



Employer Update

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Limitations on Conduct Protected Under Sarbanes-Oxley

By Jeffrey S. Klein, Nicholas J. Pappas and Kim Turner

Litigants and regulators have debated the scope of protections provided to whistleblowers under the Sarbanes Oxley Act (“Sarbanes-Oxley” or “SOX”) ever since its enactment in 2002. Some tribunals have held that whistleblowers seeking protection under Sarbanes-Oxley must allege fraud with adverse effects on investors, and that allegations of fraud in the abstract would be insufficient to state a claim for relief. Others have suggested that no such showing is necessary to trigger the whistleblower protections of Sarbanes-Oxley.

We will discuss two cases that addressed this issue but arrived at divergent conclusions. In *Platone v. FLYi, Inc.*, ARB Case No. 04-154, 2006 WL 3246910, at *7 (Dep’t of Labor Sept. 29, 2006), *aff’d*, *Platone v. U.S. Dep’t of Labor*, 548 F.3d 322 (4th Cir. 2008), *cert. denied*, 130 S.Ct. 622 (U.S. Nov. 16, 2009), the Administrative Review Board of the U.S. Department of Labor (the “ARB”) held that while complaints of employer fraud are not limited to fraudulent activity that directly or indirectly affect investor interests, “when allegations of mail or wire fraud arise under the employee protection provision of the Sarbanes-Oxley Act, the alleged fraudulent conduct must at least be of a type that would be adverse to investors’ interests.” By contrast, in *O’Mahony v. Accenture Ltd.*, 537 F.Supp.2d 506, 517 (S.D.N.Y. 2008), Judge Marrero ruled that SOX “clearly protects an employee against retaliation based upon the whistleblower’s reporting of fraud under any of the enumerated statutes regardless of whether the misconduct relates to ‘shareholder’ fraud.” After analyzing these cases, we propose certain issues employers should consider in seeking to comply with SOX while also asserting arguments most favorable to their positions in the context of an investigation, administrative proceeding, or litigation.

Background

Sarbanes-Oxley provides a civil cause of action to any employee of a publicly traded company that discriminates against the employee for reporting information or making a complaint about employer conduct that the employee reasonably believes constitutes a violation of six enumerated sources of law. These sources of law are 18 U.S.C. §§ 1341 (mail fraud); 1343 (wire fraud); 1344 (bank fraud); or 1348 (securities fraud); any rule or regulation of the Securities and Exchange Commission; or any provision of Federal law relating to fraud against shareholders. 18 U.S.C. § 1514A(a)(1). As with other anti-discrimination statutes, in order to establish a violation of this section, the employee must demonstrate that (1) he engaged in

activity protected by Section 1514A; (2) the employer was knowledgeable of the protected activity; (3) he suffered an adverse employment action; and (4) the protected activity contributed to the adverse action. 29 C.F.R. §§ 1980.104(b)(1)(i)-(iv); 1980.109(a). The *Platone* and *O'Mahony* cases came to conflicting views as to what constitutes protected activity sufficient to establish a Section 1514A cause of action.

Platone v. FLYi Inc.

In *Platone*, after the complainant, Stacey Platone, assumed the position of labor relations manager of FLYi, formerly known as Atlantic Coast Airlines (“ACA”), she noted accounting discrepancies in the airline’s process of obtaining reimbursements due from the Air Line Pilots Association (“ALPA” or “union”) for flights missed by pilots attending union meetings. *Platone v. FLYi, Inc.*, ARB Case No. 04-154, 2006 WL 3246910, at *2-3 (ARB Sept. 29, 2006). Platone, a former ALPA employee, investigated the “flight loss” issue and reported her concerns to the direct supervisor, who then contacted the union regarding its obligations to reimburse ACA. *Id.* Simultaneously, Platone’s supervisor became aware that Platone was engaged in a romantic relationship with an ACA pilot, who also was a former high-ranking union representative, thereby raising a conflict of interest that prompted ACA to terminate Platone’s employment. *Id.* at *4-5.

In her initial complaint to the Occupational Safety and Health Administration Platone alleged that her employment was terminated because she discovered and reported “a scheme to defraud shareholders and members of the pilot’s union.” *Id.* at *5. Platone additionally asserted that ACA was complicit in a scheme to exchange improper payments,

totaling \$125,000, to union members for concessions in upcoming labor negotiations. *Id.* at *5-6. Platone alleged that the scheme violated federal mail and wire fraud statutes as well as SEC Rule 10b-5. *Id.* at *5. Platone added that losses related to the union billing issue were not reported to shareholders. *Id.* While the Administrative Law Judge

While complaints of employer fraud are not limited to fraudulent activity that directly or indirectly affect investor interests, “when allegations of mail or wire fraud arise under the employee protection provision of the Sarbanes-Oxley Act, the alleged fraudulent conduct must at least be of a type that would be adverse to investors’ interests.”

(“ALJ”) found reasonable Platone’s suspicions that a fraud was being perpetrated on the airline and on company shareholders, the Administrative Review Board reversed the ruling, holding that Platone had not engaged in SOX-protected activity. *Id.* at *8. The Board stated that “[t]hese statutes are not by their terms limited to fraudulent activity that directly or indirectly affects investors’ interests” yet, “when allegations of mail or wire fraud arise under the employee protection provision of the Sarbanes-Oxley Act, the alleged fraudulent conduct must at least be of a type that would be adverse to investors’ interests.” *Id.* at *7 (emphasis added). Furthermore, the Board emphasized that Sarbanes-Oxley “does not provide whistleblower protection for all employee complaints about how a public company spends its money and pays its bills.” *Id.* at *8. Rather, in order to be protected under SOX, “the employee’s communications must ‘definitively and specifically’ relate to any of the listed categories of fraud or securities violations” under § 1514A(a)(1). *Id.* Thus, Platone’s investigation into the flight loss

issue and related exchanges with management did not constitute communications that definitively and specifically relate to the categories of fraud pleaded by Platone pursuant to the statute. *Id.* Instead, Platone “raised a possible violation of internal union policy” and she “expressed concern on how this might affect ACA’s ability to collect a debt, but

nothing approximating fraud against shareholders.” *Id.* at *9.

The Fourth Circuit Court of Appeals reviewed the ARB’s decision under the Administrative Procedure Act, and affirmed the ARB’s reversal of the ALJ’s ruling and dismissal of Platone’s complaint. *Platone v. U.S. Dep’t of Labor*, 548 F.3d 322 (4th Cir. 2008). However, the court of appeals declined to address the issue as to whether or not § 1514A required the complainant “when alleging mail or wire fraud, to demonstrate that the fraud would be adverse to the interests of shareholders or investors.” *Id.* at 326 n.3. Instead, the court rested its decision on the settled rule that “allegations to management under the whistleblowing provision of the Sarbanes-Oxley Act must be definitively and specifically related to one of the areas accorded protection in § 1514A(a)(1).” *Id.* at 326. Because Platone’s identification of a “billing discrepancy” and her subsequent complaint did not clearly articulate her belief that such actions constituted mail fraud, wire fraud, or a violation of Rule 10b-5, Platone failed

to engage in protected activity under Sarbanes-Oxley. *Id.* at 327.

O'Mahony v. Accenture Ltd.

In *O'Mahony v. Accenture Ltd.*, 537 F.Supp.2d 506 (S.D.N.Y. 2008), the court rejected the requirement that whistleblowers state a claim only when alleging fraud that negatively impacts shareholder interests. The court considered whether the plaintiff properly alleged a violation to justify Sarbanes-Oxley whistleblower protection with regard to the company's alleged evasion of the obligation of Accenture to make contributions to France's social security system, pursuant to a bilateral agreement between France and the United States, upon expiration of a five-year exemption period. *Id.* at 507. O'Mahony, a partner in Accenture's office in France, raised objections to the office practice of not making such social security contributions. *Id.* at 508. O'Mahony informed executives of Accenture's responsibility to pay contributions on her behalf, yet the company allegedly responded that it would not make payments and continued to conceal O'Mahony's status as an employee of the office since 1992. *Id.* O'Mahony "objected to Accenture's actions" and responded that she would "not be party to tax fraud." *Id.*

O'Mahony maintained that later that year her level of responsibility and compensation was reduced as a result of these actions, prompting her to file a complaint. *Id.* O'Mahony alleged before the Department of Labor that Accenture had violated § 1514A by retaliating against her due to "her investigation of, and objection to, a fraudulent scheme to evade the payment of social security contributions that were due in France for United States' employees on secondment to that country." *Id.* The DOL dismissed the complaint for

lack of jurisdiction over events taking place in France; however, the district court extended subject matter jurisdiction over the matter. *Id.* at 515.

The district court rejected defendants' argument for dismissal on the ground that plaintiff could not show that she engaged in activity protected under § 1514A. *Id.* at 516-17. Defendants argued that "the protection of § 1514A applies only to an employee's reporting of 'fraud against shareholders,'" yet, O'Mahony alleged violations of §§ 1341 [mail fraud] and 1343 [wire fraud] without any allega-

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tions of fraud against shareholders. *Id.* at 516. Although the district court noted that the context of the disclosure and the circumstances giving rise to the communication, if closely related to the potential fraud against shareholders, may be sufficient to satisfy the pleading requirements of § 1514A, the court held that the statute does not limit whistleblower protection solely to employees who provide information concerning fraud against shareholders. *Id.*

Noting that the Second Circuit had not yet addressed "whether § 1514A limits the activity protected only to reporting conduct that involved 'fraud against shareholders,'" the court highlighted the paucity of decisions on the issue and cited two contrasting opinions considering the question. *Id.* The court then applied general principles of statutory

construction which the court thought weighed against reading § 1514A as providing whistleblower protection only to employees who provide information concerning fraud against shareholders. *Id.* at 516-17. The court ruled that the first four referenced statutes of § 1514A "are not limited to types of fraud related to SOX." *Id.* at 517. Accordingly, the court found in favor of the plaintiff who engaged in protected activity when she reported her belief that Accenture engaged in mail and wire fraud regarding the social security payments, and reasoned that § 1514A "clearly protects an employee against retaliation based upon the whistleblower's reporting of fraud under any of the enumerated statutes regardless of whether the misconduct relates to 'shareholder' fraud." *Id.*

Observations

The *Platone* and *O'Mahony* cases offer important lessons to employers who may be required to investigate complaints by putative whistleblowers, or who must defend themselves against administrative or court actions brought by complainants.

An employer investigating an employee's alleged whistleblower complaint should inquire as to whether and to what extent the alleged illegality would impact shareholders. Such an investigation should allow employers to develop potential evidence that the alleged fraud did not affect shareholders' interests. Such evidence would be analogous to the information relied upon by the Administrative Review Board in *Platone* which held that mere billing discrepancies were not adverse to investor interests. Employers should consider asking the complainant whether the complaint relates to fraud against shareholders or if the alleged fraud could impact share-

holders. If the employee answers that the complaint lacks an effect on shareholders, such an admission could be relevant in future litigation. With such evidence in the administrative record, the employer may more easily bring such matters to the attention of the DOL investigator in the first instance, or in a subsequent litigation to the attention of an ALJ, or to a court. While the *O'Mahony* court found such evidence not to be dispositive based on its construction of the § 1514A cause of action, other courts may agree with *Platone* and rely on such evidence in dismissing a putative claim under SOX.

In addition to the development of evidence at the pre-litigation stage, employers should ensure that they include arguments such as those that prevailed in *Platone* in responding to complaints in both administrative and judicial proceedings. Certainly, the *Platone* case should continue to carry weight at the DOL where the ARB's decision should be given weight as precedent. However, even in the district courts, employers may assert the *Platone* defense until such time as the issue has been definitively resolved by the courts.

Circuit Court Rules Auto Damage Adjusters Covered by Administrative Exemption Under Fair Labor Standards Act

By Jonathan A. Shiffman

In *Robinson-Smith v. Government Employees Ins. Co.*, the U.S. Court of Appeals for the District of Columbia Circuit recently held that auto damage adjusters for GEICO are exempt from the overtime requirements of the Fair Labor Standards Act ("FLSA") under that statute's administrative exemption.¹ The decision is an important one for employers, as it reaffirms recent holdings by other Circuit Courts that the "discretion and independent judgment" prong of the test for the FLSA's administrative exemption may be satisfied even when employees spend a very small amount of their working time performing tasks requiring such discretion and independent judgment. Despite the favorable ruling, however, employers should be careful in applying this decision in other contexts, as each employee's status with respect to their entitlement to overtime pay under the FLSA depends upon a detailed factual analysis, as the Court made clear with its own fact-intensive review of the job duties of the GEICO auto damage adjusters ("Adjusters").

Since the Adjusters had brought their lawsuit prior to the Department of Labor's revision of the FLSA overtime exemption regulations in 2004, GEICO had to show that they were exempt under the earlier regulations' "short test," which applied to employees, like the Adjusters, who made more than \$250 per week. To qualify as exempt under that "short test," GEICO had the burden of proving: (1) that the Adjusters' primary duty was administrative in nature; and (2) that their

primary duty required the exercise of discretion and independent judgment.² The District Court, in the decision below, had rejected GEICO's argument, holding that the Adjusters did not come within the FLSA administrative exemption because GEICO failed to establish the second of the above two prongs, i.e., it did not show that the Adjusters' primary duty "include[d] the exercise of discretion and independent judgment."³ On appeal, the Court limited its review to the issue of whether this aspect of the District Court's holding should be affirmed.

The Court began its analysis by noting that, to satisfy the "discretion and independent judgment" prong of the "short test" for the pre-2004 administrative exemption, GEICO had to show that the Adjusters' "primary duty (1) includes work requiring the exercise of discretion and independent judgment (as distinguished from the mere use of skill in applying well established techniques) and that the discretion is exercised (2) free from immediate supervision and (3) with respect to matters of significance." The Court also noted that since the new FLSA overtime regulations made effective in 2004 "were meant to consolidate and streamline' the old regulations and to be 'consistent with' the old short test," it would cite to and rely on the new regulations in reaching its conclusion.

With respect to the first of the above elements, the appellees had argued that the Adjusters lacked discretion and independent judgment because they spent only a very small amount of their

time engaging in negotiations with customers regarding their insurance loss claims, and because the rest of their duties simply required them to use their skills in applying GEICO's damage assessment standards. The Court disagreed, finding that employees will meet this standard even when only a small amount of their time is devoted to tasks requiring discretion and independent judgment. Although the relevant regulations require that "the adjuster's primary duty 'include[]' the exercise of discretion and independent judgment" they "do[] not specify how frequently discretion need be exercised." Thus, the Court found, "[e]ven assuming. . . that 'the vast majority of the adjusters' work consists of using their training and skills to assess the value of the damage to the vehicle in accordance with the standards laid out by GEICO'. . . their primary duty nevertheless 'includes' work requiring the exercise of discretion and independent judgment."

With respect to the second of the above elements, the appellees had argued that the Adjusters' negotiations with customers were done pursuant to detailed GEICO guidelines, and that the Adjusters sometimes sought guidance from supervisors during those negotiations, and therefore those activities were not 'free from immediate direction or supervision.' The Court again disagreed, noting that GEICO did not require its Adjusters to seek supervisor review before settling an insurance loss claim, and that, therefore, under the relevant regulations, they had the "'authority to make independent choices,'" which satisfied the requirement that their activities be "free from immediate direction or supervision."

Finally, the Court found that the Adjusters exercised discretion and independent judgment with respect to "matters of significance," satis-

fying the third element. The Court noted that Adjusters are "empowered to negotiate with claimants and body shops and settle[] claims up to \$10,000 or \$15,000 – all actions that bind GEICO financially." According to the Court, the act of financially binding a company unquestionably qualified as a 'matter of significance.'

The appellees also argued that, even if the settling of loss claims involved discretion and independent judgment, GEICO still failed to demonstrate that the Adjusters were administratively exempt because such activities were not an aspect of their "primary duty." Rather, appellees argued, the "essence" of the Adjusters work was the "determination of facts" in connection with investigating loss claims, and that "[s]uch fact-finding is non-exempt work." The Court responded that

In light of this decision, courts may be willing to find that employees exercise "discretion and independent judgment" even when they spend only a small amount of their work-time performing tasks with those requirements.

the FLSA regulations did not define "primary duty" so narrowly, and that under the exemption an administrative employee's job could include a variety of tasks – including some which were nonexempt. Moreover, the Court found that "even if [it] were inclined to define the [A]djuster's 'primary duty' as narrowly as the appellees request, their own authority shows that even employees engaged primarily in fact-finding work may yet come within the administrative employee exemption provided they exercise discretion and independent judgment." The Court then conducted a fact-intensive analysis of the Adjusters' job duties and compared them to the types of duties that "insurance claims adjusters" must perform as their primary duty in order to be exempt under the DOL's

revised 2004 regulations. Based on that comparison, the Court concluded that Adjusters "can be said to perform a majority of the listed activities" that require discretion and independent judgment.

In light of this decision, courts may be willing to find that employees exercise "discretion and independent judgment" even when they spend only a small amount of their work-time performing tasks with those requirements. However, because each employee's exemption status depends on a fact-intensive analysis of their individual job duties, employers should proceed cautiously before reaching a determination that their employees satisfy all the criteria necessary for an exemption from the FLSA's overtime requirements.

Employers should also be cautioned that this decision's construction of the "discretion and independent judgment" prong of the administrative exemption may not apply under analogous state labor laws. For example, under the California Labor Code, an employer must show that an employee "customarily and regularly" exercises discretion and independent judgment in order to satisfy the State's administrative exemption.⁴

1 --- F.3d ---, 2010 WL 10419 (D.C. Cir. January 5, 2010). In a humorous reference to GEICO's famous ad campaign, the Court noted that it "had no occasion to decide whether the job of a GEICO auto damage adjuster is so easy a caveman could do it." *Id.* at *1, n.2.

2 See 29 C.F.R. § 541.2 (2003).

3 *Robinson-Smith v. Gov't Employees Ins. Co.*, 323 F.Supp.2d 12, 26 (D.D.C. 2004).

4 See California Industrial Welfare Commission's Wage Order No. 4-2001.

Fiduciary Duty To Disclose Fee Sharing Arrangements Between 401(k) Plan Trustees and Investment Managers

By Millie Warner

In early 2009, the U.S. Court of Appeals for the Seventh Circuit became the first appellate court to address the duties of ERISA plan fiduciaries to control fees charged to plan participants. In *Hecker v. Deere & Co.*, 556 F.3d 575 (7th Cir. Feb. 12, 2009), in a significant victory for plan fiduciaries, the Seventh Circuit held, among other things, that ERISA does not require the sponsor of a 401(k) plan to disclose to participants that the plan's investment advisor shares revenue with the affiliated plan trustee, and that nothing in ERISA prohibits a fiduciary from selecting funds from one management company or requires a fiduciary to scour the market to find the cheapest funds.

Since the Seventh Circuit's decision in *Deere*, the plaintiffs' and defendants' bars alike have been waiting to see if the other appellate courts would follow the Seventh Circuit's lead and dismiss such ERISA "excessive fees" claims on the pleadings. In November 2009, the U.S. Courts of Appeals for the Eighth Circuit became the second appellate court to confront an ERISA excessive fees case, and reached a very different conclusion from the Seventh Circuit in *Deere*.¹ In *Braden v. Wal-Mart Stores, Inc.*, 588 F.3d 585 (8th Cir. 2009), the Eighth Circuit concurred with the Seventh Circuit's conclusion that ERISA fiduciaries are not required to offer only the cheapest funds, but held that ERISA fiduciaries may be required to disclose revenue sharing arrangements, if such information would be "material" to plan participants' investment decisions.

The Eighth Circuit's decision is significant because it creates a potential circuit split on the issue of the disclosure of revenue sharing arrangements under ERISA, and raises the issue of what the majority position will become as more ERISA excessive fees cases continue to reach the appellate courts.² This article will discuss the *Deere* and *Braden* cases and offer suggestions to fiduciaries as to prophylactic measures that they should take to avoid the negative result in *Braden*.

Background: Seventh Circuit Finds No Fiduciary Duty to Disclose

In "excessive fees" cases under ERISA, plaintiffs typically allege that plan fiduciaries failed to properly protect against excessive fees paid by plans and their participants for mutual funds or other investments and also failed to properly disclose revenue sharing between service providers.

Deere involved two of Deere & Company's ("Deere") 401(k) plans, which offered participants a menu of, *inter alia*, 23 Fidelity mutual funds and a Fidelity-operated investment portal that gave participants access to approximately 2,500 additional mutual funds managed by different companies. *Deere*, 556 F.3d at 578. Each fund included within the plans charged a fee to the individual accounts based on the percentage of assets invested in the fund. *Id.* Fidelity Research, as investment adviser, shared some of the fees received by the mutual funds with Fidelity Trust, the plans' trustee,

which in turn compensated itself for the trustee services it provided through those shared fees, rather than through a direct charge to Deere for its services. *Id.* Three of the plans' participants brought suit against Deere under ERISA § 502(a)(2), alleging that Deere violated its fiduciary duties under ERISA by offering investment options under the plans that charged excessive fees and by failing to disclose to participants the revenue sharing arrangement between the plans' investment adviser and trustee. *Id.* at 579.

The district court dismissed the complaint, and the Seventh Circuit affirmed. The Seventh Circuit ruled, *inter alia*, that:

- There was no requirement under ERISA for Deere and Fidelity to disclose the revenue sharing arrangement. Rather, the "total fee, not the internal, post-collection distribution of the fee, is the critical figure for someone interested in the cost of a certain investment," and all that the Deere was arguably required to disclose. *Id.* at 585.
- The plans offered a sufficient mix of investment options with a wide range of expense ratios, and, thus, even if some of the investment options charged excessive fees, no "rational trier of fact could find" that Deere failed to satisfy any duty that may exist under ERISA to offer an acceptable array of investment options. While it is possible that some other funds might have offered lower expense ratios, "nothing in ERISA requires every fiduciary to scour the market to find and offer the cheapest possible fund." *Id.* at 586.
- Deere did not act improperly in limiting the investment options to Fidelity mutual funds, as nothing in ERISA prohibits a fiduciary

from selecting funds from one management company or requires a fiduciary to include any particular mix of investment vehicles in a plan. *Id.*

- As an alternative ground for dismissal, ERISA § 404(c), which “protect[s] a fiduciary . . . [of a plan that] includes a sufficient range of options so that participants have control over the risk of loss,” operated as a safe harbor precluding the plaintiffs’ claims. While § 404(c) is an affirmative defense to a claim for breach of fiduciary duty under ERISA, the plaintiffs chose to anticipate the defense in their complaint, thus “put[ting] it in play.” *Id.* at 588.

Braden v. Wal-Mart Stores, Inc.

Wal-Mart Stores, Inc. (“Wal-Mart”) sponsored a 401(k) plan (the “Plan”), for which Merrill Lynch & Co., Inc. (“Merrill Lynch”) served as the trustee, holding the Plan’s assets in trust and providing various administrative services necessary to the maintenance of participants’ accounts. *Braden*, 588 F.3d at 589. With more than one million participants and nearly \$10 billion in assets at the end of 2007, the Plan was one of the largest 401(k) plans in the country. *Id.* During the relevant time period, the Plan offered participants thirteen investment options selected by Wal-Mart’s Retirement Plans Committee, including ten mutual funds. *Id.*

Jeremy Braden, a Wal-Mart employee and a participant in the Plan, brought suit for breach of fiduciary duty against Wal-Mart and the individual members of the Retirement Plans Committee under ERISA § 502(a)(2). *Id.* at 589. The complaint alleged that the defendants failed adequately to evaluate the investment options included in the Plan, and that the process by which the Plan’s mutual

funds were selected was tainted by the defendants’ failure to consider Merrill Lynch’s alleged interest in including funds that shared their fees with Merrill Lynch. *Id.* at 589-90. As a result of these failures, the complaint alleged, some or all of the Plan’s investment options charged excessive fees, estimated to have cost the Plan approximately \$60 million in unnecessary expenses between 2002 and 2008. *Id.*

The Seventh and Eighth Circuits have now reached different conclusions on whether revenue sharing arrangements must be disclosed under ERISA.

The complaint further alleged that the Plan’s fiduciaries engaged in prohibited transactions under ERISA by allowing Plan assets to be paid to the Plan’s trustee in the form of revenue sharing payments. *Id.* at 590. In addition, the complaint claimed that the fiduciaries breached their duties under ERISA by failing to completely and accurately inform the Plan’s participants about the impact the mutual funds’ excessive fees had on their retirement savings. *Id.*

The district court dismissed all of the plaintiff’s claims. The district court concluded that the plaintiff lacked constitutional standing to assert claims based on breaches of fiduciary duty that occurred prior to the date he first contributed to the Plan and that he otherwise failed to state any plausible claim on which relief could be granted. *Id.* The court dismissed the remaining claims on the grounds that the plaintiff had alleged insufficient facts – as opposed to conclusory allegations – to support

the claim of imprudent or disloyal management, that the defendants had no duty to disclose the information about the revenue sharing payments that the plaintiff sought, and that the plaintiff had failed to show the revenue sharing payments constituted prohibited transactions under ERISA. *Id.* at 590-91.

The Eighth Circuit’s Decision

On November 25, 2009, the Eighth Circuit vacated the district court’s dismissal and remanded the case to the district court for trial.

The Eighth Circuit ruled that:

- The district court erred in finding that the plaintiff lacked constitutional standing to maintain claims for the period before he began participating in the Plan. *Id.* at 591. While the plaintiff could not have suffered injury before he began participating in the Plan, actions taken earlier (such as the selection of investment options that remained in place when the plaintiff commenced participation in the Plan) could have caused the plaintiff’s subsequent injury, thus forming a proper basis for his claims. *Id.* at 592, n.4.
- The district court improperly ignored reasonable inferences supported by allegations in the complaint, and instead drew inferences in favor of the defendants, faulting the plaintiff for failing to plead facts tending to contradict those inferences. For instance, the court concluded that while the complaint did not “directly address the process by which the Plan was managed,” it was reasonable to infer from what was alleged that the process was flawed. *Id.* at 596.
- The district court erroneously dismissed the plaintiff’s claim that

the Plan's fiduciaries breached their disclosure obligations under ERISA by not disclosing to participants the Plan fees issues (i.e., that the Plan's funds charged higher fees than comparable funds, that Wal-Mart had access to more cost effective institutional shares, and that the defendants did not select or evaluate the funds on the basis of the fees they charged) and the revenue sharing payments. *Id.* at 599. The court held that while there is "no per se duty" under ERISA to disclose such facts, "materiality is a fact and context sensitive inquiry" and the complaint alleged sufficient facts to support an inference that "nondisclosure of details about the fees charged by the Plan funds and the amount of revenue sharing payments" would preclude participants from making adequately informed investment decisions. *Id.* at 600.

- The district court erroneously dismissed the prohibited transaction claim by finding that the plaintiff had failed to plead facts raising a plausible inference that the payments Wal-Mart made to Merrill Lynch were unreasonable in relation to the services provided by Merrill Lynch. *Id.* According to the Eighth Circuit, the exemptions to the prohibited transaction rules are "defenses which must be proved by the defendant," and the plaintiff "does not bear the burden of pleading facts showing that the revenue sharing payments were unreasonable in proportion to the services rendered." *Id.* at 601.³

While the Eighth Circuit acknowledged and endeavored to harmonize its decision with the Seventh Circuit's decision in *Deere*, it limited its analysis of *Deere* to two footnotes.

In the first footnote, the Eighth Circuit compared Wal-Mart's Plan, which offered participants ten mutual funds, to the plan at issue in *Deere*, which provided participants with "access to over 2,500 mutual funds." According to the Eighth Circuit, "[t]he far narrower range of investment options available in this case makes more plausible the claim that this Plan was imprudently managed." *Id.* at 596, n.6.

In the second footnote to mention *Deere*, the Eighth Circuit reiterated what the Seventh Circuit had concluded in *Deere*: that it was "not suggest[ing] that a claim is stated by a bare allegation that cheaper alternative investments exist in the marketplace." *Id.* at 596, n.7. Citing *Deere*, the Eighth Circuit stated that "[i]t is clear that 'nothing in ERISA requires every fiduciary to scour the market to find and offer the cheapest possible fund.'" *Id.* (quoting *Deere*, 556 F.3d at 586).

Advice for Fiduciaries

Significantly, the Seventh and Eighth Circuits have now reached different conclusions on whether revenue sharing arrangements must be disclosed under ERISA. Whereas the Seventh Circuit concluded that there is no duty under ERISA to disclose revenue sharing, the Eighth Circuit held that there might be a duty to disclose such arrangements if such information would be material to plan participants' investment decisions. This divergence of opinion between the Seventh and Eighth Circuits is a significant issue for plan fiduciaries, particularly because, as the Eighth Circuit acknowledged, revenue sharing arrangements are "not uncommon in the industry." *Braden*, 588 F.3d at 590. Fiduciaries should monitor ERISA excessive fee cases as

they continue to reach the appellate courts to see what the majority position will become on the disclosure of revenue sharing arrangements under ERISA.

In addition, the Eighth Circuit's opinion in *Braden* confirms the importance of offering a broad array of investment options. Central to the Seventh Circuit's decision in *Deere* was an endorsement of plan structures that include multiple mutual funds in the base option available to participants and a portal for individual investment options. As described above, the Eighth Circuit distinguished *Braden* from *Deere* on the basis of the much more limited options available in the Wal-Mart plan. Plan sponsors may wish to review their investment options in light of *Braden* and *Deere* and offer a diversified range of options. In addition, to the extent that a 401(k) plan does not have an investment portal, plan sponsors and administrators should consider addition of such an optional investment vehicle, if practical.

1 The Second Circuit has also considered, and affirmed dismissal of, an ERISA excessive fees case, although in an unpublished decision, which carries no official precedential weight under Second Circuit rules. See *Young v. General Motors Investment Management Corp.*, No. 08-1532, 2009 U.S. App. LEXIS 9792 (2d Cir. 2009); see also "Second Circuit Holds That ERISA Duty To Diversify Applies To Plan As A Whole," Fall 2009 *Employer Update*.

2 The first excessive fee case under ERISA was filed in 2006, and the number of such cases has since proliferated. Since this type of case became popular, many lower courts have denied pre-discovery motions to dismiss. See "First Appellate Decision in ERISA Excessive Fees Case; Significant Victory for Plan Fiduciaries," Spring 2009 *Employer Update*.

3 The Court further noted that the plaintiff "could not possibly show at this stage in the litigation that the revenue sharing payments were unreasonable in proportion to the services rendered because the trust agreement between Wal-Mart and Merrill Lynch required the amounts of the payments to be kept secret."

Compensation Committee Roundtable

Weil, Gotshal & Manges, LLP and Steven Hall & Partners recently hosted a roundtable discussion on current issues in executive compensation. The principal topic was how to tie risk to compensation. Harvey Goldschmid of Weil Gotshal opened the discussion by noting the public anger at the size of executive compensation, but even more important was the disconnect in many companies between the CEO's compensation and performance. Sophisticated shareholders are willing to reward CEOs handsomely if they deliver handsome rewards to shareholders, but in all too many cases CEOs have received significant compensation without delivering an appropriate return for their shareholders.

Pearl Meyer from Steven Hall discussed the importance of defining the critical risks facing the enterprise so that compensation can be tied to those risks. She gave an example of a major airline whose CEO identified the principal risks facing his organization as safety and morale. This is different than what the CEO of a financial services organization or a technology company would highlight, and the compensation structure must therefore be organization specific.

Allan Dinkoff from Weil Gotshal noted that while there were legitimate issues around whether executive compensation had become excessive, the size of executive compensation probably had very little to do with the current crisis. In thinking about these issues, it is important to separate the amount of compensation from the structure of the compensation, since it was the structure not the size that potentially impacted behavior, although even that is debatable.

This led to a discussion of whether compensation was the best mechanism for managing risk, and whether an unintended consequence of all this would be corporate cultures that are too complacent and too risk averse. There was a consensus that irrespective of what impact compensation structures had or will have on risk-taking behavior, fundamentally risk control is a question of corporate culture, and corporate culture is one of the hardest things for a board to monitor effectively.

Howard Dicker, Holly Gregory and Andy Gaines from Weil Gotshal led a discussion of current disclosure and corporate governance issues related to compensation and risk. Boards need to focus not only on whether the right talent is in place to manage the company's risk, but also whether they have the talent in place to assess whether risks are in fact being managed appropriately. Consultants are marketing themselves as positioned to assess whether risks are being managed appropriately and whether the compensation structures created the wrong risk incentives.

Companies are required to disclose if their compensation structure creates risks that are reasonably likely to have a material adverse effect on the company, but they are not required to make an affirmative statement that no such risks were being created. This led to a discussion of whether companies would instead take the position that their compensation structure might create risks that could have a material adverse effect on the company in order to protect themselves from claims if the company experiences losses that people later attribute to the

compensation structure. Financial services is a good example of that, since it is safe to assume that no financial services firm in early 2007 would have said that its compensation structure created risks that were reasonably likely to have a material adverse effect on the company; to the contrary, they would have said that compensation systems that paid a significant percentage of executive compensation in stock that vested over three or more years did precisely the opposite. Yet, that very system is being widely held up today, with the benefit of 20/20 hindsight and much public anger, as being largely responsible for what many claim was reckless behavior.

A few other miscellaneous items of interest. Although not universal, it appeared that restricted stock was more in vogue than options, and various traditional compensation practices were no longer in favor, including gross-ups and make-wholes for compensation executive recruits were forfeiting at their current employer. There was little consensus about how long vesting periods should be, how long executives should be required to retain stock after it vested and how much stock executives should be required to hold. There was some concern expressed about whether requiring executives to hold too much stock for too long might create perverse incentives for executives to leave when good business cycles were maturing to avoid having their wealth wiped out in a down cycle, which would leave companies without key talent when it was needed the most.

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