



# ERISA Fiduciary Law Alert

## Recent Legal and Regulatory Developments Affecting Plan Assets and Financial Services

A publication of Nixon Peabody LLP

DECEMBER 13, 2011

### Fourth Circuit rules on duty to investigate and diversify investments

By John Hayes

A very recent decision by the Fourth Circuit Court of Appeals clarifies an important point with respect to the duty of ERISA trustees to investigate investment alternatives and to diversify the portfolio in which the plan funds are invested. In vacating the judgment of the United States District Court, the Fourth Circuit held that a breach of the fiduciary duty to investigate investment alternatives or breach of the duty to diversify does not necessarily mean the actual investments were imprudent. Therefore, such a finding, in and of itself, is insufficient to impose liability on the trustees.

Other circuits had previously held that where fiduciaries breach their duty to investigate, the fiduciaries can be held liable only for plan losses that actually result from the failure to investigate. *Diduck v. Kaszycki & Sons Contractors, Inc.* 974 F. 2d 270 (2nd Cir. 1992); *In re Unisys Savings Plan Litigation* 173 F.3d 145 (3d Cir. 1999); *Bussian v. RJR Nabisco Inc.*, 223 F.3d 286 (5th Cir. 2000); *Kuper v. Iovenko* 66 F. 3d 1447 (6th Cir. 1995); *Willet v. Blue Cross & Blue Shield* 953 f. 2D 1335 (11th Cir. 1992). The Fourth Circuit has now joined those other circuits in so holding.

The defendants in the case were two former trustees of a multiemployer pension plan. The Plan was a defined contribution plan subject to the provisions of ERISA. After the Plan sponsor merged with another plan, the former trustees were removed and the successor trustees and the Plan filed suit against the former trustees and the former plan administrator. The complaint alleged a number of breaches of fiduciary duty. The majority of the claims were resolved in favor of the former trustees prior to trial, but a three-day bench trial was held on the claim that the former trustees had violated their fiduciary duty under ERISA section 1104(a)(1)(B) to investigate alternative investments, and their fiduciary duty under ERISA section 1104(a)(1)(C) to diversify the investments in the portfolio.

During their lengthy tenure as trustees, the defendants had invested the Plan's assets in very conservative vehicles, principally United States treasury securities and federally-insured certificates of deposit. While the Plan gained in value during the time that the defendants were trustees, the plaintiffs claimed that the trustees did not adequately investigate investment alternatives, nor did they properly diversify the portfolio consistent with the requirements of ERISA. The plaintiffs asserted that had the portfolio been invested in a diversified portfolio made up of a 50/50 mix of the S&P

500 Index and the Barclays Capital Aggregate Bond Index, the portfolio would have performed better, an argument supported by the testimony of their expert. The plaintiffs asserted that the Plan had been damaged by the difference between the actual portfolio value and the value the hypothetical portfolio would have achieved.

The former trustees, on the other hand, argued that given certain characteristics of the Plan, including its declining and aging membership, their conservative investment approach was consistent with ERISA's mandate that the portfolio be diversified to avoid the possibility of large losses. The record did make clear, however, that the former trustees did not investigate alternative investments with any regularity.

At the conclusion of the trial, the district court held that the trustees had violated their fiduciary duties by failing to adequately investigate investment alternatives and by failing to properly diversify the investments in which the Plan assets were held. The district court awarded damages to the plaintiffs based upon what it found to be the difference between the actual Plan value at the end of a particular three-year period and the Plan value plaintiffs' expert testified would have been achieved if the Plan were invested in a diversified portfolio made up of 50% S&P index fund and 50% Barclays Capital Aggregate Bond index fund. The district court also awarded the plaintiffs attorneys' fees, relying upon the criteria articulated in *Quesinberry v. Life Ins. Co. of N. Am.*, 987 F. 2d 1017 (4th Cir. 1993).

The trustees appealed, arguing that the district court had erred in four respects: (1) by holding that a breach of the fiduciary duty to investigate, in and of itself, could support a damage award; (2) by failing to hold that under ERISA, the duty to diversify varies depending on the circumstances of the Plan; (3) by failing to hold that in order to award damages for breach of the duty to investigate, there must be a finding that the investments chosen were objectively imprudent; and (4) that the award of attorneys' fees was improper because the court did not follow the criteria set out in *Quesinberry*. In a published opinion, the Fourth Circuit agreed, vacating the judgment and remanding the case to the district court.

In doing so the Fourth Circuit made three rulings of significance in the ERISA area. First, the court held that a finding that a fiduciary breached the duty to investigate is not sufficient, in and of itself, to support a damage award. Rather, it is necessary to establish that the investments selected were objectively imprudent and, thus, caused loss. Moreover, the court held that the mere fact that the trustees did not investigate alternative investment options does not mean the selected investments were necessarily imprudent. The court's conclusion was that while failure to investigate is a breach of ERISA fiduciary duty, causation of loss is not an axiomatic conclusion that flows from such a breach.

Similarly, the Fourth Circuit held that the mere failure to diversify is insufficient, standing alone, to impose liability on trustees. To the contrary, the Fourth Circuit held that breach of the duty to diversify, like breach of the duty to investigate, does not establish as a matter of law that the actual investments were imprudent. Without a determination that the investments were objectively imprudent, no liability can attach. As the Fourth Circuit said, without a specific finding that the failure of the subsection (C) duty to diversify caused imprudent investments, the former trustees could not be held liable for losses to the Plan, if any.

Finally the Fourth Circuit clarified the relationship between its decision in *Quesinberry*, the Supreme Court's decision in *Hardt v. Reliance Standard Life Ins. Co.*, 130 S. Ct. 2149 (2010), and its recent decision in *Williams v. Metropolitan Life Insurance Co.*, 609 F. 3d 622 (4th Cir. 2010) explaining that

*Williams* requires that the analysis set forth in *Hardt* with respect to a claimant's eligibility for an award of attorneys' fees be conducted first. Thereafter, courts are to apply the general guidelines set forth in *Quesinberry*.

For more information on the content of this alert, please contact your Nixon Peabody attorney or:

- John Hayes at [jhayes@nixonpeabody.com](mailto:jhayes@nixonpeabody.com) or (202) 585-8345
- David Foster at [dfoster@nixonpeabody.com](mailto:dfoster@nixonpeabody.com) or (415) 984-8331
- Christian Hancey at [chancey@nixonpeabody.com](mailto:chancey@nixonpeabody.com) or (585) 263-1147
- Sherwin Kaplan at [skaplan@nixonpeabody.com](mailto:skaplan@nixonpeabody.com) or (202) 585-8224
- Brian Kopp at [bkopp@nixonpeabody.com](mailto:bkopp@nixonpeabody.com) or (585) 263-1395
- Thomas McCord at [tmccord@nixonpeabody.com](mailto:tmccord@nixonpeabody.com) or (617) 345-1337
- Eric Paley at [epaley@nixonpeabody.com](mailto:epaley@nixonpeabody.com) or (585) 263-1012