ERISA Litigation Update

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Presumed Innocent Nevermore

Fifth Third Bancorp v. Dudenhoeffer
U.S. Supreme Court

Pertinent Facts

The Fifth Third ESOP required that funds be "invested primarily in shares of common stock of Fifth Third."

From July 2007 through September 2009 (when the complaint was filed), Fifth Third's stock price fell by 74%.

The plaintiffs (plan participants) claimed that the fiduciaries knew or should have known that Fifth Third's stock was overvalued and excessively risky for two reasons:

1. Publicly available information, such as newspaper articles, provided early warning signs that subprime loans would leave creditors high and dry as the housing market collapsed.
2. Non-public information, to which the fiduciaries were privy because they were insiders, also made clear that the market had overvalued the Fifth Third stock.

Former Law of the Land

Previously, nearly every federal Court of Appeals (including our Ninth Circuit) applied a "presumption of prudence" standard in regard to ESOPs. The presumption of prudence standard is a recognition of Congress's desire to promote and encourage ESOPs.

The standard had been most precisely described in the Third Circuit's *Moench v. Robertson* case, in which the Court held that "an ESOP fiduciary who invests the [ESOP's] assets in employer stock is entitled to a presumption that it acted consistently with ERISA" in doing so.

In enacting the fiduciary provisions of ERISA, Congress included a clause providing that an ESOP fiduciary is not obligated to follow the otherwise applicable standard requiring the "diversification of investments of the plan so as to minimize the risk of large losses."

Defendant's Position

Fifth Third argued that the diversification exemption for ESOPs carried over to the separate ERISA standard imposing upon a fiduciary the duty to act "with the care, skill, prudence, and diligence" of a "prudent man."

Specifically, Fifth Third asserted that an ESOP fiduciary's decision to hold or buy company stock "cannot prevail unless extraordinary circumstances, such as a serious threat to the employer's viability, mean that continued investment will substantially impair the purpose of the plan."

Supreme Court Holding

The Supreme Court said hogwash.

"In our view, the law does not create a special presumption favoring ESOP fiduciaries. Rather, the same standard of prudence applies to all ERISA fiduciaries, including ESOP fiduciaries, except that an ESOP fiduciary is under no duty to diversify the ESOP's holdings."

Key Takeaways

ESOPs and other plans that maintain a company stock fund often are hardwired to provide that the fund must be exclusively invested in company stock. Blind adherence to these plan provisions will no longer protect a fiduciary.

ERISA states that a fiduciary must act "in accordance with the documents… governing the plan, but only "insofar as such documents… are consistent with the provisions of ERISA" (which includes the fiduciary standards). Therefore, the plan language does not absolve fiduciaries from the obligation to act prudently.

The Court decision also underscores that discharging of fiduciary duties is premised on process, rather than results. Accordingly, fiduciaries of plans with company stock funds should now more carefully monitor the plan's investment in the company stock, recognizing that ERISA's presumption of prudence standard no longer applies.

Consideration may also be given to engaging an independent fiduciary to evaluate and monitor the company stock investments.

Time's Up!

Heimeschoff v. Hartford Life & Accident Insurance Co.
U.S. Supreme Court

Pertinent Facts

Hartford was the insurer/claims administrator for the Wal-Mart LTD plan. The LTD policy required seeking the recovery of benefits be filed within three years after the "proof of loss" was due.

The plaintiff filed a claim with Hartford for LTD benefits in August, 2005. The policy required that written proof of loss be provided within 90 days of the filing of the claim. The proof of loss was due in November, 2005. It was never submitted.

After a number of appeals and extensions of appeals, a final denial of the ERISA claim was issued on November 26, 2007.

The plaintiff filed suit on November 18, 2010, which was almost (but not quite) three years from the date of the final denial, but more than three years after the proof of loss was due.

The District Court granted Hartford's motion to dismiss the case because the lawsuit was not filed within three years of the proof of loss, even though the three-year period expired prior to the deadline for filing a lawsuit under ERISA. The Second Circuit affirmed on appeal, concluding that "it did not offend ERISA" for the limitation period contained in the insurance policy to end before the plaintiff could file a suit under ERISA.

The plaintiff, and the Department of Labor in an amicus brief, argued that giving legal recognition to the limitation period imposed under the insurance policy would undermine ERISA's two-tiered benefit claims procedures scheme.

Former Law of the Land

Prior to the case, the federal Courts of Appeal were split regarding the enforceability of limitation provisions within a plan or insurance policy. Two of the Circuit Courts held that they were enforceable, and two others, including the Ninth Circuit, held that they were not enforceable.

Difference between Statute of Limitations and Plan Limitation Provisions

A statute of limitations establishes the period of time within which a claimant must file a lawsuit. A statute of limitations begins to run when the cause of action "accrues." A cause of action generally accrues when the plaintiff can file the lawsuit.

In an ERISA claims matter, a participant's cause of action does not accrue until the plan issues a final denial of the claim.

In contrast, a limitation provision of a plan or insurance policy is a contractual limit that is separate from the statute of limitations. The contract is the plan document or insurance policy.

Supreme Court Holding

The Supreme Court held that "absent controlling statute to the contrary, a participant in a plan may agree by contract to a particular limitation period, even one that starts to run before the cause of action accrues, as long as the period is reasonable." The Court found that the three-year limitation period was reasonable.

The Court further held that the ruling is consistent with ERISA, which provides that a plan participant may bring suit "to enforce his rights under the terms of the plan." In the case at hand, the terms of the plan provided for a deadline for bringing an action. Accordingly, the terms of the plan were given legal effect.

Take Away

The *Heimeschoff* decision should be favorably received by employers. Employers should consider including in their plan documents a precise deadline for bringing legal actions so as to avoid delays in resolutions to claims.

Time Stands Still

Moyer vs. Metropolitan Life Insurance Company
U.S. Sixth Circuit Court of Appeals

Pertinent Facts

In 2005, the plaintiff applied for benefits under his employer's LTD plan. The plan included the standard clause requiring that legal actions be made within three years of when the proof of loss was due. The plaintiff's application was denied at both the initial claim and appeal stages.

The claim denial notice advised of the claimant's right to initiate judicial review under ERISA, but did not provide notice of the plan's three-year contractual requirement.

District Court Ruling

The plaintiff initiated a legal claim. The plan's defense was its three-year contractual time limit for claims. The District Court agreed with the plan.

As an aside, it held that the claimant had constructive notice of the time limitation included in the plan document because, as a participant in the plan, he could have requested a copy of the plan document at any time.

ERISA Standard

The DOL's claim procedure regulations require that a claims denial notice include "A description of the plan's review procedures <u>and the time limits applicable to such procedures</u>, including a statement of the claimant's right to bring a civil action under 502(a) of the Act following an adverse benefit determination on review." (Underlining mine.)

Appeals Court Ruling

The plaintiff appealed the District Court's decision. He asserted that the plan administrator violated ERISA by not including the three-year contractual time limit in the claims denial letter (and the plan's summary plan description).

The Sixth Circuit agreed that the contractual limitations in ERISA-governed plans will be upheld so long as such limitations are reasonable in duration (with a three-year period being deemed to be reasonable) (i.e., the *Heimeschoff* standard). However, the Court then proceeded to hold that because the claim denial letter failed to include the contractual three- year time limit, the plan had not complied with the ERISA rules. As a result, the Court ruled that the claim was not time-barred.

Confusion

The Supreme Court said in *Heimeschoff* that a contractual obligation can trump ERISA, but the Six Circuit, post-*Heimeschoff*, said that an ERISA failure negated the contractual obligation.

Take Away

Plans with contractual time limits on when a participant must initiate legal action should disclose the time limits in the claims denial notices. The limits should also be included in the SPD.

Could Have or Would Have

Tatum v. RJR Nabisco Investment Committee
U.S. Fourth Circuit of Appeals

Pertinent Facts

The Tatum case was an aftermath of the spinoff of the tobacco business, RJ Reynolds ("RJR") from the food business, Nabisco. Before this spinoff, the 401(k) Plan for the combined RJR Nabisco offered two company stock funds: the Nabisco Common Stock Fund and the RJR Nabisco Common Stock Fund. Oversimplifying the facts, after the spinoff, the RJR Plan continued to hold the frozen Nabisco Funds.

Key facts established at trial are as below:

1. An RJR "working group," which did not have any authority regarding the funds, decided to eliminate the Nabisco Funds following a short meeting.

2. RJR decided against hiring "a financial consultant, outside counsel, and/or independent fiduciary to assist" in "deciding whether and when to eliminate the Nabisco Funds."

3. The RJR Human Resources Manager prepared the letter to participants stating that the Nabisco Funds were being eliminated because regulations do not allow a plan to offer ongoing investment in individual stocks other than company stock. This, of course, was not true. At trial, she testified that when she prepared this letter, she knew the statement was incorrect.

4. At the time the Nabisco stock was sold, outsiders rated it as a "buy."

5. During the six-month period between the spin-off and stock sale, the Nabisco stock had a 60% decline in value. Only a few months later, the value of the Nabisco Funds rose by 247%.

Legal Standard

The District Court acknowledged that the decision to sell the Nabisco Stock was a fiduciary act. It further declared that RJR plan fiduciaries did not adequately investigate and analyze that decision and therefore violated ERISA's procedural prudence standard.

Under established case law, once procedural imprudence and loss are established, the burden of proof shifts to the defendant fiduciary to establish that the procedural imprudence did not cause the loss.

District Court Decision

The District Court held that notwithstanding the procedural imprudence, "[a] hypothetical prudent fiduciary could have decided to sell the stock." (Underlining mine). Therefore the Court ruled that the plaintiff was not entitled to ERISA relief.

Fourth Circuit's Decision

Upon appeal, the Fourth Circuit held that in order for the defendant fiduciary to prevail, it must show that "a hypothetical prudent fiduciary would have made the same decision anyway." (Underlining mine). Thus, it ruled that the lower court's decision, which was based on what a hypothetical fiduciary "could have" done, was in error.

The "could have" standard describes what is "merely possible," while a "would have" standard describes what is "probable."

Dissent

The Fourth Circuit Court's decision was split 2-1. The dissenting judge wrote a vigorous dissent, arguing that objective prudence describes a range of reasonable decisions that are not appropriately divided into the "more likely than not" and "less likely than not." Rather, ERISA allows for more than one prudent decision when all of the facts existing at the time the decision is made are considered.

Take Away

Plan fiduciaries should undertake proper investigation and analysis before divesting of investment fund offerings.

ERISA's Blind Eye

Roe v. Empire Blue Cross Blue Shield
United States District Court for the Southern District of New York

<u>Pertinent Facts</u>

St. Vincent's Hospital sponsored a self-funded health plan. The terms of the plan provided that "[s]ame sex spouses and domestic partners are NOT covered under this plan" (emphasis in plan document).

Jane Roe was employed by the Hospital since 2007. She married Jane Doe after New York legalized same-sex marriages (the "Marriage Equality Act"). Thereafter, Jane Roe sought to add Jane Doe to her coverage.

The plan denied the request on the basis that the plan expressly excluded the coverage of same-sex spouses.

Jane Roe and Jane Doe sued the Hospital and its third-party administrator, Empire Blue Cross Blue Shield.

<u>Legal Claim</u>

The plaintiffs brought suit under ERISA, specifically ERISA § 510, which generally makes it unlawful for any employer to discriminate against a participant or beneficiary for exercising his or her benefit rights or to interfere with the attainment of any benefit right.

The plaintiffs also argued that ERISA required the plan to follow New York's Marriage Equality Act in light of the Supreme Court's opinion in *U.S. v. Windsor*.

<u>Court Decision</u>

The Court rejected these arguments.

The Court ruled that a finding of an ERISA § 510 violation requires interference with an employment relationship.

It expressly stated that "ERISA gives employers broad discretion in writing the terms of welfare benefit plans and Section 510 does not apply to the facts of this case because there has been no adverse employment action."

Scope of Ruling

The Court made clear that:

- It was not ruling on whether plans that exclude same-sex couples from the definition of "spouse" are constitutional; and

- It was not addressing whether the exclusion was lawful under other federal laws.

The Court merely declared that its opinion "holds only that the [same-sex spouse exclusion] does not violate Section 510 of ERISA as it is currently promulgated."

Washington State Law

On June 8, 2014, the Washington State Attorney General, Insurance Commissioner and Executive Director of the Human Rights Commission issued a joint letter stating that a health plan that covers opposite-sex spouses, but fails to exclude same-sex spouses, constitutes discrimination based on sexual orientation, and thus is prohibited by Washington Law.

Take Away

Although it may not be a violation of ERISA to exclude coverage for same-sex spouses, other potential federal or state causes of action may be asserted.

Excess Fee Decision – Round Two

Tussey vs. ABB
U.S. Eighth Circuit Court of Appeals

Pertinent Facts

ABB sponsored a 401(k) plan for its employees. Fidelity was the recordkeeper and service provider. Previously, the Vanguard Wellington (Balanced) Fund was the QDIA. Even though the Vanguard Fund was inexpensive and doing great, the ABB Plan committee mapped the funds to Fidelity target-date funds. In doing so, it did not follow the terms of the Investment Policy Statement. The fees were increased, but Fidelity reduced its fees for ABB corporate services (payroll, etc.).

Fidelity was primarily paid through a revenue-sharing arrangement, by being paid a percentage of the plans' assets from participants' accounts.

District Court Ruling

A group of plan participants brought suit. In 2012, the District Court ruled that ABB, the plan's committee and Fidelity breached their ERISA fiduciary duties by:

1. Failing to monitor and control recordkeeping fees;
2. Paying excessive revenue-sharing fees to Fidelity, which was then applied to subsidize other corporate services;
3. Mapping funds held in the Vanguard fund to the Fidelity funds, in violation of the plan's Investment Policy Statement;
4. Selecting more expensive share classes when less expensive share classes were available; and
5. Not paying "float income" to the plan.

The District Court awarded the claimants:

- $13.4 million for failing to monitor claim;
- $21.8 million on the Vanguard/Fidelity mapping claims; and
- $1.7 million based on float income.

The defendants appealed the District Court's decision to the Eighth Circuit.

Appellate Court Decision

The Eighth Circuit:

- Upheld the $13.4 million decision against ABB regarding the excess recordkeeping fees paid to Fidelity;

- Remanded the $21.8 million award based on losses due to mapping from the Vanguard fund to Fidelity's funds; and

- Reversed the $1.7 million based on float income.

Recordkeeping Claim

The District Court found that the ABB fiduciaries breached their fiduciary duty to the plan by failing to properly calculate and monitor the plan's recordkeeping costs, and by paying excessive revenue-sharing fees. On that basis, the Eighth Circuit upheld the District Court's finding, agreeing that ABB:

- Failed to calculate the amount the plan was paying Fidelity for recordkeeping through revenue sharing;

- Failed to determine whether Fidelity's pricing was competitive;

- Failed to adequately leverage the plan's size to reduce fees; and

- Failed to make a good faith effort to prevent the subsidization of administration costs of ABB corporate services with plan assets.

Selection and Mapping of Investment Options

The District Court found that the selection of the Fidelity funds as investment options for the plan and the decision to map plan investments from the Vanguard fund to the Fidelity funds was imprudent and improperly influenced by conflicts of interest.

The Eighth Circuit remanded the District Court ruling. The basis for remand was that under the ERISA prudent person standard, a fiduciary has discretion to choose plan investments to the extent its investment choices are reasonable in light of what it knows at the time of the decision.

Float Income

The District Court found that the transferring of float income to the investment funds, rather than to the plan, was a breach of Fidelity's fiduciary duty of loyalty because it transferred float income to the underlying investment options, rather than to the plan.

The Eighth Circuit reversed. It agreed with Fidelity that the investment options, and not the plan, held the property rights in the float, and thus were entitled to the benefits of ownership (including float income).

Caution: The Eighth Circuit opinion on the float issue conflicts with that of the Department of Labor Field Assistance Bulletin 2002-03. The FAB requires fiduciaries of plans whose service providers retain float to take the float income into account in establishing the service providers' fees. A dissenting judge stated that he was persuaded by the ERISA regulations and DOL authority that float is a plan asset, and that he would have found that Fidelity breached its duties.

<u>Key Take Aways</u>

The take away from this case, essentially, is to do everything that ABB should have done, but did not, including:

- Carefully monitor the revenue sharing fees paid to plan service providers;
- Establish the amount the plan is paying for recordkeeping through revenue-sharing;
- Establish whether the recordkeeper's pricing is competitive;
- If possible, leverage the size of the plan assets to reduce fees; and
- Do not enter into arrangements that provide for the subsidization of costs for corporate services with plan assets.

In addition, employers should not assume that the DOL will agree with the Court's ruling victory on the float issue. The DOL will likely continue to take the position that a plan fiduciary must take float into consideration when negotiating a service provider's fee arrangement.

So You Thought You Weren't a Fiduciary

Golden Star v. MassMutual Life Insurance Company
U.S. District Court of Massachusetts

Pertinent Facts

The Group Annuity Contracts ("GACs") at issue allowed MassMutual to assess Separate Investment Account management fees ("SIA management fees"), and to set the fees at a rate up to 1.0% of the average daily market value of the separate account.

A proposed class of client-defined contribution plans brought lawsuit against MassMutual alleging that:

- MassMutual was a functional fiduciary under ERISA § 3(21)(i) and (iii) when it determined its own compensation for services provided in the SIAs it offered through the GACs; and
- MassMutual violated ERISA when it received revenue sharing payments from third-party mutual funds and violated the fiduciary duties imposed by ERISA § 404.

Court's Decision

The Court agreed with the plaintiffs that MassMutual was a functional fiduciary because it had the discretion to unilaterally set fees up to a maximum, and exercised that discretion.

Take Away

Service agreements and terms of engagement should be reviewed to ensure that a vendor does not have the discretion to unilaterally increase its fees.

You, Too, Thought You Weren't a Fiduciary

Perez vs. Geopharma
U.S. Federal Middle District of Florida

Pertinent Facts

The Department of Labor ("DOL") brought suit against Geopharma and certain of its officers including the CEO, alleging that the defendants, having received approximately $16,500 in COBRA premium payments as well as $217,400 in employee premiums, failed to segregate those funds and use them to pay benefit claims.

ERISA Co-Fiduciary Liability

ERISA Section 405 imposes joint and several liability on a fiduciary who has knowledge of a fiduciary breach and fails to act to remedy the breach.

Department of Labor Position

The DOL complaint asserts joint and several liability with respect to the officers. Its CEO was named as a co-defendant because he possessed signature authority on Geopharma's corporate bank accounts.

The DOL complaint states that the plain language of ERISA permits a person to become a fiduciary by exercising authority or control over the management or disposition of plan assets without requiring "discretionary" authority or control. It argued that because Geopharma was named the plan administrator and fiduciary within the plan itself, Geopharma had a duty to monitor the actions of those administering the plan on its behalf.

The DOL further alleged that the CEO, as a fiduciary, knew or should have known that Geopharma was having cash flow issues and was using employee compensation and COBRA payments to fund operations instead of using the funds to pay benefits, and such knowledge should have triggered an investigation to determine whether Geopharma and its fiduciaries were administrating the plan in accordance with ERISA and the terms of the plan.

Court Decision

The Court ruled that "in light of these factual allegations, the court can reasonably infer that [the CEO] exercised authority or control over Geopharma's plan assets as an ERISA fiduciary when employee premiums were commingled with Geopharma's general assets" for which the CEO had signatory authority.

Take Away

The DOL will be very aggressive in attempting to place co-fiduciary liability on corporate officers.

ERISA Preemption. Where Hath Thou Gone?

Gray vs. FedEx Ground Package System, Inc.
U.S. District Court for Eastern Missouri

Pertinent Facts

Plaintiffs were full-time drivers for FedEx. Plaintiffs asserted, among other things, a claim under state law that FedEx had misclassified them as independent contractors when, in fact, they were employees entitled to benefits under FedEx retirement and health and welfare benefit plans.

Plaintiffs' expert had opined that each plaintiff lost $6,000 annually for benefits that they otherwise would have received under the FedEx welfare benefit plans, and $1,000 annually for estimated benefits, including matching 401(k) contributions, under the FedEx retirement plans.

FedEx countered, asserting that plaintiffs' state law claims for damages were barred by ERISA's preemption clause.

ERISA Preemption

ERISA Section 514(a) generally provides that ERISA's provisions "shall supersede any and all State laws insofar as they may now or hereafter relate to any employee benefit plan" covered by ERISA. Case decisions hold that a State law "relates to" an ERISA plan if the State law, expressly refers to the ERISA plan or has a connection with it.

Court Holding

The court rejected FedEx's preemption argument on the basis that the plaintiffs were not seeking "to recover benefits due under the FedEx plans, to enforce rights under the plans or to clarify rights to future benefits," pursuant to ERISA's civil remedies provisions. Instead, they sought to recover damages arising from their misclassification as independent contractors, and the damages would be paid by FedEx, not the plans. In addition, the challenge was brought by the plaintiffs in their role as employees, and not as ERISA participants. Although the plaintiffs' claims required some reference to the plan documents in order to calculate damages, this relationship was too tenuous to trigger ERISA preemption.

Key Take Away

ERISA preemption is not as broad as may be expected. Not every State law claim have a reference to a benefit plan involves or relates to ERISA so as to be preempted.