

# FIDUCIARY LITIGATION UPDATE

**February 9, 2019**

ABA Committee on Employee Benefits, Mid-Winter Meeting Nashville

## **PRESENTERS:**

**Marjorie Butler**, *U.S. Department of Labor, Washington D.C.*

**Nathan Goldstein**, *Segal Roitman, Boston, MA*

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# Program Overview

## Topics being addressed:

- Fiduciary burden of proof and loss causation
- Fiduciary disclosure claims
- Fiduciary status and prescription drug litigation
- ESOP litigation
- Church plan litigation

# **Burden of Proof and Loss Causation**

## **Key Developments 2018**

# Brotherston v. Putnam Investments, LLC

- *Brotherston v. Putnam Investments, LLC*, 907 F.3d 17 (1st Cir. 2018). Proprietary fund class action:
  - On fiduciary breach claims (prudence and loyalty), district court entered judgment on partial findings after plaintiffs presented case
    - District court: insufficient evidence of loss; reversed
    - 1st Circuit next addressed causation: who bears burden of proving or disproving causation once plaintiff has proven loss in wake of imprudent decision
      - Circuit split:
        - » Burden shifts to fiduciary: 4<sup>th</sup>, 5<sup>th</sup>, 8<sup>th</sup>
        - » Plaintiff bears burden: 6<sup>th</sup>, 9<sup>th</sup>, 10<sup>th</sup>, 11<sup>th</sup>

# *Brotherston v. Putnam Investments, LLC*

- 1<sup>st</sup> circuit adopted burden-shifting approach
  - Statutory language silent
  - Common law of trusts
  - Fiduciary has more knowledge about causation (*Schaffer ex rel. Schaffer v. Weast*, 546 U.S. 49 (2005))
- Shift burden of production instead? Court briefly considered but rejected in favor of “well-trodden path.”

# Will SCOTUS address the issue?

- *Brotherston v. Putnam*
  - Cert. petition filed January 11, 2019
  - Time to respond extended to March 15, 2019
- SCOTUS has indicated interest:
  - Petition for certiorari filed in *Pioneer Centres* (10th Cir.); SCOTUS in March 2018 called for views of the Solicitor General, but stipulation to dismiss petition in Sept. 2018
  - SG weighed in on *Tatum* (4th Cir.) in May 2015; certiorari denied

# **Fiduciary Disclosure**

## **Key Developments 2018**

# *Jander* and Public Company ESOPs

- *Jander v IBM*, 910 F.3d 620 (2d Cir. 2018). Claim ERISA plan fiduciaries knew IBM stock was overvalued because of impairment in its microelectronics business. Contrary to courts in other circuits, Second Circuit held this stated a plausible claim of fiduciary breach:
  - Plan fiduciaries had power to make corrective disclosures in ordinary course of securities disclosures.
  - Plausible that earlier disclosures may have limited harm.
- Held OK if ERISA imposes liability for securities disclosures that did not violate securities laws.
- Reinvigorate these claims, e.g., Johnson & Johnson lawsuit?



# Vest and Disclosure Conversion Rights

- *Vest v Resolute*, 905 F.3d 985 (6<sup>th</sup> Cir. 2018). Employee went out on long-term disability; claim employer Resolute breached a fiduciary duty to tell him he could convert his \$300,000 optional life insurance when he ceased employment. Sixth Circuit held no fiduciary breach:
  - Not a required disclosure in ERISA regulations.
  - Did not mislead and no inquiry or notice of unique facts putting Resolute on notice silence would be harmful.
- Dissent: Benefit packet Resolute sent was misleading because it failed to disclose this conversion right.

# Pearce and Reliance on SPD

- *Pearce v. Chrysler*, 893 F.3d 339 (6<sup>th</sup> Cir. 2018). Plaintiff passed on buyout because SPD stated he would remain eligible for early retirement subsidy. Chrysler terminated him that same day and enforced plan provision that (contrary to the SPD) negated early retirement subsidy for those who were terminated. Sixth Circuit held plaintiff stated a viable claim for reformation:
  - Chrysler may have committed equitable fraud, *i.e.*, a breach of duty (the misleading SPD) that constitutes an undue and unconscientious advantage of another.
  - Constructive fraud = (i) information asymmetry, (ii) defendant misrepresents the benefits, and (iii) plaintiff investigated and drew a reasonable conclusion.
- Case illustrates the importance of SPDs.

# DeRogatis SPDs and Fiduciary Liability for Acts of Ministerial Agents

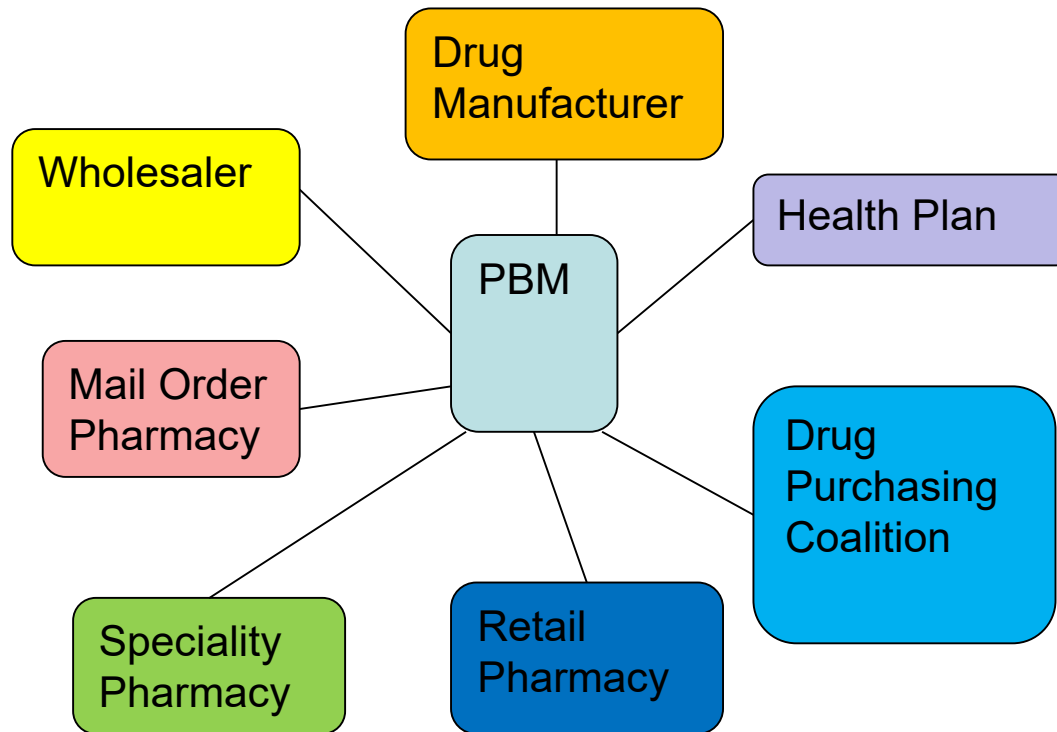
- *In re DeRogatis*, 904 F.3d 174 (2<sup>nd</sup> Cir. 2018). Spouse of husband dying on lung cancer sought to maximize benefits under multi-employer pension and welfare plans. Second Circuit held:
  - Fiduciary obligations attach to actions of ministerial employees engaged in fiduciary function of communicating on plan benefits.
  - Pension plan fiduciaries not liable for inaccurate statements of agent when SPD was clear.
  - BUT welfare plan fiduciaries may be liable since welfare plan SPD was murky, and agent misstated impact of husband's early retirement on his health benefits.
- Again case illustrates the importance of clear SPDs.

# Prescription Drug Litigation

## Key Developments 2018

# Overview

PBMs: PBMs generally contract with pharmacies, negotiate discounts and rebates with drug manufacturers, review drug utilization, manage drug formularies, and process and pay prescription drug claims.



# Overview

- Plaintiffs have argued that insurers and PBMs acted as fiduciaries with respect to:
  - Drug prices
  - Rebates
  - Formulary placement
  - Drug switching
  - Drug classification
- Courts have found that insurers and PBMs are not fiduciaries based on:
  - Contract terms
  - Arm's-length negotiations
  - Settlor function
  - Plan retaining sole discretion over price, formulary, etc.

# *In re Express Scripts*

- *In re Express Scripts/Anthem ERISA Litig.*, 285 F. Supp. 3d 655(S.D.N.Y. 2018). Insurer’s agreement with PBM requires it to provide “competitive benchmark pricing” to insurer, and periodically renegotiate to achieve same. ERISA 404 and 406 violations related to drug pricing. At motion to dismiss stage, held:
  - Neither PBM nor insurer fiduciary.
  - “Competitive benchmark pricing” term is limited by separate contractual provision limiting price. Second provision was sealed.
  - Insurer making business decision.

Appeal argued October 19, 2018 before Second Circuit.

# *Negron v. Cigna*

- *Negron v. Cigna*, 300 F. Supp. 3d 341 (D. Conn. 2018). Suit against insurer/PBM alleging fiduciary breach, PT, and benefits claims. Insurer required pharmacies to charge copay in excess cost paid by PBM. Insurer would claw-back spread and did not disclose practice to participants. Pleadings averred that plan terms limited insurer to only charging participants actual cost of drugs.
  - Exhaustion of benefit claims futile.
  - Discretion over pricing contravened plan terms and constituted plan management and administration sufficient for fiduciary status.
  - Plan contracts with insurer constituted plan assets.
  - 404, 406, and 502(a)(1)(B) violations could proceed.
  - 404 violations allowed in part based on insurer's failure to disclose claw-back.



# *In re EpiPen*

- *In re EpiPen ERISA Litig.*, 341 F. Supp. 3d 1015 (D. Minn. 2018). Participants brought suit against consortium of PBMs alleging PBMs improperly agreed to high EpiPen prices and retained spread through rebates and other payments. PBMs moved to dismiss.
  - Court declined significant inquiry into underlying contracts.
  - Defendants retained sufficient “discretion to determine the amount of their compensation as sourced for plan assets.”
  - However, 406 violations dismissed on basis that misconduct did not involve plan assets.
  - Court explained in footnote that 404 violations turned on ERISA 3(21)(a)(iii).

# Fiduciary Status

- Fiduciary status is critical threshold element. But how much discretion is sufficient? *Compare:*
  - *Express Scripts*: contract requiring “competitive benchmark pricing” + periodic renegotiation + add’l undisclosed pricing constraints = No.
  - *Negron*: contract limiting participants payments to price paid by PBM = Yes.
  - *EpiPen*: pricing discretion over unspecified spread and pass through contracts = Yes.
- Discretion over what?
  - *Negron*: status based on administration and management. Contract is plan asset.
  - *EpiPen*: status based administration. Contract is not a plan asset.

# **ESOP Trials and Valuation Issues and Employer Stock Funds Key Developments 2018**

# ESOP Trials and Valuation Issues

*Brundle v. Wilmington Trust*, Appellate docket # 18-1029  
(4<sup>th</sup> Ci. 2018)

Oral argument held on 12/11/2018 before the Honorable  
Roger L. Gregory, Diana G. Motz and Henry F. Floyd.

Case on Appeal:

*Brundle v. Wilmington Trust*, 241 F.Supp. 3d 610 (ED Va  
2017)

Wilmington Trust held liable for violating §1106(a)(1)(A),  
causing \$29,773,250 in damages to the ESOP

*Brundle v. Wilmington Trust*, 258 F.Supp. 3d 647 (ED Va  
2017)

Motion to amend the judgment (denied) or for new trial and  
participant's petition for attorneys fee (granted in part).

# *ESOP Trials and Valuation Issues*

## Background:

Participant sued ESOP Trustee which had negotiated and approved acquisition of employer stock in conjunction with the establishment of the ESOP.

Basis for loss calculation – Trustee's failure to probe valuation on following issues:

- Failure to investigate prior report
- Failure to probe riskiness and reliability of management projections
- Failure to investigate control premium/lack of control discount
- Failure to investigate rounding

# ESOP Trials and Valuation Issues

Loss calculation:

Company's growth projections accepted by Trustee inflated price by \$4,325,000

Control issues – control premium (\$8,186,000) /lack of control discount (\$9,715,250) caused losses in the amount of \$17,901,250.

Rounding procedure of SRR damaged ESOP by \$3,000,000.

Other Losses - \$4,541,000.

Total: \$29,773,250

*Motion to Amend Judgment or for new trial – not granted.*

*Petition for Attorneys fees – fees awarded under §1132 in amount of \$1,819,631 and will offset contingent fee, which will be reviewed as to excessiveness through a process analogous to class settlement.*

# ESOP Trials and Valuation Issues

## *Appeal Issues:*

*Prohibited Transaction:* Whether the District Court erred in finding that the 2013 stock purchase was a prohibited transaction because the ESOP paid more than adequate consideration.

*Damages:* Whether District Court erred in calculating damages. (In particular, finding that ESOP should not have paid a control premium because ESOP did not acquire effective control through the transaction.)

*Offset:* Whether District Court erred in failing to allow Wilmington Trust an offset by amount ESOP received in a subsequent sale to a third-party strategic buyer.

*Attorneys fees:* Whether the District Court erred in awarding attorneys fees pursuant to ERISA §502(g) and allowing attorneys' fees from common fund.

# ESOP Trials and Valuation Issues

- *Svigos v. Wheaton Securities, Inc.* 2018 EBC 29572 (N.D.III) (2018)
- Background
- Plaintiff alleged that the distribution that she received was approximately \$1.8 million less than the value of her shares in light of self-dealing on the part of the two other shareholders. She alleged violations of ERISA §502(a)(1)(B), §502(a)(2) and, alternatively, §502(a)(3)
- Holding
- Court found that the Plaintiff , alleged a sufficiently close relationship between the Defendants, their responsibilities with respect to the Plan, their positions at Wheaton, the management of the Plan, and the management of Plan assets to support the inference that Defendants acted as plan fiduciaries when they allegedly engaged in self-dealing transactions.
- Case subsequently settled and was dismissed without prejudice.



# ESOP Trials and Valuation Issues

- *Hurtado v. Rainbow Disposal Co., Inc.*, 2018 WL 3372752 (C.D.Cal.2018)
- Background
- Motion to Dismiss denied on all counts in relation to a sale of a company's stock.
- Highlighted Holdings:
- Plan assets – Stocks were plan assets. The allegation of use of the transaction of the sale of stock to secure employment contracts with the new company was sufficient for pleading prohibited transaction/self dealing.
- Self-dealing – duty to investigate and determine whether ESOP shareholders should file a derivative suit.
- Unlawful indemnity arrangements - if 100% ESOP owned company indemnifies for breach of fiduciary duties.

# *Employer Stock Held in ESOPs and Participant Directed Individual Account Plans*

A number of cases during 2018 revisited *Fifth Third Bancorp v. Dudenhoeffer*, 134 S.Ct. 2459 (2014).

*Jander v. Ret.Plans Comm. Of IBM*, 910 F.3d 620 (2<sup>nd</sup> Cir. 2018) Survived Motion to Dismiss – alleged it was imprudent not to disclose the underperformance of a company division based on market studies that early disclosure would have mitigated the eventual decline of the stock.

*Graham v. Fearon*, 721 F.App'x 429 (6<sup>th</sup> Cir, 2018). Dismissal affirmed, finding that disclosure of the negative information might have been more harmful than beneficial due to the risk of market over-reaction.

*Kopp v. Klein*, 894 F.3d 214 (5<sup>th</sup> Cir.2018) Dismissal of claim affirmed alleging that failure to disclose info about employer stock was a fiduciary breach where there was no cognizable allegation that public information was not fair assessment of stock's value and disclosure of the negative info might have been more harmful than beneficial.

# Church Plan Litigation

## Key Developments 2018

# Background – *Advocate* and *Medina* Rulings

- *Advocate Health Care v. Stapleton*, 137 S. Ct. 1652 (2017). Court held ERISA’s “church plan” exemption includes plans established by organizations that are not churches, but that are affiliated with churches, such as church-affiliated hospitals.
- *Medina v. Catholic Health Initiatives*, 877 F.3d 1213 (10<sup>th</sup> Cir. 2017). Addressed issues left open in *Advocate*:
  - Held both employer & principal purpose organization that maintains the plan must be church-affiliated.
  - Recognized church’s control over and association with hospital organization through canon law and civil law entities.
  - Held principal purpose organization maintains a plan by administering it, and the internal benefits committee constitutes an “organization.”

# What Does Maintain a Plan Mean?

- *Rollins v. Dignity Health*, 338 F. Supp. 1025 (N.D. Ca. 2018). Declined to defer to *Medina*, and adopted (pending discovery) plaintiff's position that "maintain" requires the principal purpose organization to have the power to fund, continue, and amend or terminate the plan.

## *Compare:*

- *Sanzone v. Mercy Health*, 326 F. Supp. 3d 795 (E.D. MO 2018) (following *Medina* to find "maintain" includes administration of the plan); *Smith v. OSF Healthcare*, 2018 WL 4680671 (S.D. IL Sept. 28, 2018) (same).

# Factual Issues on Church Affiliation

- *Rollins v. Dignity Health*, 338 F. Supp. 1025 (N.D. Ca. 2018). Court noted factual issues identified by plaintiffs, including statements by the Catholic Church, that stated a plausible claim whether Dignity is controlled by or associated with the Catholic Church.

*Compare:*

- *Sanzone v. Mercy Health*, 326 F. Supp. 3d 795 (E.D. MO 2018) (recognizing church's control over and association with hospital organization through canon law and civil law entities); *Smith v. OSF Healthcare*, 2018 WL 4680671 (S.D. IL Sept. 28, 2018) (same).

# State Law Claims

If plan is ERISA-exempt “church plan,” state contract (plans and related employment promises are contracts) and state trust law will apply.

- *Rollins v. Dignity Health*, 338 F. Supp. 1025 (N.D. Ca. 2018):
  - Stated claim breached employer promise in plan to fund it on an actuarial basis sufficient to pay the plan benefits.
  - Allowed unjust enrichment and state law fiduciary claims to proceed.
- *Owens v. St. Anthony*, 2018 WL 4682337 (N.D. Ill. Sept. 29, 2018):
  - Plan terminated in underfunded status in which they only received 60% to 70% of their accrued benefit.
  - Let contract claim proceed even though plan disclaimed imposing contribution obligation on employers; other statements and promises that were providing this benefit made a viable claim.
  - Also stated a fiduciary breach claim based on plan language that employers were obligated to provide contributions to fund employee’s benefits.

# Potential Developing Issue: Challenges to Governmental Plan Exemption?

- Complex relationships often occur in government-affiliated agencies or instrumentalities. *E.g.*, operation of transportation systems, hospitals.
- Suit recently filed in North Carolina challenging governmental plan exemption for retirement plans of health care system Atrium.
- Raises, *e.g.*, what constitutes an agency or instrumentality of State or its political subdivision?
  - Currently courts apply multi-factor tests developed by IRS in informal guidance. *E.g.*, *Smith v. RTA*, 827 F.3d 412, 418-20 (5<sup>th</sup> Cir. 2016).