ERISA LITIGATION UPDATE

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JAMIE FLECKNER: 617-570-1153 OR JFLECKNER@GOODWINPROCTER.COM

ALISON DOUGLASS: 617-570-1676 OR ADOUGLASS@GOODWINPROCTER.COM

STEPHEN BENWAY: 617-570-8182 OR SBENWAY@GOODWINPROCTER.COM

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GOODWIN PROCTER ALERT

SEPTEMBER 26, 2013

In *Pipefitters*, Sixth Circuit Holds Service Provider Is Fiduciary in Assessing Fee

In *Pipefitters Local 636 Insurance Fund v. Blue Cross and Blue Shield of Michigan*, No. 12-2265, 2013 WL 3746217 (July 18, 2013), the U.S. Court of Appeals for the Sixth Circuit held that an entity providing services to a plan acts as an ERISA fiduciary where it exercises discretion to determine and assess a fee paid by the plan to the service provider.

Background

In *Pipefitters*, a self-funded health plan entered into an administrative services contract ("ASC") with Blue Cross and Blue Shield of Michigan ("BCBSM"), under which BCBSM would provide certain services to the plan and the plan would be responsible for paying benefit claims and specified fees. The ASC also provided that "any cost transfer subsidies . . . ordered by [the relevant state insurance commission] will be reflected in the hospital claims cost" payable by the plan.

Under applicable state law, BCBSM was required to pay 1% of its revenues to the state to subsidize the cost of health care to senior citizens in the state receiving "Medigap" coverage (the "Medigap Obligation"), but state law did not prescribe the method by which BCBSM was to satisfy this Medigap Obligation.

During the first 18 months that the ASC was in effect, BCBSM undertook to obtain funds to satisfy the Medigap Obligation by, in effect, charging and retaining 1% of the cost of benefit claims it paid on behalf of the plan, with the amount retained referred to as the "OTG Fee." (For example, on a $100 claim, BCBSM would charge the plan $101, pay the health care provider $100, and retain $1 as an OTG Fee to pay the Medigap Obligation.) After 18 months, BCBSM unilaterally decided to stop charging the OTG Fee.

District and Appeals Court Decisions in *Pipefitters*

The Pipefitters plan sued BCBSM, asserting that BCBSM acted as an ERISA fiduciary in determining and assessing the OTG Fee. The plan argued that, in causing the plan to pay the OTG Fee, BCBSM had breached its fiduciary duties of prudence and loyalty and had engaged in prohibited self-dealing. After the district court granted summary judgment for the plan, BCBSM appealed.

The Sixth Circuit affirmed in a unanimous decision. The court noted that while state law imposed the Medigap Obligation on BCBSM, the method of obtaining funds to pay that obligation was left to the discretion of BCBSM. The court rejected BCBSM's argument that the method BCBSM decided to use – the OTG Fee – was compelled by the terms of the ASC which provided that state-required "cost transfer subsidies" would be reflected in the costs of claims paid by the plan.

The court emphasized that BCBSM had not assessed the OTG Fee against all of its self-funded plan customers, and had unilaterally decided to stop assessing the fee against the Pipefitters plan. Because its discretionary assessment of the fee against the plan benefitted BCBSM (by helping it to fund its Medigap Obligation), the court concluded that BCBSM had breached its fiduciary duties under ERISA.

In *Edmonson*, Third Circuit Affirms Summary Judgment for Insurer in Retained Asset Account Case

In *Edmonson v. Lincoln National Life Insurance Company*, No. 12-1581, 2013 WL 4007553 (Aug. 7, 2013), the U.S. Court of Appeals for the Third Circuit affirmed summary judgment for the defendant insurance company in one of the many cases challenging the use in group insurance benefit plans of retained asset accounts.

Background

The litigation was brought by a beneficiary of a group life insurance plan whose sponsor had purchased group life insurance contracts from the insurer defendant. The insurer paid benefit claims under the group contract through interest-bearing accounts backed by funds that the insurer retained until the account holders wrote checks or drafts against the account. The plaintiff challenged the practice, which she claimed constituted a breach of fiduciary duty and a prohibited transaction under ERISA. The plaintiff purported to sue on behalf of a class of beneficiaries under contracts issued by the insurer defendant who had received their benefits through a retained asset account.

District and Appeals Court Decisions in *Edmonson*

In February 2012, the U.S. District Court for the Eastern District of Pennsylvania entered an order granting judgment to the defendant on the grounds that assets backing the retained asset accounts were not plan assets and the defendant was not acting as an ERISA fiduciary with respect to the plan.

On appeal, the Third Circuit ruled in favor of the defendant, albeit on somewhat different grounds. With respect to the plaintiff's claim that the defendant exercised fiduciary discretion in selecting the method of claims payment, the court held the insurer to be an ERISA fiduciary with respect to plan administration and management because the plan at issue permitted the insurer "some leeway" to decide how claims would be paid, and therefore conferred discretion upon it.

The court also held that the insurer's selection of the method of claims payment involved exercising authority or control over a plan asset – the policy. However, while the court held the insurer to fiduciary standards with respect to its selection of the method of payment, the court nonetheless concluded that the insurer did not breach its fiduciary duty of loyalty when it chose to settle claims via retained asset accounts because such accounts are not inconsistent with the beneficiary's interests and the insurer's potential to profit was "wholly dependent" on the beneficiaries' actions. The court noted that ERISA does not mandate nor preclude any specific mode of payment.

Fiduciary Status and Standing

With respect to the plaintiff's claim concerning the defendant's investment of retained assets, the court held that the defendant was not a fiduciary with respect to that conduct because retained assets are not ERISA plan assets.

In addition to its fiduciary analysis, the court also addressed issues of constitutional and statutory standing, ruling that the plaintiff had both constitutional and statutory standing to assert her claims in light of her allegations that (i) she suffered an alleged injury in fact with respect to any difference between the defendant's investment earnings on retained assets and the crediting rate paid on retained asset accounts; (ii) her alleged injury was traceable to the defendant's decision to settle benefit claims via retained asset accounts; and (iii) ERISA's equitable relief provision afforded her a claim for disgorgement of ill-gotten profits.

One member of the three-judge panel expressed disagreement with these standing rulings in an opinion that dissented from that portion of the majority opinion, but otherwise joined the majority in affirming judgment for the defendant. With respect to whether the plaintiff suffered any actual injury, in affirming judgment for the defendant on the merits, the court concluded

"[p]ayment via the retained asset account, by itself, caused [the plaintiff] no injury," because the plaintiff "could have … withdraw[n]" the funds from the account at any time.

In *Abbott*, Seventh Circuit Refines Applicability of Class Action Device in Defined Contribution Challenge

On August 7, 2013, the U.S. Court of Appeals for the Seventh Circuit took what it called "the next step" in its analysis of when a class may be certified in a case alleging breach of ERISA fiduciary duties with respect to a defined contribution plan, after it first addressed the question in its January 2011 decision, *Spano v. Boeing Co.*, reported in Goodwin Procter's March 30, 2011 ERISA Litigation Update. In *Abbott v. Lockheed Martin Corporation*, No. 12-3736, 2013 WL 4010226, a panel comprised of the same judges who decided the *Spano* case reversed denial of a class that was "more focused" than the one it rejected in *Spano*, and remanded the case to the trial court, allowing a class of 401(k) participants who invested in a single fund available under their plan to proceed to trial.

Background

Abbott is one of many cases challenging the fees associated with 401(k) plan investments. Through a number of previous rulings, the district court had narrowed the case down to three claims: (i) the administrative fees paid by the plan were excessive; (ii) the stable value fund investment option was imprudently managed resulting in underperformance, and (iii) the company stock fund investment option was imprudently managed due to allegedly excessive fees and a high level of cash held in the fund. The trial court had once before certified a class, though the decision had been remanded by the Seventh Circuit in 2011 based on *Spano v. Boeing*. After *Spano*, the trial court again ruled on class certification, with one of the classes it declined to certify receiving interlocutory review by the Seventh Circuit.

The Trial Court Decision as to the Challenged Class

After remand, the trial court certified two classes, one with respect to the administrative fee claim and a second with respect to the stock fund. However, it declined to certify a third class of participants who invested in the stable value fund during a six-year period when the fund underperformed relative to a specified index. The court below had held that, in attempting to navigate the Seventh Circuit's earlier *Spano* decision, the plaintiffs created a fatal issue – asking the court to use the class certification mechanism to "backdoor" the contested question of underperformance with their chosen benchmark. Because the trial court had not ruled substantively on whether such alleged underperformance constituted any breach of duty, it declined to certify the stable value class.

In its decision, the Seventh Circuit addressed only the stable value proposed class.

The Seventh Circuit Finds That Certification Was Appropriate

Preliminary to its discussion of class certification, the Seventh Circuit rejected the defendants' challenge to the constitutional standing of the sole named plaintiff who was invested in the stable value fund – and whose account outperformed the index he selected – holding that there could be harm aside from underperformance with the index.

Turning to the class issues, the appellate court held that simply allowing a class definition that makes reference to underperformance of a fund to an index is not tantamount to accepting that the index is the proper measure of harm or breach. The court observed that the class definition is simply a "tool of case management" and does not, as defendants contended, "sneak into the case a theory of liability that was rejected at summary judgment."

The court went on to explain why certification of the single, stable value fund class was consistent with *Spano*. It explained that the class in *Spano* was not limited to a single fund and, indeed, it was not apparent from the complaint in *Spano* which fund(s) were challenged "or why." The Seventh Circuit explained that *Spano* stood for the proposition that a combination of a broad class and vague claims would inevitably create "intra-class conflict of the sort that defeats both typicality and adequacy-of-representation requirements" of the Federal Rules of Civil Procedure 23(a). It found, by contrast, that the class in *Abbott* was "considerably narrower than those at issue in *Spano*" and that the nature of stable value funds were such that there was little risk that some investors would reap a windfall by mismanagement such that a conflict would exist for a class comprised solely of investors in a stable value fund.

Postscript on *Spano*

On September 19, 2013, six weeks after *Abbott* was decided by the Seventh Circuit, the district court in *Spano* granted in part the plaintiffs' amended motion for class certification, and certified a class and four sub-classes. The class was comprised, again, of all plan participants, but was limited to a six-year period and specified that all participants paid recordkeeping fees. One subclass was comprised of participants in all mutual funds during that period under the theory that every fund was "laden with imprudently excessive fees," and the three remaining sub-classes corresponded to individual fund choices for

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In *PBGC*, Second Circuit Affirms Dismissal of Prudence Claims Despite Allegations of Investment Losses

In *PBGC. v. Morgan Stanley Investment Management, Inc.*, No. 10-4497-cv (April 2, 2013), the Second Circuit held that a complaint's allegations of "a decline in a security's market price does not, by itself, give rise to a reasonable inference that the holding of the security was or is imprudent." The court concluded that an ERISA complaint asserting imprudence regarding plan investments in securities must plausibly allege that the process utilized by the relevant fiduciary in deciding to acquire and hold the securities was imprudent.

District Court Decision in *PBGC*

As described in our analysis of the district court opinion, in *PBGC* a plan sponsor claimed that the manager of the plan's fixed-income portfolio had imprudently caused the plan to invest excessively in securities backed by subprime mortgages. When the value of those securities dropped following the subprime real estate crash in 2007 and 2008, the portfolio allegedly lost $25 million. (The Pension Benefit Guaranty Corporation ("PBGC") was substituted as appellant after the plan was terminated and assumed by the PBGC.) The district court dismissed the plan sponsor's complaint, reasoning that under ERISA a fiduciary's "actions are not to be judged from the vantage point of hindsight."

The Test for Prudence

In affirming that dismissal, the Second Circuit emphasized that the test for prudence focuses on process rather than simply investment results. The court of appeals noted that, because the complaint contained no allegations directly relating to the manager's "knowledge, methods, or investigations" regarding the challenged investments, it could survive a motion to dismiss under FRCP 12(b)(6) only if it alleged facts and circumstances that gave rise to a reasonable inference that an adequate investigation would have revealed to a reasonable fiduciary that the investment at issue was improvident.

According to the court, this standard could be satisfied by allegations showing that the relevant investments were "so plainly risky" that appropriate investigation would have revealed their imprudence, or that an adequate review would have uncovered a "readily apparent" superior alternative investment.

The Second Circuit ruled that the complaint in *PBGC* failed to meet this standard. The court noted that PBGC pointed to certain "warning signs" regarding the relevant securities alleged in the complaint – e.g., that some issuers of the securities disclosed large losses in 2007 and 2008. The complaint, however, "fail[ed] to connect the alleged 'warning signs' to any specific characteristics of the securities in the [plan's fixed-income] portfolio."

In *Leimkuehler*, Seventh Circuit Affirms Judgment for Insurer in Challenge to Use of Separate Accounts in 401(k) Platform

In *Leimkuehler v. Am. United Life Ins. Co.*, Nos. 12-1081, 12-1213, & 12-2536 (Apr. 16, 2013), the Seventh Circuit affirmed dismissal, on summary judgment, of all claims against an insurer concerning the investment options offered to a retirement plan on a platform structured through separate accounts within group annuity contracts sold to the plan's trustees.

Background

The trustee of a 401(k) plan sued the insurer providing investment and recordkeeping services to the plan through a group variable annuity contract. Suit was brought on behalf of the plan and a purported class of all other plans that purchased the insurer's variable group annuity product. The trustee claimed that the insurer breached its alleged ERISA fiduciary duty and committed a prohibited transaction by establishing and operating the platform and receiving revenue sharing payments from mutual funds (or affiliates of the funds) held in separate accounts and made available to the insurer's customers through its group variable annuity contracts under the platform.

District Court Decision in *Leimkuehler*

The U.S. District Court for the District of Indiana granted the insurer summary judgment on the claims, holding that the insurer was not acting as a fiduciary under ERISA in establishing and operating the platform through which it received revenue sharing. The Seventh Circuit affirmed the judgment of the district court and held that an insurer was not acting as an ERISA fiduciary in structuring the platform and could therefore not be liable for breach of ERISA fiduciary duty or prohibited transactions in receiving the revenue sharing payments.

ERISA Fiduciary Status

The Seventh Circuit confirmed that the creation of a menu of funds as part of a product offering to retirement plan trustees does not give rise to ERISA fiduciary status. It also expressly held that ERISA's fiduciary status analysis is not altered merely because the insurer established and maintained separate accounts to hold specified mutual funds.

While an insurer may be an ERISA fiduciary as to the actual operation of such separate accounts, the court held that it can only be liable if it "mismanaged the separate account—say, by losing track of participants' contributions or withdrawing funds in the separate account to pay for a company-wide vacation to Las Vegas."

The court also expressly rejected arguments made in an amicus curiae brief submitted by the Department of Labor, and held that an insurer's contractual ability to substitute funds did not give rise to fiduciary status with respect to all of the investments that the insurer includes on its product platform.

In *McCutchen*, Supreme Court Vacates and Remands Case Concerning Enforcement of Plan Reimbursement Provision

In *U.S. Airways, Inc. v. McCutchen*, No. 11-1285 (Apr. 16, 2013), the U.S. Supreme Court vacated judgment and remanded the case in a matter seeking to enforce a reimbursement provision in a health benefit plan.

Background

The case involved a self-funded group health plan. The plan provided coverage for medical expenses that were not covered by a third party. Under the plan, if benefits were paid on a claim resulting from the actions of a third party, the participant would be required to reimburse the plan for amounts paid for claims out of any monies recovered from any third party (including an insurer).

McCutchen was injured in a car accident caused by another driver. The plan paid $66,866 in healthcare benefits in connection with McCutchen's injuries. McCutchen pursued claims against his automobile insurer and the other driver and ultimately

recovered $110,000 by way of settlement. After attorney's fees, McCutchen recovered $66,000. The employer demanded reimbursement of 100% of the benefits paid under the plan. When McCutchen refused, the employer brought suit under ERISA § 502(a)(3), seeking equitable relief in the form of a lien on the $66,866 it demanded.

District and Appeals Court Decisions in *McCutchen*

The U.S. District Court for the Western District of Pennsylvania found for the employer on the ground that the plan "clear[ly] and unambiguous[ly]" provided for full reimbursement of medical expenses paid, and ordered McCutchen to pay the employer $66,866.

On appeal, the Third Circuit vacated. Reasoning that traditional "equitable doctrines and defenses" applied to § 502(a)(3) suits, the Third Circuit held that the principle of unjust enrichment overrode the plan's reimbursement provision because it would be a windfall for the employer to recover its entire lien amount without paying a share of attorney's fees. The appeals court stated that Congress's use of the term "appropriate equitable relief" in the statute was intended to allow defenses typically available in equity, such as unjust enrichment.

Equitable Defense vs. ERISA Plan Reimbursement

The Supreme Court granted certiorari to resolve a circuit split on whether equitable defenses can override an ERISA plan's reimbursement provision. The Court vacated the Third Circuit's decision, ruling that a participant who receives medical payments for an injury pursuant to an ERISA health benefit plan may not avoid the reimbursement requirements of that plan by arguing that such reimbursement is "inequitable."

In so ruling, the Court pointed to its decision in *Sereboff v. Mid Atlantic Medical Services, Inc.*, 547 U.S. 356 (2006), in which the Court permitted a health plan administrator to bring suit under § 502(a)(3) to enforce a reimbursement clause. The Court held that, under *Sereboff*, the equitable doctrine of unjust enrichment could not override the terms of the plan, which afforded the employer an "equitable lien by agreement" on amounts recovered by the participant from a third party.

The Court stated that enforcing such a lien means holding the parties to their mutual promises and declining to apply equitable principles that are at odds with the parties' expressed commitments. Rejecting McCutchen's argument that § 502(a)(3) authorizes broad equitable relief, the Court held that the statute does not "authorize 'appropriate equitable relief' *at large*," but provides only such relief as will enforce "the terms of the plan" or the statute.

Nonetheless, while the Court held that equitable principles could not trump the plan's reimbursement provision, it also concluded that – where the plan was silent on the allocation of attorney's fees – equitable principles could inform how attorney's fees expended by McCutchen should be allocated among the parties. Accordingly, the Court remanded the case for further proceedings on the attorney's fee issue.

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MARCH 28, 2013

Ninth Circuit Addresses Numerous ERISA Issues in Affirming District Court's Rulings in *Tibble* Case

In *Tibble v. Edison International*, Nos. 10-56406, 10-56415, 2013 WL 1174167, No. 11-56628, 2013 WL 1150788 (9th Cir. Mar. 21, 2013), participants in a 401(k) plan brought a class action against the employer sponsoring the plan (and various individuals and entities affiliated with the employer), asserting that the selection of investment options made available to them under the plan violated ERISA fiduciary requirements. As we previously reported in the September 2010 ERISA Litigation update, available here, the U.S. District Court for the Central District of California had dismissed most of the participants' claims, but (after a bench trial) held that the defendants had breached their duty of prudence under ERISA by including within the plan's investment menu the retail class shares, rather than the institutional class shares, of three specific mutual funds, absent any evidence that the defendants considered the alternative share classes or that the plan benefitted from the retail share classes. In reviewing the district court's rulings, the U.S. Court of Appeals for the Ninth Circuit addressed a number of ERISA issues that frequently arise in litigation challenging the selection of investment options for participant-directed investment plans.

The Court of Appeals affirmed the district court's holding that claims challenging the inclusion of investment options first selected for the plan's menu more than six years before the filing of the complaint were barred by ERISA's statute of limitations – which, in pertinent part, provides that ERISA fiduciary breach claims may not be brought "more than six years after the last action that constituted part of the breach." ERISA § 413(1)(A). The court rejected the "continuing violation theory" advanced by the plaintiffs and the Department of Labor as amicus curiae ("DOL"), under which the claims would be timely so long as the investment options in question remained available under the plan during the six year limitations period. The court concluded that such a result "would make hash out of ERISA's limitation period and lead to an unworkable result."

The defendants did not fare as well in seeking dismissal, on statute of limitations grounds, of claims challenging the inclusion of certain options utilizing mutual fund retail class shares that were added to the plan's menu less than six years, but more than three years, before commencement of the action. The defendants argued that these claims were barred by the ERISA statute of limitations provision that precludes claims brought more than "three years after the earliest date on which the plaintiff had actual knowledge of the breach." ERISA § 413(2). According to the panel of the Ninth Circuit, the "breach" with regard to the claims involving the retail shares was not based simply on their inclusion in the plan's investment menu, but focused rather on the defendants' failure to investigate alternatives to offering retail shares as an option. Because the evidence did not establish that the plaintiffs had – more than three years before the filing of the complaint – "actual knowledge" of the defendants' process of selecting the retail shares as an option, and their failure to investigate alternatives, the three-year statute did not bar those claims.

The defendants also argued that the participants' claims challenging the selection of investment options were proscribed by ERISA § 404(c), which provides a safe harbor from fiduciary liability in cases where participants exercise investment control over their defined contribution plan accounts, and certain conditions are satisfied. The Ninth Circuit noted, however, that under the relevant DOL regulation the Section 404(c) safe harbor protects fiduciaries from liability only from losses that are the "direct and necessary result" of the participants' exercise of control, *see* 29 C.F.R. § 2550.404c-1(d)(2), and that the DOL had specifically stated in the regulation's preamble that a fiduciary's selection of investment options is not a direct or necessary result of a participant's investment direction. The Court of Appeals concluded that the position of the DOL stated in the preamble (and reiterated by the DOL consistently since the adoption of the regulation) was an interpretation of Section 404(c) that is entitled to "Chevron deference," *see Chevron, U.S.A., Inc. v. Natural Resources Defense Council*, 467 U.S. 837

(1984). Because the court found the statutory language of Section 404(c) ambiguous, and the DOL's position to be reasonable, it held that the safe harbor from fiduciary liability did not cover the defendants' selection of the retail class shares as an option for the plan's investment menu.

The plaintiffs prevailed on the merits of their retail class share claims relating to three specific mutual funds. The Ninth Circuit affirmed the district court's holding that the defendants had breached their duty of prudence under ERISA § 404(a)(1) when, without sufficient investigation, they selected for the plan's investment menu retail class shares of funds that also offered institutional class shares, even though there were no meaningful differences in the investment quality or management of the fund when purchasing the institutional shares rather than the retail shares, and the fees and expenses associated with the retail shares were 24 to 40 basis points more expensive than those of the institutional shares. The court rejected the defendants' argument that they reasonably relied on their investment consultant in selecting the retail shares, because there was "an utter lack of evidence that [the defendants] considered the possibility of institutional classes for the [relevant] funds" and the defendants presented no evidence that their consultant had specifically recommended investment in retail shares. The court below, and the appellate court, did not address in this context the benefits to the plan of use of revenue sharing through these funds to reduce or eliminate other plan expenses.

The participants failed, however, in their general challenge to the use of revenue sharing payments made by the plan's investment options to compensate the plan's recordkeeper. They argued that this practice violated a plan provision stating that "[t]he cost of the administration of the Plan will be paid by [the sponsoring employer]." They also asserted that the defendants violated ERISA's anti-kickback provision – Section 406(b)(3) – by selecting investment options that paid revenue sharing which reduced the employer's obligation to pay the plan's administrative expenses. The court noted, however, that the plan's benefits committee had discretion under the plan to construe its terms, and that the committee had interpreted the relevant plan language as obligating the employer to pay plan administrative costs "net of any adjustments" such as revenue sharing. The court found this interpretation of plan language entitled to deference under *Firestone Tire & Rubber Co. v. Bruch*, 489 U.S. 101 (1989) and its progeny, and therefore held that the use of revenue sharing to compensate the recordkeeper (and to reduce the employer's costs) violated neither the plan document nor ERISA § 406(b)(3).

The Ninth Circuit also affirmed the district court's dismissal of the participants' remaining claims, including: claims that the defendants violated their duty of prudence by including mutual funds (rather than only collective funds or single plan separate accounts) in the plan's investment menu; claims that the mutual funds made available under the plan charged excessive fees; a claim that the selection of a short-term investment fund ("STIF"), rather than a stable value fund, was imprudent; and a prudence challenge to the plan's use of a "unitized" employer stock fund (rather than direct investment in employer stock). Significantly, the Court of Appeals also upheld the district court's decision not to award attorneys' fees or costs to either party.

Fourth Circuit Affirms Dismissal of Claims and Summary Judgment in Case Challenging Financial Services Company's Use of Proprietary Products in Its Retirement Plans

In *David v. Alphin*, 704 F.3d 327 (4th Cir. 2013), participants in a defined contribution plan and a defined benefit plan sponsored by a bank brought putative class claims under ERISA alleging breaches of fiduciary duty and prohibited transactions in connection with the selection of bank-affiliated mutual funds for the plans. Specifically, the plaintiffs alleged that the defendants breached their fiduciary duties of prudence and loyalty by selecting and failing to remove bank-affiliated funds from the plans despite poor performance and higher fees than other viable options. They further alleged that the defendants caused the plans to enter into transactions with the funds that were subject to conflicts of interest.

The U.S. District Court for the Western District of North Carolina dismissed all claims related to the defined benefit plan for lack of standing under Article III of the U.S. Constitution. After the completion of discovery, the district court granted summary judgment to the defendants as to all remaining counts on statute of limitations grounds.

The Fourth Circuit affirmed both rulings. With respect to claims concerning the defined benefit plan, the Fourth Circuit found that, under the plan, the plaintiffs were entitled to receive only a fixed level of retirement benefits. As a result, any risk to the plan's investments resulting from the defendants' investment selection had no effect on the participants' benefit rights, particularly where the plan was over-funded. Accordingly, the court held that the plaintiffs could not demonstrate actual harm sufficient to show an injury-in-fact as required for constitutional standing under Article III. The court rejected arguments advanced by the Department of Labor in an amicus brief in support of the plaintiffs, including the argument that the plaintiffs had representational standing to sue with respect to injuries to the plan even if they themselves had suffered no harm.

With respect to claims concerning the defined contribution plan, the Fourth Circuit held that the district court correctly concluded that the plaintiffs' claims were time-barred under ERISA's statute of limitations—which, in relevant part, bars actions commenced more than six years after the date of "the last action which constituted a part of the breach." Specifically, the court concluded that the alleged prohibited transactions and breaches of duty could be based only on the initial selection of the challenged funds for the plan. Where there was no dispute of fact that such initial selection occurred more than six years prior to the filing of the complaint, ERISA's six-year limitation period barred the claims. In this regard, the court rejected the plaintiffs' argument that the challenged conduct was not the initial selection of the funds, but the ongoing failure to remove the funds. The court held that the initial inclusion of bank-affiliated funds on the plan's investment lineup "triggered the limitations clock."

The Fourth Circuit also affirmed the district court's decision to dismiss the complaint with prejudice on the ground that the plaintiffs had not moved to amend the complaint and had already filed four complaints in the matter. The plaintiffs' petition for rehearing and/or rehearing *en banc* was subsequently denied.

Second Circuit Vacates Dismissal of Stock Drop Claim As to Plan That Neither Required Nor Encouraged Holding of Employer Stock

In two companion decisions, the Second Circuit Court of Appeals affirmed in part, and vacated and remanded in part, a decision by the United States District Court for the Southern District of New York dismissing all claims as to the inclusion in two 401(k)-style plans that allowed participants to invest in the stock of the sponsoring employer. *Taveras v. UBS AG,* 708 F.3d 436, No. 12-1662, 2013 WL 692720 (2d Cir. Feb. 27, 2013).

In *Taveras*, four former employees of a financial services company sued their former employer and related individuals and entities regarding investments in the employer's stock made by two company-sponsored retirement savings plans. The plaintiffs alleged that the stock investments were imprudent due, in part, to the sponsoring employer being on the "brink of collapse" as a result of alleged sub-prime exposure in 2007 and 2008. The plaintiffs purported to sue on behalf of a class of other participants and former participants of the two plans during a period when the price of the stock fell 74% between April 26, 2007 and October 16, 2008. The district court dismissed all claims, holding, among other things, that the plans' fiduciaries were entitled to a presumption of prudence under *Moench v. Robertson*, 62 F.3d 553 (3d Cir. 1995), and that the complaint did not sufficiently plead the "dire circumstances" necessary to meet that standard. The Second Circuit Court of Appeals affirmed dismissal of the claim of breach of the duty of prudence as to one plan, the 401(k) Plus Plan ("Plus Plan"), but vacated and remanded as to the other, the Savings and Investment Plan (the "SIP").

As to the Plus Plan, the appellate court held that the presumption of prudence applied given that the plan document stated that one purpose of that plan was to provide employees the opportunity "to acquire" the company's stock, and elsewhere stated that one of the initial investment options for the Plus Plan "shall be" a fund consisting of the employer's stock — even though the plan also allowed the fiduciary committee to change options. Having found that the presumption of prudence applied given that plan language, the court in its companion order held that the presumption was not defeated by the pleaded allegations. The court acknowledged that it had not "defined precisely the contours of what constitutes a 'dire' situation sufficient to defeat the presumption of prudence," but it made clear that a "showing that the company made bad business decisions is insufficient to show that it was in a 'dire situation'" (internal quotations omitted). The court did say that any dire circumstances must be those that would have been "objectively unforeseeable" by the employer when it established the plan. It held that the pleadings at issue here did not meet that standard.

The Second Circuit, however, vacated dismissal of the prudence claim relating to the SIP and remanded for further proceedings. The SIP only mentioned the existence of an employer stock fund, and neither mandated such a fund nor strongly encouraged it. Under those circumstances, the court held that no presumption of prudence applies to the holding of employer stock because the policy underlying the *Moench* presumption, and the Second Circuit's earlier *Citigroup* decision (reported previously in the December 14, 2011 ERISA Litigation Update at the link available here), did not apply given that there was no need to balance a tension between a fiduciary's duty of prudence and an obligation under plan documents (encouraged by ERISA) to offer investment in employer stock.

As to both plans, the appellate court affirmed dismissal of other claims. The court held that statements in SEC filings (relating to corporate prospects effecting the company stock value) by the defendants were not actionable under ERISA because they were not made in an ERISA fiduciary capacity. Similarly, the court followed the settled principle that an "alleged ERISA fiduciary's mere officer or director status, taken alone, is insufficient to state a claim for conflict of interest" that would violate ERISA.

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DECEMBER 13, 2012

District Court Refuses to Dismiss Challenge to Financial Services Company's Use of Proprietary Product for Its Own Retirement Plan

On November 20, 2012, the U.S. District Court for the District of Minnesota denied a motion to dismiss ERISA claims in a case challenging the use by a financial services company of affiliated investment products as options for its 401(k) plans. The case is Krueger v. Ameriprise Financial, Inc., No. 11-cv-02781, 2012 WL 5873825 (D. Minn. Nov. 20, 2012).

Krueger involves the 401(k) plan sponsored by a financial services company. The plan makes available as investment options proprietary mutual funds and collective trusts, along with a company stock fund and a brokerage window. Until last year, the brokerage window was managed by the sponsor. And until a 2007 sale, the plan's record-keeper was also an affiliate of the sponsor. The case was brought by seven current and former participants of the plan. Plaintiffs raised seven counts under ERISA, alleging breaches of fiduciary duty, prohibited transactions, co-fiduciary liability, and knowing participation in other's alleged breaches of duty. Plaintiffs asserted one claim alleging unjust enrichment under supposed federal common law.

Plaintiffs alleged that the investments managed by the sponsor or its affiliates were selected as options for the plan because they generated profits to the sponsor and its affiliates. Plaintiffs alleged that, as to some of those investment options, the sponsor used the plan's investments to "seed new and untested mutual funds," which had the alleged effect of making those funds more marketable outside of the plan. Among other things, the complaint also: (i) alleged the improper use of two tiers of fees in the proprietary target date funds made available on the menu, when supposedly comparable funds charged one tier of fees; (ii) challenged purported limitations on the funds available on the affiliated brokerage window — limitations which they allege were imposed because of "kickbacks" paid to the sponsor or its affiliates; and (iii) asserted that various fees charged in connection with the brokerage window and trust and recordkeeping services were improper.

The court followed the holdings in other "excessive fee" cases in its district — the Eighth Circuit Court of Appeals decision in *Braden v. Wal-Mart*, 588 F.3d 585 (8th Cir. 2009), and an earlier decision by the U.S. District Court for the District of Minnesota (*Gipson v. Wells Fargo*, 2009 WL 702004 (D. Minn. Mar. 13, 2009)) — to deny defendants' motion to dismiss. The court held that, like in those cases, plaintiffs' allegations plausibly alleged that the defendants selected affiliated funds "to benefit themselves at the expense of participants" and that the selection process was "flawed," each of which it found sufficient to support a claim of breach of ERISA fiduciary duty. The court also held that the fact that defendants included a range of investment options under the plan — which included investments managed by unaffiliated entities — did not shield defendants from liability. It further found that defendants could be liable for allegedly excessive record-keeping fees and for profits derived from the sale of its record-keeping and trust business if, as plaintiffs alleged, defendants used the plan's relationship to "prop up" the trust and record-keeping business for sale.

The *Krueger* court further held that (i) the plaintiffs' allegations sufficiently stated a claim for prohibited transactions given the affiliation between the plan sponsor and the fund managers; and (ii) exceptions to the prohibited transaction rules did not apply on a motion addressed to the pleadings as a procedural matter because such exceptions are of the nature of an affirmative defense. Largely on the basis of its rulings as to fiduciary breach and prohibited transactions, the court also allowed claims of failure to monitor and co-fiduciary liability to proceed. The only claim the court dismissed was a claim for common law unjust enrichment, which the court found to be preempted by ERISA.

Summary Judgment Decided in Suit Challenging Insurer's Use of Retained Asset Account to Settle Group Life Insurance Benefits

The U.S. District Court for the District of Massachusetts entered an order on cross summary judgment motions in one of the many cases challenging the use in group insurance benefit plans of retained asset accounts, denying the beneficiary's motion and granting, in part, the insurer's motion in Vander Luitgaren v. Sun Life Assurance Company of Canada, No. 09-11410, 2012 WL 5875526 (D. Mass. Nov. 19, 2012).

The litigation was brought by a beneficiary of a group life insurance plan whose sponsor had purchased group life insurance contracts from the insurer defendant. The insurer paid benefit claims under the group contract through interest-bearing accounts backed by funds that the insurer retained until the account holders wrote checks or drafts against the account. The plaintiff challenged the practice, which he claimed constituted a breach of fiduciary duty and a prohibited transaction under ERISA. The plaintiff purported to sue on behalf of a class of beneficiaries under contracts issued by the insurer defendant who had received their benefits through a retained asset account.

In 2011, the insurer's motion to dismiss the complaint was denied because, among other reasons, the court found that the plaintiff had adequately alleged that the insurer was an ERISA fiduciary with respect to retained assets.

In its recent order, the court granted summary judgment to the insurer on the plaintiff's prohibited transaction claim under ERISA § 406. The court found that nothing in the insurance contract suggested an ongoing property interest by the plan or participants in the insurer's assets that back retained asset accounts. Accordingly, the assets were not ERISA-governed plan assets. In this regard, the court distinguished the First Circuit's decision in *Mogel v. Unum*, 547 F.3d 23 (1st Cir. 2008), in which the appeals court held that sums due retained asset accountholders remained plan assets subject to ERISA fiduciary duties until "actual payment." The *Vander Luitgaren* court stated that *Mogel* should not be interpreted to hold that assets held in an insurer's general account – which are not plan assets – are "transformed into plan assets" once a defendant establishes a retained asset account. In rejecting the plaintiffs' fiduciary self-dealing claim, the court held that, unlike in *Mogel*, where the insurance contract required payment by lump sum, the contract at issue in *Vander Luitgaren* did not. The insurer therefore discharged any fiduciary obligations that it had with respect to the management and disposition of plan assets when it set up the account.

With respect to the plaintiff's claim for breach of fiduciary duties under ERISA § 404, the court denied the insurer's motion for summary judgment. The court followed the First Circuit's holding in *Mogel* that disposition of benefits to beneficiaries falls squarely within the insurer's fiduciary responsibilities with respect to plan administration, holding that the insurer was acting as a fiduciary with respect to plan administration when it paid the plaintiff's benefits claims. In particular, the court concluded that the insurer exercised discretionary fiduciary authority (i) in selecting to pay benefits via retained asset accounts; and (ii) in determining the crediting rates.

The court declined to decide the issue of whether the insurer breached its duty, noting that discovery was required to determine if the insurer was acting to optimize its own earnings when it established the retained asset accounts, and to determine if the interest rate that the insurer paid was competitive.

Third Circuit Holds Nonfiduciary Who Is Not a "Party in Interest" May Be Liable For Participation in Fiduciary's Violation of ERISA Section 406(b)(3)

In *National Security Systems, Inc. v. Iola*, No. 10-4154, 2012 WL 5440113 (3d Cir. Nov. 8, 2012), the U.S. Court of Appeals for the Third Circuit held that a nonfiduciary who knowingly participates in a fiduciary's breach of ERISA's anti-kickback provision,

Section 406(b)(3), may be subject to appropriate equitable relief under ERISA Section 502(a)(3), even though that nonfiduciary is not a "party in interest" under the statute's prohibited transaction rules.

The relevant facts of *National Security Systems* are as follows. Ronn Redfearn created a tax avoidance scheme (known as "EPIC") under which employers would establish ERISA-covered welfare plans and would make tax deductible contributions to a trust maintained for the plans. The trust in turn would pay premiums under life insurance policies selected by a company established by Redfearn to administer EPIC (the "Administrative Company"). The insurance policies would fund tax-free, annuity-like payments for the employer's owners after their retirement. The insurance company that issued the policies would pay commissions to the Administrative Company.

James Barrett, a financial planner, induced a number of his clients to become participating employers in EPIC, and Barrett became the contact person for their communications with, and contributions to, EPIC. The Administrative Company compensated Barrett for his services with payments from the commissions it received from the insurance company. After a number of years, the Internal Revenue Service audited the employers and determined that EPIC's structure did not satisfy applicable requirements under the Internal Revenue Code. The IRS disallowed the deductions the employers had taken for contributions to EPIC and assessed penalties against the employers. The employers then brought suit in federal district court in New Jersey against a number of entities and persons associated with EPIC, including Barrett, asserting violations of various laws, including ERISA.

As part of a decision resolving numerous claims and defenses (under ERISA and other laws), the district court ruled that Barrett had not acted as an ERISA fiduciary in connection with the plaintiff employers' participation in EPIC, but could be held liable for appropriate equitable relief as a nonfiduciary who had knowingly participated in the Administrative Company's violation of ERISA Section 406(b)(3), which prohibits a fiduciary from receiving consideration from a third party dealing with a plan in connection with a transaction involving plan assets. The district court concluded that the Administrative Company breached Section 406(b)(3) when it acted as a fiduciary in selecting the insurance policies in which contributions would be invested and received commissions from the insurance company issuing those policies. The court ruled that Barrett knowingly participated in this breach and ordered him to disgorge to the plaintiffs one half of the payments he had received from the Administrative Company. The court ordered this remedy under ERISA Section 502(a)(3), which authorizes appropriate equitable relief to remedy violations of the statute.

On appeal, Barrett argued that, under the leading case on nonfiduciary liability -- *Harris Trust and Savings Bank v. Salomon Smith Barney, Inc.*, 530 U.S. 238 (2000) -- only nonfiduciaries who are "parties in interest" under ERISA's prohibited transaction rules may be subject to liability for knowingly participating in a fiduciary's breach. Barrett noted that just last year, in *Renfro v. Unisys Corp.*, 671 F.3d 314 (3d Cir. 2011), the Third Circuit had indicated that *Harris Trust* had "authorized suits for nonfiduciary participation by parties in interest to transactions prohibited under ERISA." *Id*. at 325 n.6. He asserted that, because he was not a party in interest, he could not be subject to knowing participation liability under Section 502(a)(3).

The Third Circuit panel in *National Security Systems* rejected this argument and affirmed this aspect of the district court's decision. It reviewed the underlying analysis of the Supreme Court in *Harris Trust*, and concluded that, while the defendant in *Harris Trust* happened to be a party in interest, that fact was not critical to the Supreme Court's holding that nonfiduciary liability was authorized by Section 502(a)(3). The Third Circuit noted that the Supreme Court had emphasized that, in authorizing appropriate equitable relief to remedy violations of ERISA, the text of Section 502(a)(3) does not limit the persons who can be subject to liability. The panel in *National Security Systems* determined that the suggestion to the contrary by a different Third Circuit panel in *Renfro* was dicta — and, in any event, it was not bound to follow its own precedent that was inconsistent with the Supreme Court's reasoning in *Harris Trust*.