No Good Deed Goes Unpunished: R.J. Reynolds disposes of a company stock during a turbulent period and now must defend action.

by Matthew J. Renaud

R.J. Reynolds Tobacco Company found out the hard way that no good deed goes unpunished (Tatum v. R.J. Reynolds Tobacco Co., No. 04-1082 (4th Cir. December 14, 2004)). The cigarette manufacturer directed the sale of its 401(k) plan’s Nabisco stock following a spin-off of the tobacco company from RJR Nabisco Holdings Corp. which was effected in the wake of the omnibus tobacco settlement of 1998. At the time of the sale, the value of the various Nabisco stocks sold by the plan had plummeted from forty to sixty percent. The stocks later rebounded, some to more than three times their price at the time they were sold. The Fourth Circuit Court of Appeals reversed the dismissal of the ERISA lawsuit by the District Court for the Middle District of North Carolina. The lower court had dismissed the suit for breach of fiduciary duty for failure to state a claim, finding that the employer, in its settlor capacity, had eliminated the Nabisco company stock as an investment option. The Fourth Circuit reversed, finding that the language of the plan amendments purporting to eliminate the Nabisco stock funds failed to accomplish that goal and a plain reading of the language indicated that the plan fiduciaries had not been stripped of the authority over the Nabisco stock investments.

Other recent cases.

In addition to the RJR Tobacco ruling, the following cases have been reported in the past few months. The EDS case, described in the article below by John Costello, provides an interesting look at how class actions are treated in ERISA fiduciary breach suits. The case provides an excellent discussion of class certification generally; however, the portion of the case that is the interesting ERISA litigation issue relates to why ERISA company stock claims based on reliance on misleading communications are unsuitable for class certification. The case rejects plaintiffs’ argument that the “fraud-on-the-market” theory, primarily used in securities litigation, could be used as a proxy for individual reliance in ERISA breach of fiduciary duty cases arising out of alleged misrepresentations concerning company stock information and investment options. The court did certify the class for the “prudence” cause of action.

In re Tyco International Ltd. Multidistrict Litigation, D. N.H., No. 02-1335-PB, 12/2/04

In Re Electronic Data Systems Corp. ERISA Litigation No. 6:30-MDL-1512, 6:30-CV-126 ("ERISA"), (E.D. Tex. Nov. 8, 2004)

In re WorldCom, Inc. ERISA Litigation, 02 Civ. 4816 (S.D. N.Y. Feb. 1, 2005) (granting Merrill Lynch summary judgment as directed trustee of the WorldCom 401(k) plan)

Milofsky v. American Airlines Inc., No. 03-11087, (5th Cir. March 16, 2005) (participants lack
EDS ERISA Litigation: Mixed results for EDS in class certification ruling

No certification of the class for misrepresentation cause of action (Fraud-on-the-Market theory not a proxy for reliance); but, prudence claim is certifiable.

by John F. Costello, Jr.

The United States District Court for the Eastern District of Texas, in In re Electronic Data Systems Corp. “ERISA” Litigation, — F. Supp. 2d —, 2004 WL 2616225 (E.D. Tex. Nov. 8, 2004), clarified when a class action should be certified in ERISA breach of fiduciary duty cases involving company stock litigation.

In this case, participants and beneficiaries in EDS’s 401(k) plan (“the Plan”) brought an action against EDS, EDS’s Chief Executive Officer, the EDS Compensation and Benefits Committee and its members, the EDS Benefit Administration Committee and its members, and the EDS Investment Committee and its members. Plaintiffs alleged that the defendants’ breached their fiduciary duties as set forth under ERISA.

One of the investment options under the Plan was the EDS Stock Fund, which invested up to 99% of its assets in EDS stock. Additionally, whenever EDS made matching contributions to employee investments, the matching contributions were invested in the EDS Stock Fund and were required to remain there for two years. In September 2002, EDS issued a press release announcing that an earlier estimate of a revenue increase was incorrect, and the company would actually suffer a revenue decrease. EDS also announced that estimated earnings per share were similarly over-estimated. EDS’s stock price plummeted over 50% in the wake of this press release.

The putative class members’ complaint contained five counts, four of which were based on ERISA. The ERISA claims were as follows: (1) defendants breached their fiduciary duties by failing to prudently manage the Plan assets when, despite knowledge of EDS’s financial problems, defendants offered EDS stock as an investment option and invested matching funds in the EDS Stock Fund rather than safer alternative investments; (2) EDS, EDS’s Chief Executive Officer and the EDS Compensation and Benefits Committee and its members breached their fiduciary duties by failing to appropriately monitor and provide accurate information to the EDS Benefit Administration Committee and the EDS Investment Committee; (3) defendants breached their fiduciary duties by failing to provide the Plan participants and beneficiaries with complete and accurate information regarding EDS’s stock and by conveying inaccurate information about the soundness of EDS’s stock; and (4) defendants breached their duty of loyalty to act solely in the Plan participants’ and beneficiaries’ interests through their conflicting duties to EDS and the Plan and their failure to eliminate that conflict of interest.

The court referred to Counts 1, 2 and 4 as the “Prudence Claims,” which involved allegations that defendants breached their fiduciary duties by how they treated or managed the Plan. The court referred to Count 3 as the “Misrepresentation Claim,” which involved the allegation that defendants breached their fiduciary duties by how they treated plaintiffs as Plan participants and beneficiaries. The court noted that the “Prudence Claims” were properly brought pursuant to section 502(a)(2) as the relief sought would inure to the Plan as a whole. In contrast, the “Misrepresentation Claim” was properly brought to section 502(a)(3) as it was only applicable to those plaintiffs that invested in the EDS Stock Fund because of defendants’ misrepresentations. The court proceeded to separately address the propriety of class certification for each claim, noting that the distinction was important in terms of whether the requirements of class certification were satisfied.
The court held that both the “Prudence Claims” and the “Misrepresentation Claim” satisfied the requirements of Rule 23(a) of numerosity, commonality, typicality and adequacy. However, the claims differed with respect to whether the requirements of Rule 23(b) were satisfied.

With respect to the “Prudence Claims,” the court held that class certification was proper pursuant to Rule 23(b)(1)(A) and (B), as separate actions would create a risk of inconsistent adjudications that would establish inconsistent standards of conduct for the defendants and separate actions would create a risk that individual adjudications would substantially impair the other members’ ability to protect their interests. The court also noted that class certification of the “Prudence Claims” was also proper pursuant to Rule 23(b)(2), as plaintiffs sought injunctive relief for the class as a whole and that monetary damages were only incidental to, and contingent upon, receiving that injunctive relief. Having found that the “Prudence Claims” should be certified under Rule 23(b)(1) and (2), the court declined to certify that claim under Rule 23(b)(3) (common questions of law).

With respect to the “Misrepresentation Claim,” the court held that class certification was not proper pursuant to Rule 23(b)(1) or (2), as that claim required individual determinations of materiality and reliance. With respect to certification pursuant to Rule 23(b)(3), providing for class certification where common questions of law of fact predominate over individual issues, the court noted that there was no authority in the Fifth Circuit addressing the standards for materiality and reliance in an ERISA breach of fiduciary duty class action for misrepresenting plan investment options. However, relying on Sandwich Chef, Inc. v. Reliance National Indemnity Ins. Co., 319 F.3d 205, 219 (5th Cir. 2003), the court noted that “[g]enerally, claims involving individual reliance are unsuitable for class certification.” The court rejected plaintiffs’ argument that the court apply the fraud-on-the-market presumption of reliance utilized in the securities litigation to the ERISA context. The court also noted that a section 404(c) defense, which creates an affirmative defense to liability for losses caused by a participant’s exercise of control over the assets in his account, would raise individualized issues that would predominate over common issues.

DOL Issues Guidance for Directed Trustees
by Matthew J. Renaud

The Department of Labor released Field Assistance Bulletin No. 2004-03 on December 17, 2004, providing guidance on the fiduciary responsibilities of directed trustees in company stock matters. In a well-written, seven page memorandum, the DOL provides that “in the context of purchasing, selling or holding publicly traded securities on a generally recognized market, the [directed] trustee may follow the named fiduciary's directions absent extraordinary circumstances as discussed [in the memorandum].” According to the memorandum, “extraordinary circumstances” means “clear and compelling public indicators, as evidenced by an 8-K filing with the Securities and Exchange Commission, a bankruptcy filing or similar public indicator, that call into serious question a company’s viability as a going concern.”