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In This Issue:

March 2011

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The Seventh Circuit Clarifies the Availability of Class Claims Alleging 401(k) Improprieties

By David Haase and Michael Congiu

The Seventh Circuit Court of Appeals recently issued a significant ruling on the availability of class-wide claims alleging improprieties in an employer-supported defined-contribution ("401(k)") plan. In so doing, the Seventh Circuit consolidated two cases that it described as "nearly identical" in terms of the claims made and the underlying facts – *Spano v. Boeing*, No. 09-3001, and *Beesley v. International Paper Co.*, No. 09-3018, 2011 U.S. App. LEXIS 1192 (7th Cir. Jan. 21, 2011).

Although the court left open many questions about the general propriety of class actions in this context, the *Spano/Beesley* opinion is nonetheless an illuminating piece of what continues to be a developing area of law.

Background Facts

In both lawsuits, the plaintiffs brought Employee Retirement Income Security Act (ERISA) Section 502(a)(2) claims alleging that their respective employers violated their fiduciary duties to 401(k) plan participants by: (1) causing their respective plans to have excessive fees; (2) "including imprudent investment options in the plan[;]" and (3) concealing or misrepresenting material information regarding the plans' fees, expenses or investments. The plaintiffs alleged class claims under Federal Rule of Civil Procedure 23, and the Southern District of Illinois certified classes in both cases on the same day as follows:

> All persons, *excluding the Defendants and/or other individuals who are or may be liable for the conduct described in this Complaint*, who are or were participants or beneficiaries of the Plan and who are, were or may have been affected by the conduct set forth in this Complaint, as well as those who will become participants or beneficiaries of the Plan in the future.[1]

Defendants appealed the district court's orders certifying the respective classes, arguing that the district court had incorrectly determined that the class definition met the requirements of Rule 23(c)(1)(B), and that the plaintiffs had otherwise failed to meet several other Rule 23 prerequisites. As discussed in greater detail below, and although the court left some significant legal issues unresolved, the Seventh Circuit agreed that the plaintiffs had failed to demonstrate sufficiently that they had met Rule 23's requirements and remanded the cases back to the district court.

The Court's Analysis

The court began by turning to the substantive law underlying the plaintiffs' claims – ERISA Section 502(a)(2) – and noted that the court's attention to this particular subsection was based on it being the only relevant ERISA provision that allows a plan participant to sue for a fiduciary duty breach. From that premise, the court moved on to determine whether proceeding as a class under such a theory was warranted.

The Distinction Between Defined-Benefit and 401(k) Plans

The court drew a distinction between defined-benefit plans – where employers "hold a pool of assets in trust for the plan" that is administered by trustee-fiduciaries – and 401(k) plans where employee benefits are defined by the amount of employee and employer contributions and future plan benefits are dependent, at least in part, on the success or failure of the investments for which those contributions are used.[2]

The court noted the relative ease with which ERISA's fiduciary rules apply to defined-benefit plans in contrast to 401(k) plans, where individual accounts may be affected differently by plan fiduciaries' actions. Regardless, the court acknowledged the Supreme Court's ruling in *LaRue v. DeWolf, Boberg & Assoc., Inc*.[3] that ERISA fiduciary duty claims can attach to improprieties in 401(k) plans that have an adverse impact on plan assets in individual accounts. With that in place, the court turned to whether Section 502(a)(2) actions could appropriately proceed as a class where alleged fiduciary duty breaches in a 401(k) plan are at issue.

The Propriety of ERISA Section 502(a)(2) Class Claims

The court devoted the majority of its analysis to the Spano plaintiffs[4] and began by evaluating whether those plaintiffs had adequately established the requirements of Rule 23(a). The court acknowledged that the *Spano* plaintiffs had met Rule 23(a)'s numerosity requirement as the plan had close to 200,000 participants. The court also held that the *Spano* plaintiffs met Rule 23(a)'s commonality requirement over Boeing's argument that an individual participant's plan decisions destroyed any commonality among putative class members. The plaintiffs argued that Boeing's allegedly imprudent choice of investment options, allegedly unreasonable fees, and alleged failure to describe materials plan items adequately, led to common questions of law and fact among the putative class. Determining that commonality had been established, the court agreed that these allegations would, at least in some way, affect all plan participants regardless of their individual investment choices.

Despite this critical determination, the court went on to hold that the plaintiffs had not sufficiently met Rule 23(a)'s typicality requirement – which requires that the claims and defenses of the representative parties are typical of the claims or defenses of the putative class.[5] The court reasoned that the "breathtaking" scope of the class definition proffered by the district court made it impossible to discern whether the claims of the class representatives would be typical of the putative class, as it was unclear the degree to which putative class members had investments similar to those of the class representative. Although the court refused to draw a bright line, it nonetheless instructed "that a class representative in a [401(k)] case would at minimum need to have invested in the same funds as the class members." For essentially the same reasons, the court also held that the class representatives (and not the class lawyers) were inadequate Rule 23(a)(4) representatives.

After determining that the *Spano* plaintiffs had failed to meet Rule 23(a)'s requirements, the court went on to hold that the plaintiffs had also failed to meet Rule 23(b)'s requirements. Most critically, the court held that, because of the various options available to employees under the company's plan, some participants may be harmed and others benefited by the alleged improprieties depending on their choices to include, or not include, the allegedly imprudent funds in their portfolio. The court distinguished this scenario from a recent Third Circuit Court of Appeals decision, *In re Schering Plough Corporation ERISA Litigation*[6] – where the class was limited to individuals who had invested in one specific fund – and determined that the bevy of investment options available to the *Spano* plaintiffs demonstrated that Rule 23(b)(1)(B) could not be met. The court could not determine, given the lack of clarity as to how the alleged improprieties affected particular investment choices, whether "adjudications with respect to individual class members" would be dispositive of or affect other class members' interests.[7] In connection with the proposed *Beesley* class, the court explained:

> the close-to-infinite variety of combinations in each participant's account—varying by which investment, when purchases were ordered, when money was shifted from one fund to another—make this claim singularly unattractive for class treatment.[8]

Although the court also rejected the possibility that Rule 23(b)(1)(A) would be available,[9] the court significantly left open the issue of whether the plaintiffs could proceed under other Rule 23(b) theories. In conclusion, the court noted that, although a defined-contribution plan could be held liable for the investment options it provides to its participants, it remained to be seen whether a proper class could be defined based on one or more allegedly imprudent funds and whether the existence of an imprudent fund would be sufficient to taint the whole plan for the purposes of endorsing a class action.

Looking Forward

At a minimum, the Seventh Circuit has placed important limitations on class-based treatment of these kinds of claims. However, the decision leaves many questions unanswered. It remains to be seen whether plaintiffs can narrowly define the putative class in such a way so as to surmount the Rule 23(a) defects identified by the court and the Rule 23(b)(1)(B) defect in light of the vast array of investment options available to plaintiffs.

More generally, and although the *Spano/Beesely* decision can be viewed as a victory for the defense bar, it did not foreclose the possibility of the class vehicle in this context. There is likely to be additional litigation on this issue, until the contours become more clearly defined. As just one example, the *Spano/Beesley* court's refusal to pronounce generally that the individualized harm inherent in alleged 401(k) plan breaches was inappropriate for class treatment was significant, and may not dissuade future litigation in this area.

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[1] Noting that the district court's class definition was essentially identical in both cases, the court restated only the class definition used in the *Spano* litigation. *Spano/Beesley*, 2011 U.S. App. LEXIS 1192, at *5. (emphasis in original)

[2] The court referred to *Massachusetts Mutual Life Insurance Co. v. Russell*, 473 U.S. 134, 148 (1985), to provide the contrast of how Section 502(a)(2) claims are assessed where a defined-benefit plan is at issue.

[3] 552 U.S. 248 (2008).

[4] With relatively minor exceptions, the court's analysis of the proposed *Beesley* class mirrored its analysis of the proposed Spano class. 2011 U.S. App. LEXIS 1192, at *39 ("Much of what we have said about the *Spano* class applies with equal force to the *Beesley* class.").

[5] FED. R. CIV. P. 23(a)(3).

[6] 589 F.3d 585 (3d Cir. 2009).

[7] FED. R. CIV. P. 23(b)(1)(B).

[8] 2011 U.S. App. LEXIS 1192, at *43.

[9] The court was not persuaded that class treatment would appropriately avoid a risk of incompatible standards of conduct in Boeing's 401(k) plan given the flexibility with which it could administer its plan to avoid any such problems. *Id.* at *38.