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Benefits Report

DECEMBER 2014

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"An Ounce of Prevention Is Worth a Pound of Cure": The Ninth Circuit's Holding in *Spinedex* Lowers the Bar For Plaintiffs Seeking ERISA Plan Benefits In Court

VIRGINIA PERKINS

On November 5, 2014, the Ninth Circuit issued an opinion in *Spinedex Physical Therapy USA, Inc. v. United Healthcare of Arizona, Inc.*, 770 F.3d 1282 (9th Cir. 2014), of potentially great importance to sponsors and administrators of ERISA plans.

Of particular interest are the Ninth Circuit's holdings that:

- A contractual statute of limitations must be specifically stated in a particular location within the plan's summary plan description in order to be enforced;
- A plan document must affirmatively and unambiguously state that a participant has to exhaust administrative remedies before filing a lawsuit in order for that requirement to be enforced; and
- Claims administrators (and, potentially, other plan fiduciaries) may be proper defendants in claims for benefits brought under ERISA § 502(a)(1)(B).

Plan sponsors and administrators should review their plan documents to ensure that contractual limitations periods are properly located in the summary plan description ("SPD") and that plan documents clearly state that plan participants must exhaust all administrative remedies prior to filing a lawsuit against a plan for benefits. Otherwise, plan sponsors and administrators may find themselves litigating benefit claims in court without the benefit of an administrative record, and without the deference often afforded plan administrators in interpreting their own plans.

Furthermore, claims administrators of self-funded plans, who may already be considered plan fiduciaries based on their discretion to decide benefit claims, should also be aware that the Ninth Circuit views them as proper defendants in lawsuits seeking benefits.

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Trucker ✦ Huss is pleased to announce that Elizabeth Loh became the newest Director of the Firm on January 1, 2015. Congratulations to Liz!

Background

The underlying lawsuit in *Spinedex* involved claims brought by health care provider Spinedex Physical Therapy ("Spinedex") against several health plans (the "Plans") and their claims administrator, United Healthcare of Arizona ("United"). United was also the insurer of some, but not all, of the Plans.

Spinedex provided physical therapy services to participants in the Plans. As an out-of-network provider, the Plans' participants were required to submit Spinedex's bills to their respective Plans for reimbursement. However, as part of the client intake process, Plan beneficiaries assigned their right to seek payment of Plan benefits to Spinedex. Spinedex then sought payment directly from the Plans for physical therapy services provided to Plan beneficiaries. United denied some of Spinedex's claims, and Spinedex, as an assignee, brought suit in federal court against the Plans and United ("Defendants"), seeking payment of benefits under ERISA § 502(a)(1)(B) and asserting breaches of fiduciary duty under ERISA.

The district court granted summary judgment in favor of the Defendants on the ground that Spinedex lacked standing under Article III of the United States Constitution. The district court reasoned that, because Spinedex had not actually sought payment for its services from the individual Plan beneficiaries, the beneficiaries had suffered no "injury in fact"; therefore, as an assignee of their claims, Spinedex suffered no "injury in fact" as required for Article III standing. On appeal, the Ninth Circuit reversed the district court's ruling on that issue, holding that, "[a]t the time of the assignment, Plan beneficiaries had the legal right to seek payment directly from the Plans for charges by non-network health care providers. If the beneficiaries had sought payment directly from their Plans for treatment provided by Spinedex, and if payment had been refused, they would have had an unquestioned right to bring suit for benefits…. However, instead of bringing suit on their own behalf, plaintiffs assigned their claims to Spinedex. … [I]t is black-letter law that an assignee has the same injury as its assignor for purposes of Article III." *Spinedex,* 770 F.3d 1282 at 1291.

Because the Ninth Circuit reversed the district court on the threshold question of Article III standing, the Court also considered several other alternative holdings reached by the district court. The Court's reversal of the district court on three key issues provides important lessons to plan sponsors and administrators in drafting and administering their plans.

Lesson # 1:
Make Sure That Any Contractual Statute of Limitations in Your Plan Document is Correctly Located in Your SPD, or It Might Not Be Enforced

The District Court had held that Spinedex's claims against two of the defendant Plans were barred by the two-year statute of limitations contained in those plan documents. The SPDs for both plans contained two-year limitations periods for benefit claims, and there was no question that Spinedex filed its action after the two-year period had expired. However, on appeal, the Ninth Circuit reversed the district court on this issue, holding that the Plans'

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contractual limitations periods were unenforceable because they were not properly disclosed in the SPDs. Specifically, the provisions were in the wrong place in the SPDs.

The Ninth Circuit noted that according to ERISA § 102(b), which sets forth the required contents of an SPD, "circumstances which may result in disqualification, ineligibility, or denial or loss of benefits" must be "clearly disclosed" in the SPD, holding that the inclusion of a contractual statute of limitations provision qualifies as such a circumstance. *Id.* at 1294-95, quoting ERISA § 102(b). Under Department of Labor ("DOL") regulations, additional specific rules apply to the placement and format of SPD provisions falling within ERISA § 102(b) requirements. 29 C.F.R. § 2520.102-2(b). The Ninth Circuit read those rules to require either that a contractual statute of limitations provision must be placed "in close conjunction with the description or summary of benefits," in the SPD or the page containing the contractual statute of limitations provision must be "noted" "adjacent to the benefit description." *Id.* at 1295.

The two SPDs at issue addressed the Plans' covered benefits and exclusions therefrom in Sections 1 and 2, which spanned pages 2 through 36 of one SPD and pages 3 through 38 of the other SPD. By contrast, the Plans' contractual statute of limitations provision was described in Section 9 (entitled "General Legal Provisions") as the sixteenth of nineteen subsections and found on page 66 of one SPD and page 69 of the other SPD. Applying a "reasonable plan participant" standard, the Court rejected the Defendants' argument that the contractual limitations period was placed "in close conjunction with the description or summary of benefits." According to the Court, "[i]f we were to hold that the placement of the limitation provision in Section 9 satisfies [the] 'reasonable plan participant' standard under § 2520.102-2(b), we would, in effect, require a plan beneficiary to read every provision of an SPD in order to ensure that he or she did not miss a limitation provision." *Id.* at 1296. Furthermore, the respective benefits descriptions failed to include page number references to the page on which Plans' contractual statute of limitations provision was described. *Id.* at 1295. Therefore, the Ninth Circuit held that the Plans' contractual statute of limitations did not meet the placement or formatting requirements of the DOL SPD Regulations and was not enforceable.

Plan sponsors and administrators should take note of the Ninth Circuit's holding and consider the placement of any contractual limitations provision in their SPDs. Either the contractual limitations period language should be placed in close conjunction with the SPD's description of covered benefits, or the description of covered benefits should include a page reference to the SPD section addressing the Plan's contractual the statute of limitations.

Lesson #2:
Your Plan Documents Should Clearly and Unambiguously State That Participants Must Exhaust Administrative Remedies Prior to Filing a Lawsuit, or Participants May Go Straight to Court

"As a general rule, an ERISA claimant must exhaust available administrative remedies before bringing a claim in federal court." *Id.* at 1298. In practice, the requirement that participants "exhaust their administrative remedies" means that a participant may not bring a lawsuit seeking plan benefits if he or she has not already filed an administrative claim and appeal under the plan's terms. In *Spinedex,* the Ninth Circuit relaxed this requirement if a plan document could be interpreted as stating that a participant is not required to exhaust administrative remedies before filing a lawsuit for benefits. The Court also heightened the standard that plan administrators are held to in responding to administrative claims and appeals, holding that if a plan administrator makes more than a "de minimis" error in the response, the participant may be "deemed" to have exhausted all administrative remedies and may go directly to court.

The district court had held that "[e]ven if standing existed, many individuals did not exhaust their administrative remedies for their benefit denial claims." *Id.* at 1298. On appeal, the Ninth Circuit reversed the district court on this issue, explicitly adopting, for the first time, the rule that a participant need not exhaust administrative remedies when the plan does not clearly require it. According to the Court, "[w]here plan documents could be fairly read as suggesting that exhaustion is not a mandatory prerequisite to bringing suit, claimants may be affirmatively misled by language that appears to make the exhaustion requirement permissive when in fact it is mandatory as a matter

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of law." *Id.* The Ninth Circuit held that some of the Plans' SPD language was ambiguous as to whether exhaustion was required prior to filing a lawsuit. For example, one plan stated that "[i]n the interest of saving time and money, *you are encouraged* to complete all steps in the complaint process … before bringing any legal action against us." *Id.* at 1299 (emphasis in original).

The Ninth Circuit noted that other circuit courts had held that a participant is not required to exhaust administrative remedies prior to filing a claim for benefits in court if the plan does not require it. The Court further noted that excusing participants in plans with ambiguous language from exhausting administrative remedies would have the beneficial effect of encouraging employers and plan administrators to make sure their plan provisions are clear, "thereby … leading more employees to pursue their benefits claims through their plan's claims procedure in the first instance." *Id.* at 1298-99.

Following the Ninth Circuit's holding in *Spinedex,* participants in plans with arguably ambiguous exhaustion language may attempt to bypass the administrative claim and appeal process and head straight for federal court with a claim for benefits. One of the dangers of this approach is that, without the record developed during an administrative claim and appeal, the deference typically afforded to plan administrators by district courts in their benefit determinations may be lost. It is therefore important for employers and plan sponsors to review their plan documents to ensure that any administrative remedy exhaustion requirement is clearly and unambiguously stated.

In addition to waiving the requirement of exhaustion in the face of ambiguous plan terms, the Ninth Circuit also heightened the standard to which plan administrators are held in their review of administrative claims and appeals. Historically, when a plan administrator fails to establish or follow claims procedures consistent with the DOL regulations, a participant may be "deemed to have exhausted [his] administrative remedies." *Id.* at 1299. However, the standard was relatively loose, and minor violations would not lead to "deemed" exhaustion. In *Spinedex,* the Ninth Circuit adopted the Secretary of Labor's view that anything more than a "de minimis" violation of the claims regulations or claims procedures would lead to a participant being deemed to have exhausted his or her administrative remedies. *Id.* Following *Spinedex,* plan administrators should be even more careful to adhere to the claims and appeals procedures set forth in the DOL regulations and their own plan documents to prevent participants from being able to bypass the administrative claim and appeal process altogether.

Lesson #3:
Claims Administrators (and other Plan Fiduciaries) May Be Named as Defendants in Lawsuits for Benefits

The Ninth Circuit in *Spinedex* clarified that its prior holding in *Cyr v. Reliance Standard Life Ins. Co.,* 642 F.3d 1202 (9th Cir. 2011) significantly expanded the realm of proper defendants in a lawsuit for benefits brought under ERISA § 502(a)(1)(B). Prior to *Cyr,* the prevailing rule in the Ninth Circuit was that the only proper defendants in a lawsuit for benefits under ERISA § 502(a)(1)(B) were the plan itself and the plan administrator. In *Cyr,* the plaintiff named Reliance, the plan's insurer, as a defendant in a lawsuit for benefits. However, because Reliance was not the plan administrator, the district court dismissed the plaintiff's claims against Reliance on the ground that Reliance was an improper defendant in a claim for benefits under ERISA § 502(a)(1)(B).

On appeal, the Ninth Circuit in *Cyr* held that if a "party's individual liability is established," that party is a proper defendant in a claim under ERISA § 502(a)(1)(B). *Cyr,* 642 F.3d at 1207. Because Reliance was the plan's insurer and responsible for paying legitimate benefits claims, the Ninth Circuit held that Reliance was a "logical defendant for an action by Cyr to recover benefits due to her under the terms of the plan and to enforce her rights under the terms of the plan." *Id.*

Following *Cyr,* it remained unclear how far the Ninth Circuit had opened the door to naming parties, other than the plan, the plan administrator and the plan's insurer, as defendants in a lawsuit for benefits under ERISA § 502(a)(1)(B). In *Spinedex,* the Ninth Circuit clarified that the universe of defendants in a benefit claim may be larger than expected.

The district court in *Spinedex* had dismissed claims for benefits brought against United relating to plans for which United was the claims administrator, but not the insurer of benefits. United was not designated as the "plan administrator" in the plan documents. Therefore, according to the

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district court, United was an improper defendant because it was not the plan, not the plan administrator, and not responsible for paying benefits under the plans.

On appeal, the Ninth Circuit vacated this aspect of the district court's holding and remanded, stating that proper defendants in a lawsuit under ERISA § 502(a)(1)(B) for improper denial of benefits "***at least include*** ERISA plans, formally designated plan administrators, insurers or other entities responsible for payment of benefits, ***and de facto plan administrators that improperly deny or cause improper denial of benefits."*** *Spinedex* at 1297 (emphasis added). The Ninth Circuit further stated that lawsuits to recover benefits may be brought against "***plan fiduciaries,***" defined as "any entity that exercises any discretionary authority or discretionary control respecting management of such plan or exercises any authority or control respecting management or disposition of its assets … [or] has any discretionary authority or discretionary responsibility in the administration of such plan." *Id.* at 1298 (emphasis added).

The Ninth Circuit noted that the district court held that United was not an "administrator" of the Plans in question, but the defendants had conceded that United was the "claims administrator" for each of the defendant Plans. The Ninth Circuit stated that it was "unable to reconcile the district court's holding with Defendants' apparent concession" and it was unclear whether United "is a formally designated or de facto administrator." *Id.* The Court therefore remanded the question of whether United was a proper defendant to the district court for further proceedings.

Following *Spinedex,* the realm of proper defendants in a claim brought under ERISA § 502(a)(1)(B) arguably includes not just the plan, the named plan administrator and the plan's insurer, but also any de facto plan administrator, and possibly other plan fiduciaries.

Conclusion

The Ninth Circuit's holding in *Spinedex* has potentially significant consequences for plan sponsors, plan administrators and plan fiduciaries. However, at least some of these consequences can be avoided with carefully drafted plan contractual limitations periods and specific adherence to claims procedures. De facto plan administrators and plan fiduciaries should also be aware that they may be called to defend against lawsuits for benefits brought under ERISA § 502(a)(1)(B), even if they are not identified as the "plan administrator" and have no obligation to fund plan benefits.

The Impact of *Dudenhoeffer* on Lower Court Stock-Drop Cases

ALYSSA OHANIAN

The Supreme Court recently held in *Fifth Third Bancorp v. Dudenhoeffer,* 134 S. Ct. 2459 (2014), that employer stock ownership plan ("ESOP") fiduciaries are not entitled to a special presumption that they acted prudently in investing in employer stock. Rather, ESOP fiduciaries are subject to the same duty of prudence that applies to ERISA fiduciaries in general, except that they need not diversify the plan's employer stock investment, as would otherwise be required.

While *Dudenhoeffer* invalidated the presumption of prudence that had been applied to ESOP fiduciaries for over a decade, the holding may be advantageous for fiduciaries of plans sponsored by publicly traded companies, in that the Court has set a potentially high bar that plaintiffs must meet in their pleadings to avoid a motion to dismiss.

In light of the significant impact of *Dudenhoeffer* on breach of fiduciary duty litigation against ESOP fiduciaries, it is important to consider the recent cases that have interpreted *Dudenhoeffer*.

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ERISA Stock-Drop Cases

Employees have filed hundreds of actions against defined contribution plan fiduciaries with employer stock investments following a decline in stock values. These "Stock-Drop" cases brought under ERISA are often filed as class actions and typically include the following allegations:

- The company established an individual account defined contribution plan, featuring company stock as an investment option.
- Participants suffered losses because the company stock value declined, often as the result of some purported wrongdoing by the company or insiders.
- The company, its board of directors, and its senior officers are ERISA fiduciaries who breached their duties by:
  1. Investing plan assets in company stock;
  2. Failing to freeze or divest company stock from the plan;
  3. Making false statements about company stock to plan participants; or
  4. Failing to monitor other plan fiduciaries.

Under Section 502(a)(2) of ERISA, plan participants may obtain relief from plan fiduciaries for breaches of their fiduciary duties.

Prudent Person Rule for Investments

ERISA requires that plan trustees exercise the same degree of care, skill, prudence and diligence under the circumstances then prevailing in making plan investment decisions as they must use in discharging all their duties with respect to an employee benefit plan. With respect to plan investments, the prudence requirement generally requires diversification of investments to minimize risk and loss of profits.

ESOP Fiduciaries and the Presumption of Prudence

Prior to the Supreme Court's decision in *Dudenhoeffer,* a majority of the Circuit Courts of Appeals had adopted a presumption of prudence for ESOP fiduciaries, referred to as the *Moench* Presumption (based on the Third Circuit's holding in *Moench v. Robertson),* that fiduciaries of plans requiring or encouraging investment in employer stock are entitled to a presumption that their decision to invest employer securities was prudent. The *Moench* Presumption protected ESOP fiduciaries and created a significant hurdle for plaintiffs alleging that an ESOP fiduciary breached his fiduciary duty of prudence in a Stock-Drop case, requiring plaintiffs to allege extraordinary circumstances, including that the ESOP's sponsor was facing dire circumstances or was on the brink of collapse.

Fifth Third Bancorp v. Dudenhoeffer

Fifth Third Bancorp., a large financial services firm, maintained a defined contribution plan for its employees. The plan participants filed a class action lawsuit with the District Court for the Southern District of Ohio, alleging that the Fifth Third plan fiduciaries breached their ERISA fiduciary duties by continuing to offer the employer stock fund as an investment alternative despite a 74% price drop, causing the plan to lose tens of millions of dollars during the class period.

The District Court dismissed the complaint for failure to state a claim, finding that the defendant ESOP fiduciaries were entitled to the presumption that their decision to remain invested in employer securities was reasonable under *Moench*. On appeal, the Sixth Circuit reversed and remanded, agreeing that ESOP fiduciaries are entitled to a presumption of prudence, but it found the presumption to be evidentiary only and inapplicable at the pleading stage, concluding that the complaint stated a claim for breach of fiduciary duty.

Dudenhoeffer Supreme Court Holding

The U.S. Supreme Court granted certiorari based on the Circuit Courts' varying approaches to the presumption of prudence applicable to ESOP fiduciaries. On June 25, 2014, the Supreme Court unanimously held that when an ESOP fiduciary's decision to buy or hold the employer's stock is challenged in court, the fiduciary is not entitled to a special presumption that the fiduciary acted prudently in managing the plan's assets. Rather, ESOP fiduciaries are subject to the same duty of prudence that applies to ERISA fiduciaries in general under ERISA § 404(a)(1)(B), except that they need not diversify the

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employer stock fund's assets as otherwise required under ERISA § 404(a)(2).

The Court further found that the *Moench* presumption was not an appropriate way to eliminate meritless lawsuits, which the Court stated could be better accomplished through a careful, context-sensitive scrutiny of a complaint's allegations under the pleading standard discussed in *Bell Atlantic Corp. v. Twombly and Ashcroft v. Iqbal*.

On remand, the Court instructed the Sixth Circuit to reconsider the respondents' allegations in light of the *Twombly* and *Ashcroft* pleading standard, as well as several enumerated considerations applicable to duty-of-prudence claims made in the context of publicly traded stock and the use of non-public information.

Cases Interpreting *Dudenhoeffer*

Amgen Inc. v. Harris

On June 30, 2014, the Supreme Court ordered the Ninth Circuit to reconsider its ruling in *Harris et al. v. Amgen,* 717 F.3d 1042 (9th Cir. 2013), allowing fiduciary breach claims to proceed against two Amgen Inc. retirement plans in light of *Dudenhoeffer*.

In *Harris I,* the Ninth Circuit had held that the presumption of prudence did not apply to the participants' claim that ERISA plan fiduciaries acted imprudently by continuing to provide Amgen stock as an investment alternative for its defined contribution plans, despite knowing that its price was artificially inflated. The plans neither required nor encouraged fiduciaries to establish a company stock fund as an available investment, nor did they require participants to invest in employer's stock, but merely referred to a company stock fund as a permissible investment.

On remand from the Supreme Court, the Ninth Circuit, in *Harris II,* held that in light of *Dudenhoeffer,* the plaintiffs were not required to satisfy the criteria articulated under prior law in order to demonstrate that no presumption of prudence applied. The defendants had argued that their actions were prudent even if the presumption of prudence did not apply and that *Dudenhoeffer* requires a higher pleading standard of particularity or plausibility. The Ninth Circuit rejected these arguments, holding that plaintiffs had stated a claim that defendants acted imprudently and breached their fiduciary duties under ERISA by continuing to offer Amgen common stock as a plan investment alternative when they knew or should have known that the stock was being sold at an artificially inflated price. The court explained that the Supreme Court had already decided *Ashcroft* and *Twombly* when this case was first before the Ninth Circuit on appeal, and the Supreme Court's citation of those two cases indicates that it was not articulating a new pleading standard in *Dudenhoeffer*.

Rinehart v. Akers

Participants in Lehman Brothers Holdings Inc.'s 401(k) plan argued in *Rinehart v. Akers,* 722 F. 3d 137 (2nd Cir. 2013) that plan fiduciaries acted imprudently by failing to divest the plan of company stock. The Second Circuit affirmed the lower court's dismissal of the participants' claims, finding they failed to allege sufficient facts to demonstrate that Lehman Brothers' benefit committee knew or should have known that the company was in a "dire situation" based on publicly available information, and therefore could not overcome the *Moench* presumption. The court further held that material, nonpublic information could not form the basis of the participants' imprudent investment claims.

On July 1, 2014, the Supreme Court ordered the Second Circuit to reconsider its ruling in *Rinehart,* in light of *Dudenhoeffer*.

Kopp v. Klein

On July 1, 2014, the Supreme Court ordered the Fifth Circuit to reconsider its ruling dismissing a fiduciary breach claim against the fiduciaries of an ESOP in light of *Dudenhoeffer*. On August 7, 2014, the Fifth Circuit vacated the judgment of the district court and remanded the case.

In re UBS ERISA Litig.

This employee class action was brought against UBS, alleging violations of fiduciary duties under ERISA. UBS offered its employees several retirement benefit plans, including the UBS Savings and Investment Plan (the "SIP"), which offered the UBS Company Stock Fund as an investment option to UBS employees. The plaintiff alleged that the defendants breached their duties to the SIP by failing

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to eliminate the UBS Company Stock Fund from the menu of investments at a time of financial crisis.

On March 24, 2011, the district court granted defendants' motion to dismiss. On appeal, the Second Circuit vacated the district court's dismissal of plaintiff's claims related to the SIP and remanded the case, holding that claims against the SIP were improperly dismissed because the lower court applied a presumption of prudence to the SIP-related claims. The Second Circuit explained that because the SIP Plan Document did not require or even "strongly encourage" investment in the UBS Stock Fund, but just presented it as one permissible investment option, fiduciaries of the SIP were not entitled to the presumption of prudence.

On September 29, 2014, the District Court for the Southern District of New York dismissed the claims against UBS for lack of standing, explaining that,

"Plaintiff's assertion that the Supreme Court's decision in Dudenhoeffer has changed the landscape for claims arising under ERISA overshoots the mark. In this case, the Second Circuit already determined that the presumption of prudence does not apply to the SIP. As a result, the Supreme Court's rejection of the presumption of prudence in general has little impact on this case in its present posture." *In re UBS ERISA Litig.,* No. 08-cv-6696 (RJS), 2014 WL 4812387 (S.D.N.Y. Sep. 29, 2014).

The court went on to note that it was unclear whether *Dudenhoeffer's* invalidation of the *Moench* presumption would be beneficial to the participant to begin with:

"It could be argued that the Supreme Court's decision in *Dudenhoeffer* has, if anything, *raised* the bar for plaintiffs seeking to bring a claim based on a breach of the duty of prudence. … Notwithstanding the uphill battle Plaintiff's claims would face in any adjudication on the merits, Plaintiff's lack of standing deprives the Court of jurisdiction to reach Defendants' Rule 12(b)(6) arguments."

Gedek v. Perez

In *Gedek v. Perez,* No. 12-CV-6051L, 2014 WL 7174249 (W.D.N.Y. Dec. 17, 2014), participants and beneficiaries of the Savings and Investment Plan ("SIP") of Eastman Kodak Company ("Kodak") and the Eastman Kodak Stock Ownership Plan ("ESOP") (collectively "the Plans") brought an action against the administrators and fiduciaries of the Plans. The plaintiffs alleged that the defendants violated ERISA by failing to prudently manage the Plans' assets, principally by continuing to invest plan assets in Kodak stock even after it allegedly became obvious that Kodak was headed for bankruptcy and that its stock was going to plummet in value.

The court quoted *Dudenhoeffer's* holding that because "[t]he Court of Appeals did not point to any special circumstance rendering reliance on the market price imprudent, [t]he court's decision to deny dismissal ... appears to have been based on an erroneous understanding of the prudence of relying on market prices" as a measure of a stock's "true" value. The court explained that *Dudenhoeffer* did not address the situation presented by the plaintiffs' factual allegations in the instant case; that is, allegations that a company's downward path was so obvious and unstoppable that, regardless of whether the market was "correctly" valuing the stock, the fiduciaries should have halted or disallowed further investment in company stock.

In examining the impact of *Dudenhoeffer* on the instant case the court emphasized the factual differences between the two cases. In *Dudenhoeffer,* the court explained, the allegation was that the fiduciaries knew or should have known that the company's stock was overvalued. In contrast, plaintiffs in the instant case alleged that:

> "[d]efendants knew or should have known that Kodak stock was an imprudent investment for the Plans because the Company: (a) depended on a dying technology and the sale of antiquated products no longer sought by the consumer; (b) was unable to bring new products to the market to counter the rapidly declining profits from the sales of its antiquated products; (c) was unable to generate sufficient cash-flow from its short term business strategy of initiating lawsuits, which would presumably garner settlements, to maintain the Company's cash flow; (d) was suffering from a severe lack of liquidity; and (e) its stock price collapsed because of the above dire circumstances."

The court explained that the plaintiffs' key argument was not that the price of Kodak stock was inflated, as it rather accurately tracked the company's steadily

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worsening fortunes, which had no reasonable chance of improving. Therefore, the issue was not whether defendants paid an artificially inflated price for Kodak stock, but whether they should have realized that Kodak stock represented such a poor long-term investment that they should have ceased to purchase, hold, or offer Kodak stock to plan participants. The court explained that *Dudenhoeffer* provided little explicit guidance on this question.

What the court found was clear from *Dudenhoeffer* was that (1) there is no presumption that a fiduciary acted prudently, regardless of the type of fund at issue; and (2) as stated in ERISA, an ESOP fiduciary is exempt from § 1104(a)(1)(B)'s duty of prudence, but only to the extent that the statute requires diversification. Thus, the court concluded, in all other respects, an ESOP fiduciary's duty of prudence is no different or less stringent than that of any other ERISA fiduciary.

After considering the allegations, the court held that, particularly without the *Moench* presumption of prudence, the plaintiffs stated a facially valid claim against the Kodak defendants with regard to the ESOP. The court explained, "Accepting the truth of plaintiffs' allegations, a reasonable factfinder could conclude that at some point during the class period, the ESOP fiduciary should have stepped in and, rather than blindly following the plan directive to invest primarily in Kodak stock, shifted the plan's assets into more stable investments, as permitted by the plan document, and as consistent with the plan's and ERISA's purposes." The court stressed that in the aftermath of *Dudenhoeffer,* plaintiffs need no longer plead facts to overcome the *Moench* presumption. Thus, the court concluded that, assuming the truth of plaintiffs' allegations, they stated a plausible claim that defendants violated their duty to act prudently.

Non Stock-Drop Case: Tatum v. RJR Pension Inv. Committee

On August 4, 2014, the Fourth Circuit found that a district court failed to use the appropriate standard in determining if a 401(k) plan's investment decision was "objectively prudent" and thus in accordance with ERISA.

The district court had held that the RJR Pension Investment Committee breached its duty of procedural prudence in 2000 by divesting the R.J. Reynolds ("RJR") 401(k) plan of stock in Nabisco, a subsidiary of RJR's parent, RJR Nabisco Holdings Inc. Participants alleged that the defendants breached their fiduciary duties under ERISA by forcing participants to sell their Nabisco stock when such shares were selling at an all-time low. The district court ruled in favor of RJR and found that, despite the breach of procedural prudence, a hypothetical prudent fiduciary "could have" divested the plan of the Nabisco stock if it had carried out a sufficient investigation, thus the breach did not cause any of the plaintiff's alleged losses.

The Fourth Circuit quoted *Dudenhoeffer's* finding that, "Because the content of the duty of prudence turns on 'the circumstances ... prevailing' at the time the fiduciary acts, § 1104(a)(1)(B), the appropriate inquiry will necessarily be context specific." Relying in part on *Dudenhoeffer,* the Fourth Circuit explained that the district court had applied the wrong standard, holding that the proper standard was to determine if the hypothetical prudent fiduciary "would have" divested the plan of the stock after a proper investigation.

Conclusion

Following *Dudenhoeffer,* claims asserting a breach of fiduciary duty in employer Stock-Drop cases will no longer be dismissed at the early stages of litigation based on a presumption of prudence. However, a claim will likely be dismissed if plaintiffs do not meet the high pleading burden that has been set by the Supreme Court in *Dudenhoeffer*. Plaintiffs must plead specific facts, including "an alternative action that the fiduciary could have taken that would have been consistent with the securities laws and that a prudent fiduciary in the same circumstances would not have viewed such alternative action as more likely to harm the fund than to help it." Thus, the Supreme Court's holding in *Dudenhoeffer* is not necessarily a blow to ESOP fiduciaries. With an understanding of the cases that follow *Dudenhoeffer,* along with the Sixth Circuit's decision in *Dudenhoeffer* when it is decided on remand, ESOP fiduciaries will likely be better able to defend themselves against participants' Stock-Drop lawsuits.

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OTHER DEVELOPMENTS IN EMPLOYEE BENEFITS

Gabriel Revisited

In our June 2014 newsletter, we discussed the Ninth Circuit's decision in *Gabriel v. Alaska Electrical Pension Fund,* 755 F.3d 647 (9th Cir. 2014). Following a petition for rehearing, the Ninth Circuit recently withdrew its earlier opinion and issued a new decision. *See, Gabriel v. Alaska Electrical Pension Fund,* --- F.3d ----, 2014 WL 7139686 (9th Cir. Dec. 16, 2014). While the Ninth Circuit left intact the earlier holding that equitable estoppel and reformation were not "appropriate equitable remedies" under ERISA § 502(a)(3) for the harm alleged by Gabriel, the Court reversed course regarding the unavailability of a surcharge remedy to Gabriel. The new opinion withdrew guidance regarding the specific factual circumstances under which a surcharge remedy would be "appropriate," and remanded the issue to the district court to be considered in the first instance by the court below.

— SEAN T. STRAUSS

The Trucker ✦ Huss *Benefits Report* is published monthly to provide our clients and friends with information on recent legal developments and other current issues in employee benefits. Back issues of *Benefits Report* are posted on the Trucker ✦ Huss web site (www.truckerhuss.com).

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In response to new IRS rules of practice, we inform you that any federal tax information contained in this writing cannot be used for the purpose of avoiding tax-related penalties or promoting, marketing or recommending to another party any tax-related matters in this *Benefits Report*.

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DECEMBER 2014

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