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Watch These ERISA Cases In 2019

By **Karen Handorf and Daniel Sutter** (January 1, 2019)

A number of vexing issues facing ERISA practitioners came to a head in 2018 and are primed to be resolved in the coming year. This article will examine the cases raising these issues, and the impact their resolution in the coming year will have on retirees and the retirement industry.

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Who Is in Control? Plan Participants' Role in Retirement Plan Management Put Into Question

2018 continued the trend of courts grappling with ERISA's "functional fiduciary" definition. In the coming year, the Tenth Circuit will decide whether a plan participant's ability to divest from an investment option short-circuits a service provider's fiduciary duty to retirement plan participants who allocated retirement assets into that option.

This issue arises in Teets v. Great-West Life & Annuity Insurance Company. Great-West concerns a "stable value" product created by Great-West Life & Annuity Insurance Company that pays investing participants a rate of return set by Great-West each quarter.[1] Great-West earns a profit for itself if and when it generates returns greater than the preset rate of return.[2]

The question presented in Great-West was whether the service provider was an ERISA fiduciary because it had the contractual discretion to set a rate of return for participants and exercised that discretion every quarter year.[3] Under ERISA, an insurance company is a fiduciary with respect to a plan to the extent, among other things, that the insurance company exercises any authority or control respecting management or disposition of the plan's assets.[4]

The court noted that the contract was a plan asset, and Great-West exercised control with respect to the management of that asset by setting the rate of return every quarter, but refused to treat Great-West as an ERISA fiduciary, because the participants invested in the stable value product could still "vote with their feet if they dislike the new rate."[5] In effect, the lower court said that a service provider does not have "discretion" over plan assets if a plan participant can divest before the rate Great-West sets is paid.

There are wide-ranging implications if the Tenth Circuit agrees with the lower court, affecting both a participant's place in the fiduciary-beneficiary relationship and their ability to appropriately manage their retirement savings. If the onus is put on a participant to determine whether a rate of return is appropriate in given market conditions, they would likely need a crash course in financial literacy (and a new hobby) to benchmark the announced rate of return and determine whether market conditions indicate it is too low.

But most plan participants are not versed in these financial technicalities, which is why ERISA endows fiduciaries with the duty of care owed to the plan participants they serve.[6] Moreover, expecting participants to "vote with their feet" would require those participants to reallocate their retirement account balance. "Asset allocation is one of the most important factors in long-term portfolio performance."[7] Participants may find themselves between a rock and a hard place if they are unhappy with a suboptimal rate of return from a retirement product, but cannot divest without causing a suboptimal asset allocation in their retirement account.

Given the implications of the Tenth Circuit's impending decision, the authors of this article expect to hear more about this case in the coming year and beyond.

U.S. Bank: Will the Standard Challenge Finally Make Its Way to the Supreme Court?

The saga of U.S. Bank's pension plan continued into 2018, and will likely continue into 2019. Participants in the U.S. Bancorp Pension Plan sued the plan's fiduciary in 2013 for, among other things, mismanaging the pension plan by investing 100 percent of the pension in equities and selecting expensive proprietary mutual funds to do so.[8] This strategy was in place during the financial crisis in 2008, causing the pension plan to become severely underfunded as the stock market crashed — meaning the pension plan would not have enough money to pay the retirement benefits U.S. Bank promised employees.

After the case was filed, U.S. Bank made contributions to the plan sufficient to make the plan overfunded, and moved to dismiss on multiple grounds, including lack of Article III standing. The district court held that the case became moot once the plan became overfunded.[9] The plaintiffs appealed the court's mootness decision, and U.S. Bank sought to defend the lower court decision by arguing that the plaintiffs no longer had Article III standing once the plan became overfunded.

The Eighth Circuit upheld the dismissal, but not on Article III standing or mootness grounds.[10] Rather, the Eighth Circuit held that, without an underfunded pension, a participant in that plan does not have "prudential standing" — that is, she is not in the class of people Congress authorized to sue under the statute. The dissent was quick to challenge this result, pointing out that ERISA permits wide-ranging injunctive relief separate and apart from restoration of losses, including the removal of fiduciaries, enjoinment of imprudent investment strategies and disgorgement of ill-gotten profits.

The plaintiffs in this case are seeking certiorari, and the U.S. Supreme Court has sought the U.S. solicitor general's views on whether to hear the case.[11] So there is a decent likelihood that the Supreme Court will resolve this thorny legal issue in the coming year.

A failure by the Supreme Court to reverse the Eighth Circuit's opinion will have wide-ranging implications for retirement savers. ERISA was promulgated in the wake of high-profile pension failures, to prevent the poor pension management that left retirees scrambling to secure their future after years of hard work and corporate promises. This pragmatic and essential purpose is frustrated if a participant is only authorized to bring a suit to remedy mismanagement once irreversible harm occurs.

Moreover, the Eighth Circuit's opinion creates a perverse incentive for fiduciaries. Assuming fiduciaries will not sue themselves, the upshot of the Eighth Circuit's holding is that pension fiduciaries can outright steal from a funded pension plan, and the only entity that can stop them is the U.S. Department of Labor, which has made well known it does not have the resources to police all misconduct.

Whose Burden? Courts Grapple With Which Party Must Prove Loss Causation in a Breach of Fiduciary Duty Case

Following the recent uptick in "proprietary fee cases,"[12] courts were faced with questions concerning which party bore the burden of proving that losses in a plan were caused by financial companies' preference for in-house products. The First Circuit, in Brotherston et al. v. Putnam Investments LLC et al., recently highlighted a circuit split on this issue.

In Putnam, the plaintiffs alleged that defendants breached their fiduciary duties of loyalty and prudence by offering exclusively proprietary mutual funds in the plan, without consideration of nonproprietary investment alternatives, despite alleged issues with performance and fees.[13] Putnam made its way to a bench trial, where the judge refused to hold Putnam liable for having an investment process that was "no paragon of diligence," explaining that the plaintiffs had failed to show any losses because, even without an "objective process," the plan could "still end up with prudent investments, even if it was the result of sheer luck."[14]

On appeal, the First Circuit reversed. The First Circuit explained that there are three elements to a breach of prudence claim — "breach, loss, and causation"[15] — and that the plaintiffs had proved the first two elements by showing that the defendants failed to monitor the plan investments independently, and that those plan investments underperformed alternative investments.[16]

This left the element of causation. The First Circuit explained that, because the plaintiffs had made a prima facie showing of a violation and loss, the burden shifts to the defendants to disprove causation.[17] In so doing, the First Circuit piled on top of a now 4-4 circuit split.

On one side of the split sit the First, Fourth, Fifth and Eighth Circuits. These four circuits have all held that, once a plaintiff makes a prima facie case of a violation and loss to the plan, the burden shifts to the fiduciary to disprove causation. These courts have looked to the common law of trusts for guidance on the burden, in the absence of statutory language expressly placing the burden on one party or the other. The common law of trusts shifts the burden to the trustee to disprove causation.[18]

On the other side of the split sit the Sixth, Ninth, Tenth and Eleventh Circuits. These courts have interpreted language from 29 U.S.C. 1109(a), stating that a fiduciary is liable for "any losses to the plan resulting from each such breach," as placing the burden on plaintiffs.[19]

Putnam has asked the Supreme Court to settle the score, and with such a decisive split there is a good chance it will do so. If the Supreme Court takes this case and continues grounding its interpretation of ERISA in the common law of trusts, participants that are harmed by fiduciary misconduct will find fewer hurdles to recovery in four of the circuits.

So Long for Now? The Department of Labor's Fiduciary Rule Meets Its Demise

A look ahead to 2019 would not be complete without discussing the DOL's hotly contested fiduciary rule. The authors of this article previously wrote about the fiduciary rule near the end of 2017.[20] At that time, legal challenges to the rule had been percolating to circuit courts after surviving litigation in district courts in Texas, the District of Columbia and Kansas.

While the appeals to those cases were pending, the Trump administration poured cold water on the rule by filing a notice of proposed amendments seeking to delay the implementation of the rule's key provisions, so that the DOL could consider possible changes to the rule.[21] The provisions targeted by the delays included the requirement that a fiduciary under the rule operate in a retirement investor's best interest. Following the notice and comment period for this proposal, the DOL, on Nov. 24, 2017, officially delayed implementation of the rule's key provisions for 18 months, until July 1, 2019.[22] The DOL also filed a brief in the Fifth Circuit, stating that the United States Government "is no longer defending" the validity of the rule's prohibition against class action waivers.[23]

Subsequently, on March 15, 2018, a split panel in the Fifth Circuit vacated the rule in toto, holding that Congress had not given the DOL the authority to "expand[] the scope of DOL regulation" to the individual retirement account market, as the rule purported to do.[24] The Fifth Circuit's analysis largely focused on whether the definition of "investment advice" provided by the rule conflicted with the term "investment advice" used in ERISA (29 U.S.C. § 1002).

The primary legal question that the Fifth Circuit answered was whether, under Chevron USA Inc. v. Nat. Res. Def. Council Inc., the term "investment advice" in 29 U.S.C. § 1002 was unambiguously defined by Congress such that the DOL was unable to provide a new technical definition to the term through regulation.[25] The Fifth Circuit held that Congress had given the term unambiguous meaning, which it borrowed from the common law fiduciary definition "requir[ing] trust and confidence" stemming from "individualized advice on a regular basis pursuant to a mutual agreement with a client."[26] Because the rule did not require the relationship between an investor and broker to be founded on "trust and confidence," the Fifth Circuit held that the rule was at odds with Congressional intent.

The dissent was split on this point, explaining that Congress had not defined the term "investment advice," and had expressly authorized the DOL to adopt regulations defining "technical and trade terms used" in the statute.[27]

While this attempt to fill a regulatory gap in the ever-growing IRA market may have failed, a new chapter is likely to be written. The DOL announced that it is "considering regulatory options in light of the Fifth Circuit opinion," and is slated to issue a revised fiduciary rule in September 2019.[28] Moreover, the Securities and Exchange Commission issued a proposed rule in 2018 that seeks to establish a "best interest" "standard of conduct for broker-dealers and natural persons who are associated persons of a broker-dealer when making a recommendation of any securities transaction or investment strategy involving securities to a retail customers."[29]

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[1] Teets v. Great-W. Life & Annuity Ins. Co., 286 F. Supp. 3d 1192, 1196 (D. Colo. 2017).

[2] Id. at 1197.

[3] Id.

[4] 29 U.S.C. § 1002(21)(A).

[5] Great-W. Life & Annuity Ins. Co., 286 F. Supp. 3d at 1201-06.

[6] "What is the Significance of Being a Fiduciary" pg. 2, available at https://www.dol.gov/sites/default/files/ebsa/about-ebsa/our-activities/resource-center/publications/meeting-your-fiduciary-responsibilities.pdf.

[7] The Investment Company Institute, https://www.ici.org/pubs/faqs/faqs_target_date.

[8] Adedipe v. U.S. Bank Nat. Ass'n, 62 F. Supp. 3d 879, 885 (D. Minn. 2014).

[9] Thole v. U.S. Bank Nat'l Ass'n, 873 F.3d 617, 626 (8th Cir. 2017).

[10] Id. at 622.

[11] https://www.law360.com/articles/1087863.

[12] https://www.law360.com/articles/991210/erisa-litigation-trends-in-2017.

[13] Brotherston v. Putnam Investments LLC, 907 F.3d 17, 40 (1st Cir. 2018) ("Brotherston II").

[14] Brotherston v. Putnam Investments LLC, 2017 WL 2634361, at *12 (D. Mass. June 19, 2017).

[15] Brotherston II, 907 F.3d at 30.

[16] Id. at 31-32.

[17] Id. at 34-38.

[18] See Restatement (Third) of Trusts, § 100 cmt. f.

[19] E.g., Pioneer Centres Holding Co. Employee Stock Ownership Plan & Tr. v. Alerus Fin. NA, 858 F.3d 1324, 1337 (10th Cir. 2017), cert. dismissed sub nom. Pioneer Centres Holding v. Alerus Fin., 139 S. Ct. 50 (2018).

[20] https://www.cohenmilstein.com/update/rule-flux-employee-benefits-committee-newsletter-aba-section-labor-and-employment-law.

[21] 82 Fed. Reg. 41365.

[22] 18-Month Extension of Transition Period and Delay of Applicability Dates, EBSA (Nov. 27, 2017) (Public Inspection document).

[23] Brief for Appellees at 60-61, Chamber of Commerce of Am. v. United States Department of Labor, No. 17-10238 (5th Cir. July 3, 2017).

[24] Chamber of Commerce of United States of Am. v. United States Dep't of Labor, 885 F.3d 360, 388 (5th Cir. 2018), judgment entered sub nom. Chamber of Commerce of Am. v. United States Dep't of Labor, No. 17-10238, 2018 WL 3301737 (5th Cir. June 21, 2018).

[25] Id. at 467 U.S. 837, 842, 104 S. Ct. 2778, 2781, 81 L. Ed. 2d 694 (1984).

[26] Chamber of Commerce of United States of Am, 885 F.3d at 374 (5th Cir. 2018).

[27] Id. at 390 (Stewart, CJ., dissenting).

[28] https://www.reginfo.gov/public/do/eAgendaViewRule?pubId=201810&RIN=1210-AB82.

[29] https://www.sec.gov/rules/proposed/2018/34-83062.pdf.

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