ERIC Legal / Litigation FocusOn Call

October 1, 2014

Agenda

- Recent benefits litigation on:
  - Employer stock and fiduciary considerations,
  - Deference, and
  - Equitable remedies cases

Employer Stock and Fiduciary Considerations after *Tatum* & *Dudenhoeffer*

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Topics of Today's Discussion

Recap of Fiduciary Basics

Recap of *Dudenhoeffer* and *Tatum*

Takeaways From the Cases

Emerging Best Practices for Plans with Employer Stock and Related Fiduciary Issues

ERISA Roles 101

- ERISA's two hats: the fiduciary role and settlor role
- One hat per head
  - Manage risk by dividing the fiduciary and settlor roles
  - Assign fiduciary duties to committee
  - Delegate settlor powers to officer(s) not on committee

ERISA Fiduciary Litigation 101

- Plaintiff must allege that:
  - Defendant is an ERISA fiduciary
  - Defendant breached its fiduciary duty
  - Defendant's breach "caused loss"

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Fifth Third Bank v. Dudenhoeffer

- Background
  - ESOP component of 401(k) plan
  - Matching contributions initially invested in employer stock, but eligible for immediate reinvestment in other funds
  - Employer stock allegedly overvalued based on public reports about subprime lending and insider information about financials

Fifth Third Bank v. Dudenhoeffer (continued)

- Holdings
  - Neither ERISA policy goals nor settlor directive to invest in employer stock justify presumption of prudence
  - However, securities law standard of plausibility now clearly applies; allows public companies to rely on "efficient market hypothesis" that market price reflects public information
    - possible "special circumstances" exception
  - Fiduciaries also have a defense for failing to act on insider information where such action would violate securities laws

Tatum v. RJR Pension Investment Committee

- Background
  - Nabisco spun off from RJR Nabisco
  - RJ Reynolds 401(k) plan was amended in June 1999 to “freeze” Nabisco stock fund (not ESOP) barring investments/reinvestments in Nabisco stock
  - “Working group” and EVP-HR determined to eliminate Nabisco stock fund
  - Neither committee with settlor/amending powers nor committee with investment responsibility took formal action
  - Nabisco was near all-time low, but with positive analyst reports when stock fund was eliminated
  - EVP-HR did not sell personal equity holdings until months after stock fund was eliminated

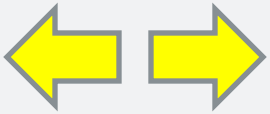
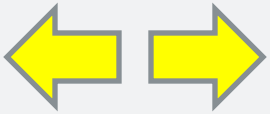
Tatum v. RJR Pension Investment Committee (continued)

- Findings
  - Breach of fiduciary duty--process was not prudent
    - Hurried decision to eliminate while misinformed about law
    - No reasoning for timeline to eliminate stock fund
    - Motivated by administrative/liability concerns, not participant interests
- Holdings
  - If breach proven, fiduciary has burden of proving his/her course of action did not cause participants' losses
  - Fiduciary must prove "reasonable fiduciary" would have taken same actions as he/she took
  - Would = probable

Takeaways from *Dudenhoeffer* and *Tatum*: Implications of the Holdings

- Plan investment generally a fiduciary, not settlor matter
- Prudence, prudence, prudence
- Process, process, process
  - Assignment of fiduciary duties to committee
  - Attention to Fiduciary Committee composition
  - Diligence of Fiduciary Committee in monitoring investments
  - Bonus: Process requirements for independent trustee from DOL/GreatBanc settlement
- Cases come down to evidence of a fiduciary breach; loss causation an exceptionally high burden for fiduciary

Takeaways from *Dudenhoeffer* and *Tatum*: Toolkit to Mitigate Employer Stock Risk

Plan Document Mandate	
Holdings Limit	
Mandatory Reallocation	
Plan Committee	
Independent Trustee	

Takeaways from *Dudenhoeffer* and *Tatum*: How to Win a MTD Now

- Plaintiff failed to allege means for fiduciary to deal in employer stock without violating securities laws
  - Potential silver bullet… depending on the courts

OR

- Plaintiff failed to allege:
  - Fiduciary used insufficient/imprudent process; and
  - Company stock subject to "special circumstances" such that efficient market hypothesis inapplicable; or
  - Fiduciary had non-public information such that efficient market hypothesis inapplicable
- What can we do now to make defense counsel's job easier later on?

Emerging Best Practices: Monitoring Employer Stock Investments

- Exclusion of executives with insider information from fiduciary committee
  - Officers with involvement in financials
  - Officers with business line oversight
  - Officers likely to be unblinded in advance of transactions
- Regularly documented meetings of fiduciary committee
- Special attention to “special circumstances” as that doctrine unfolds

Emerging Best Practices: Structural Changes to Employer Stock Investments

- New Employer Stock Features
  - Subject to a limit
  - Investment advisor input
  - ESOP component
- Removal/Curtailment of Employer Stock Features
  - Gradual transition from freeze to reallocation
  - Diligent monitoring; nothing is ever set in stone
  - Independent trustee

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Deference and Claims Exhaustion

Anthony F. Shelley, Miller & Chevalier

Deference

- General concepts
  - Deference idea arises from trust law
  - *Firestone* case in 1989 engraves deference into ERISA cases
    - Plan documents must give decision-maker discretion to interpret ambiguous terms
  - *MetLife v. Glenn* reinforces *Firestone*, and then prescribes how conflicts of interest shall be taken into account
    - *Post-Glenn*, there is general agreement that "sliding scales" of deference are inapplicable
    - But much dispute regarding the extent of discovery to determine *if* a conflict of interest exists

Recent Developments on Deference

- *Pacific Shores Hosp. v. United Behavioral Health*, No. 12-55210 , 2014 U.S. App. LEXIS 16062 (9th Cir. Aug. 20, 2014)
  - Holds that deference can be lessened due to procedural irregularities
  - Suggests third-party administrator might labor under conflict of interest simply because it has a contract with the employer
  - Rejects "any reasonable basis" test when no conflict of interest is present, in favor of a totality-of-circumstances test
- DOL *amicus* brief strongly supports Ninth Circuit's "clarification" of deference standard and participants' position

Recent Developments on Deference

- *Tibble v. Edison Int'l*, 729 F.3d 1110 (9th Cir. 2013), *pet'n for cert. pending*, No. 13-550 (U.S.)
  - Relevant question presented: "whether *Firestone* deference applies to fiduciary-breach actions under 29 U.S.C. § 1132(a)(2), where the fiduciary allegedly violated the terms of the governing plan document in a manner that favors the financial interests of the plan sponsor at the expense of plan participants"
- Solicitor General recommends denial of cert on this question
  - Favors review of *Tussey instead*
  - SG's view turns on whether fiduciary-breach claim centers simply on violation of plan terms or instead also involves violations of duties of prudence and loyalty

Recent Developments on Deference

- *Tussey v. ABB, Inc.*, 746 F.3d 327 (8th Cir. 2014), *pet'n for cert. pending*, No. 14-130 (U.S.)
  - Involves question of whether deference should be afforded to administrator's position on fiduciary-breach claim (not a benefits claim) that involves some construction of plan terms but also involves allegations of violations of duties of prudence and loyalty
  - SG seems ready to support Tussey's position, and may favor the grant of certiorari
  - Petition likely not considered by the Supreme Court until about December 2014

Recent Developments on Deference

- *Frommert v. Conkright*, 738 F.3d 522 (2d Cir. 2013)
  - Supreme Court had instructed lower courts to afford deference to administrator's second attempt to decide the issues in the case
  - District Court then applied deference, upholding administrator's subsequent decision-making
  - Second Circuit reverses, purportedly applying an abuse-of-discretion standard
- Point is hard to prove, but appears to be a case of an Appeals Court believing it was right the first time and getting to the same result under the guise of a more lenient standard of review
- Dueling *amicus* briefs from DOL and ERIC

Recent Developments on Deference

- *Cottillion v. United Refining Co.*, No. 09-140, 2013 U.S. Dist. LEXIS 49913 (W.D. Pa. Apr. 8, 2013), *appeal pending*, Nos. 13-4633 & 13-4743 (3d Cir.) (oral argument Oct. 1, 2014)
  - Post-*Conkright* issue of how much deference to be afforded to second decision of administrator
  - District Court allows prior, erroneous decision of administrator to skew the deference afforded to a subsequent, correct decision of the administrator

Claims Exhaustion

- Exhaustion of administrative remedies is firmly rooted in ERISA
  - ERISA § 503, 29 U.S.C. § 1133
  - DOL claims regulations, 29 C.F.R. § 2560.503-1
    - Particularly complicated in the health benefits area
  - Exhaustion is key to obtaining deference later
- Main exception: alleged futility
- Concept of "deemed exhaustion"
- Must "issues" be administratively pursued, or only the claim generally?

Recent Developments on Claims Exhaustion

- *Pacific Shores*, supra
  - Also addressed the significant issue of what is the record on review in court after exhaustion has occurred
  - Ninth Circuit took the expansive position that material from outside the administrative record can be offered in court to support a plaintiff's position
    - Ninth Circuit opines that, if there are procedural irregularities, the reviewing court itself can recreate the record that "should" have been created administratively

Equitable Remedies

Scott Macey & Debra Davis

Cigna v. Amara

- Supreme Court - 2011
  - SPDs are not plan documents
    - Cannot be basis for benefit claim litigation
    - But can give rise to equitable remedies claims if inaccurate or incomplete
- Roadmap for full range of equitable remedies
  - Includes equivalent of money damages

Common Post-Amara Cases

- Surcharge
  - Money damages
- Reformation
  - Rewriting of plan to expand coverage or benefits
- Subrogation
  - Sponsor right to recover payments

Key Principles

- Fiduciaries cannot lie or intentionally misrepresent
- Individuals likely to get relief if they are led to believe they are:
  - Covered by the plan; or
  - Entitled to specific benefits

Open Issues

- Mistake or ambiguity in plan communications
- DOL argues fiduciaries should be liable even if no reliance by or harm to participants
  - Approach permits class action lawsuits
- Fiduciaries argue that the individual must have acted upon and was harmed by the communication
  - Approach would inhibit class action lawsuits and recoveries where no specific harm

Recent Cases

- Operational Error
- Equitable Surcharge
- Simultaneous Claims

Operational Error

- DB plan erroneously paid benefits to former employee for long period
- Individual was not entitled to equitable relief
  - Plan cannot be equitably estopped where payment would conflict with plan document
  - Administrative records are not part of the plan
  - No evidence of fraud
- Case is helpful as would allow fiduciaries to continue to correct operational failures

Gabriel v. Alaska Elec. Pension Fund, 2014 BL 158469, 58 EBC 1633 (9th Cir. 2014)

Equitable Surcharge

- Availability of equitable surcharge
  - Fiduciaries misinformed participants about requirements
  - Courts found fiduciary breaches (even where unintentional)
  - Beneficiaries could recover monetary compensation as surcharge
- Fiduciaries required to clearly explain plan requirements to employees

Weaver Bros v. Braunstein, 2014 BL 160149 E.D. Pa., No. 2:11-cv-05407-JHS, 6/10/14; Echague v. Metro. Life Ins., N.D. Cal., No. 3:12-cv-00640-WHO, 8/22/14)

Simultaneous Claims

- Ability to seek both benefits and equitable relief
  - 8th Circuit – Participants can seek both equitable relief and benefits
- District Courts
  - Simultaneous claims are duplicative
  - Claim for equitable relief is unavailable if can assert claim for benefits
- Participants may be required to accurately identify the type of relief sought in some courts, but not others
  - Need to assert either reliance on plan terms or some mistake in administration or communication

Silva v. Metro. Life Ins. Co., 2014 BL 218916, 8th Cir., No. 13-2233, 8/7/14; Gibbs v. Paul Revere Life Ins. Co., N.D. Ill., No. 1:13-cv-08878, 8/8/14; Ensley v. N. Ga. Mountain Crisis Network, N.D. Ga., No. 2:12-cv-00254-RWS, 8/20/14