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ERISA Advisory

June 7, 2017

'Coulda, Woulda, Shoulda:' Fourth Circuit Re-Revisits a Controversial Position on ERISA's Prudence Standard

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Almost exactly 15 years after the case commenced and more than 17 after the events that led to it, the Fourth Circuit Court of Appeals handed down its third decision in *Tatum v. RJR Pension Investment Committee*, 855 F.3d 553 (4th Cir., April 28, 2017). The court reaffirmed the principle that it enunciated in its prior decision, 761 F.3d 346 (4th Cir., 2014), namely, that a fiduciary who did not follow a prudent process in making an investment decision can avoid liability only by showing by a preponderance of the evidence that a prudent fiduciary would more likely than not have reached the same decision. The contrary view, put forward in a strong dissent in the earlier case, is that a successful defense requires only showing that the fiduciary's decision was within the range of decisions that a prudent fiduciary could have made. Nonetheless, despite its more stringent standard, a 2-1 majority of the panel affirmed a district court decision in favor of the plan fiduciaries.

The case stemmed from RJR's spinoff in 1999 of its Nabisco food-related operations. Following the spinoff, the RJR 401(k) plan's investment options included two funds that held only Nabisco stock; one a successor to a previous Nabisco fund, the other consisting of stock in Nabisco's post-spinoff parent. RJR's pension investment committee concluded that retaining investment funds consisting solely of shares in a single, unrelated corporation was inadvisable. In January 2000, the plan liquidated the Nabisco funds, and participants whose accounts held interests in them had to move their money elsewhere.

The price of Nabisco shares declined after the spinoff from RJR and was at an historic low when RJR's 401(k) plan sold out. Thereafter, a startling reversal of fortune took place. Following an unsolicited tender offer from Carl Icahn, newly independent Nabisco put itself on the block. By the end of 2000, it had been acquired at a huge premium over the price at the start of the year. If the RJR plan had retained its Nabisco funds, the stock in one would have nearly doubled in value from its January low, and in the other more than tripled.

In May 2002, a participant initiated the mirror image of a "stock drop" suit. Instead of alleging that the plan fiduciaries had imprudently kept an investment option that ought to have been closed down, the plaintiff contended that they had imprudently gotten rid of an option that should have been retained. Initially the district court dismissed the participant's claims based on defendants' argument that the elimination of the Nabisco funds was accomplished through plan amendments, and was therefore a non-fiduciary, settlor activity. *See Tatum v. R.J. Reynolds Tobacco Co.*, 294 F. Supp. 2d 776, 784 (M.D.N.C. 2003). The Fourth Circuit reversed that decision, holding that "the plain language of the amendments did not strip the fiduciaries of discretion to maintain funds in the plan." *Tatum v. R.J. Reynolds Tobacco Co.*, 392 F.3d 636, 637 (4th Cir. 2004).

Following a bench trial on remand, the district court concluded that the plan fiduciaries had been procedurally imprudent; their decision to eliminate the Nabisco funds was based on hasty, superficial analysis that did not meet ERISA's fiduciary standards. Nonetheless, the court ruled that the defendants had met their burden of proving that the breach did not cause a loss to the plan by showing that a hypothetical prudent fiduciary *could* have made the same decision. *Tatum v. R.J. Reynolds Tobacco Co.,* 926 F. Supp. 2d 648, 689-90 (M.D.N.C. 2013).

In its 2014 *Tatum* decision, the Fourth Circuit affirmed the district court's holding that the defendants breached their duty of prudence and thus had the burden of proving that the breach did not cause any loss. *Tatum v. RJR Pension Investment Committee*, 761 F.3d 346, 361 (4th Cir. 2014). However, a 2-1 majority ruled that the district court, in concluding that the defendants had met their burden of proof on loss causation, had failed to apply the correct standard of "objective prudence." According to the majority, the district court had –

> required RJR to prove only that "a hypothetical prudent fiduciary *could* have decided to eliminate the Nabisco Funds on January 31, 2000." . . . [I]nstead of determining whether the evidence established that a prudent fiduciary, more likely than not, *would* have divested the Nabisco Funds at the time and in the manner in which RJR did, the court concluded that the evidence did not "compel a decision to maintain the Nabisco Funds in the Plan," and that a prudent investor "could [have] infer[red]" that it was prudent to sell. [*Id.* at 364 (emphasis added by the court)]

The "would" standard drew a vigorous dissent, which contended that the majority –

> would substitute for the fiduciary's duty to make a prudent decision a duty to make the best possible decision, something ERISA has never required. Take a scenario in which 51% of hypothetical prudent fiduciaries would act one way and 49% would act the other way. What sense, let alone justice, is there in penalizing a fiduciary merely for acting in accordance with a view that happens to be held by a bare minority? And how, absent an unhealthy dose of hindsight, could we ever know the precise breakdown of hypothetical fiduciaries with regard to a particular investment decision? [*Id.* at 378 (Wilkinson, J., dissenting)]

On remand, the district court concluded that the decision to sell Nabisco stock at the time when the plan did "would have" been made by a prudent fiduciary. The case returned to the circuit court, where the same panel heard it. The vote was again 2-1, but this time in favor of the fiduciaries.

The district court's decision turned largely on expert testimony about how prudent fiduciaries would have evaluated Nabisco's long-term prospects. In a nutshell, the district judge held, and the Fourth Circuit majority agreed, that the stock's rapid recovery was a fortuitous, unforeseeable circumstance that a prudent fiduciary would not have anticipated and that prudent consideration of the facts that were known in late 1999 and early 2000 would have led to a decision to divest.

The plaintiff offered an ingenious counterargument: Because Nabisco shares were publicly traded on an efficient market, their price reflected all publicly available information and therefore was the best available measure of their true value. Hence, a prudent fiduciary would have concluded that the price of Nabisco stock in January 2000 accurately reflected its value and would not have closed down the Nabisco funds.

Similar reasoning, founded on the "efficient market hypothesis," was used by the Supreme Court in *Fifth Third Bancorp v. Dudenhoeffer*, 134 S. Ct. 2459 (2014), in holding that it was not imprudent for 401(k) plan fiduciaries to continue offering employer stock as an investment option despite publicly available adverse information about its prospects. The *Tatum* majority believed that the plaintiff misapplied the court's decision, misreading it –

> to hold that a hypothetical prudent fiduciary is *not justified* in divesting a stock based on public information about risk. But the court in *Fifth Third* held no such thing. It merely held that a fiduciary is *not required* to divest a high-priced stock based on public information that shows a risk of price decrease. [2017 U.S. App. LEXIS 7561 at 22 (emphasis in original)]

The court went on to approve the district court's findings concerning the justification for divesting Nabisco stock:

> The district court explained that a prudent fiduciary would have balanced the increased risk of loss that the Nabisco Funds brought to the Plan – risk reflected in the low stock price, but also the risk inherent in their lack of diversity within the Plan and the Nabisco stock's high correlation with RJR's battered stock – against the Funds' likely *average* returns. . . . The court found that a prudent fiduciary would have concluded the Nabisco Funds' expected returns did not justify the increased risk of loss to the Plan, [footnote omitted] especially because ERISA requires that a fiduciary diversify plan assets to minimize risk of loss. . . . This conclusion was well-supported by the record and accords with the efficient market hypothesis. [*Id*. at 27 (emphasis in original)]

Although the Fourth Circuit affirmed the district court's judgment in favor of the defendants, the majority rejected the defendants' argument that the court's prior adoption of a "would have" rather than "could have" standard should be revisited in light of *Amgen Inc. v. Harris*, 136 S. Ct. 758 (2016) (per curiam). In *Amgen*, the Supreme Court held that, in considering allegations that fiduciaries had imprudently allowed an employer stock fund to continue despite their possession of nonpublic information indicating that the employer's outlook was worse than indicated by publicly available data, a court must "assess whether the complaint in its current form has plausibly alleged that a prudent fiduciary in the same position *could not have concluded* that the alternative action [proposed by the plaintiff] would do more harm than good." 136 S. Ct. at 760 (emphasis added, internal quotation marks omitted).

The new *Tatum* decision's majority opinion (written by the same judge as the last one) relegates to a footnote (2017 U.S. App. LEXIS 7561 at 12, fn. 5) the suggestion of inconsistency between its standard and that of the Supreme Court, concluding that *Tatum* and *Amgen* addressed two different issues.

Practitioners and courts in other circuits undoubtedly will continue to debate whether the issues in *Tatum* and *Amgen* are so different that in one case the fiduciary's decision should pass muster only if a hypothetical prudent fiduciary *would* have made the same decision, while in the other the fiduciary's decision survives challenge if a prudent fiduciary *could* have reached the same decision. But regardless of who ultimately wins that debate, *Tatum* provides at least some comfort that the proof requirements of the "would have" standard are not insurmountable in those jurisdictions which, like the Fourth Circuit, shift the burden of proof to defendants on this issue.