ERISA Litigation

Structural Impediments to Breach of Fiduciary Duty Claims

Recently, listening in on an excellent Webinar on current topics in ERISA liability, I was struck by a particular disjunction between the views of two of the panelists, the first a well-regarded expert on financial issues and risk management in the plan context, and the second a well-known ERISA compliance lawyer. The latter represented that the odds that a fiduciary of a plan will be sued are slim, but that moreover, plan sponsors and plan fiduciaries are likely to prevail at an early stage in any such litigation, such as at the motion to dismiss stage. This came not long before the former of the two speakers noted the fundamental problems inherent in the investment selections and risk management of many plans, and the potential fiduciary exposure represented by those problems. One would think that both statements could not be simultaneously true—that if there are significant problems in many plans, it should not be the case that lawsuits against fiduciaries often peter out, frequently at the motion to dismiss stage.

By Stephen D. Rosenberg

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As I thought about it, however, I became more convinced that, in fact, both statements could be, and based purely on anecdotal evidence are, simultaneously true. Although ERISA litigation has boomed in recent years, particularly with the downturn in the market, a close eye on outcomes does not suggest that the win/loss ratio for participants in breach of fiduciary duty cases is improving markedly, and that it instead remains relatively low ["Year End Reflections for ERISA Plan Sponsors and Fiduciaries: Highlights from 2010 and Thoughts on What's in Store for 2011," Proskauer ERISA Litigation Newsletter (January 2011) (surveying selected results), available at http://www.proskauer.com/files/News/beaea310-fcb8-4c30-acaf-04bb5ade5d52/Presentation/NewsAttachment/92164c45-80e0-41ed-9995-0f9c1384c50a/erisa-litigation-newsletter-january-2011.pdf]. Nonetheless, both the commentary of financial experts and independent fiduciaries, as well as the fact patterns of various cases, clearly supports the conclusion that there are significant problems—to varying degrees—in the investment selections and operational decisions of numerous plans. This latter point should not be surprising or particularly controversial from a commonsense perspective. There are too many plans, operating in an environment of great difficulty when it comes to returns (both on sponsor investments in defined benefit plans and on participant investments in defined contribution plans) and in a legal, financial, regulatory and statutory environment of great complexity for this not to be the case. Say what you will about various aspects of the Supreme Court's recent ruling in CIGNA Corp. v. Amara, the case, if nothing else, certainly reflects the sheer difficulty of trying to make the often unwieldy beasts that are large plans work properly and without error ["CIGNA Cash Balance Conversion Case: Justice Trumps Law 6-to-2—But Who Got It Right?," Lurie, June 29, 2011, at http://benefitslink.com/articles/guests/2011_06_27_lurie.html].

The United States Court of Appeals for the Seventh Circuit's recent decision in George v. Kraft Foods Global, Inc., provides another perfect example of this phenomenon. What seemed to be a reasonable decision to use a unitized stock fund rather than allowing participants to trade in individual shares of the company's stock was found to be a possible fiduciary breach, because the fiduciaries may not have fully addressed the possible effect on participants of the investment drag and transactional drag inherent in that plan structure. This is a remarkably technical and complicated issue, and yet a majority of the Seventh Circuit believed the fiduciaries should have accounted for it. There are more complicated financial issues that end up before courts, but within the realm of most commercial litigation, this is a particularly tricky issue, one that may be apparent in hindsight in a courtroom, with expert testimony, far more readily than it is in foresight when setting up a plan. I suspect this is what the dissent in *Kraft Foods* was referring to when it called this potential breach of fiduciary duty "nitpicking."

Now a brief caveat is in order. This is not to say, and I do not mean to suggest, that problems and fiduciary breaches are pervasive. As I have written in other forums, there are many, many plans out there, and you don't have to spend too much time working with plan sponsors, their staffs, and their advisors to know that the people responsible for many of them are diligently grinding away so as to put in place the best possible plans for their participants ["Talking About Fees," Boston ERISA and Insurance Litigation Blog, July 18, 2011, at http://www.bostonerisalaw.com/archives/401k-plans-talking-about-fees.html]. At the same time, though, we know that there are at least some plans out there with significant problems in them. We know this from the court rulings that cross our desks, and, if we are honest with ourselves—whether we are lawyers to plans, lawyers for participants, or advisors to plans—we know this because we regularly see the variation in plan operation and performance that is out there (with the notable exception of my own clients, of course, whose plans are all perfect).

And yet experience suggests to me that there is no perfect correlation, or even close to perfect correlation, between the ratio of well-run plans to problem plans and the batting average of participants and their lawyers in breach of fiduciary duty suits brought against plans and fiduciaries. Interestingly, unlike in many areas of the law, we cannot attribute this to jury bias or the vagaries of the jury system, since, of course, there are no juries in such cases. Even if there were juries in such cases, we could not attribute the disjunct to the jury system anyway, because very few breach of fiduciary duty cases are ever tried, and the relatively high level of failure for such suits takes place predominately at a much earlier stage of the process, either at the motion to dismiss stage or at the summary judgment stage. So what accounts for that disjunct? I have mused on this question since the Webinar mentioned above, and I have come to think that it stems from several factors, which, in conjunction, create a structural barrier to the successful prosecution of such claims.

We should begin with one particular point in this regard, which is the simple possibility that the defendants may be right more often than not. This may explain some of the results running in favor of plan fiduciaries, but it cannot explain the existence of what appears to be a discrepancy between the limited extent to which participants succeed in such cases and the somewhat larger extent to which problems appear to exist in plans. Unless one assumes, which this article does not, the existence of perfect correlation between the percentage of plans with problems and the percentage of breach of fiduciary duty cases won by plan participants, there must be other factors at play that tilt the playing field in favor of defendants in breach of fiduciary duty cases and result in fiduciaries being exonerated more frequently than one would expect when considering solely the extent to which ERISA-governed plans are beset by operational or other problems.

At heart, the roots of the conundrum lie in the intersection of three specific aspects of breach of fiduciary duty litigation that create, in totality, a structural barrier to the successful prosecution of such cases. Two of these—informational advantages on the part of defendants and a strange warp in the case law concerning the level of care required of fiduciaries—are essentially unique to these types of cases. However, they interact with a third element that is not unique to ERISA litigation, namely, current civil procedure doctrines, in ways that seem to peculiarly affect breach of fiduciary duty suits under ERISA. I use the word peculiar here in its nonpejorative form, to mean distinct from others; these issues intersect to create this dynamic specifically in the context of breach of fiduciary duty litigation under ERISA in a way they do not in most other areas of litigation.

Asymmetry of information can be a problem in many areas of commercial litigation, but not so profoundly as it is in breach of fiduciary duty litigation under ERISA involving defined benefit or defined contribution plans. Take for instance, by comparison, another area of commercial litigation I have done some work in, which is patent litigation [Rosenberg, Stephen, "Patent Litigation Doesn't

Have to Be Prohibitively Expensive," *New England In-House Magazine* (November 2007); "Controlling Costs in Patent Infringement Litigation," Boston ERISA and Insurance Litigation Blog, December 11, 2007, at http://www.bostonerisalaw.com/archives/patent-infringement-controlling-costs-in-patent-infringement-litigation.html]. The elements of a patent are publicly available, as are, to varying degrees, the elements of publicly sold and allegedly infringing products to which the patent's terms must be compared for purposes of prosecuting a patent infringement claim. In contrast, plan participants begin a case knowing very little about the decision-making of the fiduciaries with regard to specific plan investments or operational decisions, even though those decisions are, at heart, what breach of fiduciary duty litigation is about. The statute itself requires plan fiduciaries to act as reasonably prudent experts in making those decisions, and it is the failure to do that, as opposed to the failure to simply reach certain outcomes—such as a particular level of return—that constitutes a fiduciary breach. As you move into ever more complicated plan structures and investment decisions, the question of what was done and why becomes, simultaneously, both more important for prosecuting breach of fiduciary duty claims and less transparent. Consider, for example, the litigation over the use of the ESOP assets of the Chicago Tribune's parent company in a significant corporate transaction; the plaintiffs alleged that the defendants committed a fiduciary breach while engaged in a corporate transaction that involved many of the tools of modern finance known to Wall Street [Neil v. Zell, 677 F. Supp. 2d 1010 (N.D. Ill. 2009)]. Most of the information concerning that transaction cannot have been known to the participants at the onset of the litigation, while every last bit of it would have been known to the plan sponsor, the plan fiduciaries, and their lawyers.

Case law concerning the amount of information that must be provided to plan participants bears out this discrepancy. If we continue with the example of ESOP plans, we find a perfect instance of this. A key element in litigation over breaches of fiduciary duty involving ESOP plans is often the manner of valuation of the stock held in the ESOP. Although there is a split in authority, some courts hold that the documentation concerning the valuation is not an instrument in the operation of the plan that must be produced to participants upon request. [*Compare* Werner v. Morgan Equipment Corp., 1992 WL 453355 (C.D. Cal. 1992) *with* Faircloth v. Lundy Packing Co., 91 F.3d 648 (4th Cir. 1996).] While one can question the propriety of decisions to that effect, the very fact of litigation over this question points out that such information—crucial as it is to understanding the decision-making of ESOP fiduciaries—is often not available to plan participants prior to litigation or (even after litigation is instituted) at any time prior to full blown discovery, even while it remains fully disclosed to the plan sponsor and plan fiduciaries.

This discrepancy in the information known to each side is not merely of academic interest, or simply an odd curiosity, because of the manner in which it intersects with current doctrines of federal civil procedure. It is probably not an overstatement to say that millions of words have been spilled over the past few years by academics and practicing lawyers on the Ashcroft v. Iqbal and Bell Atlantic Corp. v. Twombly rulings by the Supreme Court, and I will spare us all by not reviewing the rulings in those cases in depth here. In a nutshell, however, the rulings significantly changed the standards governing motions to dismiss, which are filed at the start of cases and decided before plaintiffs have an opportunity to conduct discovery into the facts of their cases. The two cases combine to establish that under the federal rules of civil procedure a complaint should be dismissed if it does not state facts that plausibly support the plaintiff's claim to recovery. Under the rule as it is developing, assumptions, speculation and the like do not suffice to sustain a claim for breach of fiduciary duty, and are not sufficient to show the factual predicate for the claim. This means that a complaint for breach of fiduciary duty under ERISA can technically only survive a motion to dismiss if it contains sufficient facts that, if proven, demonstrate that the breach occurred. In trying to present sufficient facts in the complaint to make this showing, lawyers for plan participants can only allege facts that they have already determined are supported by the evidence, pursuant to Federal Rule of Civil Procedure 11.

The combination of these rules means that a complaint filed by plan participants alleging breach of fiduciary duty must allege facts that, if proven, will demonstrate that such a breach occurred, but only by means of facts for which an evidentiary basis to allege them already exists. Otherwise, the complaint is subject to being dismissed at a very early stage, on a motion to dismiss.

This aspect of litigation in the federal courts is not specific to breach of fiduciary duty claims under ERISA, but it does, however, interact with the initial problem identified above—the asymmetry of information—in a manner that is specific to such cases. The asymmetry of information, and the comparative paucity of the relevant information known to the plan participants and their lawyers in comparison to that known to the fiduciaries, seriously impinges on the ability of lawyers for participants to craft a complaint that satisfies these standards; this makes complaints for breach of fiduciary duty much more likely to be dismissed at the motion to dismiss stage than would be the case in the absence of the asymmetry. Practical experience (my own) and commonsense (yours) both support the same conclusion: that plaintiffs would be far more able to allege enough facts to show a fiduciary breach if they had full access to the facts of the fiduciaries' conduct before having to plead such facts.

The result of the intersection of these phenomena—the asymmetry of information and the heightened pleading standards for complaints in the federal courts at this time—combine to make it difficult for plaintiffs alleging breach of fiduciary duty to make it past the motion to dismiss stage, and increase the likelihood of defendants prevailing at that early stage of the litigation. Bear in mind, however, than when a complaint alleging breach of fiduciary duty is dismissed at that early point in the litigation, it is more often a verdict on the lack of information available to plan participants and the corresponding limitation on their lawyers' ability to draft a well-pleaded complaint than it is a verdict on the conduct of the defendants; it is in essence a ruling that the complaint itself does not contain enough facts to show the existence of a breach, rather than a ruling that the defendants did not commit a breach on the actual facts.

The barrier to maintaining a breach of fiduciary duty suit past the most initial stage that is posed by the combination of the current pleading standards with the asymmetry in access to information is made far more formidable by the gap—and at times, yawning chasm—between the oft-stated principle that the fiduciary standards under ERISA are the "highest known to the law" and the fiduciary standards actually applied by courts in many instances, which can at times fall far short of that aspiration, depending on the circuit and the type of case [Braden v. Wal-Mart Stores, Inc., 588 F.3d 585, 598 (8th Cir. 2009) ("Congress intended that private individuals would play an important role in enforcing ERISA's fiduciary duties—duties which have been described as 'the highest known to the law.'"); Johnson v. Couturier, 572 F.3d 1067, 1077 (9th Cir. 2009) ("Our holding merely comports with congressional intent in establishing ERISA fiduciary duties as 'the highest known to the law.'")]. This makes it doubly difficult for plan participants to plead a breach of fiduciary duty claim in an initial complaint that will survive a motion to dismiss because it increases the difficulty of setting forth an actionable case. Even if plan participants manage to compile enough facts from the limited information available to them to satisfy the pleading standards of *Iqbal* and *Twombly*, they can still face dismissal on the legal argument that those facts simply do not add up to a fiduciary breach. Dismissal on this basis is most likely to occur in circumstances in which courts apply a lesser standard to the fiduciaries' conduct than holding them to the highest fiduciary standards known to the law. The simple fact of lowering the standards against which a fiduciary's conduct is tested increases the likelihood of the defendant prevailing, including at the motion to dismiss stage.

The simplest way to illustrate this point, and the fact that courts, in many circumstances, simply are not applying this very high standard to decide breach of fiduciary duty claims, is to consider the woeful history (from the perspective of plan participants, anyway; from defendants' perspective, there is nothing woeful about it) of employer stock drop litigation under ERISA. The underlying thesis of such claims, in a nutshell, is that in plans that hold employer stock where the stock has fallen in price, fiduciaries committed actionable breaches by allowing participants to hold such stock, or by allowing them to continue to buy it, or by not taking actions towards divesting plans of such stock. In jurisdiction after jurisdiction, however, courts have dismissed such claims based on what has come to be known as the *Moench* presumption. The presumption is based on the decision in Moench v. Robertson, 62 F.3d 553 (3d Cir. 1995), and its evolution is discussed in detail as part of the Ninth Circuit's recent adoption of the presumption in Quan v. Computer Sciences Corp. [623 F.3d 870 (9th Cir. 2010)]. Although courts phrase the presumption in different manners, the general principle of that presumption as applied by courts is that a breach of fiduciary duty cannot be based on these actions in the circumstances of a fall in the price of the company stock unless, in essence, the company was in such poor shape that the failure of the company was likely. A detailed discussion of this test can be found in *Quan*, among other cases and sources. This is obviously a far higher standard than simply showing a lack of prudence—which is the usual standard for analyzing whether a breach of fiduciary duty occurred—by fiduciaries with regard to whether to buy, hold, or sell employer stock in the face of a poor market.

Courts' consistent application of the *Moench* presumption to this scenario makes clear that they are not following the maxim that the obligations of a fiduciary under ERISA are the highest known to the law, at least not in the context of employer stock drop cases. I am no expert on the securities laws, but I feel quite confident that company officers can violate the securities laws by their conduct even if the company is not going to fail. The *Moench* presumption, in comparison, in essence declares that the misconduct of company officers who are fiduciaries cannot violate ERISA's fiduciary obligations except in that scenario. It is not much of a syllogism to point out that, as a result, the standards imposed on company officers by the securities laws are higher than those imposed on them by ERISA's fiduciary standards in this context, thus making it impossible for the fiduciary obligations imposed by ERISA to be the highest known to the law when they are not even as high as those imposed by the securities acts.

This alteration of the bar for fiduciary conduct significantly impacts the ability of plaintiffs, who are plan participants, to plead a breach of fiduciary duty claim involving employer stock that will survive the motion to dismiss stage. They may have access to all of the facts needed to plead that the stock fell under circumstances in which fiduciaries, acting as reasonably prudent experts, should have acted to protect them, but absent the additional allegation, which may not exist at all, that the company was under threat of collapse, plaintiffs still will not succeed in pressing such a claim beyond the motion to dismiss stage if they are in a jurisdiction that applies some variation of the *Moench* presumption. In essence, even if able to hurdle the problems of pleading caused by the asymmetry of information and the *Iqbal* and *Twombly* pleading standards, they are then undone by rules lowering the bar for fiduciary conduct to a level that allows a dismissal.

A couple of caveats are in order on this point, however. Initially, the question exists as to whether the courts that do apply the *Moench* presumption are correct to do so in the first place. This is a significant point of contention, and there are good arguments, at the risk of invoking Harry Truman's preference for a one-handed economist, on both sides of the question. (Harry Truman "famously asked to be sent a one-armed economist, having tired of exponents of the dismal science proclaiming 'On the one hand, this' and 'On the other hand, that.'" "One-Armed Economists," *The Economist*, Buttonwood's Notebook Blog, June 7, 2010, at http://www.economist.com/blogs/buttonwood/201%6/inflation_deflation_and_asset_allocation.) This is in and of itself a substantial enough point to warrant a separate article. The point of this article is simply that this type of a barrier—the raising of a high standard for proving a fiduciary breach, as opposed to a high standard for establishing fiduciary compliance—at the initial pleading stage creates yet one more structural barrier to the successful prosecution of a breach of fiduciary duty claim. It means, quite simply, that the combination of legal standards, the asymmetry of access to information and high pleading standards for complaints makes it difficult for plan participants to advance breach of fiduciary duty suits even into discovery (which normally will not occur until after the motion to dismiss stage) and to survive motions to dismiss. This article posits that it is this three-headed Hydra that is responsible for the seeming disjunct identified at the outset of this article, in which problems in plans seem to exist to a greater degree than litigation outcomes would suggest.

The second caveat, which likewise could warrant an extended analysis all its own that is beyond the scope of this article, is whether the structural barriers and their impact on the ability of plan participants to advance such claims is warranted, or desirable. Once again, the point of this article is simply to identify them, not to make a call on their propriety. However, it is important to remember that these barriers to such litigation are not what the Canadian novelist Robertson Davies might have called "bred in the bone," in the sense that they are immutable characteristics [Robertson Davies, "What's Bred in The Bone," 436 pp., New York: Elisabeth Sifton Books/Viking, review in the *New York Times* available at http://www.nytimes.com/books/97/08/24/reviews/davies-bredbone.html]. Rather, they are the product of decisions made in the legal system, whether consciously or not. If we believe that the combination of these factors makes it too difficult to prove a breach of fiduciary duty claim, or too hard even for plaintiffs to get to the point in discovery where they have access to enough information to prove them, then the factors can obviously be targeted and revised. For instance, there is no barrier to increasing the range of information that must be provided to plan participants upon request, which might allow their lawyers to better plead a case that will overcome the other barriers. There is likewise no barrier to establishing an exception to the pleading standards established by *Iqbal* and

Twombly for breach of fiduciary duty cases involving a significant discrepancy in the information available to all sides of a case; it would be simple enough to recognize in the jurisprudence or by amendment to the federal rules themselves that the pleading standard should take account of the plaintiff's access or lack thereof to the relevant facts in circumstances in which the defendants control the relevant information. Finally, of course, whether the fiduciary standards applicable to certain claims, such as stock drop claims, should be set at their current height is completely open to attention by the courts that created the relevant doctrines and principles, such as the *Moench* presumption, in the first instance.

If, on the other hand, we believe the ability to press such claims is exactly as easy or hard as we believe optimal, then no change is needed. The point, though, is that the structural barriers do exist, and can be revised to the extent the court system and the lawyers who participate in it find warranted. ■