EMPLOYEE BENEFITS AND EXECUTIVE COMPENSATION LITIGATION GROUP

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ERISA STOCK DROP UPDATE

During the economic downturn, it has become commonplace for putative class action lawsuits to be filed under the Employee Retirement Income Security Act of 1974 ("ERISA") on the heels of federal securities cases against publicly traded companies and the directors and officers at their helm. These ERISA class actions, commonly referred to as "stock drop" cases, quickly have become one of the preferred class action vehicles.

Notably, however, not many of these cases have progressed to the summary judgment phase – the claims are typically resolved through settlement at the motion to dismiss or class certification stage. For example, in September, the U.S. District Court for the Central District of California approved a settlement that requires a mortgage investment firm to pay no less than $300,000 in common stock to as many as 400 employees who alleged they suffered investment losses tied to their investment in the firm's stock. ***See Page v. Impac Mortgage Holdings, Inc.***, (C.D. Cal., No. SACV-07-1447-AG 9/14/09).

However, in one recent case, the United States District Court for the Northern District of Illinois reviewed the merits and granted summary judgment to the Plan, confirming the fact that ERISA's Section 404(c) safe harbor provision will protect companies that provide sufficient disclosures about the risks of investing in company stock. ***Lingis v. Motorola***, 2009 U.S. Dist. LEXIS 50684 (N.D. Ill. 2009). In Lingis, a putative class of Motorola employees asserted that Motorola and its officers and directors breached fiduciary duties they owed class members under ERISA by offering the Motorola stock fund as an investment option in their 401(k) Plan when defendants knew about problems with the financial condition of the company.

While plaintiffs argued that defendants could not meet four out of the nine criteria to invoke the Section 404(c) safe harbor, the Court found that the prospectus disclosures stating that the Motorola stock fund was the riskiest, non-diversified investment option available provided more than adequate information to employees concerning their assets in an ERISA-covered plan. The Court also rejected plaintiffs' argument that the employees were deprived of the opportunity to exercise "independent control over their [Plan] assets" because defendants allegedly concealed material nonpublic information. Instead, the Court concluded that Section 404(c) of ERISA and its regulations does not "require[ ] a fiduciary to guarantee that all material facts are conveyed to participants. Rather, the regulation prohibits fiduciaries from *concealing* such facts." This disclosure duty, the Court explained, is equivalent to the duties imposed under ERISA more generally and does not extend to SEC public filings, such as the 10-K and 10-Q Forms, because they are prepared in a corporate capacity rather than an ERISA capacity. In essence, plaintiffs' claim rested on alleged misrepresentations in public filings and plaintiffs failed to cite anything misleading about defendants' acts as ERISA fiduciaries. As a result, the Court found that defendants had no fiduciary duty to disclose certain negative information regarding the Turkish loan because they had not, as ERISA fiduciaries, provided investors with any materially misleading information that needed to be corrected and thus, the Section 404(c) defense was applicable.

The Court also rejected plaintiffs' failure to "appoint, monitor and inform" claim stating that it would effectively require the "entire board of one of the world's largest telecommunications company [] not only to monitor the competence and overall performance of its 401(k) committee, but also to monitor the committee's individual decisions."

Whether the ***Lingis*** decision sets the stage for the end of the ERISA stock drop cases remains to be seen. However, the Court's reasoned and thoughtful analysis gives companies guidance on how to satisfy the Section 404(c) safe harbor and avoid potential stock drop litigation.

> **"As the court reads the statute and regulation [Section 404(c) of ERISA and 29 C.F.R. 2550.404c-1(c)(1)(ii)], however, neither provision requires a fiduciary to guarantee that all material facts are conveyed to participants. Rather, the regulation prohibits fiduciaries from concealing such facts."**

DISCOVERY IN ERISA CASES; MORE THAN A YEAR AFTER METLIFE V. GLENN

LIMITING DISCOVERY IN ERISA DENIAL OF BENEFITS CASES

More than a year ago, in ***Metropolitan Life Ins. Co. v. Glenn***, 128 S.Ct. 2343 (2008), the United States Supreme Court ("Supreme Court") opined that a claims administrator that both evaluates claims for benefits and pays benefit claims operates under a conflict of interest. Furthermore, the Supreme Court held that the conflict must be weighed by the Court as one factor in determining whether a decision to deny benefits was arbitrary and capricious.

Notably, ***Glenn*** was not a case about discovery. Yet, post-***Glenn*** several decisions have glossed over the fact that the Supreme Court stressed that the conflict is simply one of several factors to be reviewed in the process of determining whether a decision was arbitrary and capricious. There are however, several federal district courts that have continued to recognize the basic idea that discovery should be permitted in ERISA cases only in very limited situations. Included among these decisions are the following:

- ***Wattenhofer v. Target Corp.***, 2009 U.S. Dist. LEXIS 92037 at *8 (D. Minn. Oct. 2, 2009) (finding that Target took several steps to reduce bias and promote the accurate administration of the Plan, including hiring a third party administrator, establishing a trust fund to pay claims, and ensuring those who renewed the appeal were not involved in the creation, funding or administration of the Plan's trust fund).
- ***Kendel v. Zurich Am. Ins. Co.***, 2009 U.S. Dist. LEXIS 86930 at *6 (E.D. Ark. Sept. 21, 2009) ("[T]here is no evidence in the administrative record that Zurich failed to follow its own claims-handling procedures much less that it has a history of biased claims administration.")
- ***Williams v. Jefferson Pilot Finan. Ins. Co.***, 3:08-0001 (M.D. Tenn. 3/16/09) ("Sixth Circuit jurisprudence requires at least some initial showing demonstrating bias or other procedural irregularity before pretrial discovery will be allowed in an ERISA denial of benefits case.")
- ***Christie v. MBNA Group Long Term Disability Plan***, 2008 WL 4427192 (D. Me. 2008) (Due to ***Glenn's*** silence on discovery issues, the Plaintiff must establish "at least some very good reason . . . to overcome the strong presumption that the record on review is limited to the record before the administrator.")
- ***Marsalek v. Marsalek & Marsalek Plan***, 2008 WL 2006765, *2 (N.D. Ill. 2008) (The Court denied plaintiff's request for discovery when he failed to establish "exceptional circumstances.")
- ***Singleton v. Hartford Life & Accident Ins. Co.***, 2008 WL 3978680 (E.D. Ark. 2008) (Court rejected document requests for performance awards, incentives, and bonuses for employee's involved in plaintiff's claim).

As these cases, suggest, even post-***Glenn***, a plaintiff challenging a denial of benefits must still carry the burden of establishing that there is a specific need to go outside the administrative record based on the particular facts of his or her case. Generally, conclusory allegations will not meet this burden. As one court has noted, the ***Glenn*** decision "does not mean, . . . that discovery will automatically be available any time the defendant is both the administrator and the payor under an **ERISA** plan. The limitation on discovery [in ERISA cases]. . . is a result of the determination that matters outside the administrative record are ordinarily not relevant to the court's review of an **ERISA** benefit decision." ***Johnson v. Conn. Gen. Life Ins. Co.***, 324 Fed. Appx. 459, 467 (6th Cir. Ohio 2009). Plan sponsors, plan administrators, claims administrators and insurers must nevertheless be mindful of the ***Glenn*** decision and carefully scrutinize claims procedures in order to minimize the likelihood that plaintiffs will be permitted to successfully seek discovery outside of the administrative record.

EIGHTH CIRCUIT AFFIRMS ARBITRARY AND CAPRICIOUS STANDARD OF REVIEW

CHRONISTER V. UNUM LIFE INS. CO. OF AM.

Earlier this year, the United States Court of Appeals for the Eighth Circuit issued an opinion in ***Chronister v. Unum Life Ins. Co. of America***, 563 F.3d 773 (8th Cir 2009), which affirmed the application of the arbitrary and capricious standard of review in denial of benefits cases arising under the Employee Retirement Income Security Act of 1974 ("ERISA") and clarified how courts sitting in the Eighth Circuit will apply the standard.

In ***Chronister***, Unum denied the plaintiff's long-term disability claim under the plan's "self-reported symptoms" limitation. After Chronister exhausted her administrative remedies, the district court remanded the case back to Unum, instructing the insurance company to re-open the administrative record and issue a new determination. Both parties appealed, and Chronister argued that the abuse of discretion standard should not apply, in part because Unum was under a financial conflict of interest. The Court rejected Chronister's argument, holding that she "failed to demonstrate any connection between" the alleged conflict of interest and the denial of her claim. After Unum denied her claim on remand, the district court applied the abuse-of-discretion standard of review and upheld Unum's denial.

On appeal, Chronister argued that the Supreme Court's decision in ***Metropolitan Life Ins. Co. v. Glenn***, 128 S.Ct. 2343 (2008), required a less deferential standard of review of Unum's decision on remand. The Court held that ***Glenn*** did not change the standard of review, but did impact how the Eighth Circuit applied the standard in ERISA cases.

First, the Court following ***Glenn***, held that an inherent conflict of interest does exist when the same entity administers claims and pays benefits "out of its own pocket." Before ***Chronister***, the Eighth Circuit had held that such a conflict of interest could not be assumed.

Also, prior to ***Glenn***, the Eighth Circuit required plaintiffs to show a causal connection between a conflict of interest and an entity's denial of benefits before the Court would use a less deferential standard of review. In ***Chronister***, the Court held that Plaintiffs no longer must show such a causal connection. Instead, the Court will take the conflict into consideration when deciding whether the administrator abused its discretion—regardless of whether there is evidence that the conflict influenced the administrator's decision.

It is noteworthy that the Eighth Circuit in ***Chronister*** specifically declined to state what impact, if any, it viewed ***Glenn*** as having on discovery although it did recognize the discovery limitations in ERISA cases. Subsequent decisions within the Eighth Circuit have rejected plaintiffs' attempts to seek discovery inside the record. See, for example, Kendel v. Zurich Am. Ins. Co., 2009 U.S. Dist. LEXIS 86930 at *6 (E.D. Ark Sept. 21, 2009) (noting that the court in Chronister recognized limitations in ERISA cases and finding that plaintiffs failed to establish good cause justifying discovery outside of the administrative record).

ENSURING THE REASONABLENESS OF CONTRACTS UNDER ERISA IN LIGHT OF UNCERTAIN GUIDANCE

Under the Employee Retirement Income Security Act of 1974 ("ERISA"), plan fiduciaries must ensure that no more than reasonable compensation is paid for services provided to plans. In order to do this, however, fiduciaries need to have information regarding the actual fees and compensation a service provider receives. While fiduciaries typically have access to the direct compensation that will be paid to service providers (e.g., $10,000 for specific types of recordkeeping services), fiduciaries historically have had little to no knowledge of the amounts of indirect compensation service providers may receive. Indirect compensation consists of payments from third-parties other than the plan or plan sponsor, and includes amounts such as 12b-1 fees, revenue-sharing payments or rebates.

It should come as no surprise, then, that plan participants have begun examining the total compensation, both direct and indirect, paid by plans to service providers. In fact, there has been a recent spate of litigation concerning fee disclosure, particularly in the realm of 401(k) plans. In response to this increased scrutiny regarding the compensation paid to service providers, the Department of Labor issued new proposed regulations in December 2007 regarding the fees and services that must be disclosed in order for a contract or arrangement to be considered "reasonable" under Section 408(b)(2) of ERISA.

The proposed regulations affect both welfare and retirement benefit plans and apply to a wide range of service providers, including investment managers, recordkeepers and third-party administrators. In short, the regulations provide that contracts must require the service provider to disclose detailed information regarding all services to be performed for the plan and, most importantly, all compensation that will be received either directly from the plan or indirectly from third-parties. In other words, service providers will be required to provide information that is sufficiently detailed for plan fiduciaries to determine whether the contract or arrangement is, in fact, reasonable.

Despite the fact that the proposed regulations were issued nearly two years ago, they have not yet been finalized and there are rumblings that the Department of Labor may withdraw them entirely. Nonetheless, this topic continues to be a hot-button issue for litigation. Consequently, the issue of increased transparency in fee disclosure will not be going away anytime soon, regardless of the ultimate effect of the 2007 proposed regulations.

So what guidelines should plan fiduciaries follow when contracting for plan-related services in light of this uncertain guidance? First and foremost, fiduciaries should continue to pressure service providers for increased and full disclosure of all services and fees that will be provided to the plan, particularly with respect to any indirect, third-party compensation that may be received by the service provider.

These disclosures and the requirement to make continued disclosures should be memorialized in the contract between the plan and the service provider. Of course, plan fiduciaries should be prepared for service providers to resist such efforts. Increased disclosure obligations are sure to be costly for service providers, and they will therefore be hesitant to agree to the increased obligations. Nevertheless, full disclosure will be increasingly important for plan fiduciaries, particularly if the fiduciary is called upon in litigation to defend the compensation it pays (or allows to be paid) to service providers. For the time being, the 2007 proposed regulations represent the "best practices" with respect to appropriate fee disclosures; thus, plan fiduciaries should insist on compliance with the proposed regulations to the fullest extent possible when negotiating contracts with service providers.

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