponsors of 401(k) plans that offer company securities file a Form S-8 registration statement with the SEC.
- Not all courts, however, have embraced this rationale, and thus some courts have allowed disclosure claims to survive a motion to dismiss where the SPD incorporates allegedly inaccurate securities filings.
- In addition, some courts have recognized that there may be a fiduciary breach claim for failure to make affirmative disclosures to correct participant misimpressions. The *Citigroup* court found that the courts recognizing an affirmative duty to disclose have done so only with respect to information concerning plan benefits, and that there was no corresponding duty with respect to plan investments. See *In re Citigroup ERISA Litig.*, 2009 WL 2762708, at *20-22.



DOL's Position With Respect to the Disclosure Claim

- In its amicus briefs, the DOL has generally taken the position that:
 - Fiduciaries have a duty not to mislead plan participants and to correct misrepresentations by disclosing information necessary to protect retirement benefits.



Directors and Officers as Fiduciaries

- Often in ERISA stock drop complaints, Plaintiffs will name Directors and Officers of the company as Defendants, alleging that:
 - They are liable directly on the prudence and disclosure claims;
 - They are liable for failure to prudently monitor the conduct of other fiduciaries;
 - They are liable as co-fiduciaries;
 - They knowingly participated in breaches of fiduciary duties; and/or,
 - They are liable under other theories of secondary liability.



Directors and Officers as Fiduciaries (Contd.)

- The direct claims require pleadings establishing that the Directors and Officers had fiduciary responsibility for the acts alleged
- The secondary claims against Directors and Officers are unsustainable absent a viable underlying claim for fiduciary breach.
- If there is a viable underlying claim for breach fiduciary duty, it can be argued in the alternative that the Plaintiffs failed to allege the required elements of these claims.
- *See, e.g., Edgar*, 2006 WL 1084087, at *12; *In re Bausch & Lomb*, 2008 WL 5234281, at *11. *See Harris Trust & Sav. Bank v. Salomon Smith Barney Inc.*, 530 U.S. 238,251 (2000)

Directors and Officers as Fiduciaries (Contd.)

- In order for a “duty to monitor” claim to be sustainable, Plaintiffs must allege a sustainable claim that there was an underlying breach of fiduciary duty, or else there is no basis for concluding that the Directors or Officers breached their duty to appoint, monitor and inform. *See, e.g., In re Bausch & Lomb*, 2008 WL 5234281, at *10; *Crowley*, 234 F. Supp. 2d at 229-30 (same); *In re RCN*, 2006 WL 753149, at *6-8 (same); *In re Dynegy Inc. ERISA Litig.*, 309 F. Supp. 2d 861.
- Also, a breach of the duty to monitor requires proof that: (i) the entity charged with the breach was responsible for appointing and removing the fiduciaries responsible for the conduct at issue; *and* (ii) the entity charged with this duty to monitor also had knowledge of or participated in the breaches by the appointees. *See, e.g., In re Bausch & Lomb*, 2008 WL 5234281, at *10.



Directors and Officers as Fiduciaries (Contd.)

- Plaintiffs may claim that each Defendant is liable for the breaches of fiduciary duty of the other Defendants under ERISA § 405 because they “knowingly participated” in the conduct of the other Defendants.
- However, these claims are unsustainable absent a viable underlying claim for fiduciary breach, or if Plaintiffs fail to allege the elements of these claims, including that Defendants knowingly participated in these claims. *See, e.g., Edgar*, 2006 WL 1084087, at *12; *In re Bausch & Lomb*, 2008 WL 5234281, at *11. *See Harris Trust & Sav. Bank v. Salomon Smith Barney Inc.*, 530 U.S. 238,251 (2000).



Recent ERISA Stock Drop Decisions

- Cases dismissing ERISA stock drop claims at the motion to dismiss stage:
 - *In re Wachovia Corp ERISA Litig.*, 2010 WL 3081359 (W.D.N.C. Aug. 6, 2010)
 - *In re Lehman Brothers Securities and ERISA Litig.*, 2010 WL 354937 (S.D.N.Y. Feb. 2010)
 - *Gearren v. The McGraw-Hill Companies, Inc. & Sullivan v. The McGraw-Hill Companies, Inc.*, 2010 WL 532315 (S.D.N.Y. Feb. 10, 2010)
 - *Herrera v. Wyeth*, 2010 WL 1028163 (S.D.N.Y. Mar. 16, 2010)
 - *Wright v. Medtronic, Inc.*, No. 09 Civ. 443 (D. Minn. Mar. 17, 2010)



Recent ERISA Stock Drop Decisions (Contd.)

- Cases dismissing ERISA stock drop claims at the motion to dismiss stage without applying the *Moench* presumption:
 - *Harris v. Amgen, Inc.*, 2010 WL 744123 (C.D. Cal. Mar. 2, 2010)
 - *Kenney v. State Street Corp.*, 2010 WL 938333 (D. Mass. Mar. 15, 2010)
- Cases declining to apply the *Moench* presumption and denying defendants' motions to dismiss:
 - *In re Regions Morgan Keegan ERISA Litig.*, 2010 WL 809950 (W.D. Tenn. Mar. 9, 2010)
 - *Jones v. MEMC Electronic Material, Inc.*, No. 08 Civ. 1991 (E.D. Mo. Mar. 17, 2010)



Recent ERISA Stock Drop Settlements

Company Name	Settlement Amount
JDS Uniphase	\$3 million
Aon Corp.	\$1.8 million
Jones Novastar	\$925k
Guidant Corp.	\$7 million
Monster Worldwide, Inc.	\$4.25 million
Marsh & McLennan Cos.	\$35 million
Conexant Systems Inc.	\$12.5 million
Countrywide Financial Corp.	\$55 million
General Electric Co.	\$40 million
Tyco Intl. Ltd.	\$70.5 million



ERISA Litigation: Defense of ERISA “Stock Drop” Cases

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together

THE 404(c) SAFE
HARBOR DEFENSE



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INTRODUCTION TO SECTION 404(c)

- ERISA section 404(c), 29 U.S.C. 1104(c)
 - Immediately on the heels of section 404(a)'s prudence standard:
In the case of a pension plan which provides for **individual accounts** and permits a participant or beneficiary to **exercise control over the assets in his account**, if a participant or beneficiary exercises control over the assets in his account (**as determined under regulations of the Secretary**)
 - A) such participant or beneficiary shall not be deemed to be a fiduciary by reason of such exercise, and*
 - (B) no person who is otherwise a fiduciary shall be liable under this part for **any loss**, or by reason of any breach, which results from such participant's or beneficiary's exercise of control.*
 - Exhaustive set of companion DOL regulations, 29 C.F.R. § 2550.404c-1, et seq.
 - *Outside of the regulations is somewhat notorious “Preamble” commentary from the Secretary, more on that later.*
 - *Not easily satisfied, some fiduciaries/plan sponsors think not worth the effort.*
WRONG

CAUSATION, CAUSATION, CAUSATION

- Interesting/useful parallel can be found in ERISA section 409(a), 29 U.S.C. § 1109(a), which works with section 502(a)(2), 29 U.S.C. § 1132(a)(2), to determine when fiduciary can be liable “to the plan” for a fiduciary breach.
 - “any person who is a fiduciary with respect to a plan who breaches any of the responsibilities . . . imposed upon fiduciaries . . . shall be personally liable to make good to such plan **any losses** to the plan resulting from each such breach”
- Provisions central to Congress’ effort to afford plan sponsors means to provide retirement income without costs and/or liabilities associated with defined benefit pension plans.
- Goal (at least according to defense counsel) is to impress risks associated with investments on participants.

THRESHOLD INTERPRETIVE QUESTION

- Where the rubber meets the road.
- DOL's aggressive stance based on "preamble" to the regulations.
 - Regulations provide that fiduciaries are relieved of responsibility for losses that are the "direct and necessary result" of a participant's exercise of control. 29 C.F.R. § 2550.404c-1(d)(2)(i).
 - DOL contends that Section 404(c)'s safe harbor protection is unavailable to fiduciaries engaged in the "act of limiting or designating investment options ... [because this activity] is not a direct or necessary result of any participant's direction of such plan." Final Regulation Regarding Participant Directed Individual Account Plans (ERISA Section 404(c) Plans), 57 Fed. Reg. 46,905, 46,924 n.27 (Oct. 13, 1992).
 - In other words, 404(c) cannot insulate threshold investment decisions from fiduciary breach claims because participant typically plays no role in determining investment options on the plan's investment lineup.

AT THE THRESHOLD . . .

- The Courts of Appeals Weigh In:
 - **In Re Unisys Savings Plan**, 74 F.3d 420 (3d Cir. 1996).
 - *Prior to promulgation of 404(c) regulations, CTA3 puts down an indelible marker on the statutory construction question.*
 - *“There is nothing in section 1104(c) which suggests that a breach on the part of a fiduciary bars it from asserting section 1104(c)'s protection. On the contrary, the statute's unqualified instruction that a fiduciary is excused from liability for 'any loss' which 'results from [a] participant's or [a] beneficiary's exercise of control' clearly indicates that a fiduciary may call upon section 1104(c)'s protection where a causal nexus between a participant's or a beneficiary's exercise of control and the claimed loss is demonstrated.”*
 - *Also draws support from ERISA's parallel causation provisions.*
 - *“This requisite causal connection is, in our view, established with proof that a participant's or a beneficiary's control was a cause-in-fact, as well as a substantial contributing factor in bringing about the loss incurred.”*
 - *Absolutely no room for contrary judicial or regulatory interpretation because language 404(c) is “plain.” Brand X.*

AT THE THRESHOLD . . .

- **Langbecker v.EDS**, 476 F.3d 299 (5th Cir. 2007).
 - 23(f) appeal of class certification order raising conflict questions given varied participant instructions.
 - *“Neither ERISA’s remedy provision, § 502(a)(2), nor § 404(c) articulates an exception to the availability of the § 404(c) defense when a plaintiff sues on behalf of a plan.”*
 - *“A plan fiduciary may have violated the duties of selection and monitoring of a plan investment, but § 404(c) recognizes that participants are not helpless victims of every error.”*
 - *“The DOL footnote would render the § 404(c) defense applicable only where plan managers breached no fiduciary duty, and thus only where it is unnecessary.”*
 - *“Section 404(c) contemplates an individual, transactional defense in these situations, which is another way of saying that in participant-directed plans, the plan sponsor cannot be a guarantor of outcomes for participants.”*
 - Participant direction yields conflicts requiring vacating of class certification order.

AT THE THRESHOLD . . .

- **Hecker v. Deere**, 556 F.3d 575 (7th Cir. 2009).
 - 404(c) “lite.” Court looks at lineup and says no possible breach before reaching 404(c). 404(c) just a narrow exposition of causation defenses elsewhere enshrined in ERISA.
 - Citing Unisys and Langbecker, “[e]ven if § 1104(c) does not always shield a fiduciary from an imprudent selection of funds under every circumstance that can be imagined, it does protect a fiduciary that satisfies the criteria of § 1104(c) and includes a sufficient range of options so that the participants have control over the risk of loss.”
 - “Given the numerous investment options, varied in type and fee, neither Deere nor Fidelity (assuming for the sake of argument that it somehow had fiduciary duties in this respect) can be held responsible for those choices.”
 - 404(c) can be raised on 12(b)(6), more on that later.
 - CTA7 on rehearing tells DOL to go back to the drawing board --“it should go without saying that the Secretary is free to propose and enact new regulations.”

AT THE THRESHOLD . . .

- DeFelice v. US Airways, 497 F.3d 410 (4th Cir. 2007).
 - Court of Appeals affirming judgment for defendants in stock drop suit brought after plan sponsor filed for bankruptcy.
 - *Compelling example how poorly employer stock drop suits have fared at trial.*
 - *Again 404(c) lite? Threshold musings on prudence. “U.S. Airways offered twelve diversified, and less risky, alternatives for investment and allowed participants to transfer their investment funds freely between these diversified options, always allowing participants to remove funds from the Company Fund without restriction.”*
 - The slender reed. CTA4, in *dictum*, adopts DOL position.
 - *“Although the Plan comported with section 404(c) of ERISA, which limits the liability of fiduciaries for actions undertaken as a direct result of investment instructions given by participants . . . **this safe harbor provision does not apply to a fiduciary’s decisions to select and maintain certain investment options within a participant-driven 401(k) plan.**”*

TIMING IS EVERYTHING!

- Stock drop litigation, timing is everything.
 - Might need to keep powder dry on the 404(c) defense.
 - Because 404(c) is an affirmative defense, some courts hold premature on motion to dismiss, 12(b)(6).
 - *E.g., In re Regions Morgan, 2010 WL 809950 (W.D. Tenn. Mar. 9, 2010).*
 - Others hold that the prevalence of factual issues make 404(c) ill-suited for resolution on 12(b)(6).
 - *E.g., In re Enron Corp. Securities, Derivative and ERISA Litig., 284 F. Supp. 2d 511 (S.D. Tex. 2003).*
 - Historically, many stock drops complaints specifically tried to plead around the defense – “ERISA SECTION 404(C) NOT APPLICABLE”
 - But district court and CTA7 in Hecker v. Deere specifically held that, if plaintiff tries to avoid 404(c) by raising affirmatively in the complaint, the defense might be fair game on a motion to dismiss.

404(C) ON SUMMARY JUDGMENT

- Recent success on summary judgment.
 - *Lingis v. Motorola*, 649 F. Supp. 2d 861 (N.D. Ill. 2009).
 - *Motorola embroiled in dispute with equipment purchaser who borrowed some \$1.8 billion then defaulted. Stock price falls fifty percent during the class period.*
 - *By end of class period, nine investment options available to participants, including Motorola Stock Fund.*
 - *In response to Motorola’s motion for summary judgment, Plaintiffs argued that Motorola failed to adequately disclose “risk and return” characteristics and, as such, participants could not make informed decisions regarding their retirement savings.*

404(C) ON SUMMARY JUDGMENT

– *Lingis v. Motorola* (cont.)

- *Prospectus statement including general disclaimer on risks of non-diversification sufficient.*
- *Plaintiffs further argued Motorola failed to disclose material non-public information about the loan, precluding application of the safe harbor.*
- *Court limits disclosure requirements to not concealing information.*
- *Some independent directors didn't have a clue.*
- *Cannot conceal material information but “the disclosure duty contemplated by the regulation is equivalent to the disclosure duty more generally.”*

404(C) ON SUMMARY JUDGMENT

– *Lingis v. Motorola* (cont.)

- *No ERISA negligent misrepresentation claims actionable under CTA7 authority.*
- *SEC filings do not constitute fiduciary activity.*
- *Disclosure duty does not extend to information concerning specific plan investments. Also, insider trading issues.*
- *Game, set, match.*

404(C) ON SUMMARY JUDGMENT

- Rogers .v Baxter Int'l, 2010 WL 1780349 (N.D. Ill. May 3, 2010).
 - Company stock price suffers – steep percentage declines as company fails to meet sales and earnings projections.
 - General description of risk characteristics sufficient to discharge duty under regulation requiring a general description of the investment objectives and risk and return characteristics of each alternative.
 - Citing Lingis, plaintiff “has not shown that plan fiduciaries affirmatively conceded facts from plan participants.”
 - Again, concern with possible violations of insider trading prohibitions.
 - Claimed violation of “ten percent rule” given short shrift. “The evidence and relevant regulations indicate that any acquisitions that violated the ten percent rule were caused by the sum of individual participants’ choices in exercise of their control over their individual accounts, not from defendants’ conduct.”

DETAILS, DETAILS, DETAILS . . .

- Strict compliance with all “25” requirements of 404(c)?
 - Regulatory requirements to 404(c) are exhaustive.
 - Generally speaking, and details beyond scope of this presentation, must show:
 - *An Eligible Individual Account Plan*
 - *Broad range of investment alternatives (varying risk/return characteristics) (only need three – Renfro v. Unisys).*
 - *Opportunity to transfer money as between the investment alternatives.*
 - Perhaps don’t need to satisfy every requirement if not central to the dispute.
 - *DOL – Plan will not lose 404(c) protection simply because one investment option fails to comply with regulations. See 57 Fed. Reg. 46906, 46928.*
- Jenkins v. Yager, 444 F.3d 916 (7th Cir. 2006) (“although section 404(c) and its accompanying regulation . . . create a safe harbor for a trustee, we see no evidence that these provisions necessarily are the only possible means by which a trustee can escape liability for participant-directed plans.”).

DETAILS, DETAILS, DETAILS . . .

- Query – fail to prove 404(c) compliance raises specter that the participants are, in fact, subject to counter/cross claims for fiduciary liability?
- An ounce of prevention is worth a pound of cure.
 - The complaint that compliance “too costly” and of uncertain utility no longer holds water!