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Peters & Nye Win Trial for Client in Insurance Coverage and Bad Faith Case filed by Bankruptcy Trustees

Represented by Peters & Nye, LLP, the Cincinnati Insurance Company secured a judgment in the trial of an insurance coverage and bad faith lawsuit filed against it by two bankruptcy trustees. The U.S. Bankruptcy Court in Montana held that a Proof of Claim filed by the Trustee of Yellowstone Club World in the bankruptcy estate of Edra Blixseth, the former owner and manager of Yellowstone Club World, is not covered under Cincinnati's Directors and Officers Liability Insurance Policy because (1) the insured did not comply with the Policy's notice clause; (2) the claim was not made during the policy period; and (3) Ms. Blixseth did not act in her capacity as a director or officer of an insured entity. Judgment for Cincinnati was entered on March 12, 2012 following a three day trial conducted by Peters & Nye partner, Nancy Tordai. The Court's forty-nine page opinion is reported at *Richard Samson and Ross Richardson v. Cincinnati Insurance Company*, 2012 WL 845472, 2012 Bankr. LEXIS 1029 (Bkrtcy.D.Mont. March 12, 2012).

Edra Blixseth and her former spouse, Timothy Blixseth, were the founders of a complicated web of corporations, real estate holdings and operating companies, which included Yellowstone Mountain Club and Yellowstone Development, through which they created an ultra-exclusive, members only master-planned development that was touted as the world's only private ski and golf community. Cincinnati had issued a claims made Directors and Officers liability policy to Yellowstone Mountain Club for the January 31, 2008 to January 31, 2009 policy period. Timothy Blixseth also owned a third entity, Yellowstone Club World, which was not an insured under the Cincinnati Policy. Yellowstone Club World was formed to provide its members with access to worldwide luxury properties.

Edra Blixseth assumed control over Yellowstone Mountain Club, Yellowstone Development and Yellowstone Club World in August 2008 following her divorce from Tim Blixseth. Yellowstone Mountain Club and Yellowstone Development filed Chapter 11 bankruptcy petitions in November 2008. An involuntary Chapter 7 bankruptcy petition was filed against Yellowstone Club World on January 25, 2009, and Ross

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Richardson, one of the Plaintiffs in the coverage litigation, was appointed bankruptcy trustee of Yellowstone Club World on February 18, 2009. Edra Blixseth filed a bankruptcy petition on March 26, 2009, and the other Plaintiff in the coverage litigation, Richard Samson, was appointed the Chapter 7 Trustee of Edra's bankruptcy estate.

On January 30, 2009, the day before the Cincinnati Policy expired, counsel for the Insured, Yellowstone Mountain Club, provided Cincinnati with a notice of "wrongful acts" that might give rise to a "claim" against Policy insureds. The correspondence identified the "wrongful acts" as "transfers of assets to persons and/or entities outside Yellowstone without proper authorization or in violation of applicable law" that could result in injury and damage to Yellowstone Mountain Club's creditors.

After the Policy had expired, counsel for Yellowstone Mountain Club gave Cincinnati notice of the *Snow v. Blixseth, et al.* adversary proceeding which was filed against Tim and Edra Blixseth. The *Snow* lawsuit was based on the "wrongful acts" identified in January 30 notice letter, and Cincinnati agreed to defend Tim and Edra Blixseth subject to a reservation of rights. Edra Blixseth and her counsel did not respond to Cincinnati's multiple offers to defend the *Snow* litigation.

Counsel for Tim Blixseth notified Cincinnati of a second adversary proceeding that was filed after the Policy expired against Tim Blixseth by the Committee of Unsecured Creditors of Yellowstone Mountain Club. This lawsuit was also based on the "wrongful acts" identified in the January 30 notice letter, and Cincinnati agreed to defend Tim Blixseth against the Unsecured Creditors' litigation subject to a reservation of rights.

In November 2009 Cincinnati obtained relief from the Yellowstone Mountain Club bankruptcy stay to defend and advance defense costs for Mr. Blixseth's defense of the *Snow* and Unsecured Creditors litigation. While Ms. Blixseth, Mr. Samson and Mr. Richardson were all served with Cincinnati's motion for stay relief, which advised them that Policy limits would be reduced through the payment of Tim Blixseth's defense costs, none of them objected to the motion.

Cincinnati proceeded to expend Policy limits defending Tim Blixseth against the *Snow* and the Unsecured Creditors litigation. The $5 million limit of liability was exhausted by November 2010. Pursuant to the Policy, upon exhaustion, Cincinnati no longer had any obligation under the Policy.
In February 2010, Cincinnati received a letter from counsel for the Yellowstone Club World Trustee, Ross Richardson. The letter, which the Court found was seeking to assert an outright claim under the Policy, requested that Cincinnati pay a Proof of Claim that had been filed by Yellowstone Club World in Edra Blixseth's bankruptcy case. In response, Cincinnati advised that it would not respond to the items and issues raised in the letter, as Richardson and Yellowstone Club World were not "insureds" under the Policy issued to Yellowstone Mountain Club, and invited them to contact Cincinnati with any questions. The Yellowstone Club World Trustee made no further effort to contact Cincinnati. As the Court found, at no time did the Trustee for Edra Blixseth's estate, the purported Insured under the Policy, demand that Cincinnati defend the Proof of Claim or communicate with Cincinnati regarding the Proof of Claim.

In January 2011, Edra's Trustee, Samson, and the Yellowstone Club World Trustee, Richardson, stipulated to a $9,699,455 judgment for the Proof of Claim, and agreed that the judgment would be collected from only Cincinnati. The Trustees then filed suit against Cincinnati. They alleged that Cincinnati was liable under Montana law for the $9.6 million judgment because it breached its duty to defend that part of the Proof of Claim that charged Edra Blixseth with the failure to record Yellowstone Club World's options and rights of use in certain properties. The complaint against Cincinnati also alleged violations of the Montana Unfair Trade Practices Act, bad faith, and violation of the automatic stay of Edra Blixseth's bankruptcy case.

As a condition precedent to coverage, the Cincinnati Policy required that the Insured give Cincinnati written notice of "claims". The Trustees argued that the February 2010 letter from third party claimant, the Yellowstone Club World Trustee, triggered Cincinnati's obligation to defend the Proof of Claim, despite the Insured's failure to tender the defense of the Proof of Claim to Cincinnati. The Montana Bankruptcy Court agreed with Cincinnati that the Insured's failure to comply with the notice clause barred the Trustees' claims. The Court found the Cincinnati Policy to be very clear that the "policy insureds" must give written notice of any "claim" as a condition precedent to coverage. The Court held that the language of the Policy is explicit and should be enforced as written. The Court rejected the Plaintiffs' argument that the third-party claimant could satisfy the notice provision and that Policy terms are irrelevant when "actual notice" is given by a third party claimant. Because the Insured failed to satisfy this condition precedent to coverage, the Court held that Cincinnati had no obligation to defend the Proof of Claim, and that Cincinnati properly responded to the Yellowstone Club World Trustee's letter.

The Bankruptcy Court ruled that the Trustees' failure to have a "policy insured" provide notice of the Proof of Claim was not the only flaw in their case. The Court also held that the Proof of Claim was not timely. The Policy required that claims be made during the January 31, 2008 to January 31, 2009 Policy Period, and the Proof of Claim was filed on July

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29, 2009 after the Policy had expired.

The Policy also contained an automatic 60 day Extended Reporting Period, which potentially extended coverage for claims made and reported in writing prior to April 1, 2009. The Bankruptcy Court rejected the Plaintiffs' novel argument that Section 108(b) of the Bankruptcy Code extended the Policy Period and the Extended Reporting Period for Yellowstone Club World to make a claim against an insured. The Court explained that Section 108(b) offered no relief to Yellowstone Club World because it was not an insured under the Policy, and the Policy fixed the time within which only a "Policy Insured" could take certain action. The Court also held that Section 108(b) was not relevant because Edra Blixseth and her Trustee, Samson, did not tender the Proof of Claim to Cincinnati.

The Plaintiffs also argued that the Proof of Claim filed against Edra Blixseth should be deemed made during the Extended Reporting Period because it related to a proof of claim that Yellowstone Club World had filed against Yellowstone Mountain Club during the Extended Reporting Period. The Court rejected this argument. The Court found that the Proof of Claim against Edra Blixseth could not be deemed made during the Extended Reporting Period because the proof of claim against Yellowstone Mountain Club upon which the Plaintiffs' argument relied was not reported to Cincinnati prior to the expiration of the Extended Reporting Period and it was never tendered to Cincinnati by Yellowstone Mountain Club.

The Bankruptcy Court also held that Cincinnati had no duty to defend the Proof of Claim against Edra Blixseth because it is not a "claim" that could be deemed to have been made during the Policy Period. The Trustees argued that the Proof of Claim could be deemed made during the Policy Period because it arose out of the wrongful acts identified in the January 30, 2009 notice letter. The Court disagreed, finding that the notice letter identified "unauthorized transfers" of Yellowstone Mountain Club property, while the conduct complained of in the Proof of Claim involved the failure to do something, such as the failure to adequately document and protect Yellowstone Club World's property, and the claims asserted against Edra Blixseth did not involve the unauthorized transfers referenced in the notice letter.

The Bankruptcy Court also held that the Plaintiffs' own argument was fatal to their claim that Cincinnati had a duty to defend. The Court stated that the Plaintiffs went to "great lengths" at trial to prove that Cincinnati had a duty to defend. However, the Court held that Cincinnati tried three times to tender a defense to Edra Blixseth for the *Snow* litigation, without success, and the Court found it reasonable for Cincinnati to reject Yellowstone Club World's attempt to tender the claim when Ms. Blixseth made it clear that she did not want Cincinnati to defend her through her failure to respond to Cincinnati's multiple tender attempts.

Under the Policy, a "claim" must be for a "wrongful act", which was defined as acts by the directors and officers in the discharge of duties solely in their capacity as a director or officer of the insured company. The Court found that the Proof of Claim complained of Edra Blixseth's failure to fulfill her fiduciary obligations to Yellowstone Club World. As the Court stated, the Plaintiffs conceded that Yellowstone Club World is not a named insured and Edra's failure to act on behalf of Yellowstone Club World is not a matter for which coverage is available under the Policy.

For all these same reasons, the Bankruptcy Court held that the claims for violation of the Montana Unfair Trade Practices Act and for breach of the duty of good faith and fair dealing failed.

Last, the Bankruptcy Court rejected the Plaintiffs' argument that Cincinnati violated the automatic bankruptcy stay in Ms. Blixseth's bankruptcy proceeding by paying out Policy proceeds to defend the claims against Mr. Blixseth. The Bankruptcy Court determined that the Plaintiffs' contentions at trial led it to believe that the Plaintiffs were arguing that the proceeds, not the Policy, were the property of Ms. Blixseth's bankruptcy estate, and, even if the proceeds were estate property, Yellowstone Club World sought untimely relief from the stay after the Policy limits had been exhausted and it had settled its claim against Edra's bankruptcy estate. The Court also held that there were no competing claims against the Policy because the Plaintiffs did not show that Edra Blixseth had a covered claim that she could assert against the Policy. Thus, the Court found that Cincinnati did not violate the automatic stay of Edra's bankruptcy case when it defended Mr. Blixseth and exhausted the Policy limits after seeking and obtaining relief from the automatic stay in the Yellowstone Mountain Club bankruptcy case.

Based upon these findings and conclusions, the Bankruptcy Court entered Judgment in favor of Cincinnati and against the Plaintiffs and dismissed the Plaintiffs' Complaint with prejudice.

3rd Circuit joins 5th and 8th Circuits in Finding Supervisor Individually Liable Under the Family and Medical Leave Act Rejecting 6th and 11th Circuit Divisions

- *Haybarger v. Lawrence County Adult Prob. & Parole*, 667 F.3d 408 (3d. Cir. Pa. 2012)

For the first time, the United States Third Circuit Court of Appeals held that a supervisor in a public agency or a private employer may be subject to individual liability under the Family and Medical Leave Act ("FMLA"). The issue was presented to the Third Circuit Court of Appeals after Debra Haybarger sued her former employer, Lawrence County Probation, and her former supervisor, William Mancino, for violation of the American with Disabilities Act ("ADA") and the FMLA, among other claims. Haybarger sued Mancino in both his official and individual capacities. On March 14, 2007, the Pennsylvania District Court dismissed many of Haybarger's claims against Lawrence County and Mancino. As to Haybarger's FMLA claim against Mancino in his individual capacity, the District Court held that a supervisor can be found individually liable under the FMLA if the supervisor constitutes an "employer" as defined by the FMLA. The District Court, however, did not find that Haybarger presented sufficient evidence to show that Mancino was her "employer" and personally liable under the FMLA.

Haybarger appealed the District Court's ruling, arguing that there is a genuine issue of material fact as to whether Mancino was Haybarger's "employer". While the issue presented to the Court of Appeals was narrow, the Third Circuit first addressed whether supervisors at public agencies are subject to liability under the FMLA. In doing so, the Third Circuit relied upon the plain language of the FMLA defining "employer" to mean, in relevant part, "any person who acts, directly or indirectly, in the interest of an employer to any of the employees of such employer…" The Court held that this definition of "employer" clearly contemplates that FMLA violations may be imposed against individuals. According to the Third Circuit, ignoring this definition of "employer" would render the definition meaningless.

For additional support, the Court of Appeals concluded that the Department of Labor permits individual liability for violations of the FMLA because the Fair Labor Standards Act ("FLSA"), which similarly defines "employer", expressly holds that officers, managers and supervisors acting in the interest of employers can be held individually liable. In its decision, the Third Circuit did not distinguish between public and private employers in applying the FMLA to individuals.

The Third Circuit's decision is consistent with both the Fifth and Eighth Circuits, both of which have already held that individual supervisors of public agencies can be held liable for violation of the FMLA. While the Fifth and Eighth Circuits have permitted individual liability for supervisors, the Sixth and Eleventh Circuits have not. In rejecting individual liability under the FMLA, the Sixth Circuit has held that the FMLA is distinguishable from the FLSA and Congress did not likely intend to create the same definition of "employer" under the FMLA and the FLSA. The Eleventh Circuit has held that a public official sued in an individual capacity is not liable under the FMLA because an individual lacks sufficient control over an employee's employment.

Ultimately, the Third Circuit agreed with the Fifth Circuit and held that the FMLA is similar to the FLSA. The Third Circuit agreed that Congress intended the FLSA and FMLA to be treated similarly, thus permitting individual liability against supervisors.

After concluding that individual liability is permissible under the FMLA, the Third Circuit analyzed Mancino's control over Haybarger and held that there is a material fact in dispute as to whether Mancino had sufficient control over Haybarger's employment. Among other things, the Third Circuit considered Mancino's control over Haybarger's work situation, the decision to terminate Haybarger, and Mancino's substantial authority over Haybarger in determining that a reasonable juror could find that Mancino qualified as Haybarger's employer under the FMLA. In finding so, the Third Circuit vacated the District Court's dismissal of Hayberger's FMLA claims and remanded the case for further proceedings.

Gross Negligence Liability Standard in Georgia for Director and Officer Liability

- *FDIC as Receiver for Integrity Bank v. Steven Skow et al.*, No. 1:11-CV-0111-SCJ (N.D. Ga. Feb. 27, 2012)

On February 27, 2012, the District Court for the Northern District of Georgia ruled that the appropriate standard in Georgia for liability of bank directors and officers is gross negligence. The *Skow* Complaint was filed by the FDIC, in its capacity as Receiver for Integrity Bank, against eight former directors and officers of the failed Bank for negligence, gross negligence, and breach of fiduciary duty in connection with their alleged failure to perform their duties by pursuing unsustainable rapid growth.

On March 25, 2011, the defendants filed several motions including, but not limited, to a Motion to Dismiss and a Motion for Judgment on the Pleadings. The Motion to Dismiss and Motion for Judgment on the Pleadings similarly argued that: (1) the Bank's Articles of Incorporation exculpate the defendants from liability for all actions or omissions alleged in the *Skow* Complaint; and (2) the FDIC's allegations in support of its claims for ordinary negligence and breach of fiduciary duty are insufficient to rebut the presumption of good faith under Georgia's Business Judgment Rule.

In rendering its decision, the District Court first held that, although the defendants' arguments are based upon affirmative defenses, and the existence of affirmative defenses generally do not support a motion to dismiss, a complaint may nevertheless be dismissed under Rule 12(b)(6) when the complaint's own allegations clearly indicate the existence of an affirmative defense.

With respect to the defendants' first argument that the Bank's Articles of Incorporation exculpate the directors and officers from liability, the District Court held that the FDIC's claims are governed by both federal law under the federal Financial Institutions Reform, Recovery and Enforcement Act ("FIRREA") and by Georgia state law, which permits a bank to eliminate the personal liability of its directors to shareholder of the bank through its Articles of Incorporation.

The District Court held that FIRREA defers to state law to define "gross negligence" and FIRREA does not preempt state laws with lesser liability standards than gross negligence. In applying Georgia law, the District Court held that while the Bank's Articles exculpate directors for personal liability to the Bank or its shareholders, the law has no applicability to the *Skow* Complaint because the exculpatory provision could not be applied to bar claims by the FDIC as Receiver for the Bank. The District Court therefore denied the defendants' Motion to Dismiss and Motion for Judgment on the Pleadings based upon the exculpatory clause of the Bank's Articles of Incorporation.

The District Court next turned to the defendants' argument that Georgia's Business Judgment Rule applies to bar an ordinary negligence claim by the FDIC. Georgia statute provides pursuant to O.C.G.A. §7-1-490 that "[d]irectors and officers of a bank or trust company shall discharge the duties of their respective positions in good faith and with that diligence, care, and skill which ordinarily prudent men would exercise under similar circumstances under like positions." The statute further provides that "[a] director or officer who so performs his duties [essentially in good faith] shall have no liability by reason of being or having been a director or officer of the bank or trust company." After applying Georgia statute and applicable Georgia case law, the District Court agreed with the defendants that directors and officers are protected from liability for ordinary negligence. In support of its ruling, the District Court cited a 2009 Georgia Court of Appeals case styled *Brock Built, LLC v. Blake*, 300 Ga. App. 816, 821-822, which held that the purpose of the Business Judgment Rule is to afford an officer the presumption that he or she acted in good faith and absolve the officer of personal liability absent proof that he or she engaged in fraud, bad faith, or abuse of discretion. The *Brock* Court held that "allegations amounting to mere negligence, carelessness, or 'lackadaisical performance' are insufficient as a matter of law."

In *Skow*, the District Court observed that the Business Judgment Rule has been raised as an affirmative defense and a complaint is subject to dismissal under Rule 12(b)(6) when its allegations, on their face, show that the affirmative defense bars recovery on the claim. The District Court ruled that the allegations of the Complaint do, in fact, show the existence of the Business Judgment Rule affirmative defense. Thus, the District Court held that the FDIC's claims for negligence and breach of fiduciary duty based upon negligence fail to state a claim upon which relief can be granted. The District Court ruled that the only claims that can be sustained by the FDIC are for gross negligence and breach of fiduciary duty based upon gross negligence, as both fall outside the protection of the Business Judgment Rule.

This summary only addresses the District Court's decision as to Georgia's liability standard for directors and officers. It should be noted, however, that there are several other key holdings by the District Court with respect to the FDIC's Motion to Strike the directors' and officers' damages and causation defenses. The District Court denied the FDIC's Motions to Strike and held that the directors' and officers' may be able to rely on the FDIC's pre-Receivership conduct to rebut causation. The District Court also held that the directors' and officers' failure to mitigate, estoppel, and reliance defenses are valid to the extent that they are based upon post-Receivership conduct by the FDIC in its capacity as Receiver for the Bank.

Breaking From Other Circuits, the Sixth Circuit Holds the *Moench* Presumption Does Not Apply at the Motion To Dismiss Stage

The Employee Retirement Income Security Act ("ERISA") is designed to protect the interests of employees and their beneficiaries who participate in employer sponsored retirement plans such as 401(k) plans. A specific type of retirement savings plan also governed by ERISA allows participants to invest in the stock of the company where they work. These types of plans are known as Employee Stock Ownership Plans ("ESOPs"). ESOPs, like other employer sponsored plans, are run and administered by plan fiduciaries whose duties and obligations are governed by ERISA. One of the more significant decisions made by plan fiduciaries is designating and monitoring which investment options should be included in a given plan. Plan fiduciaries are being sued with increasing frequency by plan participants when investment choices offered by the plan perform poorly.

The volatility of the stock market since the crash in the credit and housing markets have led to a growing trend wherein ESOP participants sue their Plan fiduciaries for alleged ERISA violations. Plaintiffs in these cases often complain that it was imprudent for the plan fiduciaries to include company stock as an investment option when the company was having significant problems causing a dramatic decrease in the value of the company stock. These types of lawsuits are commonly referred to as "ERISA stock drop" cases. The primary issue in these cases is whether it was prudent for the plan fiduciaries to permit plan participants to invest in company stock and whether the plan should have divested the company stock.

Courts have codified three broad components that plan fiduciaries must adhere to in order to fulfill their ERISA-based fiduciary duties. First, a plan fiduciary owes a duty of loyalty to the Plan. To satisfy this duty all decisions regarding an ERISA plan must be made with the intent of doing what is in the best interests of the plan participants and beneficiaries. Second, ERISA imposes an unwavering duty upon plan fiduciaries to act how a prudent person would act in a similar situation and with a single-minded devotion to the plan's participants and their beneficiaries. Third, ERISA fiduciaries must act for the exclusive purpose of providing benefits to plan participants and their beneficiaries. *See, Kuper v. Iovenko*, 66 F.3d 1447 (6th Cir. 1995). To satisfy these three broad components, plan fiduciaries generally must offer diverse investment options with the goal of minimizing large investment losses.

With respect to ESOPs, Courts recognize that investment in company stock will necessarily involve a greater degree of risk since the investment in company stock will have minimal (or no) diversification. Nevertheless, Courts have generally held that fiduciaries for plans that permit or require investment in company stock will not be held liable for failing to diversify that investment options regardless of whether diversification would be prudent under an ordinary non-ESOP plan. Courts recognize that the purpose of an ESOP is to promote a policy of employee ownership of a company. As such, the prudence requirement of diversification is modified for ESOP plans. *See, e.g. Kuper,* 66 F.3d 1447. Accordingly, the majority of Courts follow a rule of law which generally holds that a plan fiduciary is presumed to act with prudence when including company stock as an investment option. *See, Moench v. Robertson*, 62 F.3d 553 (3d Cir. 1995). This is commonly referred to as the *Moench* presumption of prudence. The *Moench* presumption of prudence can be rebutted if the plaintiffs establish that: (1) there was a precipitous decline in the price of the company stock; and (2) the plan fiduciaries had knowledge of its impending collapse. *See, Kirschbaum v. Reliant Energy, Inc.*, 526 F.3d 243, (5th Cir. 2008).

There is now a split amongst the circuits concerning whether the *Moench* presumption of prudence applies at the Motion to Dismiss Stage. The Second Circuit (*In Re Citigroup ERISA Litig*, 662 F.3d 128 (2d Cir. 2011)) and the Third Circuit (*Edgar v. Avaya*, 503 F.3d 340 (3d. Cir 2007)) have held that the *Moench* presumption of prudence applies at the pleadings stage. In other words, Courts in the Second and Third Circuits will grant a defendant's Motion to Dismiss unless the plaintiffs have plead facts that sufficiently demonstrate that they will be able to rebut the *Moench* presumption of prudence. The Fifth Circuit (*Kirschbaum v. Reliant Energy, Inc.*, 526 F.3d 243, (5th Cir. 2008)) and Ninth Circuit (*Quan v. Computer Sciences Corp.*, 623 F.3d 870 (9th Cir. 2010)) have formally adopted the *Moench* presumption of prudence but have not addressed whether plaintiffs must plead sufficient facts to rebut the presumption of prudence in order to survive a Motion to Dismiss.

On February 22, 2012 the Sixth Circuit Court of Appeals issued an opinion that addressed whether the Sixth Circuit would apply the *Moench* presumption of prudence at the Motion to Dismiss Stage in a case captioned *Raymond M. Pfeil, et al v. State Street Bank and Trust Company* (Case No. 10-2302). In *Pfeil*, the Sixth Circuit held that the *Moench* presumption of prudence would not be applied at the Motion to Dismiss stage. Rather, in the Sixth Circuit, "a complaint must plead facts to plausibly allege that a fiduciary has breached its duty to the plan, the pleadings need not overcome the presumption of reasonableness in order to survive a motion to dismiss."

At issue in *Pfeil* is a 401(k) Plan that General Motors offered to its employees. The 401(k) Plan had numerous investment options, including the option to invest in a GM common stock fund. The complaint alleged that between $1.45 and $1.9 billion was invested in the GM common stock fund. The Plan's participants brought suit against the plans'

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fiduciary, State Street Bank and Trust, asserting violations of ERISA for failure to divest the GM plans of company stock.

State Street became fiduciary for the GM plans on June 30, 2006. The plaintiffs allege that GM was already having severe financial problems at that time. On July 15, 2008 GM's CEO announced that GM needed restructuring to combat significant second quarter losses. The restructuring plan included the elimination of shareholder dividends, a reduction in GM's workforce and curtailing truck and large vehicle production. On August 1, 2008 GM announced $15.5 billion in third quarter net losses. On November 7, 2008 GM announced that it would exhaust cash reserves by mid-2009. On November 10, 2008 a Form 10-Q for third quarter 2008 was filed disclosing that GM's auditors had "substantial doubt" regarding the company's "ability to continue as a going concern." On November 21, 2008 State Street informed plan participants that it was suspending further purchases of shares in the GM Common Stock Fund. State Street decided to sell the plans' holding in the GM Common Stock Fund on March 31, 2009. The sell-off was completed on April 24, 2009. GM filed for bankruptcy on June 1, 2009.

The *Pfeil* plaintiffs filed suit on June 9, 2009 alleging that State Street breached its fiduciary duties under ERISA complaining that State Street should have recognized by July 15, 2008 that GM was bound for bankruptcy and was no longer a prudent investment. The GM plans provide that State Street would divest the plan's holdings in the GM Common Stock Fund when:

> In its discretion, using an abuse of discretion standard, determines from reliable public information that (A) there is a serious question concerning [General Motors'] short-term viability as a going concern without resort to bankruptcy proceedings; or (B) there is no possibility in the short-term of recouping any substantial proceeds from the sale of stock in bankruptcy proceedings.

State Street filed a Motion to Dismiss arguing that the plaintiffs failed to state a claim, arguing that the plaintiffs failed to plead sufficient facts to rebut the *Moench* presumption of prudence. The United States District Court for the Eastern District of Michigan granted the Motion to Dismiss. The District Court's order granting dismissal emphasized that the plan participants had a large menu of investment options from which to choose and that participants retained full control over the allocation of assets in their accounts at all times. The District Court reasoned that because the participants could have elected at any time to move funds from the General Motors Common Stock Fund to one of the other investment options offered in the plans, that State Street could not be liable for the losses to the plans.

The Sixth Circuit reversed the dismissal holding that the *Moench* presumption of prudence is an evidentiary presumption, not a pleading requirement. The Sixth Circuit further held that plan fiduciaries cannot insulate themselves from breach of ERISA fiduciary duty claims by merely including a large menu of investment options for plan participants. The *Pfeil* Court's discussion on this point includes the following:

> We hold that as a fiduciary, State Street was obligated to exercise prudence when designating and monitoring the menu of different investment options that would be offered to plan participants. *See Howell v. Motorola, Inc.*, 633 F.3d 552, 567 (7th Cir.), *cert. denied sub nom. Lingis v. Dorazil*, 132 S. Ct. 96 (2011); *DiFelice v. U.S. Airways, Inc.*, 497 F.3d 410, 418 n.3 (4th Cir. 2007); *Langbecker v. Elec. Data. Sys. Corp.*, 476 F.3d 299, 312 (5th Cir. 2007). As the Seventh Circuit explained, "[t]he choice of which investments will be presented in the menu that the plan sponsor adopts is not within the participant's power. It is instead a core decision relating to the administration of the plan and the benefits that will be offered to participants." *Howell*, 633 F.3d at 567. Therefore, "[i]t is . . . the fiduciary's responsibility . . . to screen investment alternatives and to ensure that imprudent options are not offered to plan participants." *Id.*; *see also Hecker v. Deere & Co.*, 569 F.3d 708, 711 (7th Cir. 2009) (rejecting the notion that a fiduciary "can insulate itself from liability by the simple expedient of including a very large number of investment alternatives in its portfolio and then shifting to the participants the responsibility for choosing among them).

Thus, under the current state of the law, the applicability of the *Moench* presumption of prudence applies differently in the Sixth Circuit than it does in the Second and Third Circuits. It will be interesting to see if the other Circuits follow the Sixth Circuit or the Second and Third Circuits on this issue and whether the Supreme Court will choose to weigh in on this area of the law.

Firm News

Peters & Nye LLP is happy to announce that **David Rock** has recently joined the firm as an associate. David's practice will focus on professional liability insurance coverage and defense, including directors and officers liability and errors and omissions liability. David is a graduate of the University of Illinois College of Law, *cum laude*, and was admitted to the practice of law in the State of Illinois in November 2011. While at the University of Illinois College of Law, David represented the University of Illinois College of Law in the Chicago Bar Association Moot Court competition and received a CALI award in Legal Research. David can be contacted at DavidRock@petersnye.com.

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