Berkshire Hathaway Specialty Insurance

Fiduciary Liability Ledger

Recent Court Rulings Breathe Life Into Stock Drop and Excessive Fee Claims

By Brian Ortelere and Rhonda Prussack

One of the most worrisome aspects of ERISA litigation is that each judicial ruling brings new challenges and uncertainty. Recent Supreme Court and Federal Circuit decisions have only added to the confusion, and created new and uncertain risks for plan sponsors and fiduciaries.

Employer Stock - Supreme Court Rejects The Presumption Of Prudence

A key source of both clarity and confusion is the Supreme Court's recent opinion in *Fifth Third Bancorp v. Dudenhoeffer*, 134 S.Ct. 2459 (2014), which rejected the "presumption of prudence" argument that for years was used to successfully defend cases challenging 401(k) plans' investment in employer stock. Prior to the Court's ruling, most Circuits had held that such investments were presumed prudent unless the stock had suffered a precipitous drop and the employer was careening towards bankruptcy. The Supreme Court found that ERISA contained no such presumption and held that employer stock was to be scrutinized like any other plan investment.

Hardwiring Rejected, Too

The opinion next rejected the argument that if the plan required the offering of employer stock (aka "hardwiring"), then the fiduciaries had no responsibility to prudently assess and monitor such investments. Simply stated, the Court found that "trust documents cannot excuse trustees from their duties."

Reliance On The Market Okay, Except In "Special Circumstances"

The Court sharply limited the duty to determine the reasonableness of employer stock investments on the basis of publicly-available information, based upon the notion that, where the security is traded in an efficient market, it is likely that the stock price already incorporates all relevant information, so efforts to outguess or predict the market are likely useless. The Court made an exception however, when there are "special circumstances." Unfortunately, they gave no guidance on what those terms mean. That aspect of the Court's ruling will no doubt bedevil the lower courts for years to come.

Handling of Inside Information

The Supreme Court next wrestled with a problem unique to the investment in employer securities - that fiduciaries often are privy to inside information, raising the specter that federal securities violations might occur if the fiduciaries were to trade on such information to advantage the participants, perhaps at the expense of the larger market. Since fiduciaries cannot be expected to violate the law in discharge of their duties, the Court held that prior to taking actions such as refusing new investments in employer stock or disclosing inside information and then trading on it, fiduciaries must first assess whether such steps might "do more harm than good to the fund by causing a drop in the stock price."

The Supreme Court offered some relief for defendants in these cases in the form of a higher plausibility standard at the pleading stage. Nonetheless, the lower courts are now applying Dudenhoeffer, and the results present new challenges, and ensure litigation for years to come. First up, the Fifth Circuit in *Whitley v. B.P., P.L.C.*, No. 12-20670 (5th Cir. July 15, 2014), simply dropped back and punted, confronted with a district court's dismissal of stock drop claims and armed with the then newly-minted Supreme Court ruling. Rather than try to give guidance to the lower court on the governing standards, the Court of Appeals, in but a couple of sentences, just told the lower court to try again.

Woulda, Coulda, Shoulda

The Fourth Circuit's recent opinion in *Tatum v. RJR Pension Investment Committee*, 2014 WL 3805677 (4th Cir. Aug. 4, 2014), deserves mention. It is another employer stock case; however, here the plan's fiduciaries divested a plan of employer stock with little or no related study or process, and then the stock price subsequently rose, arguably to the detriment of participants. Perhaps expecting clairvoyance, the court ruled that upon a finding of breach, the burden of proof rests with the defendants to show that a prudent fiduciary, employing a prudent process, "would have" reached the same conclusion. The Fourth Circuit rejected arguments that the standard should only require a showing that a prudent fiduciary "could have" made the same decision, in favor of the much more stringent standard.

Commented the dissenting judge in this case, "As for those who might contemplate future service as plan fiduciaries, all I can say is: Good luck."

Excessive Fees – Supreme Court To Decide Whether Statute of Limitations Applies

The Ninth Circuit in *Tibble v. Edison*, 2013 WL 3947717 (9th Cir. Aug. 1, 2013), decided, among other things, that certain claims challenging investment options in a 401(k) plan were time-barred under ERISA's six year statute of limitations. The court held that, assuming no changed circumstances in the interim, the clock starts running on a claim challenging an investment at the time the decision to make the investment is made (and the subsequent failure to revisit an investment's prudence, perhaps at subsequent investment committee meetings, does not give rise to a new claim and a new accrual period). On October 2, 2014, the Supreme Court granted review of the limitations aspect of the Circuit Court's ruling. If the Ninth Circuit's ruling is overturned, it will have enormous consequences for fiduciary breach litigation, as the time bar argument was raised successfully in many so-called excessive fee cases.

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