GROOM LAW GROUP

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Second Circuit Affirms Dismissal of *Young, Brewer* Lawsuits Against General Motors Investment Management Corp. and State Street

On May 6, 2009, the Second Circuit Court of Appeals affirmed the dismissal of two related actions, concluding that the plaintiffs failed to state claims based on allegations that plan fiduciaries failed to diversify plan investments and invested in funds that carried excessive fees. The Second Circuit's decision is unpublished, and hence carries no official precedential value. It nonetheless underscores the strict scrutiny that courts are increasingly applying to the plaintiffs' allegations in the high-profile 401(k) fee lawsuits.

Background

The plaintiffs are participants in several defined contribution pension plans sponsored by General Motors. In filing suit against the plans' named fiduciary (General Motors Investment Management Corporation, "GMIMCo") and trustee (State Street Bank & Trust Co., "State Street"), plaintiffs alleged that the defendants breached their fiduciary duties under ERISA by investing in "single equity funds" – an investment option that principally consisted of the stock of a single publicly traded company, and by investing in certain funds that carried allegedly excessive fees relative to other products available to institutional investors.

In March 2008, the district court dismissed the lawsuit, concluding that the plaintiffs' claims were time-barred. Under Second Circuit case law, a plaintiff generally must have knowledge of all facts necessary to constitute a claim in order to have "actual knowledge" sufficient to trigger a three year statute of limitations period under ERISA. The district court ruled that, where a plaintiff's claim is based upon an inherent statutory breach of fiduciary duty, knowledge of the transaction, alone, may be enough to start the running of the limitations period.

Addressing the plaintiffs' claim for failure to diversify, the district court held that the claim was based on an inherent breach, that all of the single equity fund investments were made more than three years prior to the plaintiffs' filing suit, and that plan documents provided to the plaintiffs more than three years prior to their lawsuit accurately described the single equity funds as undiversified investments. Accordingly, the district court determined that the plaintiffs had actual knowledge of the facts upon which their claim was based outside of the statute of limitations period and the claim was time barred.

As to the plaintiffs' excessive fees claim, the court found that plan participants received prospectuses advising them of their investment options under the plans and quarterly performance summaries clearly disclosing investment fees and expenses more than three years before they filed their lawsuits. As such, it similarly ruled that this claim was barred by the statute of limitations.

<u>The Second Circuit's Ruling</u>

In its May 6 decision, the Second Circuit did not address the district court's statute of limitations ruling, but rather affirmed the dismissal on alternative grounds not addressed by the district court. Specifically, the appellate court analyzed the specific allegations in the plaintiffs' complaints and found that the plaintiffs failed to state cognizable claims for relief.

As to the plaintiffs' claim related to the single equity funds, the court noted that the duty to diversify under ERISA § 404(a)(1)(C) applies across the plan investments as a whole, not within plan investment options. The plaintiffs only alleged that a few individual investment options within the plans were undiversified and made no allegations that the plans, on whole, were not diversified. As such, the court concluded that the plaintiffs' claim should be dismissed.

With respect to the plaintiffs' excessive fees claim, the court noted that ERISA § 404(a) does not specifically address when fees are excessive. However, the court looked for guidance to potentially analogous case law interpreting the Investment Company Act. The Second Circuit case law provides that to establish an excessive fees claim under the Investment Company Act, an investment adviser must charge a fee that is so disproportionately large that it bears no reasonable relationship to the services rendered and could not have been the product of arm's length-bargaining. Looking at the plaintiffs' complaint, the court noted that the plaintiffs failed to allege that the fees were excessive relative to the services rendered and otherwise failed to allege facts relevant to the determination of whether the fees were excessive.

<u>Impressions</u>

In looking to the Investment Company Act, the Second Circuit opens the door to alternative grounds for defendants to explore in the pending ERISA fee cases. We note that the Supreme Court likely will be addressing the excessive fee standard under the Investment Company Act in a case in which it recently granted certiorari, *Jones v. Harris Associates,* Case No. 08-586 (*cert. granted* March 9. 2009).

And, in connection with the single equity fund claim, the Second Circuit's opinion makes some interesting points about a fiduciary's duty to diversify that may be helpful in other contexts, such as the stock drop cases. The Court's emphasis on the diversification of a plan as a whole, rather than on individual investments within the plan, is particularly helpful for fiduciaries.

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There are a number of other 401(k) fee cases against plan service providers in which dispositive motions are pending or are currently being briefed. Groom Law Group continues to monitor developments in this area. As decisions are issued, we will be preparing similar summaries and updating the 401(k) fee litigation materials on our website http://www.groom.com/401k_fee_litigation.html

Please contact one of the following Groom attorneys if you have any questions.

Mike Prame	mjp@groom.com	(202) 861-6633
Chris Rillo	cjr@groom.com	(202) 861-5418
Jason Lee	jhl@groom.com	(202) 861-6649
Alex Ryan	apr@groom.com	(202) 861-6639