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Another Dismissal of an ERISA Class Action Arising From the Financial Crisis

The recent dismissal of the ERISA “stock-drop” class action against Lehman Brothers provides arguments for companies and individuals facing ERISA class action litigation in the wake of the financial crisis.

ERISA Stock-Drop Litigation

The past two years have seen a large increase in shareholder suits against companies, especially financial institutions, whose share prices fell significantly in the context of the global financial crisis. In 2008 and 2009 alone, over 150 federal securities class actions were filed relating to the credit and subprime mortgage crisis. Many of these securities class actions were accompanied by proposed ERISA class action claims brought by company employees whose retirement plan investments in company stock lost value. Typically, the plaintiff employees in these actions allege that the individuals responsible for overseeing the retirement plans violated ERISA by allowing the plans to remain invested in company stock, which the suing employees contend was an imprudent investment alternative under the circumstances.

These ERISA “stock-drop” class actions are often consolidated with related securities class actions for pre-trial purposes, and it is common for the securities and ERISA cases to be litigated, dismissed, or settled in conjunction with each other. As explained in this update, a recent decision in the *Lehman Brothers* case is

the latest dismissal of an ERISA class action arising out of the financial crisis and notable in several respects. In particular, the decision is instructive for those determining the composition and appointment of ERISA plan committees and for those who advise on those determinations and appointments.

The Lehman ERISA Decision

On February 2, 2010, Judge Kaplan of the U.S. District Court for the Southern District of New York dismissed an ERISA stock-drop class action arising from the September 15, 2008 collapse of Lehman Brothers. Plaintiffs in *In re Lehman Brothers ERISA Litigation*, No. 08 Civ. 5598 (S.D.N.Y.) were former Lehman employees who alleged that defendants – eleven former members of the company’s Board of Directors in addition to the former chair of the company’s “Employee Benefit Plans Committee” – knew or should have known of Lehman’s impending collapse and acted imprudently by continuing to offer company stock as a retirement plan investment option. Judge Kaplan’s decision comes only months after U.S. District Judge Stein dismissed another ERISA stock-drop suit based on Citigroup’s exposure to

subprime mortgages and other credit risks in *In re Citigroup ERISA Litigation*, No. 07 Civ. 9790 (S.D.N.Y.) (Aug. 31, 2009).

In the *Lehman Brothers* case, the two central issues were (1) whether the defendants sued were fiduciaries of the retirement plan, and (2) if so, whether the defendants breached fiduciary duties owed under ERISA.

On the first issue, it was undisputed that the chair of the retirement plan committee was explicitly designated as a fiduciary in the plan documents. The other defendants (all members of Lehman's Board of Directors), however, were not named as fiduciaries in the plan documents or members of the retirement plan's committee. Accordingly, the plaintiffs needed to plead that these defendants exercised actual control and authority over the plan in order to pursue ERISA claims against them. Plaintiffs argued that the directors acted as "functional" fiduciaries by (1) appointing the compensation committee members who, in turn, appointed the plan committee members; (2) approving allegedly inaccurate SEC filings that were incorporated by reference into the plan documents; and (3) making allegedly misleading communications to plan participants.

In rejecting each of plaintiffs' arguments, Judge Kaplan held that the complaint did not allege any actual breach of fiduciary duty with respect to the selection and appointment of the compensation committee, and referred to "emerging" case law, including *In re Citigroup ERISA Litigation*, holding that those who prepare SEC filings incorporated into plan documents do not become ERISA fiduciaries merely through such routine corporate acts that occur independently of retirement plan disclosure and management. Finding no fiduciary status, Judge Kaplan

dismissed the claims against the director defendants with prejudice.

Moving to the second – and more involved – issue, the court analyzed whether the chair of the plan committee breached her ERISA fiduciary duties by allegedly allowing the plan to remain invested in Lehman stock and failing to disclose negative information about Lehman's financial condition to plan participants. The court relied on the Third Circuit's well-known decision in *Moench v. Robertson*, 62 F.3d 553 (3d Cir. 1995), which held that a plan fiduciary who allows investments in company stock is "entitled to a presumption that it acted consistently with ERISA by virtue of that decision." This presumption can be overcome only by showing that the fiduciary abused his or her discretion, which typically requires knowledge or reckless disregard of the fact that the company was facing imminent collapse or a sufficiently dire situation to justify discontinuing company stock as an investment option. On this point, Judge Kaplan focused on the committee chair's position as a senior vice president of human resources. The court held that the complaint did not allege any facts showing that the committee chair, as an HR executive, had any access to, let alone knowledge of, information regarding Lehman's financial condition or the devaluation of its assets, and thus, plaintiffs could not overcome the *Moench* presumption. Likewise, regarding the alleged failure to disclose, plaintiffs did not allege facts sufficient to show that the committee chair was privy to any negative financial information that could have allegedly triggered an affirmative duty to disclose. Judge Kaplan therefore dismissed the complaint in its entirety as against the committee chair defendant (and thus the entire case).

Implications for ERISA Fiduciaries and Those Who Appoint and Advise Them

The *Lehman Brothers* decision illustrates the significance of *who* is appointed as a plan fiduciary. In *Lehman Brothers*, an undisputed plan fiduciary was absolved of ERISA liability primarily by virtue of her position in the company's organizational structure. Judge Kaplan found nothing in the complaint to suggest that "an employee responsible for human resources data and employee benefits knew or should have known about Lehman's dire financial condition prior to its bankruptcy filing." As a result, plaintiffs could not overcome the *Moench* presumption.

A similar result was reached in *In re Citigroup ERISA Litigation*. There, the court dismissed claims against members of the plan administrative committee – whose fiduciary status was not disputed – because plaintiffs failed to show they had any knowledge of the company's subprime exposure that may have contributed to its stock price decline. Judge Stein held that, without factual enhancement, naked assertions that defendants "knew or should have known" the relevant information were insufficient to withstand dismissal. None of this is to suggest that an ERISA fiduciary should not be carefully and rigorously chosen based on qualification to act in that capacity. The "take-away" of these decisions is that selecting a person who is qualified to be an ERISA

fiduciary, but not himself privy to non-public information concerning the company's financial health, may be the best approach for avoiding conflicts of interest and potential ERISA class action liability in "stock-drop"-driven cases.

Conclusion

The *Lehman Brothers* and *Citigroup* decisions offer helpful arguments for defendants named in subprime-related ERISA litigation – even for those who are designated as fiduciaries in the plan documents. It is also significant that these cases were dismissed at the pleading stage rather than at summary judgment, the latter of which occurs only after burdensome and costly discovery is completed. Indeed, more and more courts are applying the protective *Moench* presumption at the pleading stage. (*Moench* itself was a summary judgment decision.) Given the focus on the specific roles and positions of plan fiduciaries, public companies whose retirement or benefit plans offer company stock should closely consider who is appointed as fiduciaries under the plan documents, and what positions they occupy in the company's overall organizational structure, both of which could have an effect on potential liability under ERISA, and the company's exposure to indemnity claims by their ERISA fiduciaries who are sued by plan participants.

This memorandum is intended only as a general discussion of these issues. It should not be regarded as legal advice. We would be pleased to provide additional details or advice about specific situations if desired.

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