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Fiduciary Liability Ledger

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Last year was quite a ride for plan sponsors and fiduciaries – with a continued ratcheting up of excessive fee and proprietary fund cases filed and the specter of the return of ERISA stock drop claims, tempered by some good outcomes in these cases.

Our guest authors are Nancy Ross, Richard Nowak, and Samuel Block, of the law firm Mayer Brown LLP, who in this article explore noteworthy developments in the area of stock drop and proprietary fund and fee litigation, and highlight certain trends, including a recent Second Circuit decision that plaintiffs' attorneys are hoping will breathe new life into stock drop litigation in 2019.

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Is Stock Drop Litigation Coming Back?

In recent years, companies have frequently fended off stock drop cases through motions to dismiss. In a typical stock drop lawsuit, plan participants will allege that they lost money by investing in their employer's stock because the plan's fiduciaries failed to take appropriate actions based on material information that they had about the stock's value. Participants often allege that the fiduciaries should have disclosed the alleged material information, frozen the plan's investment in the company's stock, or even forced the divestment of company stock to avoid losses to the plan.

In 2014, the Supreme Court in *Fifth Third Bancorp v. Dudenhoeffer* dismantled the long-standing legal principle that retirement plan investments in the employer's stock are presumptively prudent. The Court, however, held that the mere allegation that plan fiduciaries should have recognized from publicly available information that the market was overvaluing or undervaluing the company's stock was not actionable in the absence of "special circumstances." The Court also held that, to plead a plausible fiduciary breach claim relating to insider information, participants have to allege (i) an alternative action that the fiduciaries could have taken that would have been consistent with the securities laws and (ii) that a prudent fiduciary in the same circumstances could not have concluded that the alternative action would do "more harm than good" to the company's stock price. In 2016, the Supreme Court reaffirmed the "special circumstances" requirement in *Amgen Inc. v. Harris* and further clarified that it was insufficient for participants to merely allege that a proposed alternative action would not cause "undue harm."

Following *Dudenhoeffer* and *Amgen*, lower court decisions suggest that the following fact patterns might qualify as special circumstances: (1) there is evidence that illicit forces (such as fraud, improper accounting, illegal conduct, etc.) were influencing the market; (2) the market was not efficient and therefore the market price of the security in that market was not necessarily indicative of its underlying, fundamental value; and (3) the public market price did not reflect the true value of the shares. However, plausible factual allegations sufficient to establish these fact patterns have proven elusive.

For stock drop cases involving insider information, the law remains unsettled with respect to what a participant must allege to plausibly state a claim for failure to disclose. Since *Dudenhoeffer* and *Amgen*, some lower courts have applied a "*could have*" standard, which means that the disclosure claim should be dismissed if *any* prudent fiduciary "could have" concluded that disclosure would do more harm than good to the stock price. Other courts have applied a more stringent "*would have*" standard, which means that the disclosure claim should be dismissed if an average prudent fiduciary in the same circumstances "*would have*" determined that the disclosure would be more likely to harm the stock price than help it.

Although many recent stock drop decisions have been favorable to employers, plaintiffs' attorneys are hopeful that the Second Circuit's December 2018 decision in *Jander v. IBM* will be a turning point in the post-*Dudenhoeffer* stock drop litigation era. In *Jander*, the participants alleged that the defendant fiduciaries knew or should have known about non-public issues with IBM's microelectronic business and issued a corrective disclosure. Reversing the lower court's dismissal of the complaint, the Second Circuit held that the participants plausibly alleged that the corrective disclosure, which could have been included in IBM's quarterly SEC filings, could not have done more harm than good. The Court found it "particularly important" that the participants had alleged that the disclosure was inevitable because this changed the analysis from a disclosure vs. non-disclosure review to an early vs. late disclosure review. Applying this framework, the Court found that the participants had plausibly alleged that IBM's market price would inevitably drop and that the fiduciaries' failure to disclose was more harmful because it would cause lasting reputational damage. In so holding, the Court also noted that it did not need to determine the appropriate review standard (could have vs. would have) because the participants' allegations satisfied either standard.

Future plaintiffs are likely to rely on Jander in opposing a motion to dismiss their own stock drop allegations. While it remains to be seen whether other courts will follow the Second Circuit's lead, it appears that plaintiffs' attorneys believe the tide is turning given the recent uptick in stock drop litigation.

Proprietary Fund Litigation

Proprietary fund cases involve allegations that the company's retirement plan improperly included "proprietary" in-house investment products that were more expensive and performed worse than other comparable investments. While it is not necessarily a breach of the duty of loyalty for a company to offer only its proprietary investment funds, proprietary fund cases routinely include allegations of self-dealing. For this reason alone, courts have often been hesitant to dismiss proprietary fund cases on a motion to dismiss.

Faced with the common practice of financial institutions including proprietary investment products in their retirement plans, courts have struggled with the inherent tension of evaluating common marketplace conduct, which suggests no fiduciary breach, with simultaneous allegations of self-dealing, which suggest a fiduciary breach.

As a result, different courts have come to different conclusions with respect to similar proprietary fund allegations. For example, in *Lechner v. Mutual of Omaha Insurance Co.*, the district court denied a motion to dismiss allegations that the defendants had breached their fiduciary duties by offering in-house investment products. The court noted that "[t]he burden of proof is always on the party to the self-dealing transaction to justify its fairness" and that the facts alleged were sufficient to state a plausible claim.

By contrast, the district court in *Dorman v. Schwab* dismissed allegations that the defendants had breached their fiduciary duties by offering overpriced proprietary investment funds. The court emphasized that the defendants had offered a "roughly equal mix of affiliated and unaffiliated funds" in the retirement plan and that the mere allegation that the investment lineup included an affiliated fund when an alleged better, cheaper alternative was available is insufficient to state a claim. As the court explained, to allow claims to proceed on such a basis "would mean that almost every plan administrator who offered an affiliated fund would be subject to an ERISA suit. Standing alone, offering and retaining funds that have underperformed modestly and have somewhat higher fees is not enough to show malfeasance."

Summary judgment has also presented mixed results for defendants in proprietary fund cases. For example, in *Cryer v. Franklin Resources Inc.*, the district court denied the defendants' motion for summary judgment, finding there was triable issue as to whether the retirement plan participants were receiving as favorable a rebate as third parties who were investing in the same proprietary funds. In so holding, the court relied on a First Circuit decision (*Brotherston v. Putnam Investments*) in which the Court of Appeals held that an analogous rebate structure raised a fact issue as to whether Putnam's 401(k) participants were being treated differently—and less favorably—than other investors.

Although *Cryer* reflects the difficulty that companies may have in obtaining an early dismissal of proprietary fund allegations, a recent post-trial decision suggests that companies should remain hopeful if their case proceeds to trial. Earlier this year, the district court in *Wildman v. American Century Services* dismissed the participants' proprietary fund allegations following an eleven-day bench trial. The court emphasized that, to prevail on their claims at trial, the participants needed to prove that the defendant fiduciaries put their own "interests over those of the Plan participants"—which they failed to do. The court thus demanded more than the superficial appearance of impropriety—which is often sufficient for participants to avoid dismissal at the pleadings or summary judgment stage.

Ultimately, whether proprietary fund allegations will survive a motion to dismiss or motion for summary judgment may come down to the jurisdiction where the case was filed and the assigned judge (particularly since the denial of a motion to dismiss generally cannot be appealed).

Non-Proprietary Fund Excessive Fee Cases

While non-proprietary excessive fee cases typically lack the self-dealing allegations that are prevalent in proprietary fund cases, the fiduciary duty of prudence analysis is similar. For this reason, a significant number of large (and not so large) companies offering 401(k) plans, and universities and hospital groups offering 403(b) plans, have faced excessive fee litigation in recent years.

As with proprietary fund cases, similar allegations in non-proprietary excessive fee cases have led to dramatically different results. In January 2019, the district court in *Bell v. Anthem, Inc.* denied summary judgment because there was a genuine issue of material fact as to whether Anthem paid excessive recordkeeping fees to Vanguard by offering higher cost retail share classes instead of lower cost institutional class shares. Specifically, the court emphasized that there was a factual dispute "as to whether Defendants discussed or even understood the difference between certain types of fee arrangements, whether they periodically checked to see if the Plan could pay lower administrative fees, and whether Defendants acted prudently regarding the fees paid by the Plan."

Within weeks of the court's decision, the parties announced that they had agreed to a settlement, which is currently pending court approval.

In stark contrast to *Bell*, the Ninth Circuit in *White v. Chevron* affirmed the dismissal of nearly identical allegations that Chevron had breached its fiduciary duty of prudence by offering retail share classes instead of institutional share classes. The Ninth Circuit emphasized that the participants' allegations were insufficient because they "showed only that Chevron could have chosen different vehicles for investment that performed better during the relevant period, or sought lower fees for administration of the fund." And "[n]one of the [participants'] allegations made it more plausible than not that any breach of a fiduciary duty had occurred."

Finally, the district court in *Wilcox v. Georgetown University* continued a recent trend of courts dismissing excessive fee allegations against prominent universities. In finding that the participants had failed to state a claim, the court emphasized that ERISA lacks a cause of action for "underperforming funds" and that plan fiduciaries are not obligated to select the best performing fund–which would be akin to a duty of perfection–but must simply "discharge their duties with care, skill, prudence, and diligence under the circumstances then prevailing." Other district courts have dismissed similar allegations against the University of Pennsylvania, Northwestern University, and Washington University in St. Louis. Those cases are currently up on appeal before the Third, Seventh, and Eighth Circuits.

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He previously worked for the City of Chicago in the Mayor's Office Fellowship Program. During law school, Sam served on Harvard Law School's Board of Student Advisers and was a finalist for the 2015 Ames Moot Court Competition.

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