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Fiduciaries in Conflict Situations Under ERISA

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Introduction

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The Employee Retirement Income Security Act of 1974, as amended, imposes fiduciary duties upon individuals who, with respect to an employee benefit plan, (1) exercise discretionary authority or control respecting management of such employee benefit plan or management of its assets, (2) render or have authority or responsibility to render investment advice for a fee, or (3) have discretionary authority or responsibility in the administration of such plan.[1] Generally these fiduciary duties relate to the management of the assets of an employee benefit plan. In carrying out their functions with respect to the plan, especially when it comes to investing the assets of the plan, situations arise where fiduciaries are faced with conflicts of interests that make it difficult for them to uphold their fiduciary duties. In such instances, while not required, the appointment of an independent fiduciary eliminates the conflict and the potential for a breach of such fiduciary duties.

Conflict situations may also be presented in benefits claims situations, especially where the claimants can argue that the committee evaluating the claims has a financial interest in its outcome. Though the use of an independent fiduciary is generally not common in many claims situations, the benefits claims committee, by following clear procedures and acting in an unbiased manner, can still obtain the arbitrary and capricious standard of review so important under ERISA. However, the case law, as discussed below, illustrates how nuanced and complex the review of benefit claims has become.

Finally, the report discusses the fiduciary conflict situations inherent where a company's tax-qualified retirement plan is invested in company stock, and due to subsequent financial circumstances, claimants challenge the fiduciaries' decision on prudence grounds to continue holding the stock. When those fiduciaries are also company officers, a clear conflict situation is presented.

Fiduciary Standards Under ERISA

What Does ERISA Require?

ERISA Section 404(a)(1)[2] requires that a fiduciary must discharge its duties with respect to a plan *solely in the interest of participants and beneficiaries* and:

(i) for the *exclusive purpose* of providing benefits to participants and beneficiaries and defraying reasonable expenses of administering the plan;

(ii) with the *care, skill, prudence, and diligence* under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such

[1] ERISA § 3(21)(A), 29 U.S.C. § 1002(21)(A).

[2] 29 U.S.C. § 1104(a)(1).

matters would use in the conduct of an enterprise of a like character and with like aims;

(iii) by diversifying the investments of the plan so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so; and

(iv) in accordance with the documents and instruments governing the plan (to the extent such documents and instruments are consistent with ERISA).[3]

The Sixth Circuit Court of Appeals described the above fiduciary duties as having three components:

> The first is a "duty of loyalty" pursuant to which "all decisions regarding an ERISA plan 'must be made with an eye single to the interests of the participants and beneficiaries.' " [citations omitted] The second obligation imposed under ERISA, the "prudent man" obligation, imposes "an unwavering duty to act both as a prudent person would act in a similar situation" and "with single-minded devotion" to those same plan participants and beneficiaries. [citation omitted] Finally, an ERISA fiduciary must "act for the exclusive purpose" of providing benefits to plan beneficiaries. [citation omitted][4]

The court continued, "When enforcing these duties, 'the court focuses not only on the merits of the transaction, but also on *the thoroughness of the investigation into the merits of the transaction*.' "[5]

The Department of Labor has stated in its regulations governing pension plans that with regard to an investment or investment course of action taken by a fiduciary pursuant to its investment duties, the prudence requirements of ERISA Section 404(a)(1), as discussed above, are satisfied if the fiduciary (i) has given "appropriate consideration" to those facts and circumstances that, given the scope of such fiduciary's investment duties, the fiduciary knows or should know are relevant to the particular investment or investment course of action involved, and (ii) has acted accordingly.[6] For these purposes, "appropriate consideration" includes, but is not limited to, (i) a determination by the fiduciary that the particular investment or investment course of action is reasonably designed, as part of the portfolio, to further the purposes of the plan, taking into consideration the risk of loss and the opportunity for gain (or other return) associated with the investment or investment course of action, and (ii) consideration of (a) the composition of the portfolio with respect to diversification, (b) the liquidity and current return of the portfolio relative to the anticipated cash flow requirement of the plan, and (c) the projected return of the portfolio relative to the funding objectives of the plan.[7]

Procedural Steps For Compliance With ERISA's Fiduciary Standards

In order to satisfy ERISA's fiduciary duty standards with respect to a particular transaction involving plan assets, the plan fiduciary must take several steps.[8] The first step is to conduct an independent investigation into the merits of a particular transaction. This independent investigation is generally tied to the "prudent man" obligation, as described above. Indeed, courts generally "have focused the inquiry under the prudent man rule on a review of the fiduciary's independent investigation of the merits of a particular [transaction], rather than on an evaluation of the merits alone."[9] As the court in *Donovan v. Cunningham*[10] noted, "the test of prudence—the Prudent Man Rule—is one of conduct, and not a test of the result of performance of the investment. The focus of the inquiry is how the fiduciary acted in his selection of the investment, and not whether his investments succeeded or failed."[11] Indeed, "[a] trustee must make reasonable investigation into the representations of interested parties and where investigation would have revealed evidence that the investment was unsound, the trustee can be held liable."[12] Thus, any review of compliance with ERISA's prudence requirements will be based upon a review of the *procedural steps* the fiduciary followed, i.e., procedural prudence, under the then prevailing facts and circumstances.

In seeking to satisfy the fiduciary duties that are owed to a plan's participants and their beneficiaries with respect to a transaction involving plan assets, including investments, fiduciaries, if they are themselves not experts at evaluating the investment, should seek expert advice.[13] Seeking such expert advice does not relieve the fiduciary from fulfilling its duties under ERISA. In order for the fiduciary to be able to properly rely on expert advice, the fiduciary must (1) investigate the expert's qualifications, (2) provide the expert with complete and accurate information, and (3) make certain

[3] ERISA § 404(a)(1), 29 U.S.C. § 1104(a)(1) (emphasis added).

[4] *Chao v. Hall Holding Co*., 285 F.3d 415, 426, 27 EBC 2153 (6th Cir. 2002), cert. denied, 537 U.S. 1168, 29 EBC 2280 (2003) (quoting *Kuper v. Iovenko*, 66 F.3d 1447, 1458, 19 EBC 1969 (6th Cir. 1995)(quoting *Berlin v. Michigan Bell Tel. Co.*, 858 F.2d 1154, 1162, 10 EBC 1217 (6th Cir. 1988), quoting *Donovan v. Bierwirth*, 680 F.2d 263, 271, 3 EBC 1417 (2d Cir. 1982), cert. denied, 459 U.S. 1069 (1982)).

[5] *Hall Holding*, 285 F.3d at 426, 27 EBC at 2159 (quoting *Howard v. Shay*, 100 F. 3d 1484, 1488, 20 EBC 2097 (9th Cir. 1996)) (emphasis added).

[6] 29 C.F.R. § 2550.404a-1(b).

[7] *Id.*

[8] It is also noted that a plan fiduciary is required under ERISA to avoid involving the plan in a prohibited transaction with certain related persons and to avoid certain proscribed acts of self-dealing with respect to the assets of the plan. *See* ERISA §§ 406(a) & (b), 29 U.S.C. § 1106(a) & (b).

[9] *Donovan v. Cunningham*, 716 F.2d 1455, 1467, 4 EBC 2329 (5th Cir. 1983).

[10] *Id.*

[11] *Id.*, quoting 19B, S. Young, *Business Organizations Pension and Profit-Sharing Plans* § 17.02[3] at 17-29.

[12] *Reich v. Valley Nat'l Bank of Ariz.*, 837 F. Supp. 1259, 1273, 17 EBC 1257 (S.D.N.Y. 1993); *Katsaros v. Cody,* 744 F.2d 270, 279, 5 EBC 1777 (2d Cir. 1984).

[13] While ERISA does not expressly prohibit a plan's in-house fiduciary from making investment decisions, case law and relevant DOL guidance strongly suggest that prudence requires obtaining an expert's advice (where it is available) where the fiduciary is not an expert in order to assist the fiduciary in making an informed decision.

that reliance on the expert's advice is reasonably justified under the circumstances.[14]

In *Hall Holding*,[15] a case involving the purchase of company stock by an employee stock ownership plan, the court held that a plan fiduciary fell short of the prudent man standard when it failed to provide a professional appraiser it had retained to value the company's stock with the information the appraiser needed to make a proper valuation.[16]

Penalties for Noncompliance With ERISA's Fiduciary Standards

If a fiduciary fails to satisfy any of ERISA's fiduciary standards, the fiduciary can be liable for substantial civil penalties as a result of such failure. ERISA Section 409 requires that a fiduciary with respect to a plan who breaches any of its responsibilities, obligations, or duties under ERISA "shall be *personally liable* to make good to such plan any losses to the plan resulting from each such breach . . . and shall be subject to such other equitable or remedial relief as the court may deem appropriate, including removal of such fiduciary."[17]

In addition to ERISA Section 409, ERISA Section 502(*l*)[18] states that if there is any breach or violation of ERISA's fiduciary requirements by a fiduciary or any knowing participation in such breach or violation by any other person, a civil penalty of 20 percent of the "applicable recovery amount" can be assessed against such fiduciary or other person. ERISA Section 502(*l*) defines "applicable recovery amount" as any amount recovered from the fiduciary or other person (i) pursuant to any settlement agreement with the Secretary of Labor, or (ii) ordered by a court to be paid by the fiduciary or other person to a plan or its participants and beneficiaries in a judicial proceeding instituted by the Secretary under ERISA Section 502(a).[19]

Where Conflicts Arise: The Duty of Loyalty

In General

The duty of loyalty requires that a fiduciary must act solely in the interest of the plan's participants and beneficiaries. Often fiduciaries face situations where a potential or actual conflict of interest exists. In these situations fiduciaries are obligated to make decisions "with an eye single to the interests of the participants and beneficiaries," but often it is difficult for the fiduciary to uphold such duty because of the conflict.[20] Similarly, the duty of loyalty imposed upon fiduciaries is a duty to "avoid placing themselves in a position where their acts as officers and directors of the corporation will prevent their functioning with complete loyalty to participants."[21] When fiduciaries find themselves in a conflict situation, the appointment of an independent fiduciary, while not necessarily required, may help to ensure that the duty of loyalty is not breached. The following are common situations where fiduciaries encounter conflicts of interests.

Fiduciary Obligations With Respect to a Merger Transaction

Fiduciaries of employee benefit plans are often officers and directors of companies. One situation where such fiduciaries may face conflicts of interest is where the corporation is entering into a merger and the company to be merged maintains a company stock fund within a § 401(k) plan. In the situation where the assets of the company stock fund (which is a part of an employee benefit plan) would be exchanged for stock in the newly formed company, the stock fund would, in effect, own a portion of the newly formed entity as a result of the merger. In such cases, the fiduciary must ensure that the resulting valuation of the new shares (and underlying acquisition) is a proper investment of such plan assets.

To make this determination, the fiduciary may have to assess the fair market value of the resulting entity's assets, including the assets of the other party to the merger, because, in effect, the original company stock fund would be receiving an interest in the new company in the transaction. Only when the respective fair market values of the assets are properly determined will the fiduciary be able to determine what the anticipated value of the new entity would be, the relative contributions of the parties to the transaction, and the minimum level of equity interest in the new entity it would need to receive in order for the investment to be proper.

Such determination can be very difficult to make, especially when the assets to be valued are for a closely held or private corporation and the fair market value is not readily ascertainable. In such instances, fiduciaries invariably receive and review a professional valuation of the assets involved in the transaction. As noted above,

[14] *Howard v. Shay*, 100 F.3d 1484, 1489, 20 EBC 2097 (9th Cir. 1996) (citations omitted).

[15] *Chao v. Hall Holding Co.*, 285 F.3d 415, 426, 27 EBC 2153 (6th Cir. 2002), cert. denied, 537 U.S. 1168, 29 EBC 2280 (2003).

[16] *Id.*

[17] ERISA § 409, 29 U.S.C. § 1109 (emphasis added).

[18] 29 U.S.C. § 1132(*l*).

[19] ERISA § 502(*l*), 29 U.S.C. § 1132(*l*).

[20] *See Donovan v. Bierwirth*, 680 F.2d 263, 271, 3 EBC 1417 (2d Cir. 1982).

[21] *Id.* However, the U.S. District Court for the Northern District of California criticized the broad reach of *Bierwirth* in *In re McKesson HBOC, Inc. ERISA Litigation*, 391 F. Supp. 2d 812, 834-35, 35 EBC 2683 (N.D. Cal. 2005), stating that:

> "[] *Donovan* cannot mean that fiduciaries face liability for merely creating the *potential* for a conflict of interest. Indeed, 'nowhere in the statute does ERISA explicitly prohibit a trustee from holding positions of dual loyalties.' *Friend v. Sanwa Bank California*, 35 F.3d 466, 469, 18 EBC 2057 (9th Cir. 1994); *Pegram v. Herdrich*, 530 U.S. 211, 225, 24 EBC 1641 (2000) ('[u]nder ERISA... a fiduciary may have financial interests adverse to beneficiaries'). Instead, the duty of loyalty requires fiduciaries to refrain from actual disloyal conduct, not simply running the risk that such behavior will occur. . . .No case of which the court is aware has held that ERISA fiduciaries breach their duty of loyalty simply for 'placing themselves in a position' where they might act disloyally."

the fiduciary may have to conduct an independent investigation into the merits of the transaction.[22]

DOL has offered some guidance with respect to valuations of this sort in connection with a statutory exemption from ERISA's otherwise applicable prohibitions concerning the purchase or sale of employer securities or employer real property from or to a party in interest to a plan. In order to avoid engaging in a prohibited transaction in those instances, a plan fiduciary must, among other things, ensure that the plan receives not less than, or pays not more than, "adequate consideration" in exchange for a security bought or sold by the plan.

A DOL proposed regulation issued in 1988 required that to be certain that the adequate consideration requirement was met, the valuation determination either must be made by a fiduciary independent of all parties to the transaction (other than the plan), or must be based on the report of an independent appraiser. It is important to note that DOL stated that when issuing the proposed regulation, "if the independent fiduciary has neither the experience, facilities nor expertise to make the type of valuation under consideration, the decision by that fiduciary to make the valuation would fail to meet the prudent investigation and sound business principles requirement of [the] proposed [regulation]."[23] Although the DOL proposed regulation was limited in its scope, it nonetheless provided a strong indication of DOL's continuing view of the prudence rules when applied to valuations of nonpublicly traded assets to be transferred from, or received by, an ERISA plan. Indeed, as one court noted in describing the utility of the proposed regulation, "[t]he Proposed Regulation incorporates applicable statutory and trust law standards and furnishes a useful paradigm for asset valuation and analysis."[24] Furthermore, although the proposed regulation has yet to be finalized, many federal courts have affirmatively adopted DOL's proposed standards for evaluating the adequacy of consideration in this context.[25]

In order for a valuation of a nonpublicly traded asset to be considered sufficient for reliance by a plan fiduciary, such valuation should consider a wide range of issues, and not be limited to one or two measures (such as revenues or net income). Here, again, the DOL proposed regulation provides helpful guidance. The DOL proposed regulation provides that a valuation of an asset for which there is no readily available trading market must consider the following elements, along with any other relevant factors:

- the nature of the business and the history of the enterprise from its inception;
- the economic outlook in general, and the condition and outlook of the specific industry in particular;
- the book value of the securities and the financial condition of the business;
- the earning capacity of the company;
- the dividend-paying capacity of the company;
- whether or not the enterprise has goodwill or other intangible value;
- the market price of securities of corporations in the same or a similar line of business, which are actively traded in a free and open market, either on an exchange or over-the-counter;
- the marketability, or lack thereof, of the securities; and
- whether a control premium should apply.[26]

Even if a plan fiduciary receives an independent appraisal of a business or other assets to be transferred or received in a transaction, the required investigation is not yet over. The fiduciary must then examine the appraisal and determine how it affects the particular transaction. The fiduciary may not blindly rely on the independent appraisal in making its decision with respect to the transaction in question.[27] In this regard, a court has noted, "the fiduciary is required to make an honest, objective effort to read the valuation, understand it, and question the methods and assumptions that do not make sense. If after a careful review of the valuation and discussion with the expert, there are still

[22] See *Chao v. Hall Holding Co.*, 285 F.3d 415, 426, 27 EBC 2153 (6th Cir. 2002), cert. denied, 537 U.S. 1168, 29 EBC 2280 (2003), wherein somewhat similar factors regarding an ESOP were discussed.

[23] Preamble to Department of Labor Proposed Regulation Relating to the Definition of Adequate Consideration, 53 Fed Reg. 17,632 (May 17, 1988).

[24] *Montgomery v. Aetna Plywood, Inc.*, 39 F. Supp. 2d 915, 919 n.1 (N.D. Ill. 1998). The author notes that although the DOL proposed regulation was never finalized and was in fact withdrawn by DOL, it is still widely considered and followed in cases dealing with asset valuation in connection with determinations of "adequate consideration." The *Montgomery* court stated in note 1 that "Although the proposed regulation has not been formally adopted, the experts for both sides have acknowledged that it is widely considered and followed. It is referred to in the experts' reports, in the testimony of the experts and in a valuation treatise accepted by defendants' expert as authoritative."

[25] *See, e.g., Keach v. U.S. Trust Company,* 419 F.3d 626, 636, 35 EBC 1818 (7th Cir. 2005) (naming the Seventh, Sixth and Ninth Circuit Courts of Appeals as adopting DOL' s standards); *DeFazio, et. al. v. Hollister, Inc.,* 854 F.Supp.2d 770, fn. 19, 53 EBC 2658 (E.D. Cal. 2012) (noting that the Second Circuit has adopted DOL's standards, and clarifying that the Ninth Circuit applies a standard similar to DOL's proposed regulation but has not expressly adopted it).

[26] Prop. DOL Reg. 29 C.F.R. § 2510.3-18(b)(4)(ii).

[27] *Donovan v. Cunningham,* 716 F.2d 1455, 1467, 4 EBC 2329 (5th Cir. 1983). The appraisal must also be timely. In *Donovan v. Cunningham*, the court held that the fiduciaries of an ESOP that had relied on a professional appraisal of their company's fair market value in determining whether the ESOP should purchase the company's stock were in violation of ERISA's fiduciary requirements because at the time of the plan transaction at issue, the appraisal was already 20 months old and the fiduciaries did not evaluate the appraisal in light of events that would have affected the company's fair market value after such appraisal had been completed. *See also DeFazio et. al. v. Hollister, Inc.,* 854 F.Supp.2d 770, 53 EBC 2658 (E.D. Cal. 2012)(citing *Cunningham* to evaluate the use of a December 31 book value rather than a month-end book value to set the price of shares).

uncertainties, the fiduciary should have a second firm review the valuation."[28]

Hiring an expert to perform the valuation not only helps to satisfy a fiduciary's duties to the plans' beneficiaries, it also avoids the potential conflict of interest that may arise where the fiduciary is an officer and may have an interest in the valuation, which may not be for the exclusive benefit of the participants and beneficiaries. In this situation, the fiduciary has an interest in swaying the final valuation to set the transaction price, regardless of the effect such valuation has on the plan participants and beneficiaries. The fiduciary can manipulate the price even after hiring the expert by limiting the information conveyed to the expert and in selecting the expert.

Practice Tip: In light of the ERISA fiduciary duty to act prudently and exclusively for the benefit of participants and beneficiaries, and in light of the serious ramifications (including penalties) that can apply if the transaction were found to be imprudent, it may be advisable—depending on the complexity and nature of a given merger (e.g., a merger of private companies where public market information is not available may favor more strongly the case to hire an independent valuator)—for the trustee to retain an independent valuation adviser who would be independent of all parties to the merger and who would be capable of determining the fair market value of the resulting entity interest to be received as revalued shares in the company stock fund. The trustee must also be diligent in its review of any valuation report it receives.

Even if an independent investigation, review or appraisal is made by a fiduciary that is facing a potential conflict of interest, such actions do not create an absolute defense to charges of fiduciary breach. In *Howard v. Shay*,[29] the court found that the mere hiring of an expert to value the stock purchased by an ESOP did not fulfill the investigative requirements triggered by the fiduciary duties. In *Howard*, executives of a company were also fiduciaries of the company's ESOP. The fiduciaries caused the plan to sell all of its company stock to the president and chairman of the company, one of the plan's fiduciaries. A valuation expert, who was hired by one of the fiduciaries, determined the value of the stock sold. The fiduciaries relied on the result of the valuation and did not question the valuation methodology or retain a second firm to review such valuation.

The court noted that even a cursory review of the report would reveal that the methodology chosen was not supported or explained in the valuation report and a prudent fiduciary would have at least sought an explanation.

Practice Tip: To justifiably rely on an independent appraisal, a conflicted fiduciary need not become an expert in the valuation of closely held corporations. However, the fiduciary is required to make an honest, objective effort to read the valuation, understand it, and question any of its methods and assumptions that do not make sense. If after such review uncertainties exist, then a second firm should review the valuation.

The *Howard* court noted that the fiduciary must (1) investigate the expert's qualifications, (2) provide the expert with complete and accurate information, and (3) make certain that reliance on the expert's advice is reasonably justified under the circumstances.[30]

Fiduciary Obligations With Respect to Investment Activities in Contests for Corporate Control

Fiduciaries who are also officers or directors face conflicts of interest when their corporation is the subject of a contest for corporate control. Employee benefit plans may have the potential to influence the outcome of battles over corporate control by buying or selling a substantial number of securities in a company that is the object of a takeover attempt. By doing so, the benefit plans may thwart a takeover effort or ensure its success. The conflict arises typically when fiduciaries' decisions to buy or sell securities are made to promote their own goals in respect of the battle for control rather than for the exclusive benefit of the beneficiaries. For example, a fiduciary's decision to use plan assets to buy stock as part of an effort to force the acceptance of a leveraged tender offer is a decision motivated by the fiduciary's desire to obtain control of the entity and serve as management of the newly acquired corporation, and not a decision motivated exclusively for the benefit of the participants.[31] Officers of the target clearly have an interest in retaining their jobs and possibly fighting off the tender; however, conflicts also arise for fiduciaries of the acquirer. Officers of the acquirer want to maintain favorable relations with their current management to protect their own positions and, therefore, as fiduciaries, such officers may make decisions regarding the investment of plan assets that will assist in a successful takeover bid, but their actions may not be in the sole interests of the participants.

The Second Circuit, in *Donovan v. Bierwirth*,[32] examined the duty of loyalty in the context of a corporate control contest. In *Bierwirth*, a corporation was the subject of a takeover bid, and the fiduciaries (who were officers) did not tender the corporation's stock owned by the plan to the acquiring company. Instead, the fiduciaries purchased more of the corporation's stock on behalf of the plan at a time when the price of the stock was inflated due to the takeover contest.[33] The court used two approaches to examine whether the duty of loyalty was breached. The first approach focused on the existence of the conflict between the trustees and the plan participants and beneficiaries. The court noted that it would be "almost impossible" for the trustees to have decided to use the plan assets in a manner that would have weakened their own position in the control contest, irrespective of the interests of the plan participants and

[28] *Howard v. Shay*, 100 F. 3d 1484, 1490, 20 EBC 2097 (9th Cir. 1996).
[29] *Howard v. Shay*, 100 F.3d 1484, 20 EBC 2097 (9th Cir. 1996).
[30] *Id.*
[31] *Sandoval v. Simmons*, 622 F. Supp. 1174, 6 EBC 2161 (D. Ill. 1985).
[32] 680 F.2d 263, 3 EBC 1417 (2d Cir. 1982).
[33] *See id.*

beneficiaries. Under this approach the court determined that fiduciaries that face such substantial conflicts in corporate control contests must remove themselves so that a neutral, independent trustee can manage the plan for the duration of the contest.[34]

The second approach the court used focused on the investigation of the investment alternatives open to the trustees in the contest. The court stated that a thorough, impartial, and careful investigation should have been performed in order to justify the actions taken by the trustees to invest plan assets in the corporation during a takeover. "They should have realized that, since their judgment on this score could scarcely be unbiased, at least they were bound to take every feasible precaution to see that they had carefully considered the other side."[35]

The court ultimately rested its decision on the second approach, stating that where it is possible that the fiduciary's loyalty is compromised, the fiduciary is obligated to at least engage in an intensive and scrupulous independent investigation of its alternatives to ensure that its actions are in the best interests of the participants and beneficiaries.[36]

The court in *Leigh v. Engle*,[37] adopting the *Bierwirth* analysis, stated that it is virtually impossible for fiduciaries to discharge their duties with an "eye single" to the interests of the beneficiaries, and the fiduciaries may need to step aside, at least temporarily, from the management of the plan assets when faced with such potential conflicts.[38] In *Leigh*, fiduciaries of a profit-sharing plan invested approximately 30 percent of the plan's assets in three different companies that were each involved in contests for corporate control. The fiduciaries were actively engaged on behalf of the controlled groups of companies affiliated with the sponsoring company to acquire the three targeted companies.

In order to determine whether the fiduciaries breached their duty, the court examined a variety of factors, including: (1) the risk of a conflict between the interests of fiduciaries and beneficiaries, (2) whether the fiduciaries with divided loyalties made an intensive and scrupulous investigation of the plan's investment options, and (3) whether the fiduciaries consistently managed plan assets with their own personal interests in mind over a substantial period of time during a control contest.[39]

The court found that fiduciaries of the plan faced a clear risk of conflicting interests. As fiduciaries, they were bound by a duty to act in the sole interest of the beneficiaries; however the fiduciaries' ties to the controlled group of companies, and their involvement in the control contests for the three companies in which they had invested plan money, gave them interests that had the potential to be adverse to the interests of the beneficiaries.[40] While the interest of realizing the maximum value of the stock was a common goal, the interests of the beneficiaries and the investors were very different. It was in the plan participants' interest to have the value of the stock increase, but it was also in the participants' interest to dispose of the stock when the potential for further increases in price no longer existed. Contrarily, the investors had an interest in holding on to the stock for the purposes of completing a successful bid for control. In this instance, an independent fiduciary would focus on the greatest possible return on the investment irrespective of how such investment would affect the contest for control. In fact, an independent fiduciary may have sold earlier, or not invested at all, if it believed that the target management was acting contrary to the best interests of the stockholders.

Although an actual conflict never arose in *Leigh*, the mere fact that the fiduciaries faced potentially conflicting interests and continued to exercise control over the plan assets in a manner that directly benefited the controlled group of corporations, leads to doubts concerning the fiduciaries' loyalty.[41] Even without an actual conflict, the fiduciaries breached their duty of loyalty because it was clear that the investments made in the three companies were made by fiduciaries faced with conflicting loyalties and who made no effort to seek independent advice as to actions taken with respect to the plan. Given that the investment decisions were made at a time when the controlled group of companies was seeking to acquire those targeted companies, the court determined that "the trust's investments were not made with an 'eye single' to the interests of the participants and beneficiaries."[42]

The court favored the position of the Secretary of Labor, writing as amicus curie, that when a fiduciary finds himself in a situation of a potential conflict of interest such as this, where the risk is too great that the fiduciary is unable to uphold his duty of loyalty, such fiduciary should resign and have an independent trustee appointed in his place to manage the assets of the plan through the contest for control. Appointing an independent trustee will decrease the likelihood of a breach of fiduciary duty while alleviating the concerns of the beneficiaries that might arise during the contest for control. Although an independent trustee is subject to the same fiduciary duties, the neutral trustee will help to "calm the fears of plan beneficiaries who might otherwise perceive the need to resort to the courts in order to ensure the safety of their entitlements."[43] However, the court declined to adopt a per se rule that fiduciaries remove themselves from such potential conflict situation.[44] Instead, the court stated, should a fiduciary choose not to resign, before any actions are taken with

[34] *Id.*, 680 F.2d at 271-72.
[35] *See Bierwirth*, 680 F.2d at 276.
[36] *Id.*
[37] 727 F.2d 113, 8 EBC 2409 (7th Cir. 1984).
[38] *Id.*, 727 F.2d at 125.
[39] *Id.*, 727 F.2d at 127.
[40] *Id.*, 727 F.2d at 128.
[41] *See id.*, 727 F.2d at 128.
[42] *Id.*, 727 F.2d at 129.
[43] *Id.*, 727 F.2d at 133.
[44] *See id.*, 727 F.2d at 132.

respect to the plan assets, the fiduciary must at least "engage in an intensive and scrupulous independent investigation of [its] options to insure that [it] acts in the best interests of the plan beneficiaries." [45] It is interesting to note that, in both *Bierwith* and *Leigh*, the plans ultimately made a profit from the investments and this fact did not prevent either court from determining that a breach of fiduciary duty occurred.

Although the duty of loyalty requires that the fiduciary act solely in the interest of the plan's participants and beneficiaries, the duty is not necessarily violated merely because such action has an incidental benefit to the employer.[46] In such situations, a fiduciary must act only after "careful and impartial" investigation and the decision must be made with an "eye single" to the interests of the participants and beneficiaries.[47]

The Secretary of Labor, as amicus curiae in its brief (see Part I and Part II) in *Tittle v. Enron Corp.*,[48] underscored that fiduciary actions or the failure to act on behalf of a plan and its beneficiaries with an "eye single to the interests of the participants and beneficiaries" is a clear breach of the duty of loyalty. While the brief does not explicitly reference a conflict of interest, the arguments made by the Secretary inherently relate to the conflicts the officers faced in their capacity as fiduciaries when continuing to purchase Enron stock. One of the arguments advanced by the Secretary is that the fiduciaries knew or should have known that there was a "potentially critical threat to the plan or the plan assets" and that continuing to purchase Enron stock at inflated prices, in light of the company's impending financial problems, was a breach of fiduciary duty.

According to the Secretary, the fiduciaries should have taken some action to protect the plan; for instance, discontinuing the purchase Enron stock and preventing additional losses to the plan. Instead, the fiduciaries continued to purchase the stock at inflated prices, which resulted in catastrophic losses for the plan.[49] Clearly, hiring an independent trustee to make investment decisions in this case would have, at the very least, eliminated the conflict that the fiduciaries faced when confronted with the decision to continue to purchase Enron stock.

Structural Conflicts of Interest

Impact of Met Life v. Glenn

There are often situations in the administration of benefit plans, in particular, in the case of welfare benefit plans, where a conflict of interest arises because the same person both evaluates and pays benefit claims from its own funds. In *Metropolitan Life Insurance Co. v. Glenn*,[50] the U.S. Supreme Court addressed the question of whether a plan administrator with such dual responsibilities creates a fiduciary "conflict of interest," and if so, how such conflict should be taken into account in a judicial review of the fiduciary's discretionary benefit determination.

The court first considered the appropriate standard of judicial review of benefit determinations by plan fiduciaries. Based on its decision in *Firestone Tire & Rubber Co. v. Bruch*,[51] the court articulated four principles of judicial review: (i) a court shall be guided by principles of trust law, (ii) courts are required to review denials of benefit claims under a *de novo* standard unless the plan provides otherwise, (iii) if the plan provides the fiduciary with discretionary authority to determine eligibility for benefits, then a deferential standard of review is appropriate, and (iv) if a fiduciary with discretionary authority to determine benefits eligibility is operating under a conflict of interest, the conflict must be weighed as a factor in determining whether an abuse of discretion exists.[52] Although it is usually clearer where the employer both funds the plan and evaluates benefit claims that a conflict of interest exists, the court found equally that a conflict exists in those instances where an insurance company has dual responsibilities under a plan to evaluate claims and pay approved benefits.[53]

As to the question of how a conflict of interest should be taken into account on judicial review of a discretionary benefit determination, the court stated that, in accordance with *Firestone*, the conflict should be weighed as a factor in determining whether there is an abuse of

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[45] *Id.*, 727 F.2d at 125-26.

[46] *See Crowhurst v. California Inst. of Technology,* No. 96-5433, 23 EBC 1416 (C.D. Calif. July 1, 1999).

[47] *Id.* Notwithstanding the well-cited precedent of *Leigh* and *Bierwirth*, at least one court narrowed in on the *Leigh* court's notion that there are no bright-line rules and that the "entire context of the transactions in question" must be evaluated. *Nelson v. IPALCO Enterprises, Inc.,* 480 F. Supp. 2d 1061, 1101, 40 EBC 1983 (S.D. Ind. 2007). The *Nelson* court distinguished that line of cases to find that there was no breach of fiduciary duties even where defendant ERISA benefit plan fiduciaries did not engage in "an intensive and scrupulous independent investigation" when the plan sponsor was acquired in a stock-for-stock transaction and participants and beneficiaries in the acquired company's § 401(k) plan received a stock exchange for the interest they held in the former company under the § 401(k) plan and the value of the acquirers' stock later lost over 90 percent of its market value. *Id.* at 1101-2. In contrast to *Leigh* and *Bierwirth*, the defendant fiduciaries were not using ERISA benefit plan assets as an integral part of a corporate venture, there was no hostile takeover requiring the plan fiduciaries to take sides, and the plan fiduciaries were very familiar with both sides of the transaction. In finding for the defendant plan fiduciaries, the *Nelson* court stated that the plan fiduciaries, "[w]ithout the benefit provided by hindsight. . .reasonably believed at the time that they already knew what they needed" to assess the transaction, and there was "no compelling reason for them to undertake an additional inquiry into the suitability" of the corporate decision. *Id.* at 1101-2.

[48] Brief for Secretary of Labor as Amici Curiae Opposing the Motions to Dismiss, *Tittle v. Enron Corp.*,, 31 EBC 2281 (S.D. Texas Sept. 30, 2003)(No. H-01-3913). Part I and Part II of the briefs are available in the Laws, Regulations & Agency Documents section of the Benefits Practice Resource Center.

[49] See *id.* at at 27-29.

[50] 128 S.Ct. 2343, 43 EBC 2921 (2008).

[51] 489 U.S. 101, 10 EBC 1873 (1989)

[52] *Glenn*, at 128 S. Ct. at 2348, quoting *Firestone*, 489 U.S. at 115.

[53] *Id.* at 2349.

discretion.[54] The court, however, made it clear that the "weighing of a conflict as a factor" does not implicate a change in the otherwise deferential standard of review.[55] Thus, a fiduciary who is granted discretionary authority to review benefit claims would not be subject to *de novo* judicial review even though the fiduciary is subject to a "structural" conflict of interest as a result of the fiduciary's responsibilities to both evaluate claims and pay approved benefits.[56]

The Supreme Court, in *Glenn*, offered no special procedural or evidentiary rules in analyzing the fiduciary's conflict of interest, noting that as benefit decisions arise in too many contexts, concern too many circumstances, and can relate in too many different ways to conflicts (which themselves vary in kind and degree of seriousness), it would not be possible to devise a "one-size-fits-all" procedure or standard for assessing the impact of a conflict of interest. Instead, courts are to consider the conflict of interest as but one factor when determining whether an abuse of discretion exists.[57]

The Supreme Court noted that a conflict of interest should prove more important where circumstances suggest a higher likelihood that it affected the benefits decision, such as where an insurance company has a history of biased claims administration.[58] However, the court said a conflict "should prove less important (perhaps to the vanishing point) where the administrator has taken active steps to reduce potential bias and to promote accuracy, for example, by walling off claims administrators from those interested in firm finances, or by imposing management checks that penalize inaccurate decisionmaking irrespective of whom the inaccuracy benefits."[59] The court concluded that a structural conflict of interest would be taken into account "as a factor" in determining whether the fiduciary's conduct constituted an abuse of discretion. The court further held that a court's review in making such determination was not susceptible to a particular formula or standard for guidance and that the "want of certainty in judicial standards partly reflects the intractability of any formula to furnish definiteness of content for all the impalpable factors involved in judicial review."[60]

[54] *Glenn*, 128 S. Ct. at 2350.
[55] *Id.* at 2350.
[56] *Id.* at 2350.
[57] *Id.* at 2351.
[58] *Id.* at 2351.
[59] *Id.* at 2351.
[60] Chief Justice Roberts issued a concurring opinion in which he agreed with the majority opinion that a structural conflict of interest is relevant in assessing whether a fiduciary is entitled to deference in its decisionmaking, but would only take the conflict into account upon judicial review where there is evidence that the benefits denial was actually motivated or affected improperly by the administrator's conflict. *Id.* at 2353. Further, Justice Scalia (with whom Justice Thomas joined) offered a dissenting opinion in which he disagreed with the majority opinion's "totality-of-the-circumstances test" (which provides that the existence of a conflict be put into the mix and given some (unspecified) weight, and instead would find that a conflict would not result in an abuse of discretion "unless the conflict actually and improperly motivates the decision." *Id.* at 2357.

Structural Conflicts: Merely a Factor

In *Blankenship v. Metropolitan Life Insurance Co.*,[61] the Eleventh Circuit applied *Glenn* to the denial of long-term disability benefits involving an insurance company with dual responsibility for administering claims for benefits and paying approved claims. Although the district court in *Blankenship* found MetLife's decision to deny benefits arbitrary and capricious principally due to MetLife's structural conflict of interest, the appeals court took a more lenient approach in analyzing the effect of MetLife's conflict.

The Eleventh Circuit viewed the issue ultimately as a determination of whether MetLife, in light of the discretionary authority bestowed on it to make benefits decisions, had a reasonable basis for its determination. Accordingly, the court, relying on a six-step formula in reviewing a plan administrator's benefits decision, noted that if a deferential review standard applies and there exists a structural conflict of interest, then the conflict should merely be a factor for the court to take into account when determining whether the plan administrator's decision was arbitrary and capricious.[62] The court further noted, "The effect that a conflict of interest will have within the *Williams* [v. BellSouth Telecommunications Inc., 373 F.3d 1132, 1137-38, 33 EBC 1195 (11th Cir. 2004)] analysis in any given case will vary according to the severity of the conflict and the nature of the case: we look to the conflict's 'inherent or case-specific importance.' "[63] The court stated further, "[T]he presence of a structural conflict of interest—an unremarkable fact in today's marketplace—constitutes no license, in itself, for a court to enforce its own preferred *de novo* ruling about a benefits decision.[64] As a final point, the Eleventh Circuit, in holding that MetLife, on the record in such case, did not act arbitrarily and capriciously in rendering its benefits denial decision, stated that, "[T]he burden remains on the plaintiff to show the decision was arbitrary; it is not the defendant's burden to prove its decision was not tainted by self-interest."[65]

[61] 644 F.3d 1350, 51 EBC 2300 (11th Cir. 2011), cert. denied, 132 S. Ct. 849, 51 EBC 2984 (2011).
[62] *Id.* at 1355.
[63] *Id.* at 1355, citing *Glenn*, 128 S. Ct. at 2351-52.
[64] *Id.* at 1356.
[65] *Id.* at l355. *See Green v. Union Security Insurance Co.*, 646 F.3d 1042, 1053, 51 EBC 2175 (8th Cir. 2011) (where the court said a fiduciary's structural conflict of interest should be weighed as a factor in determining whether there is an abuse of discretion and that the conflict's weight will depend on the circumstances). The court in *Green* noted that if a deferential standard of review applies to the fiduciary's conduct, the fiduciary's decision should be affirmed if it is reasonable, meaning it is supported by substantial evidence, which is more than a scintilla but less than a preponderance. *Green*, 646 F.3d at 1050. The court then stated, "[T]he requirement that the plan administrator's decision be reasonable should be read to mean that a decision is reasonable if a reasonable person *could* have reached a similar decision, given the evidence before him, not that reasonable person would have

Structural Conflicts: Actual Impact is Key

In *Boison v. Insurance Services Office, Inc.,*[66] the district court considered the impact of a structural conflict of interest possessed by an employer in its administration of a nonqualified supplemental retirement plan. In *Boison*, the plaintiff alleged that the employer, who was responsible for both administering and interpreting the plan as well as paying benefits from its own assets, acted arbitrarily and capriciously in failing to interpret the plan to cover former employees, such as plaintiff.

The court, in applying the holding in *Glenn* that a structural conflict of interest is a factor for a court to consider in determining whether an abuse of discretion occurred, stated, "[T]he arbitrary and capricious standard applies unless the plaintiff can show not only that a potential conflict of interest exists, . . . but that the conflict affected the reasonableness of the administrator's decision . . . and no weight is given to a conflict in the absence of any evidence that the conflict actually affected the administrator's decision."[67] Here, the court held that the mere existence of a structural conflict of interest would not, in and of itself, be sufficient to prove an abuse of discretion existed, and a conflict would be relevant to such determination where evidence showed that the conflict actually affected the reasonableness of the administrator's determination.[68] Thus, for instance, in order to show that a structural conflict actually affected the administrator's decisionmaking, a plaintiff would need to offer evidence indicating that an administrator ignored a detailed medical report without further investigation and unreasonably relied on a single report that was aligned with its financial interest, had a history of biased claims, and engaged in deceptive practices toward the applicant.[69]

Stock Drop Cases: Impact of Moench Presumption

Quite often individual account plans maintained by public companies, such as Section 401(k) plans and ESOPs, offer participants the opportunity to direct the investment of their plan accounts among a number of investment funds, which include a fund that invests exclusively in stock of the employer/plan sponsor. Under ERISA, investments in employer stock enjoy certain fiduciary-friendly protections. The fiduciary duty to diversify the plan's investments and the duty of prudence, to the extent it would otherwise require the diversification of investments, do not apply to the acquisition and holding of qualifying employer securities.[70]

During the 2008 financial market crisis, the value of employer stock held by plans suffered tremendous losses. Accordingly, lawsuits were brought by plan participants claiming, *inter alia*, that the plan fiduciary breached its duty of prudence in the management of the employer stock held in the plan.

Moench Presumption

In *Moench v. Robertson*,[71] the U.S. Court of Appeals for the Third Circuit addressed the interaction between the Congressional policy of encouraging employee ownership of employer stock through plans and the duty of a fiduciary to follow the terms of the plan documents as they relate to an investment in employer stock to the extent those terms are consistent with ERISA.[72] In *Moench*, the court determined that a fiduciary who invests plan assets in employer stock is entitled to a rebuttable presumption that it acted consistently with ERISA by virtue of that decision.[73] In addition to the Third Circuit, the Fifth, Sixth, and Ninth Circuit Courts of Appeals have adopted the *Moench* presumption.[74]

Second Circuit: Citigroup ERISA Litigation

In a 2011 Second Circuit case, *In re Citigroup ERISA Litigation*,[75] the court addressed a number of fiduciary duty claims relating to the significant drop in the price of Citigroup stock as a result of Citigroup's exposure to the market in subprime mortgage securities. In particular, the class plaintiffs alleged that the plan fiduciaries breached their duty of prudence and loyalty by continuing to offer the Citigroup stock fund as an investment option under Citigroup's individual account plan and by failing to divest the employer stock fund of Citigroup stock despite public reports of Citigroup's substantial exposure and significant losses incurred with respect to the subprime mortgage securities market.

In regard to the prudence claim, the court held, applying the *Moench* presumption, the fiduciary's decision to continue to offer the Citigroup stock fund and its

reached that decision." *Id.* at 1050 (quoting *Jackson v. Metro. Life Ins. Co.*, 303 F. 3d 884, 887, 29 EBC 1788 (8th Cir. 2002)).

[66] 829 F. Supp. 2d 151, 52 EBC 2134 (E.D.N.Y. 2011).

[67] *Id.* at 159, quoting *Griffin v. New York State Nurses Association Pension Plan*, 757 F. Supp. 2d, 199, 210 (E.D.N.Y. 2010).

[68] *Id.* at 159.

[69] *Id.* at 159. *See Cramer v. Appalachian Regional Healthcare, Inc.*, No. 5:11-cv-00049-KKC, 53 EBC 2463 (E.D. Ky. March 23, 2012)("Although the plaintiff has a right to obtain discovery regarding defendants' conflict of interest, the scope of discovery is narrow. Any discovery must be limited to the conflict of interest and allegations of bias."); *Hoffman v. Sara Lee Corp.*, No. 1:11-cv-03899 (N.D. Ill. Feb. 8, 2012)(". . .this Court will likewise limit discovery to those inquiries targeting conflict-of-interest allegations and the safeguards in place to protect the appeals process from bias.").

[70] ERISA §§ 404(a)(1)(B); 404(a)(1)(C); 404(a)(2). Qualifying employer securities are issued by an employer whose employees are covered by the plan, or by an affiliate of such employer, and which securities are stock, certain marketable obligations, or certain interests in a publicly traded partnership. ERISA §§ 407(d)(1), (d)(5).

[71] 62 F.3d 553, 19 EBC 1713 (3d Cir. 1995).

[72] See ERISA § 404(a)(1)(D).

[73] *Id.* at 571. *See also, Edgar v. Avaya, Inc.,* 503 F.3d 340, 345, 41 EBC 2249 (3rd Cir. 2007)(extended the *Moench* presumption to individual account plans other than ESOPs).

[74] *See Kirschbaum v. Reliant Energy, Inc.*, 526 F.3d 243, 254, 43 EBC 2281 (5th Cir. 2008); *Kuper v. Iovenko*, 66 F.3d 1447, 1459, 19 EBC 1969 (6th Cir. 1995); *Quan v. Computer Sciences Corp.*, 623 F.3d 870, 881, 49 EBC 2642 (9th Cir. 2010); *Edgar v. Avaya*, 503 F.3d 340, 347-48, 41 EBC 2249 (3rd Cir. 2007).

[75] 662 F.3d 128, 51 EBC 1737 (2nd Cir. 2011), cert. denied, No. 11-1531 (Oct. 15, 2012).

determination whether to divest the fund of its employer stock is presumed to be consistent with ERISA and shall be subject to judicial review based on an abuse of discretion standard.[76] The court noted that, ". . .judicial scrutiny should increase with the degree of discretion a plan gives its fiduciaries to invest."[77] "Thus, a fiduciary's failure to divest from company stock is less likely to constitute an abuse of discretion if the plan's terms require—rather than merely permit—investment in company stock."[78]

The presumption, however, can be rebutted only in circumstances that place the employer in a "dire situation" that was objectively unforeseeable by the plan sponsor, and therefore the fiduciary would be required to override plan terms providing for an investment in employer stock.[79] The presumption is a strong one, as the court noted, "it is to serve as a substantial shield that should protect fiduciaries from liability where there is room for reasonable fiduciaries to disagree as to whether they are bound to divest from company stock."[80]

In *Citigroup*, the court found that, despite published reports indicating the negative impact of the subprime mortgage crisis on Citigroup's earnings and stock price, the plaintiffs failed to allege sufficient facts that would support a fmding that the fiduciaries could have foreseen Citigroup would suffer billions of dollars in losses (noting, as well, the relative impact of the stock price decline on Citigroup's $200 billion market capitalization), and thus, no "dire situation" was shown to exist.[81] In addition, the court held that the *Moench* presumption is a standard of judicial review of a fiduciary's decision and therefore appropriately applied at the pleading stage.[82] Accordingly, the presumption was available to the fiduciary against the plaintiffs at a point in the proceedings that preceded any opportunity for discovery by plaintiffs to support their allegations of an abuse of discretion.

Plaintiffs also alleged that the fiduciaries breached their duty of loyalty by (i) failing to provide complete and accurate information regarding Citigroup and (ii) conveying through statements and omissions inaccurate material information regarding the soundness of Citigroup stock. As to the first claim, the court found no fiduciary breach because "fiduciaries have no duty to provide plan participants with non-public information that could pertain to the expected performance of plan investment options.[83] With respect to the second claim. the court held that no breach occurred because the persons who made the statements concerning the impact of the subprime crisis on Citigroup either were not doing so in a fiduciary capacity or the facts alleged did not, without the benefit of hindsight, support a conclusion that the statements, when made, were known to be false.[84]

Finally, the plaintiffs also asserted that the fiduciaries breached their duty to avoid conflicts of interest because the compensation of some fiduciaries was tied to the performance of Citigroup stock. However, the court determined that a conflict of interest claim cannot be based solely on the fact that a fiduciary's compensation was linked to the company's stock.[85]

Sixth Circuit: Pfeil Case

Another recent stock drop decision was issued in the Sixth Circuit. In *Pfeil v. State Street Bank and Trust Co.*,[86] the Sixth Circuit addressed breach of fiduciary duty claims based on the fiduciary of the General Motors (GM) 401(k) plans continuing to permit participant-directed investments in GM common stock despite public reports that indicated GM was headed for bankruptcy. The plan document provided expressly for a company stock fund to be invested exclusively in GM stock and to do so without regard to, *inter alia*, diversification of assets or fluctuations in the market value of the stock. The plan also provided the fiduciary, State Street Bank and Trust, with discretionary authority, under an abuse of discretion standard, to override the plan terms regarding investment in GM stock and to divest the plans of their GM stock if, pursuant to reliable public information, (i) there is a serious question concerning GM's short-term viability as a going concern without resort to bankruptcy protection or (ii) there is no possibility in the short-term of recouping any substantial proceeds from the sale of stock in bankruptcy proceedings.[87]

On July 15, 2008, GM made public statements regarding significant corporate losses incurred, and on Nov. 10, 2008, the company's Form 10-Q for the third quarter disclosed its outside auditor's view expressing substantial doubt regarding the company's ability to continue as a going concern. On Nov. 21, 2008, State Street informed participants that it was suspending further pur-

[76] *Id.* at 138. *See also, Gearren v. McGraw-Hill Companies, Inc.,*, 660 F.3d 605, 51 EBC 1765 (2nd Cir. 2011), cert. denied, No. 11-1550 (Oct. 15, 2012); *Fisher v. JP Morgan Chase & Co.*, No. 10-1303-cv (2d Cir. May 8, 2012), cert. denied , No. 12-298 (Nov. 15, 2012).
[77] *Id.* at 138. *See Quan*, 623 F.3d at 883 (citing *Kirschbaum*, 526 F.3d at 255 and n.9).
[78] *Id.* at 138. *See also In re Glaxosmithkline ERISA Litigation*, No. 11-2289-cv, 2012 BL 225649 (2nd Cir. Sept. 4, 2012) ("Because the Plans' terms strongly favor an investment option in employer stock, plaintiffs must plausible plead that GSK faced a "dire situation" to state a claim that Plan fiduciaries abused their discretion in continuing to offer the GSK Stock Fund as an investment and in failing to liquidate USK stock already held.").
[79] *Id.* at 140. *See, Edgar*, 503 F.3d at 348.
[80] *Id.* at 140. *See, Kirschbaum*, 526 F.3d at 256; *Quan*, 623 F.3d at 882.
[81] *Id.* at 140-41.
[82] *Id.* at 139.
[83] *Id.* at 142.
[84] *Id.* at 142-44. *See In re Glaxosmithkline ERlSA Litigation*, 2012 BL 225649.
[85] *Id.* at 146. Judge Straub issued a dissenting opinion in *Citigroup* with respect to the prudence claim, where he opined that the *Moench* presumption should not apply, and instead the fiduciary's conduct should be reviewed under the general prudent man standard of conduct. *Id.* at 147-48.
[86] 671 F. 3d 585, 52 EBC 1641 (6th Cir. 2012).
[87] *Id.* at 589.

chases of GM stock citing GM's recent earnings announcements. Finally, on March 31, 2009, State Street began divesting the plans of their GM stock holdings, which divestiture was completed on April 24, 2009. GM filed for bankruptcy on June 1, 2009.

The Sixth Circuit, in reviewing State Street's decisions regarding the plans' GM stock holdings, applied the *Moench* presumption, as it first did in *Kuper*.[88] The court noted that a plaintiff may rebut the presumption "by showing that a prudent fiduciary acting under similar circumstances would have made a different investment decision."[89]

The court next considered whether the *Moench* presumption applies at the pleading stage. If it does, as is the Second Circuit's view in *Citigroup*, then the plaintiff has a much greater hurdle to overcome based solely on the factual allegations in its pleadings. However, the court, in *Pfeil*, held that the presumption of reasonableness (*i.e.*, the *Moench* presumption) is not an additional pleading requirement, and thus does not apply at the motion to dismiss stage.[90] The court, based on its precedence in *Kuper*, stated that the presumption of reasonableness is an evidentiary presumption, not a pleading requirement.[91] Accordingly, under *Pfeil*, a plaintiff need not plead enough facts to overcome the presumption in order to survive a motion to dismiss.[92]

In addition, the Sixth Circuit acknowledged that it had not adopted a rebuttal presumption standard that requires a plaintiff to prove the company faced a "dire situation" (see *Citigroup*) or an "impending collapse" (see *Quan*), but instead would require a plaintiff to prove that a "prudent fiduciary acting under similar circumstances would have made a different investment decision."[93] Accordingly, in the Sixth Circuit, a plaintiff appears to have a somewhat easier road to take in order to survive a motion to dismiss and get to the discovery stage with the opportunity to develop a full evidentiary record for a court to review.[94]

Eleventh Circuit: Lanfear Case

The Eleventh Circuit also addressed a stock-drop case involving Home Depot's stock. In *Lanfear v. Home Depot, Inc.*,[95] an individual account plan maintained by Home Depot offered participants an employer stock fund which under the terms of the plan was required to invest primarily in Home Depot stock. As a result of certain inappropriate adjustments to its financial statements, including the improper back dating of stock option grants, the value of Home Depot stock declined and significant financial statement losses were recognized. Plaintiffs, who were participants in the Home Depot plan, filed suit alleging the plan fiduciaries breached their duty of prudence by continuing to offer and approve Home Depot stock as an investment option under the plan and their duty of loyalty by incorporating by reference into the plan documents securities law filings that contained inaccurate and misleading statements and by failing to disclose nonpublic information to participants regarding Home Depot's deceitful business practices.

In reviewing the plan fiduciary's decision to invest in Home Depot stock and whether to divest the plan of such stock, the Eleventh Circuit decided, consistent with the holdings of the Second, Third, Fifth, Sixth, and Ninth Circuit Courts of Appeal, to balance the competing interests of the statutory provisions promoting employee ownership of employer entities and a fiduciary's duties of prudence and loyalty owed to participants by adopting the *Moench* abuse of discretion standard of review.[96] According to the court, such standard of review does not give a fiduciary immunity from judicial oversight. Instead, the court, drawing on trust law principles, stated that, "[A]lthough a fiduciary is generally required to invest according to the terms of the plan, when circumstances arise such that continuing to do so would defeat or substantially impair the purpose of the plan, a prudent fiduciary should deviate from those terms to the extent necessary. Because the purpose of a plan is set by its settlors (those who created it), that is the same thing as saying that a fiduciary abuses his discretion by acting in compliance with the directions of the plan only when the fiduciary would not have reasonably believed that the settlors would have intended for him to do so under the circumstances."[97]

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[88] *Id.* at 591.
[89] *Id.* at 591-92, citing *Quan*, 623 F.3d at 881-82 (presumption rebutted based on circumstances that the making of the investment "would defeat or substantially impair the accomplishment of the purposes of the trust"); see also *Kirschbaum*, 526 F.2d at 254-56 (". . .there ought to be persuasive and analytically rigorous facts demonstrating that reasonable fiduciaries would have considered themselves bound to divest.").
[90] *Id.* at 593.
[91] *Id.* at 593.
[92] The Sixth Circuit noted that its holding regarding whether the *Moench* presumption applies at the pleading stage is contrary to the positions taken by the Second and Third Circuits on this issue. *Id.* at 594. *See also Dudenhoefer v. Fifth Third Bancorp*, 692 F.3d 410, 53 EBC 2842 (6th Cir. 2012) (based on *Pfeil*, applied the presumption of reasonablenessas an evidentiary matter and not at the pleading stage).
[93] *Id.* at 595, citing *Kuper*, 66 F.3d at 1459; *see also Dudenhoefer*, 692 F.3d 410.
[94] *See also Griffin v. Flagstar Bancorp Inc.*, No. 11-1497, 53 EBC 2452 (6th Cir. July 23, 2012). The court, in *Pfeil*, also addressed whether the fact that the plans were ERISA Section 404(c) plans offers the plan fiduciary a defense against a claim that the fiduciary should be held liable for offering an imprudent employer stock investment fund. The court held, consistent with DOL's view, that ERISA Section 404(c) does not relieve a fiduciary of the responsibility to screen plan investments and thus is not available as a fiduciary breach defense at the motion to dismiss stage of the case. *Id.* at 599-600.
[95] 679 F.3d 1267, 53 EBC 1261 (11th Cir. 2012).
[96] DOL, in an amicus brief filed in *White v. Marshall & Ilsley Corp.*, No. 11-02660 (7th Cir., amicus brief filed May 30, 2012), requested that the Seventh Circuit Court of Appeals reject the *Moench* presumption of prudence in a stock-drop case, and instead, apply the general "prudent man" standard of care required of fiduciaries under ERISA Section 404(a), qualified only by the limited exception to the fiduciary duty to diversity investments under ERISA Section 404(a)(2).
[97] *Id.* at p. 13.

In applying the abuse of discretion standard, the court noted that an abuse of discretion is an element of a claim that the fiduciary's decision was imprudent, and thus, unless a plaintiff pleads facts sufficient to raise a plausible inference that the fiduciary abused its discretion by following the plan's directions, the complaint fails to state a valid claim and a motion to dismiss should be granted.[98] Therefore, in the Eleventh Circuit, the *Moench* standard of review (*i.e.*, abuse of discretion) is a standard of judicial review, not an evidentiary presumption, and thus, it applies at the motion to dismiss stage as well as thereafter.

With respect to the alleged breach of the duty of loyalty, the court held that the inaccurate statements made pursuant to federal securities law-required registration statements and related plan prospectuses did not involve fiduciary acts because the company was conducting business regulated by securities law, not ERISA.[99] As such, any misstatements in these documents did not constitute a violation of ERISA. In regard to the alleged failure to disclose to participants non-public information relating to the employer stock fund under the plan, the court held that ERISA does not impose an express duty to provide participants with non-public information about the value of the employer's stock and that the plan's summary plan description included sufficient warnings to participants concerning the significant risks associated with a participant's investment in Home Depot stock.[100] Thus, the court found no fiduciary breach of the duties of prudence and loyalty to the participants in the Home Depot plan.

Alternatives for Fiduciaries Facing Potential Conflicts of Interests

Qualified Professional Asset Manager

ERISA prohibits certain transactions between a plan and certain persons related to the plan, known as "parties-in-interest." Among the persons who qualify as parties-in-interest are those who provide services to a plan or who are fiduciaries with respect to a plan.[101]

ERISA Section 406(a) prohibits, among other things, a sale or exchange of any property between a plan and a party-in-interest and the lending of money or other extension of credit between a plan and a party-in-interest.[102] In addition, Section 406(b) prohibits certain acts of self-dealing by fiduciaries, such as prohibiting a fiduciary from using plan assets for its own interest or for its own account.[103]

In certain cases, transactions that would otherwise be prohibited are exempt from the prohibited transaction restrictions under ERISA if an exemption applies. An exemption may take any of three forms. Exemptions may be provided by statute under a specific provision of ERISA. In addition, class exemptions are, in certain instances, granted by DOL that may apply to any person who can satisfy the applicable requirements prescribed by the class exemption. Finally, individual administrative exemptions may be granted to persons who submit an application to DOL for an exemption with respect to a specific transaction.

One of the class exemptions is for a "qualified professional asset manager" or "QPAM," which may be a useful exemption in cases where conflicts arise. In Prohibited Transaction Class Exemption 84-14 (which DOL amended in 2005 and in 2010), DOL granted a class exemption from the prohibited transactions described in ERISA Section 406(a)(1)(A)-(D) with respect to transactions between a party-in-interest to a plan and an investment fund in which the plan has an interest and which is managed by a QPAM.[104] The exemption is for certain financial institutions, including banks, federally insured savings and loan associations, insurance companies, and registered investment advisers, that acknowledge their fiduciary status with respect to each plan that has retained them. Although qualifying as a QPAM does not eliminate all investment restrictions, such qualification significantly reduces such restrictions.

Under the basic QPAM exemption,[105] the following requirements must be met:

(1) the party-in-interest generally must not have the authority to appoint the QPAM, or to negotiate its management agreement, with respect to the plan assets involved in the transaction;[106]

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[98] *Id.* at pp. 13-14, citing *Edgar*, 503 F.3d at 349; *Citigroup*, 662 F.3d at 139.

[99] *Id.* at 15.

[100] *Id.* at pp. 15-16.

[101] ERISA § 3(14)(A) &(B), 29 U.S.C. § 1002(14)(A) & (B).

[102] ERISA § 406(a)(1)(A) & (B), 29 U.S. C. § 1106(a)(1)(A) & (B)

[103] ERISA § 406(b)(1), 29 U.S. C. § 1106(b)(1).

[104] It is noted that the basic QPAM exemption would not exempt transactions involving fiduciary self-dealing described in ERISA § 406(b), 29 U.S.C. § 1106(b). As part of the QPAM exemption under PTCE 84-14, DOL granted certain specific exemptions from ERISA § 406(b)(1) (and in some cases ERISA § 406(b)(2)) for transactions between a plan and an employer whose employees are covered by the plan and for transactions between a plan and the QPAM or certain persons related to the QPAM.

[105] There is a limited exception to this requirement in the case of a commingled investment fund when the plan assets, when combined with the assets of other plans maintained by the same employer (or its affiliate) managed by the QPAM in the investment fund, represent less than 10 percent of the assets of the investment fund.

[106] A QPAM is related to a party in interest if, as of the last day of the most recent calendar quarter: (a) the party in interest owns a ten percent or more interest in the QPAM, or if the QPAM owns a ten percent or more interest in the party in interest; (b) a person controlling (or controlled by) the party in interest (i) owns a twenty percent or more interest in the QPAM or (ii) has an ownership interest that is less than twenty percent but greater than ten percent in the QPAM, and this person exercises control over the QPAM' s management or policies by virtue of its ownership interest; or (c) a person controlling (or controlled by) the QPAM (i) owns a twenty percent or more interest in the party in interest or (ii) has an ownership interest that is less than twenty percent but greater than ten percent in the party in interest, and this person exercises control over the party in interest's management or policies by virtue of its ownership interest.

(2) the transaction at issue may not be described in (a) PTCE 83-1 (relating to acquisitions by plans of interests in mortgage pools), (b) PTCE 82-87 (relating to certain mortgage financing arrangements), or (c) PTCE 2006-16 (relating to securities lending arrangements);

(3) the terms of the transaction must be negotiated by, or under the authority of, the QPAM;

(4) the party in interest must not be the QPAM or a person related to the QPAM;[107]

(5) the transaction is not entered into with a party in interest with respect to any plan whose assets managed by the QPAM, when combined with the assets of other plans maintained by the same employer (or any affiliate of such employer) and managed by the QPAM, represent more than 20 percent of the total client assets managed by the QPAM at the time of the transaction;

(6) the terms of the transaction must be at least as favorable as the terms available in an arm's length transaction between unrelated parties; and

(7) neither the QPAM nor any affiliate, nor any owner of a 5 percent or more interest in the QPAM is a person who within the 10 years immediately preceding the transaction has been either convicted or released from imprisonment, whichever is later, as a result of: any felony involving abuse or misuse of such person's employee benefit plan position or employment, or position or employment with a labor organization; any felony arising out of the conduct of the business of a broker, dealer, investment adviser, bank, insurance company or fiduciary; income tax evasion; any felony involving the larceny, theft, robbery, extortion, forgery, counterfeiting, fraudulent concealment, embezzlement, fraudulent conversation, or misappropriation of funds or securities; conspiracy or attempt to commit any such crimes or a crime in which any of the foregoing crimes is an element; or any other crime described in Section 411 of ERISA. For purposes of this anti-criminal rule, a person shall be deemed to have been "convicted" from the date of the judgment of the trial court, regardless of whether that judgment remains under appeal.

As described above, the condition to the basic QPAM exemption requiring that neither the QPAM nor any of its affiliates have been convicted of certain crimes can be quite onerous (in terms of a monitoring obligation) to an entity that has many operating lines of business and that engages in frequent business acquisitions. The breadth of the crimes covered by the anti-criminal rule and the broad scope of the term "affiliate" make it necessary for the QPAM to review, on a 10-year look-back basis, the business activities of members of the QPAM's "affiliated group" as well as the activities of its directors and senior level officers.

There have been instances where business acquisitions that otherwise were advantageous to the acquirer resulted in the acquisition of entities that had, within the relevant 10-year period, been convicted of one of the crimes described in the QPAM exemption. In such case, since the acquirer would be precluded from acting as a QPAM because of its failure to satisfy the anti-criminal rule, it had to seek an individual administrative exemption from the DOL in order to obtain relief from the anti-criminal rule.[108]

The QPAM exemption eliminates the need for managers of plan assets to keep track of lists of parties in interest that also may be investing in investment funds under their management.

Investment Managers

If the trustee does not want to retain all responsibility for making the decision as to whether the plan's assets should be invested, for instance, in connection with the merger or a potential contest for control, it may alternatively delegate such decisionmaking responsibility to a third-party investment manager (as defined in ERISA § 3(38)[109]). Such investment manager (who would also need to become a fiduciary of the employee benefit plan) could be retained for either the entire decision as to whether the plan should enter into the merger, or how the plan's assets should be invested—whether it is in the context of a contest for control or otherwise— and if so, how much of an investment would be made.

Practice Tip: Since selecting an investment manager is an exercise of discretionary authority or control with respect to management of the plan, the person making such selection must act prudently and solely in the interest of the plan participants and beneficiaries not only in the selection of such person, but also in continuing such designations. Even after a delegation is made, the trustee still retains oversight responsibility over the actions of such investment manager.

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[107] 29 U.S.C. § 1111. The crimes described in ERISA § 411 include a felony violation of federal or state law involving certain controlled substances, murder, rape, kidnapping, and perjury. ERISA § 411(a).

[108] Pursuant to an individual prohibited transaction exemption, DOL granted relief from the anti-criminal rule to The Boston Company Real Estate Counsel, Inc. (BCRE), a registered investment advisor that advised large pension funds in connection with real estate investment transactions. 53 Fed. Reg. 38,803 (Oct. 3, 1988). BCRE was an indirect, wholly owned subsidiary of Shearson Lehman. After Shearson's acquisition of E.F. Hutton, BCRE became "affiliated" with EF Hutton and thus was precluded from functioning as a QPAM because EF Hutton had, within the relevant 10-year period, pled guilty to certain crimes proscribed under the QPAM exemption. Accordingly, BCRE had to seek an individual exemption from the restrictions of the anti-criminal rule. It appears that the grant of the exemption was predicated on the fact that: (i) BCRE operated independently of Shearson and EF Hutton; (ii) none of BCRE's officers was an officer or employee of EF Hutton; (iii) EF Hutton's criminal activity took place before its acquisition by Shearson; (iv) both EF Hutton and Shearson undertook steps to prevent a recurrence of the proscribed criminal activity; (v) the other conditions of the QPAM exemption, as well as Shearson's independent audit procedures, were sufficient to assure that the best interests of the ERISA plans and their participants were served; and (vi) BCRE was able to take advantage of a wider array of investments that were in the best interests of the plans.

[109] 29 U.S.C. § 1002(38).

Conclusion

There are numerous situations where fiduciaries face conflicts of interest in carrying out their duties. The appointment of an independent fiduciary may be able to alleviate many of the breaches of fiduciary duty that often occur as a result of such conflicts of interest.

The fiduciary of the plan has the responsibility for ensuring that a transaction involving plan assets is fair and appropriate for the employee benefit plan. As described above, ERISA imposes strict requirements on a plan fiduciary when it undertakes to determine how plan assets should be invested. The fiduciary is required to act in a prudent manner and to make an independent investigation into the merits of a transaction. Depending on the specific circumstances of the transaction and the potential conflict of the fiduciary decisionmakers involved, it may be prudent to retain an independent fiduciary to evaluate the transaction or hire experts as necessary. If no such independent fiduciary is hired, the trustees may hire an expert to investigate the potential worth of an investment of plan assets. However, once the trustees receive the expert's report, they may not blindly rely on such an expert, but should then closely examine the information in that report in light of all of the facts and circumstances surrounding the potential investment to determine whether or not the investment would be a proper investment of plan assets.

Once such an analysis is completed, the fiduciaries will have done much to fulfill the duties of loyalty and prudence owed by them to plan participants. Further, their actions will have demonstrated procedurally and substantively that they have understood their ERISA duties and acted in a manner that should serve as a meaningful protection to them in their role as fiduciaries if ever a subsequent claim of conflicted decision-making were to arise.

Further, it can be observed that benefit claim situations can present conflict scenarios but the fiduciary can take steps to address even the appearance of conflict (*e.g.*, by removing an officer from the committee who might represent the financial operations of the company, *i.e.*, the CFO, and otherwise follow precisely the claims procedures to overcome arguments and conflict).

Finally, conflict situations arise repeatedly in what has come to be known as the "employer stock drop cases." Fiduciaries, by acting prudently and documenting the basis of their action while following the terms of the plan with respect to the holding of employer securities, can often overcome presumptions of conflict and plaintiff's lawsuits.

[Updated November 2012]