



Fourth Circuit Rules That Retirement Plan Trustees' Failures Must Have Causal Link to Plan Losses In Order to Hold Trustees Liable: *Plasterers' Local Union No 96 Pension Plan v. Pepper*, No. 10-1364 (4th Cir., December 1, 2011)

12.14.2011

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The U. S. Court of Appeals for the Fourth Circuit has ruled that retirement plan trustees cannot be held liable for failures to investigate the prudence of plan investments or to diversify those investments, unless there is a proven causal link between such fiduciary failures and losses to the retirement plan. The court's decision in *Plasterers Local Union No. 96 v. Pepper*, No. 10-1364 (4th Cir. December 1, 2011), vacated a judgment for the current trustees of the retirement plan and remanded the case for further proceedings, with clear guidance on the crucial issue of liability.

The case arose from alleged actions and inaction of the former trustees of a multiemployer defined benefit pension plan established for the benefit of members of the Plasterers Union ("the Plan"). The Plan had been formed in 1987 to succeed an earlier plan that had experienced substantial financial losses, and from its inception the Plan had a goal of avoiding such losses. In 1992 the trustees of the Plan voted to limit investments to certificates of deposit with a maximum of \$90,000. In 1995, the trustees expanded this policy to allow investment in one-year and two-year Treasury bills. From 1995 through 2005, the Plan pursued that conservative investment policy; Plan assets were invested entirely in such limited CD's and short-term T-bills.

In 2004 and 2005, those trustees ("Former Trustees") were removed from their positions, and the successor trustees ("Current Trustees") filed a complaint in federal court, asserting that the Former Trustees breached their fiduciary duties under ERISA.

While most of those claims were dismissed before trial, the district court held a three-day bench trial on the claims that the Former Trustees violated their duty of prudence under ERISA section 404 by (1) failing to investigate whether the limited investment vehicles for Plan assets and the related investment policy were prudent in relation to the Plan's funding requirements, administrative costs, and rate of return, and (2) failing to diversify the Plan assets so as to minimize the risk of large losses, thereby causing imprudent investments and plan losses. The Current Trustees contended that these fiduciary breaches caused the Plan assets to suffer losses of more than \$432,000, a dollar amount which they alleged the Plan would have earned with more prudent investments in the three years ending at the close of 2005. The district court ruled for the Current Trustees and awarded judgment for the alleged losses.

On appeal, the Fourth Circuit vacated the judgment for the plaintiffs and remanded the case to the district court for further proceedings. In setting aside the lower court's judgment, the Fourth Circuit acknowledged that the evidence supported the findings that the Former Trustees had failed to investigate the investment vehicles chosen by the Plan and other investment options in which Plan assets might have been invested, and failed to diversify those assets.

The Fourth Circuit ruled, however, that the district court failed to make the crucial determination that these fiduciary failures caused the Plan to suffer the alleged losses. The circuit court stated that "simply finding a failure to investigate or diversify does not automatically equate to causation of loss and therefore liability." The Former Trustees' failure to investigate the Plan's investment vehicles and other investment options, and their failure to diversify the investments, "did not establish as a matter of law that the actual investments were imprudent. . . . ERISA requires an independent finding of causation of loss [to the plan] before liability for breach of a fiduciary duty is incurred."

In remanding the case to the trial court for further proceedings, the Fourth Circuit was careful not to tell the lower court which conclusions to reach, but made clear the direction of the inquiry. ERISA section 404's "prudent man" standard requires fiduciaries to discharge their duties with the care, skill, prudence and diligence "under the circumstances then prevailing" that a prudent man would use "in the conduct of an enterprise of a like character and with like aims". Likewise, ERISA's duty to diversify will apply unless, in the words of the statute, "under the circumstances it is clearly prudent not to do so." The Fourth Circuit therefore required the trial court, on remand, to determine the circumstances informing the Former Trustees' decision-making, including "the unique circumstances of the Plan". Those circumstances included, but were not limited to, the Plan's size and type, the Plan members' demographics (including age), and the Plan's investment goals and objectives. It thus remains to be seen whether, given the history of the predecessor plan and the other circumstances facing them, the Former Trustees' remarkably cautious investment strategy for the Plan satisfies ERISA's standards of prudence.

The *Pepper* decision aligns the Fourth Circuit with several other federal circuit courts in emphasizing the causal link that must be shown between alleged fiduciary breaches of duty and alleged losses to ERISA plans before fiduciary liability can be established. Proof of fiduciary liability is obviously still possible, but it will require a reasoned and more in-depth inquiry into the circumstances.

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