

**RETIREMENT PLAN INVESTMENT DECISIONS  
ATTACKED IN CLASS ACTIONS  
THREATENING FINANCIAL SERVICES INDUSTRY**

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## **Retirement Plan Investment Decisions Attacked in Class Actions Threatening Financial Services Industry**

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### ***Shifting Ground***

During the past year, there have been a number of lawsuits in which groups of retirement plan participants have challenged the plan investment decisions of plan fiduciaries under the Employee Retirement Income Security Act ("ERISA") and other federal statutes. For example, as reported in *The Wall Street Journal*, *The New York Times* and *The Washington Post*, three major corporations and the trustees of the retirement plans which these companies sponsor have been named as defendants in class actions filed in federal court in the Eastern District of Pennsylvania, the Eastern District of Virginia and the Central District of California. In each case, plan participants have asserted claims related to the decision to restrict or change their 401(k) investment choices and/or to invest defined benefit plan assets in "in-house" mutual funds. These cases are significant, particularly for employers and fiduciaries in the banking, financial services, mutual fund and insurance industries, many of which routinely offer in-house financial products as 401(k) investment choices or invest defined benefit plan assets in in-house financial products.

### **Recent Lawsuits Challenge Plan Investment Decisions**

In June 2000, four plan participants in the defined benefit and 401(k) plans of the employees and agents of New York Life Insurance Company filed a class action against the company and the trustees of the plans, asserting claims under ERISA and the Racketeer Influenced and Corrupt Organizations Act ("RICO"). Specifically, the plan participants claim that the defendants breached fiduciary duties, engaged in prohibited transactions and violated RICO by investing defined benefit plan assets in and limiting 401(k) investment choices to in-house mutual funds.

Similarly, in April of this year, a group of participants in the SBC Communications Inc. 401(k) plan sued when the fiduciaries of that plan sold investments in Airtouch stock and invested the proceeds in SBC stock. The case grew out of the acquisition of Pacific Telesis Group by SBC in 1998. Pacific Telesis employees who participated in the Pacific Telesis 401(k) plan had invested heavily in Pacific Telesis stock. When Pacific Telesis spun off its wireless communications subsidiary as Airtouch Communications in 1994, participants in the Pacific Telesis 401(k) plan received substantial blocks of Airtouch stock. In 1997, Pacific Telesis was acquired by SBC. In 1998, the Pacific Telesis 401(k) plan was merged into the SBC 401(k) plan. The SBC 401(k) plan eliminated the investment in Airtouch stock because Airtouch was no longer directly

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owned by SBC. According to the complaint filed in this matter, the Airtouch stock was valued at \$635 million at the time of the sale and purportedly rose to more than \$1 billion when Airtouch merged with Vodaphone PLC to form one of the world's largest wireless communication companies. Challenging the decision to sell the Airtouch stock, a group of plan participants sued SBC, seeking over \$1 billion for a class of some 40,000 employees.

Lastly, in May 1999, a group of plan participants sued First Union Corporation following its acquisition of Signet Banking Corp. The plaintiffs contend that First Union improperly shifted assets from Signet's 401(k) plan into First Union mutual funds after acquiring Signet in late 1997. Another group of plan participants filed a second action against First Union, alleging that the bank steered assets from its 401(k) plan into its own mutual funds to boost the bank's profits in violation of both ERISA and RICO.

Notably, the plaintiffs in each of these cases are represented by the Washington, D.C. law firm of Sprenger & Lang. The lawsuits allege that investment decisions were made to benefit the plan sponsor rather than plan participants. Moreover, in the First Union and New York Life cases, the plaintiffs challenge the application of specific prohibited transaction exemptions that permit investments by company-sponsored plans in in-house investment vehicles. None of these cases involves the investment of retirement plan assets of customers of these institutions.

### **ERISA's Fiduciary Duties**

Under ERISA, individuals who are responsible for investing plan assets have a fiduciary duty to plan participants. Specifically, fiduciaries are required to discharge their duties with respect to a plan solely in the interest of participants and beneficiaries and for the exclusive purpose of providing benefits to participants and beneficiaries and defraying reasonable expenses of administering the plan. Fiduciaries are further charged to act prudently and to diversify investments to minimize the risk of large losses, unless under the circumstances it is prudent not to do so. These responsibilities are sometimes called the duties of loyalty, prudence and diversification.

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At the time ERISA was passed, Congress recognized the impracticality of requiring banks, insurance companies and financial services companies to invest the assets of the retirement plans that they sponsored in the financial products of their competitors. Consequently, Congress enacted certain prohibited transaction exemptions in Sections 408(b)(4) and (5) of the statute that permitted such investments, and authorized the Department of Labor to promulgate additional exemptions. Consistent with this statutory authorization, the Department of Labor adopted several prohibited transaction exemptions, such as PTE 77-3, which permit financial services companies to invest retirement assets in their own financial products and even benefit from the arrangement, so long as the decision to invest in those products is otherwise prudent. Notwithstanding these exemptions, the New York Life and First Union lawsuits characterize in-house investments of retirement plan assets as prohibited transactions, breaches of fiduciary duty and criminal racketeering activity.

### **Minimizing Risks of Future Litigation**

Given the highly-publicized nature of the New York Life, SBC and First Union cases, plan sponsors and fiduciaries, especially in the banking, insurance, mutual fund and financial services industries, should anticipate greater scrutiny of their investment decisions for the plans that they sponsor. Although the cases discussed above are in their early stages, strike suit attorneys may aggressively seek out disaffected plan participants to act as named plaintiffs in class actions that allege a laundry list of fiduciary breaches. For example, some 401(k) plan participants undoubtedly have been disappointed by the performance of the market since the start of calendar year 2000. Aggressive plaintiffs' lawyers may try to exploit that disenchantment by targeting 401(k) plans that limit investment choices to in-house mutual funds. Similar attacks may be directed at in-house defined benefit plan investments. To avoid or limit the success of such challenges, plan fiduciaries should review the process they follow in making and monitoring plan investment decisions. There are various strategies and approaches that can be considered to reduce or minimize the risks to plan sponsors and fiduciaries associated with plan investments. An ounce of fiduciary procedural prudence today may defeat tomorrow's lawsuit!

Morgan, Lewis & Bockius LLP represents New York Life and its trustees in the Sprenger & Lang class action, *Mehling, et al. v. New York Life Insurance Co., et al.*, No. 99-5417 (E.D. Pa). Morgan Lewis also has extensive experience in advising plan sponsors and fiduciaries in connection with plan investment and plan design decisions, and in handling complex, benefits-related class actions under ERISA.

Michael L. Banks

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