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Despite Recent Victories, Risks Remain For Plan Fiduciaries

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Over the last few months, there have been a significant number of court decisions ruling against plaintiffs alleging Employee Retirement Income Security Act breach of fiduciary claims related to single-stock funds, including a Fourth Circuit decision in Richard G. Tatum et al. v. RJR Pension Investment Committee et al., No. 16-1293 (4th Cir.). These recent decisions suggest a new era in the ongoing saga of ERISA single-stock fund litigation — and one that may bode well for ERISA plan fiduciaries. However, even with these decisions, plan fiduciaries continue to face risks related to single-stock funds, and appropriate fiduciary process remains critically important.

Numerous Recent Decisions in Favor of Plan Fiduciaries

In recent years, there have been at least 13 decisions holding in favor of ERISA plan fiduciaries sued for alleged breaches related to single-stock funds. These recent plan fiduciary victories suggest the U.S. Supreme Court's decision in Fifth Third Bancorp v. Dudenhoeffer may be having a chilling effect on single-stock fund ERISA claims.

One example of such a ruling is the case of Graham v. Fearon et al., No. 16-2366 (N.D. Ohio, March 24, 2017). This case involved allegations that an employee stock ownership plan (ESOP), which invested primarily in company stock, suffered significant losses. The plaintiffs alleged that the losses resulted from company management providing false and misleading representations regarding the feasibility of divesting the company's automobile-part manufacturing business. The plaintiffs further alleged that these misrepresentations artificially inflated the stock's value, and ultimately caused a significant drop in the stock price (8.13 percent in one day) when those misstatements were publicly corrected. The complaint stated that the defendants could have halted new purchases of the stock, issued corrective disclosures to cure the alleged fraud, or purchased a hedging product to mitigate against a drop in the stock.

However, in March 2017, the Northern District of Ohio ruled in favor of the defendants, sustaining their motion to dismiss. The court relied upon Dudenhoeffer and determined that Dudenhoeffer and its progeny required the complaint to plausibly allege an alternative course of action that would have been consistent with securities laws and that a prudent fiduciary could not have determined to be more

harmful to the plan than helpful. The court then held that the complaint failed at least the second element because the plaintiffs had not pled a plausible alternative course that dispelled the risk of harm to the plan; i.e. had not pled an alternate course that no prudent fiduciary could determine to be more harmful than helpful to the plan. The court therefore dismissed the case without leave to amend the complaint. This case is currently under appeal before the U.S. Court of Appeals for the Sixth Circuit, Case No. 17-3407.

The Tatum Decision

Contemporaneous with these recent decisions, in April 2017 the Fourth Circuit issued a significant single-stock fund ruling in Tatum.

The Tatum case has a long history, spanning 17 years. The case stemmed from a 2000 decision by R.J. Reynolds Tobacco Co. (RJR) to divest a legacy Nabisco stock fund (a holdover from the RJR/Nabisco corporate spinoff).

The Tatum case has been referred to as a "stock rise" case because the plaintiffs alleged that the RJR fiduciaries breached their duties by eliminating the Nabisco stock fund when its stock price later increased. (In contrast, the more common "stock drop" case occurs when plaintiffs allege that fiduciaries breached their duties by maintaining a stock fund when the stock price fell.) In particular, the RJR fiduciaries determined to eliminate the single-stock Nabisco fund after a six-month "sunset" period. During the six-month period, the Nabisco stock hit historic lows. Shortly after the six-month period ended, however, the Nabisco stock hit historic highs. ERISA plaintiffs filed suit thereafter, alleging that the decision to sell the stock at a low was a breach of fiduciary duty and that prudent fiduciaries would have waited to implement the fund elimination.

Over the next decade, the district court and the Fourth Circuit both issued a number of rulings in favor of the Tatum plaintiffs, including finding that the RJR plan fiduciaries had been imprudent in their process for determining to eliminate the Nabisco stock fund and for determining the length of the sunset period.

But on April 28, 2017, a panel of the Fourth Circuit held that those plan fiduciaries were not liable for any losses related to their procedural imprudence because a "hypothetical prudent fiduciary" would have made the same decision. On May 26, 2017, the Fourth Circuit denied a petition for rehearing en banc and let the decision stand.

In so ruling, the Fourth Circuit has handed ERISA plan defendants a significant victory in the "stock drop" and "stock rise" arena by relieving them of liability, even where they fail to engage in the process ERISA requires, if a "hypothetical prudent fiduciary" would have made the same decision. The Fourth Circuit's analysis focused heavily on "efficient market theory," the idea that the price of a publicly traded stock in an efficient market already takes into account all known information. Thus, according to the Fourth Circuit, plan fiduciaries can look at the price of the stock and be comfortable that the price reflects the true value. The plaintiffs in Tatum argued that the fiduciaries should have known that the Nabisco stock would rebound in value based on various events occurring at that time (such as a potential purchase by Carl Icahn). The Fourth Circuit rejected that notion, however, quoting the Supreme Court's decision in Dudenhoeffer that a "fiduciary cannot be required to predict the future."[1]

Takeaways

These recent decisions provide a number of takeaways. First, the Tatum decision (and the many other cases recently decided against single-stock ERISA claims) should be good news to defined contribution plan fiduciaries. Since the Dudenhoeffer case held that there is no presumption of prudence in favor of company stock, fiduciaries of plans with single-stock funds (typically company stock funds) have questioned whether to eliminate or modify those stock funds. In weighing the correct course of action, some fiduciaries have feared that a decision to eliminate a single-stock fund could give rise to the type of "stock rise" claims at issue in Tatum. This may have caused some fiduciaries concern about freezing or eliminating single-stock funds and/or created reluctance to move forward with such fund changes. Tatum should provide some comfort — and defensive cover — for plan fiduciaries considering such single-stock fund eliminations. In weighing such changes, plan fiduciaries should continue to review and consider the best course for the single-stock fund, whether it is freezing, terminating or continuing with appropriate types of oversight and monitoring.

Furthermore, the efficient market theory espoused in Tatum should provide fiduciaries with protection from claims that they should have second-guessed the market value of the stock. If the efficient market theory is adopted by other circuits (and with the same strong wording used in Tatum), the theory could significantly reduce the burden on ERISA plan fiduciaries making these types of decisions.

That being said, Tatum and the other cases recently decided against plaintiffs in the single-stock fund arena are unlikely to mark an end to single-stock litigation or the risks created by such funds. In many ways, these cases, and especially Tatum, are cautionary tales that continue to underscore the importance of fiduciary process. While the Tatum plan fiduciaries ultimately won, the case dragged on for nearly 17 years, through multiple stages of litigation, trial and appeal. Some of the other recent stock cases have had similarly protracted histories. The recent plan fiduciary "victories" are, therefore, somewhat Pyrrhic and underscore that an alleged lack of fiduciary process can create ongoing risks and costs (even if the underlying decision were eventually upheld in litigation).

Moreover, ERISA plaintiffs are unlikely to stop filing these single-stock fund cases. In the past, ERISA plaintiffs have successfully evolved and refined their theories and claims, and the same can be expected here. In addition, the Tatum decision does not completely remove the burden on plan fiduciaries. At a minimum, Tatum still requires plan fiduciaries to use procedural prudence and not make decisions that a "hypothetical prudent fiduciary" would avoid (in addition to ERISA's other fiduciary duty requirements). Also, the decision includes a vigorous dissenting opinion, which both signals judicial division on this issue and may open the door for petition to the Supreme Court (in this case or a similar later decision).

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[1] Richard G. Tatum et al. v. RJR Pension Investment Committee et al., No. 16-1293, slip op. at 27 (4th Cir. Apr. 28, 2017).