

***Howell v. Motorola*: Seventh Circuit Endorses Employer Stock Fiduciary Discretion, But Muddies the Water on ERISA Section 404(c) Safe Harbor**

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Participant lawsuits against 401(k) plan fiduciaries are increasingly prevalent, particularly with today's economic climate. Many of these challenges focus on the inclusion of company stock as an investment option available to plan participants. As the challenges mount and more courts opine on these matters, the standards to which fiduciaries are held become clearer in some areas of the law, while confusion is added in other areas. The recent decision in *Howell v. Motorola*¹ is no exception.

Employer Stock Fiduciary Discretion

On January 21, a three-judge panel of the Seventh Circuit Court of Appeals decided *Howell v. Motorola*, affirming a judgment in favor of Motorola on claims that Motorola's fiduciaries breached their ERISA duties by continuing to make Motorola stock available for investment by plan participants during a stock price decline. Plaintiffs alleged that (1) the inclusion of company stock in the 401(k) plan became imprudent because of a significant stock price decline and that fiduciaries should have eliminated the fund, (2) the fiduciaries either misrepresented or failed to disclose material information about a bad business transaction that had a negative impact on the stock's value, and (3) other fiduciaries failed to monitor the committee delegated with responsibility for plan investments.

Motorola's 401(k) plan is administered by a committee that selects the investments the plan offers its participants, monitors those investments, and provides reports to Motorola's board. The plan was established to comply with ERISA section 404(c), meaning that the participants (not the plan fiduciaries) are solely responsible for allocating assets among the various funds offered in the plan. At all relevant times, the plan offered a wide array of investment options with different risk characteristics, including the Motorola stock fund, which exclusively held Motorola common stock. The plan's governing documents allowed, but did not require, the plan to offer the Motorola stock fund as one option, and no plan participant was ever required to invest in the fund. Except for a brief blackout period, plan participants were entitled to transfer funds out of the Motorola stock fund on a daily basis. Originally, the plan was structured such that participants were not permitted to invest any more than 25% of their plan assets in the Motorola stock fund. Motorola employees later voted to lift the cap and permit participants to invest up to 100% of their assets in the Motorola stock fund.

1. *Howell v. Motorola*, Nos. 07-3837 and 09-2796 (7th Cir. Jan 21, 2011).

On the merits, the court reaffirmed prior precedents, handing Motorola a strong victory and clarifying again that periodic stock price declines, even severe ones, are insufficient to support a claim of breach of fiduciary duty by plan fiduciaries.² The court rejected the plaintiffs' imprudence claim, finding that Motorola was a "fundamentally sound company" that was not facing imminent collapse. There was no evidence to suggest that Motorola's stock had become so risky or worthless that the fund needed to be withdrawn. While Motorola stock did become volatile and experience declines after a bad business decision became public, such stock fluctuations are insufficient to establish imprudence. Participants concerned with the downward trend could easily have reallocated their assets to one of the other investment options offered by the plan. Under these circumstances, the court did not find it imprudent for the fiduciaries to maintain the stock fund. This decision continues a strong trend in courts of appeals presuming the prudence of maintaining company stock as an investment option for plan participants.³

The court similarly dispatched plaintiffs' claims that the Motorola fiduciaries made misrepresentations or failed to monitor other fiduciaries. Motorola made clear that investing in employer stock was riskier than investing through other vehicles, and it was under no obligation to disclose other nonpublic information alleged by plaintiffs. There was also no evidence that information was concealed from participants nor any evidence that monitoring fiduciaries failed to carry out their ERISA-imposed duties.

ERISA Claim Release

The court also made an additional determination of note. The Seventh Circuit considered whether a general release signed by one of the plaintiffs in the *Motorola* class action effectively waived his claim for breach of fiduciary duty under ERISA section 502(a)(2). The agreement at issue contained a general release of claims under ERISA, but also contained a provision exempting any "claims for benefits under the Motorola Employee Benefits Plan." Relying on Chief Justice Roberts' concurring opinion in *LaRue v. DeWolff, Boberg & Assocs., Inc.*,⁴ the plaintiff argued that his breach of fiduciary duty claim was a claim for benefits and therefore exempted from his release. The Seventh Circuit determined, however, that the breach of fiduciary duty claim was effectively waived by the release. In so holding, the court determined that the reservation of claims for benefits applied only to those specific benefits that had already vested in the particular 401(k) plan account at the time the release was signed. In other words, the plaintiff had a right to his benefits and they could not be confiscated, but he waived any right to bring a lawsuit claiming that his account would have been worth more had the defendants not breached a fiduciary duty. The fact that the release turned on the terms of the agreement highlights the need to review separation agreements to ensure ERISA claims are effectively waived.

ERISA Section 404(c)'s Safe Harbor

In addition to its ruling, the court commented on the scope of protection afforded to 401(k) plan fiduciaries under ERISA section 404(c). In relevant part, section 404(c) exempts fiduciaries from liability "for any loss, or by reason of any breach, which results from such participant's or beneficiary's exercise of control." Thus, on its face, section 404(c) provides a statutory "safe harbor" for claims of breach of fiduciary duties for self-directed plans that meet the regulatory requirements for section 404(c) compliance.

2. See *Summers v. State Street Bank & Trust Co.*, 453 F.3d 404 (7th Cir. 2006); *Wright v. Oregon Metallurgical Corp.*, 360 F.3d 1090 (9th Cir. 2004).

3. E.g., *Quan v. Computer Sciences Corp.*, 623 F.3d 870 (9th Cir. 2010).

4. *LaRue v. DeWolff, Boberg & Assocs., Inc.*, 552 U.S. 248 (2008).

The Seventh Circuit affirmed judgment for Motorola on the merits, and therefore had no need to comment on the section 404(c) safe harbor. Nonetheless, the Seventh Circuit indicated in its opinion that it agreed with the U.S. Department of Labor’s (DOL’s) position—which is devoid of support in the statutory text—that the selection of plan investment options and the decision to continue offering a particular investment vehicle are acts to which fiduciary duties attach, and that the safe harbor is not available for such acts. In explaining its conclusion, the Seventh Circuit noted that section 404(c) was intended to ensure that a fiduciary will not be held responsible for decisions over which it had no control. Section 404(c) thus creates a safe harbor “only with respect to decisions that the participant can make.” Glossing over the fact that it is *always* the plan sponsor or fiduciaries that select plan investment options, the panel commented that the choice of which investments will be presented in the menu that the plan sponsor adopts is not within the participant’s power. It did not consider that the statute and regulations literally contemplate that participant choice is derived from the menu of investments selected by the employer.

Although the Seventh Circuit held that section 404(c) applies to disclosure claims, its analysis in this context essentially conflates the section 404(c) defense with proof of compliance with the more general disclosure duties embodied in ERISA. In other words, to take advantage of the section 404(c) defense, fiduciaries must show that they did not violate ERISA in the first place. In so holding, the Seventh Circuit recognized that “this may well mean there will be no case where a defendant can both breach ERISA’s fiduciary duty to disclose information and also take advantage of section 404(c)’s safe harbor.” The court afforded the fiduciaries section 404(c) protection only after determining that the plaintiffs had not introduced sufficient evidence that the Motorola defendants violated the general disclosure duties embodied in ERISA. Among other things, the court reiterated that the fiduciaries were not obligated under ERISA (or the section 404(c) regulations) “to provide all information about Motorola’s business decisions in real time to Plan participants”; further, the fact that Motorola had made a bad business decision “is not enough to make the omission of information a violation of ERISA. We can think of at least one problem that such a rule might create: insider trading.” The court also held that section 404(c)’s safe harbor provision applied with “equal force” to plaintiffs’ monitoring theory.

Inexplicably, the *Motorola* panel, in determining that the offering of Motorola stock did not breach ERISA’s prudence requirements, pointed to the fact that there were other investment options into which participants could have invested their money and, by so doing, avoided the decline in the price of the Motorola stock. “Plan participants were entitled throughout the class period—with the very brief exception of the blackout period, during which the stock price did not fall much at all—to move their dollars away from the Motorola Stock Fund into a different fund on a daily basis; anyone concerned by the downward trend that persisted for some time could have done so (and it is probable that many people did).” This sort of causation analysis is the lynchpin of ERISA section 404(c) and the panel’s refusal to acknowledge the application of the explicit statutory defense cannot be reconciled with the quoted language on prudence.

The *Motorola* panel’s approach to section 404(c) muddied the court’s February and June 2009 rulings in *Hecker v. Deere & Company*,⁵ which affirmed the dismissal of a “fee and expense” class action against Deere & Company. In those rulings, the Seventh Circuit held, among other things, that section 404(c)’s “safe harbor” provided a complete defense to the fiduciaries because Deere satisfied its requirements.

5. *Hecker v. Deere & Co.*, 556 F.3d 575 (7th Cir. 2009), *reh’g denied*, 569 F.3d 708 (7th Cir. 2009), *cert. denied*, 130 S. Ct. 1141 (2010).

These requirements include that a plan offer a broad range of investment options with varied risk and return characteristics, and that the fiduciaries disclose sufficient information, including information about fees and expenses, to enable participants to make informed investment decisions. In satisfying the section 404(c) requirements, the Deere plan gave participants sufficient control over the assets in their accounts immunizing the plan fiduciaries from liability.

The DOL strongly disagreed with the holding in *Deere* and joined the *Deere* plaintiffs in petitioning for reconsideration. In its June 2009 rehearing opinion in *Deere*, the court reaffirmed its judgment in *Deere*'s favor, but made additional comments that application of section 404(c) would occur on a case-by-case basis. Given the arguable circuit split on the scope of section 404(c), the issue appears destined for the Supreme Court.⁶

Class Certification Rulings

Motorola was just one of three significant ERISA cases decided by the Seventh Circuit on January 21. The Seventh Circuit also decided two consolidated interlocutory appeals challenging class certification of two substantially identical classes for claims alleging payment of "excessive" fees under 401(k) plans as well as investment losses in *Spano v. The Boeing Co.* and *Beesley v. International Paper*.⁷ Because we represented International Paper in the consolidated appeal, we cannot comment at length; however, we can report that the Seventh Circuit agreed with the defendants' challenges to the classes certified by the district court, ruling that the district court had not properly evaluated the adequacy and typicality of the claims asserted by the named plaintiffs. Accordingly, the court vacated the district court's order certifying the classes and remanded the cases for additional proceedings to consider whether the requirements for class certification under Rule 23 had been met.

Morgan Lewis is keeping a close watch on these issues and will update you with any significant developments. If you would like any further information about these decisions or the ramifications, please contact any of the following ERISA Litigation Practice partners:

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6. See, e.g., *Langbecker v. Electronic Data Sys. Corp.*, 476 F.3d 299, 305, 315–16 (5th Cir. 2007); *In re Unisys Sav. Plan Litig.*, 74 F.3d 420 (3d Cir. 1996).

7. *Spano v. The Boeing Co.* and *Beesley v. International Paper*, Nos. 09-3001 & 09-3018 (7th Cir. Jan. 21, 2011).

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