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# SECURITIES PLAINTIFFS TURN TO CLASS ACTIONS UNDER ERISA

*A look at the recent wave of litigation challenging 401(k) revenue sharing. The authors find that most ERISA class actions have survived motions to dismiss, but now must overcome obstacles to class certification and motions for summary judgment.*

By Sean M. Murphy, Mia C. Korot, and Tommaso Bencivenga *

Beginning in 2004, a significant number of securities class actions were filed challenging the practice of "revenue sharing" in the mutual fund industry. Almost all of these complaints were dismissed for failure to state a claim under the federal and state securities laws. Following a broader trend to circumscribe securities class actions, the courts in these cases foreclosed significant types of federal and state securities claims regardless of the conduct being challenged. With securities laws not providing an avenue to attack revenue sharing, private plaintiffs began filing class actions under the Employee Retirement Income Security Act of 1974 ("ERISA"), shifting their focus from revenue sharing when retail mutual funds are sold through broker/dealers to similar practices when funds are included as investment options on retirement plans. While these cases are still in the relatively early stages, it is already clear that ERISA is proving to be a more viable route to pursue civil remedies for the revenue sharing plaintiffs than the securities laws. And the evolution of securities claims to ERISA is not unique to revenue sharing. Securities plaintiffs across the U.S. continue to expand their use of ERISA to challenge any number of practices, from stock drop cases to losses from subprime mortgage investments.

This article provides some background on the securities class actions challenging revenue sharing that may have planted the seeds for the filing of the ERISA actions based on similar conduct, as well as a summary of the first court decisions being handed down in the ERISA cases.

## SECURITIES CLAIMS CHALLENGING REVENUE SHARING

Generally speaking, "revenue sharing" in the securities law context relates to an arrangement whereby a mutual fund adviser or its affiliate agrees to provide certain benefits to broker/dealers that market the mutual funds to their clients. In the classic revenue sharing scenario, this benefit comes in the form of payment from the fund adviser to the broker which is based on a percentage of fund assets sold by the broker. Another related practice, called directed brokerage, involves the adviser directing the mutual funds to execute portfolio transactions (thus generating massive commissions) with these broker/dealers. Such practices came under scrutiny for the perceived conflicts of interests these payments created between fund families and their shareholders, and between broker/dealers and their investors.

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Following a wave of regulatory inquiries into the practice of revenue sharing in the mutual fund industry in 2004,[1] dozens of civil class actions were filed in federal court against fund investment advisers challenging the practice.[2] These lawsuits were based on alleged violations of the federal securities laws, including the Investment Company Act of 1940, the Investment Advisers Act of 1940, the Securities Act of 1933 and/or the Securities Exchange Act of 1934, as well as state law. The complaints generally alleged that the advisers' disclosures about revenue sharing paid to broker/dealers were misleading, and/or the payment of revenue sharing was an indication that the funds' advisory fees were excessive.

The defendants in these cases moved to dismiss the complaints for failure to state a claim upon which relief can be granted. Over the next several years, courts almost universally granted these motions and dismissed these complaints.[3] Significantly, many of the decisions found that all of the state law claims were preempted by the Securities Litigation Uniform Standards Act ("SLUSA"),[4] and that no implied private rights of action existed under either the Investment Company Act of 1940 or the Investment Advisers Act of 1940.[5] Thus, many of the dismissals were without leave to replead, as the securities laws foreclosed any room to plead around the defects in the complaints.

These dismissals followed a trend towards limiting securities class actions through statutory reform and judicial decisions. For example, Congress enacted the Private Securities Litigation Reform Act of 1995, which imposed higher pleading standards on certain securities claims, and followed it up with SLUSA in 1998, which operated to preempt certain state law securities class actions in favor of federal law. At the same time, the Supreme Court has been raising the bar for plaintiffs to pursue securities claims in cases such as *Dura Pharmaceuticals, Inc. v. Broudo*[6] and *Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.*[7] In short, the prospects for securities plaintiffs were dimming across the board.

## THE ERISA LAWSUITS FOLLOW

Starting in late 2006, and following the dismissal of many of the securities claims based on allegations of

[1] *See, e.g.*, *In the Matter of Mass. Fin. Servs. Co.*, Inv. Adv. Act Rel. No. 2224, Inv. Co. Act Rel. No. 26409, 2004 WL 635594 (Mar. 31, 2004); *In the Matter of Franklin Advisers, Inc. and Franklin/Templeton Distrib., Inc.*, Exchange Act Rel. No. 50841, Inv. Adv. Act Rel. No. 2337, Inv. Co. Act Rel. No. 26692, 2004 WL 2884102 (Dec. 13, 2004).

[2] *See, e.g.*, Complaint, *In re Merrill Lynch Inv. Mgmt. Funds Sec. Litig.*, No. 04 Civ. 3759 (RO), 2006 WL 1628005 (S.D.N.Y. May 17, 2004) (Docket No. 1); Complaint, *In re Salomon Smith Barney Mut. Fund Fees Litig.*, 441 F. Supp. 2d 579 (S.D.N.Y. May 28, 2004) (Docket No. 1).

[3] *See, e.g.*, *In re AIG Advisor Group Sec. Litig.*, No. 06 Civ. 1625 (JG), 2007 U.S. Dist. LEXIS 69396 (S.D.N.Y. Sept. 20, 2007); *In re Salomon Smith Barney Mut. Fund Fees Litig.*, 441 F. Supp. 2d 579 (S.D.N.Y. 2006); *In re Merrill Lynch Inv. Mgmt. Funds Sec. Litig.*, 434 F. Supp. 2d 233 (S.D.N.Y. 2006); *In re Morgan Stanley & Van Kampen Mut. Fund Sec. Litig.*, No. 03 Civ. 8208 (RO), 2006 WL 1008138 (S.D.N.Y. Apr. 18, 2006). *See also In re Davis Selected Mut. Funds Litig.*, No. 04 Civ. 4186 (MGC), 2005 WL 2509732, at *2 (S.D.N.Y. Oct. 11, 2005); *In re Dreyfus Mut. Funds Fee Litig.*, 428 F.Supp.2d 342 (W.D. Pa. 2005); *In re Franklin Mut. Funds Fee Litig*., 388 F. Supp. 2d 451, 464-69 (D.N.J. 2005); *In re Lord Abbett Mut. Funds Fee Litig.*, 385 F. Supp. 2d 471, 486-88 (D.N.J. 2005); *In re Eaton Vance Mut. Funds Fee Litig.*, 380 F. Supp. 2d 222, 231-33 (S.D.N.Y. 2005); *Gilliam v. Fidelity Mgmt. & Research Co.*,

*footnote continued from previous column…*

No. 04-11600-NG, slip op. (D. Mass. Sept. 18, 2006). Only one case appears to have gone the other way. *See Siemers v. Wells Fargo & Co.*, No. C 05-04518 (WHA), 2006 WL 2355411 (N.D. Cal. Aug. 14, 2006).

[4] *See, e.g.*, *In re Lord Abbett Mut. Funds Fee Litig.*, 463 F. Supp. 2d 505, 515-16 (D.N.J. 2006); *Eaton Vance*, 380 F.Supp. 2d at 240.

[5] *See, e.g.*, *Eaton Vance*, 380 F. Supp. 2d at 230-31; *Morgan Stanley and Van Kampen*, 2006 WL 1008138, at *11.

[6] 544 U.S. 336, 347-48 (2005). *Dura* effectively increased the amount of showing required to establish loss causation under section 10(b) of the 1934 Act.

[7] 128 S.Ct. 761 (2008). *Stoneridge* limits certain types of "scheme" liability under the 1934 Act.

revenue sharing, approximately 15 class action complaints were filed under ERISA against some of the nation's largest employers with defined contribution retirement plans alleging unlawful revenue sharing. The lawsuits were filed around the same time that the Department of Labor ("DOL") was finalizing new rules aimed at fee disclosures by 401(k) plan service providers and two months prior to a report on 401(k) fees issued by the Government Accountability Office ("GAO").[8] While these lawsuits differed from the previously filed securities claims in the sense that they shifted the focus to revenue sharing payments made in the context of a defined contribution benefit plan, many of the core allegations remained (*i.e.,* lack of adequate disclosure and excessive fees).

In addition to naming the pension plan sponsors, the ERISA complaints named other plan service providers as defendants, such as the plan trustee and the investment advisers to the mutual funds included as options on the plan's investment menu. The complaints allege that the plan sponsors and the various service providers breached their fiduciary duties under ERISA by allowing the plans to incur unreasonable and excessive fees, and inadequately disclosing these fees. The alleged excessive payments include both "hard dollar" payments made directly by the plans to service providers, as well as the revenue sharing payments made by third parties.

Although plaintiffs use the term "revenue sharing" in their complaints, these arrangements are different in the ERISA context than they were in the securities context. While revenue sharing traditionally refers to an arrangement pursuant to which a mutual fund family agrees to pay a broker/dealer a fee in return for certain marketing benefits, in the context of retirement plans, revenue sharing generally refers to investment managers "sharing" asset-based revenues with administrative service providers that provide services directly to the retirement plans.[9] While some of the administrative service providers in these cases are affiliated with entities that also provide investment advisory services, many have little or no role in selecting investment vehicles under the retirement plans, so, unlike in traditional revenue sharing cases, there are no allegations of conflict of interests.[10]

Instead, plaintiffs in these cases generally allege that defendants breached their ERISA-imposed fiduciary duties by (i) failing to account for these revenue sharing payments when negotiating fees with the plan service providers; and (ii) failing to adequately disclose to plan participants and the federal government the fees paid by the plan to plan service providers.[11] Under ERISA, plan sponsors and administrators are fiduciaries of the 401(k) plan and they must ensure that fees borne by the plans are reasonable and incurred solely for the benefit of plan participants.[12] Plaintiffs contend that plan fiduciaries failed to consider whether the total amount paid to service providers (*i.e.*, direct fees combined with revenue sharing payments) was reasonable and incurred solely for the participants' benefit. Moreover, because defendants allegedly failed to disclose these revenue sharing payments to plan participants, plan participants were not fully informed about the expenses associated with their accounts.

Plaintiffs further allege that because plan fiduciaries failed to disclose these revenue sharing payments to plan participants, the defendants lost the safe harbor protection of section 404(c) of ERISA, which shields plan fiduciaries from liability to a participant for any loss "which results from such participant's or beneficiary's exercise of control," provided that they comply with the rule's requirements, including providing plan participants with sufficient information to make an informed investment decision.

Based on these alleged breaches of fiduciary duties, plaintiffs have generally pled at least two claims for relief against defendants. First, plaintiffs assert a cause of action under ERISA section 502(a)(2), which permits a plan participant to bring a cause of action for relief under section 409(a) "to make good to such plan any losses to the plan resulting from [any] breach" of its fiduciary duties. As such, plaintiffs seek to restore to the

[8] United States Government Accountability Office Report No. GAO-07-21, *Changes Need to Provide 401(k) Plan Participants and the Department of Labor Better Information on Fees* (November 2006).

[9] *See* Brief of Appellee Deere & Company at 5-6, *Hecker v. Deere & Co.*, No. 07-3605 (7th Cir. May 9, 2008).

[10] *But see Montoya v. ING Life Ins. & Annuity Co.*, No. 07-cv-2574-NRB (S.D.N.Y. Mar. 28, 2007).

[11] Specifically, section 403(c)(1) of ERISA requires that plan assets be held for the "exclusive purposes of providing benefits to participants in the plan and their beneficiaries, and defraying reasonable expenses of administering the plan." Further, section 404(a)(1)(A) provides, in part, that plan fiduciaries "discharge [their] duties with respect to a plan solely in the interest of the participants and beneficiaries," and defraying reasonable plan administrative expenses.

[12] *See* sections 403(c)(1) and 404(a)(1)(A).

401(k) plan an amount equal to the losses experienced as a direct result of defendants' breaches of fiduciary duty. Second, plaintiffs assert a cause of action under ERISA section 502(a)(3) for "appropriate equitable relief" for the alleged ERISA violations. Finally, in at least one complaint, plaintiffs have alleged a third claim for relief under ERISA section 502(a)(3) for equitable restitution relating to the revenue sharing payments.

Since the initial wave of lawsuits was filed in late 2006, a number of plaintiffs' firms have filed similar lawsuits. For example, additional lawsuits were filed against General Motors and Wal-Mart alleging that the plan fiduciaries did not exercise proper due diligence in selecting the investment options made available to plan participants.[13] Specifically, plaintiffs in these suits claim that the plan sponsors should not have selected retail mutual funds as investment options under the plan, as the fees charged by the mutual funds were excessive because they included revenue sharing payments to third-party entities. A suit was also brought against ING and the New York State Teacher's Union for allegedly breaching their fiduciary duties in sponsoring, managing, and administering a 403(b) tax-deferred annuity program.[14] In these lawsuits, plaintiffs also allege that the plans' participants paid unnecessary and undisclosed fees.

## MOTIONS TO DISMISS THE ERISA COMPLAINTS

Eager to end plaintiffs' latest spate of litigation, many of the defendants moved to dismiss the ERISA complaints or, in the alternative, moved to strike certain portions of the complaint. The types of arguments advanced by defendants in their motions to dismiss with respect to the revenue sharing allegations were that: (i) plaintiffs failed to state a claim for breach of fiduciary duty for failure to disclose revenue sharing payments because disclosure is not required by applicable statutes and/or regulations; (ii) defendants complied with the safe harbor provided by ERISA section 404(c); and (iii) plaintiffs cannot recover for investment losses under ERISA. In cases where the investment adviser or other service provider were named as defendants, those defendants argued that claims against them should be dismissed because only fiduciaries can be sued under ERISA section 502(a)(2), and they are not fiduciaries because they do not make plan investment decisions.

The courts deciding these motions to dismiss have struggled with these issues. Indeed, some courts have come to opposite holdings on nearly identical allegations. For the most part, however, the courts have sustained the core of plaintiffs' allegations. Below is a brief summary of the issues decided in these cases.

### *Application of the Safe Harbor of Section 404(c) and the Fiduciary Duty to Disclose Revenue Sharing Payments*

Perhaps the greatest divide among the courts deciding the motions to dismiss the 401(k) revenue sharing complaints has been whether the applicability of the safe harbor provisions of section 404(c) can be decided on the pleadings.

In *Kanawi, et al. v. Bechtel Corp., et al.*,[15] plaintiffs generally alleged that the Bechtel Corporation ("Bechtel") and the committee appointed to administer Bechtel's 401(k) retirement plan breached their fiduciary duties under ERISA by causing the participants in the plan to incur unreasonable and excessive fees. Plaintiffs further alleged that defendants either disguised or failed to disclose certain fees, including revenue sharing arrangements.

In deciding defendant's motion to dismiss, the court rejected defendants' argument that compliance with the ERISA disclosure provisions relieved them of their disclosure obligations, noting that "[t]he Supreme Court and the Ninth Circuit have explicitly stated that mere compliance with applicable statutes and regulations under ERISA is not sufficient to establish that a fiduciary has satisfied its obligations."[16] Similarly, the court rejected defendants' reliance on ERISA section 404(c), calling defendants' argument "premature" because "[i]t is not possible to determine, at the pleading stage, whether defendants' conduct falls within ERISA's safe harbor provision. Such a determination hinges against the 'beneficiary's exercise of control,' an issue that is called into question by the disclosures, or more precisely by the alleged lack of disclosures, that defendants provided to participants in the Plan."[17] The court also rejected Bechtel's argument that it was not a fiduciary under the Plan. While the court noted that "it

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[13] See *Young v. General Motors Inv. Mgmt. Corp*., No. 07-cv-1994-BSJ (S.D.N.Y. Mar. 6, 2007); *Brewer v. General Motors Inv. Mgmt. Corp.,* No. 07-cv-2928-LAK (S.D.N.Y. Apr. 12, 2007); *Braden v. Wal-Mart Stores Inc*., No. 08-cv-3109-SWH (S.D. Mo. Mar. 27, 2008).

[14] *See Montoya v. ING Life Ins. & Annuity Co.*, No. 07-cv-2574-NRB (S.D.N.Y. Mar. 28, 2007).

[15] No. 06-cv-05566-CRB, slip op. (N.D. Ca. May 15, 2007).

[16] *Id.*

[17] *Id.* at 4-5.

appear[ed] unlikely that Bechtel ha[d] an independent fiduciary obligation to Plaintiffs," it ultimately found that the complaint "give[s] rise to at least a *reasonable inference* that Bechtel did indeed act as a fiduciary by exercising its discretion in choosing how the Plan should be administered" so that "dismissal of Bechtel is unwarranted . . . at this stage of the proceedings."[18] The court thus rejected all of defendants' arguments, and sustained plaintiffs' complaint.

Shortly after *Kanawi* was decided, another court came to the opposite conclusion when deciding identical issues in *Hecker, et al. v. Deere & Co., et al.*[19] *Hecker* involved a purported class action filed against the plan sponsor and administrator for plaintiffs' 401(k) plans, the plan's trustee, and the investment adviser to the funds under the plan. Each defendant moved to dismiss the complaint. Deere, the plan sponsor, argued that its disclosures of the plan fees were compliant with ERISA and the safe harbor provision barred any claim based on the amount of such fees.[20] The plan trustee argued that although it has some fiduciary duties to plaintiffs, plaintiffs' claims in this action did not relate to its role as a fiduciary.[21] The investment adviser argued that it was not a fiduciary under ERISA.[22]

The court agreed with defendants' arguments and dismissed the complaint in its entirety with prejudice.[23] First, the court held that defendants were not responsible for disclosing that the fund trustee shared part of its fees with the investment adviser because neither the current ERISA regulations nor ERISA's general fiduciary requirements impose a duty to disclose revenue sharing payments.[24] The court viewed as critical that recent proposals to amend the regulations promulgated under ERISA included a requirement to disclose any revenue sharing payments between plan providers. To the court, such proposed regulatory action "unequivocally confirms that present regulations do not require disclosure of the information."[25] The court also rejected the plaintiffs' argument that compliance with the statutory ERISA disclosure requirements did not necessarily absolve defendants from their fiduciary duties. The court held that "[w]here as here Congress has by statute and related regulation, created detailed rules governing disclosure requirements, it would be inappropriate to ignore and augment them using the general power to define fiduciary obligations."[26]

The *Hecker* court further disagreed with *Kanawi* by holding that ERISA's safe harbor provision protected defendants from liability. Plaintiffs argued that the failure to provide information regarding revenue sharing payments in fund prospectuses prevented them from making informed investment comparisons.[27] The court, however, rejected plaintiffs' argument, finding that the omitted disclosure regarding revenue sharing payments was not mandated by ERISA, and thus has been held to be irrelevant by the Department of Labor and Congress, and because plaintiffs failed to suggest why receiving this additional information would enhance investment decisions.[28] Even though the court found that "Deere could have negotiated lower fees with Fidelity Research . . . but has made no effort to do so," it ultimately held Plaintiffs had access to a multitude of investment options, all with different expense ratios and thus, "[u]nquestionably, participants were in a position to consider and adjust their investment strategy."[29] In addition, the court held that neither the plan trustee nor the investment adviser to the funds included on the plan "had fiduciary responsibility for making plan disclosures or selecting plan investments" and therefore could not be held liable.[30]

Shortly after *Hecker* was decided, a third court weighed in on these issues in *Tussey, et al. v. ABB Inc. et al.*[31] In *Tussey*, participants in ABB, Inc.'s 401(k) plan sued the plan sponsor, the plan administrator, and the investment advisor for some of the investment options available to plan participants. In addition to the allegations contained in both *Kanawi* and *Hecker*, plaintiffs alleged that the defendants breached their fiduciary duties under ERISA by: (i) failing to capture additional compensation streams for the benefit of the plan; and (ii) failing to exercise bargaining leverage for

[18] *Id.* at 6-7.

[19] 496 F.Supp.2d 967 (W.D. Wis. 2007).

[20] *Id.*

[21] *Id.*

[22] *Id.*

[23] *Id.* at 977.

[24] *Id.* at 974.

[25] *Id.*

[26] *Id.*

[27] *Id.* at 975.

[28] *Id.*

[29] *Id.* at 971, 976.

[30] *Id.*

[31] No. 06-cv-04305-NKL, 2008 WL 379666 (W.D. Mo. Feb. 11, 2008).

lower cost services. Defendants moved to dismiss based on the same arguments made in *Hecker*.

The court denied the defendants' motions to dismiss in their entirety. Agreeing with *Hecker*, the court held that neither ERISA nor Department of Labor regulations required that revenue sharing be specifically identified and/or disclosed to plan participants.[32] However, the *Tussey* court did not go as far as the *Hecker* court; instead, it held that even though the plan sponsor had no duty to disclose the revenue sharing agreements, it was not automatically entitled to protection under section 404(c).[33] The court noted that section 404(c) is an affirmative defense that is not appropriately resolved in a motion to dismiss. In addition, even if a section 404(c) defense could be entertained on a motion to dismiss, the sponsor failed to show that, as a matter of law, the plan's losses were caused solely by choices made by plan participants.[34] The court expressly rejected *Hecker's* logic, finding that "[b]ecause a fiduciary cannot be sued for failing to disclose revenue sharing agreements does not mean that its failure to disclose is *irrelevant* to a section 404(c) defense." Instead, the court held that a reasonable fact finder could conclude that plan participants' losses were attributable to their lack of knowledge of the revenue sharing payments.[35] The court also rejected the defendants' argument that the plaintiffs failed to allege facts that showed the fees were excessive, and held that given ERISA's expansive definition of fiduciary, the court could not conclude, at the current stage of litigation, that the plan administrator and investment adviser were not plan fiduciaries.[36]

The disagreement between *Hecker, Kanawi,* and *Tussey*, and the other courts that have ruled on these issues[37] will be addressed by the Seventh Circuit, because the plaintiffs in *Hecker* have appealed the decision dismissing the complaint. Briefing before the Seventh Circuit was completed in May 2008, and oral arguments are scheduled for September 4, 2008. Perhaps showing the significance of these issues on the ERISA cases generally, two *amicus* briefs were filed: one by the Secretary of Labor in support of appellants, and one by the ERISA Industry Committee, the National Association of Manufacturers and the American Benefits Council (collectively, the "Associations") in support of appellees. The Secretary of Labor admitted that ERISA did not explicitly require revenue sharing payments to be disclosed, but argued that such information should have been revealed to plan participants pursuant to ERISA's general fiduciary provisions, which impose "strict duties of 'care, diligence, and loyalty' on plan fiduciaries."[38] The Secretary also noted that her interpretation of section 404(c) and its accompanying regulations limits the applicability of the safe harbor defense for the imprudent selection of investment options by plan fiduciaries, and thus should not be available to defendants in *Hecker*.[39] The Associations' brief was mostly dedicated to painting the original *Hecker* suit as a plaintiffs' bar-driven fishing expedition. The Associations argued that, because of both the expenses that would be connected to discovery in the case, and the dubious nature of the suit itself, the court should apply the heightened pleading standards of *Bell Atlantic Corp. v. Twombly*,[40] and dismiss the case for failure to plead with particularity.[41]

### *Recovery of Investment Losses*

Another area of the law in which courts have reached differing conclusions on the motions to dismiss the ERISA revenue sharing cases is whether plaintiffs have adequately pled facts sufficient to sustain a claim for investment losses for the alleged breach of fiduciary duty.

In *Loomis, et al. v. Exelon Corp., et al.*,[42] plaintiffs, participants in Exelon's Employee Savings Plan, Plan #003, brought a putative class action against Exelon Corporation, Exelon's Director of Employee Benefit Plans and Programs, Exelon's Compensation Committee, the Employee Savings Plan Investment Committee, and the Risk Oversight Committee of the Board of Directors. Plaintiffs alleged that defendants breached their fiduciary duties to the plan by causing

[32] *Id.* at *3.

[33] *Id.*

[34] *Id.* at *4.

[35] *Id.* at *3.

[36] *Id.* at *5-9.

[37] *See, e.g.*, *Spano v. Boeing*, No. 06-cv-743-DRH, 2007 WL 1149192 (S.D. Ill. Apr. 18, 2007).

[38] Amended Brief of the Secretary of Labor, Elaine L. Chao at 17-21, *Hecker v. Deere & Co.*, No. 07-3605 (7th Cir. Apr. 4, 2008).

[39] *Id.* at 13-14.

[40] 127 S. Ct. 1955 (2007).

[41] Brief of the ERISA Industry Committee, the National Association of Manufacturers, and the American Benefits Council at 8-27, *Hecker v. Deere & Co.*, No. 07-3605 (7th Cir. May 9, 2008).

[42] No. 06-cv-4900, 2007 WL 953827 (N.D. Ill. Feb. 21, 2007).

them to pay unreasonable and excessive fees. Plaintiffs further alleged that defendants concealed the true nature of the fees and expenses incurred by the Plan by, among other things, failing to disclose revenue sharing arrangements. Plaintiffs sought equitable relief in the form of compensation for (i) direct losses (*i.e.*, losses plaintiffs experienced as a direct result of the defendants' breach of fiduciary duty) and (ii) investment losses (*i.e.*, losses attributable to the ups and downs of the financial markets). Defendants moved to dismiss plaintiffs' claim for investment losses arguing, among other things, that the complaint failed to allege any nexus between the failure to disclose fees charged and any investment losses the plan participants may have suffered. Defendants also argued that investment losses are only recoverable if they were caused by the alleged breach of fiduciary duty.

The court agreed with defendants and struck plaintiffs' request for investment losses. Quoting the Supreme Court's opinion in *Dura Pharmaceuticals, Inc. v. Broudo,* the court stated that "while 'ordinary pleading rules are not meant to impose a great burden upon a plaintiff . . . it should not prove burdensome for a plaintiff who has suffered a [] loss to provide a defendant with some indication of the loss and the causal connection that the plaintiff has in mind.'"[43]

In *George, et al. v. Kraft Foods Global, Inc., et al.,*[44] plaintiffs brought a putative class action for breach of fiduciary duty against Kraft Foods Global Inc., the sponsor of Kraft's employee benefit plan, as well as its Administrative Committee, Benefits Committee, and the members of the Benefits Committee. Plaintiffs generally alleged that defendants breached their fiduciary duties under ERISA by failing to contain plan costs and by permitting the plan to pay unreasonable fees to service providers. Defendants moved to dismiss and/or strike the complaint in its entirely for failure to comply with Rule 8 of the Federal Rules of Civil Procedure, and to dismiss plaintiffs' claim of investment losses. The court rejected these arguments. Although the court found that the complaint was prone to "unnecessary verbosity," it "easily withst[ood] scrutiny under Rule 12(b)(6)" as it gave defendants sufficient notice "of the nature of the claims so as to permit [d]efendants to answer." With respect to defendants' attack on the adequacy of the pleadings concerning investment losses, the court noted that whether investment losses were caused by defendants' alleged breaches of fiduciary duty hinged on the defendants' ability to maintain a defense under ERISA section 404(c). Because section 404(c) is an affirmative defense the burden is on the defendants and not the plaintiffs to plead and prove all matters pertaining to that defense. Accordingly, the Court stated, "It is unclear to the Court why Plaintiffs have chosen to plead such matters in their complaint, and the Court will simply disregard the allegation at issue."[45]

### *Other Decisions on Motions to Dismiss*

Other sister 401(k) revenue sharing cases have reached the motion-to-dismiss stage and, for the most part, courts have allowed plaintiffs' claims to proceed.

In *Spano, et al. v. Boeing Co., et al.*,[46] plaintiffs purported to bring a class action on behalf of participants in the Boeing defined contribution plan. Plaintiffs alleged that defendants failed to minimize plan costs by paying unreasonable fees to service providers and incurring excessive costs associated with investments in employer securities. Defendants moved to dismiss on three grounds: (1) plaintiffs did not have a viable claim against defendants because they were not fiduciaries of the plan; (2) plaintiffs could not bring a claim for equitable relief under ERISA section 502(a)(3); and (3) defendants were protected from liability under ERISA's safe harbor provision, section 404(c). The court denied defendants' motion to dismiss. With respect to defendants' argument that they were not fiduciaries of the plan, the court held that whether an entity or individual is a fiduciary under ERISA is a question of fact, not ripe for decision at the motion to dismiss stage. Next, the court rejected defendants' argument that plaintiffs did not have a viable claim under ERISA section 502(a)(3) by finding the complaint's allegations were sufficient under Federal Rule of Civil Procedure 8 to allege equitable relief and declining to limit ERISA based on common law trust principles. In addition, the court found that ERISA's safe harbor is an affirmative defense and not a viable ground for dismissal.

In *In re Northrop Grumman Corp. ERISA Litig.*,[47] the court granted defendants' motion to dismiss with prejudice with respect to Northrop Grumman Corporation, as well as the individual directors who served on the Northrop Grumman board. However, claims against the Northrop Grumman Savings Plan

[43] 544 U.S. 336, 347-48 (2005).

[44] 06-cv-798-DRH, 2007 WL 853998 (S.D. Ill. Mar. 3, 2007).

[45] *Id.* at *9.

[46] No. 06-cv-743-DRH, 2007 WL 1149192 (S.D. Ill. Apr. 18, 2007).

[47] No. 07-cv-0153-JCX, slip op. (C.D. Cal. May 23, 2007).

Administrative and Investment Committees, as well as individuals on those committees, are still outstanding.

In *Taylor, et al. v. United Technologies Corp.*,[48] participants in two of United Technologies Corporation's ("UTC") employee benefit plans brought suit under ERISA alleging that UTC, its Pension and Investment Committee, Pension Administration Committee, and three UTC executives breached their fiduciary duties under ERISA. Defendants moved to dismiss the complaint, arguing that plaintiffs failed to state a claim for breach of fiduciary duty because they did not plead that the allegedly unreasonable fees were the result of defendants' imprudent conduct and that the defendants failed to disclose material information regarding revenue sharing arrangements. The court sustained the core allegations of the complaint, holding that plaintiffs had stated a claim that defendants breached their fiduciary duties by permitting the plan to charge unreasonable and excessive fees. However, relying on the decision in *Hecker v. Deere & Co.*,[49] the court dismissed claims for failure to disclose revenue sharing payments, finding that there was no statutory duty to do so.

In *Abbott, et al. v. Lockheed Martin Corp., et al.*,[50] plaintiff-employees filed a putative class action against defendants Lockheed Martin Corporation, their employer, and plan sponsor of two employee benefit plans, and Lockheed Martin Investment Management Company, the plans' administrator. Defendants moved to dismiss the complaint on the grounds that it violated Federal Rule of Civil Procedure 8(a)(2), which requires a short and plain statement of a claim and alternatively, moved to strike certain portions of the complaint that were extraneous and immaterial. The court denied defendants' motion to dismiss and motion to strike.[51]

## CLASS CERTIFICATION AND SUMMARY JUDGMENT

As defendants' motions to dismiss have been generally unsuccessful, plaintiffs and defendants have begun focusing on class certification and summary judgment. To date, class certification has been granted in three cases: *Loomis v. Exelon Corp.*, *Taylor v. United Technologies Corp.*, and *Tussey v. ABB, Inc.*[52] Class certifications of a number of cases in the Seventh Circuit have been stayed pending resolution of *Lively v. Dynegy, Inc.*[53] In *Dynegy*, the district court held that a defense under ERISA section 404(c) does not defeat the commonality and typicality requirements for class certification under Rule 23 in a class action asserting breaches of fiduciary duty under ERISA.[54] The issue on appeal in *Dynegy* was whether class certification was proper when defendants claim protection under section 404(c). The argument is that since the ERISA safe harbor provision applies on a participant-by-participant basis, it requires consideration of each participant's set of investment decisions, thus cutting against the commonality and typicality class requirement.[55] However, in early 2008, *Lively* settled before the issue reached the Seventh Circuit. Slowly, courts within the Seventh Circuit are lifting the stays initially imposed and considering the motions for class certification.

Defendants are also starting to move for summary judgment. At least two defendants have already submitted motions.[56] One of the bases upon which these

[48] No. 06-cv-1494-WWE, 2007 WL 2302284 (D. Conn. Aug. 9, 2007).

[49] *See supra* note 16.

[50] No. 06-701-MJR, 2007 WL 2316485, slip. op. (S.D. Ill. Aug. 13, 2007).

[51] *Id.* at 3.

[52] No. 06-cv-1494 (WWE), 2008 WL 2333120 (D. Conn. June 3, 2008); No. 06-cv-4900, 2007 WL 953827 (N.D. Ill. Feb. 21, 2007). For example, in *United Technologies*, the court held that the loss of retirement plan assets "represents a concrete and actual injury to satisfy standing." 2008 WL 2333120, at * 3. With respect to class certification, the court also held that: (i) the typicality element was satisfied because plaintiffs, like members of the class, were unaware of the amount of fees being charged, which "represents a central issue" in the case; and (ii) with respect to the adequacy of representation requirement, even though lead plaintiffs seemed unaware of the particular issues of the case, "a proposed class representative with even a 'sketchy' understanding of the case is deemed adequate if he understands his responsibilities, reviews pleadings, and keeps abreast of the case by conferring with his attorneys." *Id.* at 4-5. The court also allowed the inclusion of former and future plan participants to the class. *Id.* at 6-7.

[53] No. 05-cv-00063 (MJG), 2007 WL 685861 (S.D. Ill. Mar. 2, 2007).

[54] *See also, e.g.*, *Spano, et al. v. Boeing Co., et al.*, No. 06-cv-743-DRH, 2007 WL 2688456 (S.D. Ill. Sep. 10, 2007)(staying motion for class certification pending resolution in *Dynergy*); *Beesley, et. al. v International Paper Company., et. al.*, No. 06-703-DRH, slip. op (S.D. Ill. Aug. 24, 2007)(same).

[55] This argument is consistent with the Fifth Circuit's recent ruling vacating class certification in *Langbecker v. Electronic Data Systems Corp.,* 476 F.3d 299 (5th Cir. 2007).

[56] *See e.g.*, Memorandum of Law in Support of the Defendant's Motion for Summary Judgment, *Renfro, et. al. v. Unisys Corp.,*

motions are grounded is ERISA's safe harbor provision, section 404(c). In general, the defendants have pleaded section 404(c) as a basis for summary judgment by arguing that they met their disclosure duties and provided plan participants with the sufficient information to make informed decisions as to investment alternatives. Because the plan participants exercised control over their investments and in accordance with section 404(c), the argument goes, the fiduciaries cannot be held liable for any losses resulting from those investment decisions. At the motion to dismiss stage, the courts generally rejected reliance by defendants on the safe harbor provision on the grounds that it is an affirmative defense not appropriately resolved in a motion to dismiss based on the pleadings. Now, the courts will have to address the adequacy of these arguments in considering the motions for summary judgment.

## REGULATORY DEVELOPMENTS

This recent wave of litigation has further focused lawmakers on the 401(k) industry and initiated proposed reforms that, if adopted, may impact the structure and operation of 401(k) plans and alter the relationship between plans and their service providers. For example, in July 2006, the Department of Labor published for comment new regulations that would require disclosure of payments made to service providers that are challenged in the lawsuits.[57] These proposed new regulations were created "to clarify the requirements regarding reporting . . . indirect compensation . . . received during the plan year in connection with services rendered to the plan." On November 17, 2007, these new regulations were enacted.[58] The regulations provide for "more informative disclosures about the types of fees being paid or received by plan service providers" by "requir[ing] direct compensation paid by the plan to be reported on a separate line item from indirect compensation received from sources other than the plan or plan sponsor."

Additionally, in July 2007, the 401(k) Fair Disclosure for Retirement Security Act was introduced in the House of Representatives.[59] The bill, which was passed by the House Committee on Education and Labor in April of 2008, would, *inter alia*, require service providers to outline any financial relationships or potential conflicts of interest arising from managing the funds, as well as a detailed list of fees charged to the plan or its participants by plan sponsors.

## CONCLUSION

Although defendants have gained little traction dismissing this latest spate of lawsuits, plaintiffs face an uphill battle in overcoming summary judgment and ERISA's safe harbor provision. However, the plaintiffs' early success is likely to pave the way for more ERISA class actions, and should plaintiffs be successful in their appeal of *Hecker* it would only further incentivize potential plaintiffs. In addition, just as the Supreme Court appears to be limiting the scope of the federal securities laws, it appears to be expanding the scope of liability under ERISA. For example, in *LaRue v. DeWolff, Boberg & Associates, Inc.*,[60] the Supreme Court held that a participant in a defined contribution plan may recover under ERISA for a breach of fiduciary duty which causes a loss of plan assets allocated to the participant's 401(k) account. Clearly, securities lawyers need to begin to learn how to deal with this new weapon in the plaintiffs' arsenal.■

*footnote continued from previous page…*

*et. al.*, No. 07-cv-02098-BWK (E.D. Pa. July 9, 2007); Memorandum of Law in Support of the Defendant's Motion for Summary Judgment, *Will et.al. v. General Dynamics Corp., et. al.*, No. 06-698-WDS (S.D. Ill. Dec. 17, 2007).

[57] *See* Proposed Rules, Employee Benefits Security Administration, Annual Reporting and Disclosures, 71 Fed. Reg. 41392-01 (July 21, 2006).

[58] *See* Employee Benefits Security Administration, Revision of Annual Information Return/Reports, 72 Fed. Reg. 64731-01 (Nov. 16, 2007).

[59] H.R. 3185, 110th Cong. (2007).

[60] 128 S. Ct. 1020 (2008).