

## How to Avoid ERISA Litigation: Best Practices and Timely Tips

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# Introduction

- Bad things can happen to well intentioned ERISA plan fiduciaries, because the pace of class action ERISA Litigation is accelerating.
- What are ERISA fiduciary duties?
- What should an ERISA plan fiduciary do to comply with those ERISA fiduciary duties (to avoid those "bad things")?
- What protections are available for an ERISA plan fiduciary in the event of a fiduciary breach?
- How does this work in practice?
- Take aways.

# ERISA Litigation: The Beat Goes On

- 401(k) Plan employer stock fund class actions. Various theories alleging the employer stock fund is an imprudent Plan investment.
  - Violates duty of prudence.
  - Violates duty of loyalty.
  - Failure to provide material (often inside) information about company.
  - Conflict of interest as to why fiduciaries retain employer stock fund.
- 401(k) Plan fee class actions.
  - Fees paid by Plan participants for the fund are too high compared to bench-marks.
  - For financial entities, funds are proprietary.
  - The fund's performance is too low compared to bench-marks.
  - Emphasis on passively managed funds as the preferred alternatives.

# 401(k) Plan Stock Drop Class Actions

- Prior lead case: *Moench v. Robertson*, 62 F.3d 553, 571 (3rd Cir. 1995).
  - Fiduciaries presumed to act prudently when they offer employees the option to invest in employer stock unless company's viability as a going concern is in doubt or other "dire circumstances" are present.
- Current controlling Supreme Court case law: *Fifth Third Bancorp v. Dudenhoeffer*, 134 S. Ct. 2459 (2014).
- *Dudenhoeffer* explains burden on fiduciaries where the allegations involve publicly known information and material, non-public information.



# 401(k) Plan Stock Drop Class Actions

- Since *Dudenhoeffer* was decided in June 2014, approximately 30 employer stock drop class actions have been filed.
  - Some have been dismissed.
  - Many have been settled.
- Legal spend for defense of 401(k) Plan stock drop class actions – anywhere from \$1 million to \$5 million, depending on discovery.
  - Plus fees for expert witnesses and actuaries/economists.
- Settlements – in the past are as high as \$100 million.
- *Dudenhoeffer* opinion has brought down settlement amounts, but there are still many 8 figure settlements; *i.e.*, \$10 million - \$99 million.

# Fee Litigation – Sample Claims

- Plan's investment funds offered imprudent investment options.
- Fees charged were higher than fees of comparable funds.
- Failure to take into account revenue-sharing fees paid by mutual fund managers to record keepers and other vendors.
- Offering proprietary funds as investment options.
  - Allegation – Prohibited Transaction because such proprietary funds are offered because it is in the interest of the financial entity, not the participants.
- Offering retail share class mutual funds instead of institutional share class funds.
- Offering more actively managed funds instead of index funds.

# Proprietary Fee Cases

## Charles Schwab

## Wells Fargo & Co.

Allianz	BB&T
Prudential	Deutsche Bank Americas
M&T Bank	Morgan Stanley
American Century Services	New York Life
Neuberger Berman Group	Edward D. Jones & Company
JP Morgan Chase & Company	Franklin Resources

# Fee Cases Against Major Universities

Columbia University	Vanderbilt
NYU	Emory
Cornell	Yale
MIT	Johns Hopkins
Duke	Northwestern
U.S.C.	University of Pennsylvania
Excessive administrative fees	Excessive management fees/performance losses



# Fee Cases: Settlements

- Defendants' Attorney's Fees for these cases – anywhere from \$1 million to \$5 million. Some cases are more expensive.
- Settlements range from:
  - \$140 million – *Haddock v. Nationwide* (D. Conn. 2015)
  - \$62 million – *Abbott v. Lockheed Martin* (S.D. Ill. 2015)
  - \$57 million – *Spano v. Boeing* (S.D. Ill. 2016)
  - \$22.5 million – *In Re Regions Morgan Keegan* (W.D. Tenn. 2009)
- Cases are expensive to defend and expensive to resolve.

# Overview of ERISA Fiduciary Duties

- ERISA defines a fiduciary as any party who exercises any discretionary authority or control over the management of a plan, management or disposition of plan assets or administration of the plan
  - Includes a party that renders investment advice for a fee or other compensation, direct or indirect, with respect to plan money or property
- Fiduciary status is based on, and extends to, functions performed for the plan
  - Functional test - a party can be a fiduciary regardless of title
- ERISA plan can have multiple fiduciaries, but at a minimum there must be at least one "named fiduciary" that administers the plan
  - Some plans have two named fiduciaries: administrative committee and investment committee

# Overview of ERISA Fiduciary Duties

- Generally, the plan sponsor will be the ERISA named fiduciary if there is no committee
  - This means members of the plan sponsor's board of directors are ERISA fiduciaries
  - Having a committee serve as the ERISA fiduciary rather than the plan sponsor insulates the board from ERISA fiduciary liability and makes it easier to maintain settlor versus fiduciary distinction
- Settlor vs. Fiduciary
  - Fiduciary is one who has or exercises discretionary authority, control or responsibility over the management, investment or administration of a plan
  - Settlor (non-fiduciary) functions are typically considered "business functions or decisions," such as when establishing a plan, deciding who is covered, determining what benefits are to be provided, and amending or terminating a plan

# Overview of ERISA Fiduciary Duties

- Exclusive Purpose Rule
  - Fiduciary must discharge its duties for the exclusive purpose of providing benefits to participants and beneficiaries and defraying reasonable expenses of administering the plan
  - Fiduciaries wear "two hats" (i.e., as plan fiduciary and as company officer/employee) and can only wear one hat at a time
  - Fiduciaries must be sensitive to and acknowledge this potential conflict
  - Fiduciaries must be sensitive to and aware of whether they are acting as a fiduciary – if acting as a fiduciary, they must act in the interest of participants, even if contrary to the interests of the plan sponsor or employer

# Overview of ERISA Fiduciary Duties

- Prudence Rule
  - Fiduciary must discharge its duties with the care, skill, prudence and diligence that a prudent man would use under similar circumstances
  - ERISA prudence is largely procedural
  - Were the right questions asked?
  - Was expert assistance sought?
  - Was the fiduciary diligent?
  - Fiduciary need not be "right" but it must be diligent



# Overview of ERISA Fiduciary Duties

- Diversification Rule
  - Fiduciary must diversify plan investments to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so
  - Diversification is essential for ERISA Section 404(c) protection for the plan
  - Exception for employer stock under ERISA Section 407
  - Investment policy statement can assist with compliance
- Plan Document Rule
  - Fiduciary must follow the terms of the plan (and trust) to the extent they are consistent with ERISA
  - If the plan (or trust) terms are not consistent with ERISA, fiduciary must disregard the terms of the plan (or trust) to the extent necessary to comply with ERISA

# Fiduciary Breach

- Whether and to what extent a fiduciary is liable under ERISA will depend on:
  - The fiduciary's conduct under the circumstances
  - Whether such conduct satisfied the ERISA fiduciary standards of conduct
  - What loss or other harm has occurred as a result of any breach of those fiduciary duties

# Fiduciary Breach

- Breach of direct fiduciary responsibilities
- Breach of co-fiduciary responsibilities (indirect liability)
- Liability for non-fiduciary acts
- Fiduciary liability might arise when:
  - Fiduciary is not aware of its duties
  - Fiduciary does not carry out its duties
  - Fiduciary does not obtain needed expert advice
  - Fails to monitor the actions of other parties that are providing services to the plan and to ensure that fees and expenses paid with plan assets are reasonable

# Fiduciary Breach

- Plans may *not* contain exculpatory provisions that relieve fiduciary from fiduciary responsibility or liability
- Plan sponsor's by-laws generally indemnify officers and employees serving at the direction of the company to the extent authorized under law of state of incorporation
  - Includes liabilities related to ERISA excise taxes/penalties or amounts paid in settlement
- May purchase insurance or provide indemnification for losses

# ERISA Procedural Compliance

## Procedural Compliance – It's All About the Process!

- ERISA is not clear about the manner in which to meet these goals
- Committee must be active in a manner to meets the ERISA fiduciary duties
  - Committee Charter
  - Investment Policy Statement
  - Regular meetings
  - Understanding fees charged to plan and participants and watching for potential conflicts of interest
  - Documentation (minutes) of Committee due diligence and decisions



# Practical Process Considerations

- Who is capable of serving on fiduciary committees?
  - Did you elect the janitor or someone with knowledge of Company processes?
  - Are they aware they could (will) be sued individually?
    - Comes as a shock, particularly if you have non-US ownership.
  - Does the person have access to inside company information?
    - Stock drop lawsuits are even more expensive if a Committee member was actually aware that a divestment, drawdown or other corporate action is imminent.
    - How much "investment advice" are these folks giving to employees?
- Do you want to name an attorney to the Committee?
  - With all these rules, it would seem to be a good idea, but the Attorney Client privilege is likely moot if you take that route.

# Train Train Train

- Do not presume that committee members are experts – whether at the beginning, middle or end.
  - They might *think* they're experts, especially as they get more experience, but be cautious. Ask them, are they so expert that they would like to testify in a lawsuit?
- Establish ongoing fiduciary training for committee members.
  - Keep records of the training
  - Take a roll call.
  - Should the training be conducted under privilege?

# Moench Presumption legacy

- Lawsuits abound if you have company stock in your 401(k), but it is popular with employees (and execs).
  - But, this just about automatically creates a tension between duties of prudence, loyalty and diversification.
    - Even though diversification duty is exempt where company stock is concerned, where there's smoke, plaintiff's attorneys start opening up the marshmallow packages.
    - This tension is the main reason Moench gave way to Dudenhoeffer.
- Even so, the *Moench* process can set you free.
  - Step One: Hardwire the fact of company stock into the plan documents.
    - Pro: It's a Settlor act to have that investment. Con: Did you really think that would inoculate you from oversight of the stock's performance?
  - Step Two: Appoint an Independent Fiduciary to constantly review whether having that stock is a good idea.
    - Pro: Takes the decision out of the hands of company representatives, who might be "in the know". Con: Reduce control over investment options, particularly if a company exec is emotionally invested in his/her own stock.
  - *Dudenhoeffer* bottom line: If good process is followed, *Dudenhoeffer* can be better than *Moench* since can't show a reasonable person would act any differently.

# Take Aways

- To limit potential fiduciary liability, a fiduciary should:
  - Be informed by asking questions and seeking the advise of experts when needed
  - Be familiar with applicable governing plan documents
  - Be familiar with ERISA's fiduciary duties and requirements, which includes periodic fiduciary training
  - Stay apprised of and monitor co-fiduciary and service provider actions
  - Be clear in minutes regarding due diligence surrounding the selection and monitoring of investment funds and decisions regarding fees
  - Follow the Charter
- Remember it is all about process
- Questions?