Fourth Circuit Adopts More Demanding Test for Exercise of Objective Prudence by Retirement Plan Fiduciaries -Tatum v. RJR Pension Investment Committee

08.06.2014

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In the latest ruling in a long-running battle arising from company stock fund divestments, the U. S. Court of Appeals for the Fourth Circuit has underscored the importance of procedural prudence in the management of plan assets. In *Tatum v. RJR Pension Investment Committee et al*, No. 13-1360 (4th Cir., August 4, 2014), the Fourth Circuit declared that where fiduciaries act in a way that violates their duty of procedural prudence and the plan suffers a loss, the fiduciaries will be liable for causing the loss unless they demonstrate that a fiduciary who satisfied that duty of prudence *would have* made the same decision.

The Background. The seeds of this litigation were planted in 1999, fourteen years after R. J. Reynolds Tobacco Company ("RJR") and Nabisco had merged to form RJR Nabisco. The merged company decided to separate its food business from its tobacco business, RJR, to enable the food business to avoid the "taint" of association with the tobacco business. The company decided to achieve this through a spin-off of the tobacco business in mid-1999.

Prior to the spin-off, RJR Nabisco sponsored a 401(k) plan which offered several investment funds. These included two company stock funds, the Nabisco Common Stock Fund (holding shares of Nabisco Holdings Corporation) and the RJR Nabisco Common Stock Fund (holding shares of the company's food and tobacco businesses). After the spin-off, the RJR Nabisco Common Stock Fund was divided into two funds holding the food business stock and tobacco business stock separately. As a result, after the spin-off there were two company stock funds holding only Nabisco stock (the "Nabisco Funds"). This litigation concerns those funds.

On the date of the spin-off in June 1999, the existing RJR Nabisco 401(k) plan was amended to create the 401(k) plan at issue in this litigation ("the Plan"). The Plan document expressly provided for retaining the Nabisco Funds as "frozen" funds, which allowed participants to hold their existing investments in those funds but prevented any purchase of additional shares in those funds through the Plan. The Plan did not contain any provision for divesting the Nabisco Funds or limiting the time that the Plan could hold the "frozen" funds.

The Plan named two fiduciaries (both of which were defendants in this case): RJR's Employee Benefits

Committee, responsible for plan administration, and the RJR Pension Investment Committee, responsible for plan investment. However, a few months prior to the spin-off, a "working group" of RJR's corporate employees decided that the Plan should sell off the Nabisco Funds. The working group spent less than an hour to consider the matter, concluded that a stock fund holding only Nabisco stock posed a high risk to the Plan and entailed high administrative costs, and decided that the Nabisco Funds should be divested about six months after the spin-off. This recommendation was reported to an RJR officer who was a member of both of the fiduciary committees, but those committees neither reviewed whether to eliminate the Nabisco Funds nor decided to amend the Plan in order to allow the divestment.

After the spin-off but before the divestment of the Nabisco Funds, the value of the stock in the funds dropped sharply, in part due to class action tobacco lawsuits against RJR. Some market analysts still rated the Nabisco stock positively, particularly after the spin-off. However, RJR proceeded with the decision to divest the Nabisco Funds from the Plan, notifying the participants in October 1999, erroneously, that the law did not permit the Plan to maintain the funds. The Nabisco Funds were sold at the end of January 2000. By that date, the market price for the shares in the Nabisco Funds was well below their value prior to the spin-off.

Within months of the divestment, Nabisco stock began to rise in value, and by 2001, the shares were dramatically higher in comparison to their value at the time that the shares were divested. Plaintiff Tatum filed a class action suit against Defendants in 2002, alleging that they breached their duties as fiduciaries by eliminating the Nabisco Funds in an arbitrary fashion without conducting a thorough investigation and by forcing a sale of the Nabisco Funds at their all-time low value, despite a strong likelihood that the shares would rebound.

Following years of pre-trial motions and discovery, the U. S. district court conducted a four-week trial. Issuing its final judgment in 2013, the court concluded that all Defendants, including RJR, were fiduciaries – either by designation or in their functional control over plan management and assets – and that they had breached their duty of prudence under ERISA section 404(a) by divesting the Nabisco Funds without a proper investigation into the prudence of doing so. The court held also that the Plan suffered a loss. The court decided, however, that Defendants were not liable for causing the loss, because RJR's decision to divest the funds was objectively prudent, that is, the decision was "one which a reasonable and prudent fiduciary could have made performing such an investigation". Plaintiff appealed to the Fourth Circuit.

The Circuit Court's Ruling. The Fourth Circuit panel affirmed the district court's ruling that RJR acted as a Plan fiduciary, through its working group and others, in the management and control of the Plan's assets, and that all Defendants had breached their duty of prudence in failing to properly determine the prudence of the divestment of the Nabisco Funds. The Fourth Circuit noted that the fiduciary committees never met, discussed or voted on whether to divest the Nabisco Funds, that RJR based its decision to divest on misunderstandings of the law and of the actual administrative burden of retaining the funds, and that no defendant had engaged outside counsel or independent analysts to explore the prudence of the divestment.

However, the majority of the panel, in the face of a strongly worded dissent, held that the district court had applied the wrong standard to determine whether the fiduciaries were liable for causing the losses to the Plan. The Fourth Circuit majority held that in the face of "overwhelming evidence" of a breach of the duty of prudence and Plaintiff's prima facie showing of a resulting loss to the Plan, Defendants were required to show, by a preponderance of the evidence, that a prudent fiduciary *would have* made the same decision had the fiduciary undertaken a proper investigation. The court explained that the "could have" versus "would have" standards represented the difference between a decision that was merely possible versus one that was probable. The Fourth Circuit therefore vacated the judgment for Defendants and remanded the case to the district court for a determination of liability applying the "would have" standard.

The Significant Lessons. *Tatum*'s primary lesson is the Fourth Circuit's raising of the standard imposed on a plan fiduciary to demonstrate that a fiduciary action resulting in a plan loss was objectively prudent, and that the fiduciary was therefore not liable for causing the loss. The "would have" standard now in force in the Fourth Circuit will require a stronger demonstration to satisfy the test of procedural prudence. This signals the need for retirement plan fiduciaries within the Fourth Circuit to demonstrate their adherence to plan documents and also to carefully review and document their decisions to manage and control plan assets.

Tatum does not necessarily require the use of outside counsel or independent analysts to demonstrate that prudence, although the absence of such outside advice clearly troubled the court in *Tatum*. However, in order to show their prudent conduct, fiduciaries will be wise to weigh the need for such advice, as well as to carefully vet the key assumptions on which their own review is based, before reaching decisions that are likely to affect the value of the plan's assets or communicating those decisions to plan participants and beneficiaries.

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