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Proving Loss Causation When Pension Plan Investment Results Disappoint

The First Circuit Shifts The Burden To The Mutual Fund Company and Evens The Circuit Split

Although philosophers view burden shifting as a logical fallacy, courts have long been willing, under certain circumstances, to shift the burden to the accused to prove it did nothing wrong. In what is now an even split among the majority of circuits, the U.S. Court of Appeals for the First Circuit held in *Brotherston v. Putnam Investments, LLC*[1] that once a plaintiff has proven a loss following breach of fiduciary duty under the Employee Retirement Income Security Act ("ERISA"), the burden shifts to the fiduciary to prove that the loss was not caused by breach—in other words, that "a loss would have occurred even had the fiduciary acted prudently."[2]

BACKGROUND

ERISA class actions challenging the prudence of retirement plan investments have been on the rise in recent years, with more and more cases surviving motions to dismiss. In particular, there has been a surge in cases against universities challenging the fees and performance of investment options in their retirement plans[3] and against financial service providers who offered "affiliated" funds to their own employees.[4] Of the dozens such lawsuits filed in recent years, an increasing number have proceeded beyond the pleading stage. The result is that more and more ERISA breach of fiduciary duty cases are decided on summary judgment or following trial—and practical considerations, like burdens of proof, have come into sharper focus.

Brotherston is a ready example of this trend. In *Brotherston*, participants in Putnam's 401(k) plan alleged that plan fiduciaries breached their duties of prudence and loyalty by offering only affiliated investment options and failing to consider other non-affiliated options.[5] In particular, plaintiffs alleged that the fiduciaries responsible for selecting, monitoring, and removing plan investments blindly followed the governing plan document's instruction to automatically offer any Putnam mutual fund that was generally available to other retirement plans.[6] And, for most of the class period in *Brotherston*, Putnam's 401(k) plan offered only affiliated funds.[7]

After plaintiffs presented their case during a seven-day bench trial, the U.S. District Court for the District of Massachusetts entered judgment on partial findings in favor of defendants under Federal Rule of Civil Procedure 52(c).[8] The district court found that the defendants did not investigate the affiliated funds before including them in the plan, did not monitor them once in the plan, and did not remove a single fund from the plan lineup for underperformance, not even when funds had received "fail" ratings from another Putnam affiliate.[9] Despite this, the court held that the prudence claim still failed because plaintiffs had not shown any loss *resulting from* a breach, as the text of ERISA requires.[10] Rather, the district court found that plaintiffs' claims depended on a "procedural breach" theory in which the resulting choices of an imprudent process were imprudent *per se*. The district court rejected this theory, finding that it would be an "unwarranted expansion of ERISA's seemingly narrow focus on actual losses to a plan resulting from specific incidents of fiduciary breach."[11] As the district court noted, "a person could lack an independent process to monitor his investments and still end up with prudent investments, even if it was the result of sheer luck."[12]

THE FIRST CIRCUIT'S OPINION

The First Circuit vacated the district court's judgment in part and remanded for further proceedings. After accepting the district court's findings with respect to the lack of an independent selection and monitoring process, the First Circuit determined that the court's findings with respect to loss and causation were erroneous. While noting that the district court had "correctly observed that such a breach does not mean that the Plan necessarily suffered any loss," the First Circuit found that "[b]y allowing its analysis on loss to be driven by its concern regarding the objective prudence of the Putnam funds, the district court in essence required plaintiffs to show causation as part of its case on loss."[13] The First Circuit, instead, analyzed loss and causation separately, finding that the district court should have considered the analysis of plaintiffs' expert comparing the total returns of the affiliated funds with those of so-called comparator index funds to determine whether the plaintiffs made a sufficient showing of losses to the plan.[14] The First Circuit was at pains to make clear that it did not determine whether the expert's benchmarks were suitable, calculations were correct, or analysis was otherwise reliable, but simply held that district court erred by finding that the expert's analysis was insufficient to establish loss as a matter of law under Rule 52(c).[15]

Finally, the First Circuit moved to causation, noting that the circuit courts are split on which party bears the burden of proving that any loss to the plan was caused by the fiduciary's breaches. Finding guidance in the common law of trusts, the First Circuit agreed with the holdings of the Fourth[16], Fifth[17], and Eighth[18] Circuits in approving of a burden-shifting approach wherein the defendant has the burden of proving that the loss to the Plan was not caused by the fiduciary's breach—"that is, to prove that the resulting investment decision was objectively prudent."[19] The *Brotherston* court reasoned that because an "ERISA fiduciary often . . . has available many options from which to build a portfolio of investments. . . it makes little sense to have the plaintiff hazard a guess as to what the fiduciary would have done had it not breached its duty in selecting investment vehicles, only to be told 'guess again.'"[20] By doing so, the First Circuit departed from the Sixth[21], Ninth[22], Tenth[23], and Eleventh[24] Circuits, which have all held that ERISA plaintiffs must establish a causal link between the breaches of duty alleged and the losses purportedly incurred.[25]

In addressing Putnam's concerns (and those of numerous amici) that employers may forgo the risk of offering ERISA plans to employees for fear of liability, the *Brotherston* court found there to be no evidence of such a trend in the circuits that have already adopted this burden-shifting framework. In concluding, the court noted that a fiduciary can "easily insulate itself" from liability either by "selecting well-established, low-fee and diversified market index funds" or, for a fiduciary who desires to select funds that try to "beat the market," it too will be immune as long as it follows a prudent selection and monitoring process.[26]

KEY TAKEAWAYS

While the *Brotherston* court was convinced that ERISA fiduciaries can "easily insulate" themselves from liability by following a prudent process or offering a diverse selection of low-cost funds, that is cold comfort to most plan sponsors, who see significant litigation risk in the burden-shifting approach. While *Brotherston* involved a retirement plan that offered only affiliated funds, with evidentiary findings that no independent process at all was used to consider, select, and monitor those funds, most other cases are not so clear-cut. Indeed, many of the fiduciary breach cases that have survived the pleading stage in recent years involve fact-intensive inquiries into the processes used for selecting and monitoring retirement plan investment funds, both affiliated and unaffiliated. ERISA fiduciaries who plan to mount a primary defense based on the prudence of their processes, then, must be mindful of the governing circuit rule on burdens of proof even at the earlier stages of litigation, to avoid ending up with an adverse finding on breach and empty-handed in mounting a defense with respect to causation.

ERISA fiduciaries in circuits that follow the burden-shifting rule adopted in *Brotherston* should consider offering expert analysis demonstrating the objective reasonableness of the challenged funds, or at least demonstrating a measure of damages that establishes less losses than the model offered by the plaintiffs' expert. This approach would be wise even if the fiduciaries' primary defense—upon which they may ultimately prevail—is that they followed a prudent process in selecting and monitoring those funds such that no breach occurred. Failing to do so in a burden-shifting circuit may leave the fiduciaries with few good defenses if the plaintiffs are able to establish a breach and some reasonably reliable measurement of loss.

It will also be important to lay a foundation for demonstrating that the "losses" to the plan proffered by plaintiff's expert are unreliable due to, for example, unsuitable benchmark comparisons, which may also be crucial to defeating the plaintiff's attempt to demonstrate that a loss occurred in the first instance. Notably, the *Brotherston* court did not find that plaintiffs had met their burden of proof with respect to loss; only that the district court erred by finding that plaintiffs' proffered model was insufficient as a matter of law.

In short, the deepening split that divides the circuits on loss causation in ERISA cases presents practical issues of proof that require counsel in these cases to make strategically important decisions at a relatively early stage in the litigation life cycle. It remains to be seen how district courts will apply these burdens of proof on summary judgment and at trial, including, in particular, what plaintiffs must do to satisfy their burden of proof with respect to loss. Regardless of the jurisdiction, however, all ERISA practitioners should be carefully watching how this burden-shifting issue plays out. The First Circuit has already been asked to stay its mandate in *Brotherston* so that the defendants can file a petition for certiorari with the U.S. Supreme Court, so a definitive answer may be coming in the near term.

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[1] 2018 WL 4958829 (1st Cir. Oct. 15, 2018).
[2] *Id.* at *10.
[3] *See, e.g.*, *Cunningham v. Cornell Univ.*, 16-cv-6525 (S.D.N.Y.); *Cates v. Trustees of Columbia Univ. in the City of N.Y.*, 16-cv-6524 (S.D.N.Y.); *Clark v. Duke Univ.*, 16-cv-1044 (M.D.N.C.); *Henderson v. Emory Univ.*, 16-cv-2920 (N.D. Ga.); *Sacerdote v. New York Univ.*, 16-cv-6284 (S.D.N.Y.); *Kelly v. The Johns Hopkins Univ.*, 16-cv-2835 (D. Md.); *Sweda v. The Univ. of Penn.*, 16-cv-4329 (E.D. Pa.); *Cassell v. Vanderbilt Univ.*, 16-cv-2086 (M.D. Tenn.); *Tracey v. Mass. Inst. of Tech.*, 16-cv-11620 (D. Mass.); *Vellali v. Yale Univ.*, 16-cv-1345 (D. Conn.); *Short v. Brown Univ.*, 17-cv-318 (D.R.I.); *Divane v. Northwestern Univ.*, 16-cv-8157 (N.D. Ill.); *Nicolas v. Trustees of Princeton Univ.*, 17-cv-3695 (D.N.J.); *Daugherty v. The Univ. of Chicago*, 17-cv-3736 (N.D. Ill.); *Davis v. Wash. Univ.*, 17-cv-1641 (E.D. Mo.); *Stanley v. George Wash. Univ.*, 18-cv-878 (D.D.C.); *Wilcox v. Georgetown Univ.*, 18-cv-422 (D.D.C.).
[4] *See, e.g.*, *In re M&T Bank Corp. ERISA Litig.*, 16-cv-375 (W.D.N.Y.); *Baird v. BlackRock Institutional Trust Co., N.A.*, 17-cv-1892 (N.D. Ca.); *Feinberg v. T. Rowe Price Group, Inc.*, 17-cv-427 (D. Md.); *Dorman v. Charles Schwab Corp.*, 17-cv-285 (N.D. Cal.); *Patterson v. Morgan Stanley*, 16-cv-6568 (S.D.N.Y.); *Beach v. JPMorgan Chase Bank, N.A.*, 17-cv-563 (S.D.N.Y.); *Moitoso v. FMR LLC*, 18-cv-12122 (D. Mass.); *Cervantes v. Invesco Holding Company (US), Inc.*, 18-cv-2551 (N.D. Ga.).
[5] 2018 WL 4958829, at *2. Plaintiffs also alleged that the fees charged by Putnam affiliates associated with their mutual funds constituted prohibited transactions under ERISA.
[6] *Id.*
[7] *Id.* at *1.
[8] *Id.*
[9] *Id.*
[10] *Brotherston v. Putnam*, 2017 WL 2634361, at *10-12 (D. Mass. June 19, 2017).
[11] *Id.* at *12.
[12] *Id.* at *12. Finally, the district court held that because plaintiffs had not shown by a preponderance of the evidence that fiduciaries had put their own interests ahead of plan participants, they had not breached the duty of loyalty. *Id.* at *8.
[13] 2018 WL 4958829, at *10.
[14] *Id.* at *10-11.
[15] *Id.* at *11 & n.14.
[16] *Tatum v. RJR Pension Inv. Comm.*, 761 F.3d 346 (4th Cir. 2014).
[17] *McDonald v. Provident Indem. Life Ins. Co.*, 60 F.3d 234, 237 (5th Cir. 1995).
[18] *Martin v. Feilen*, 965 F.2d 660 (8th Cir. 1992).
[19] 2018 WL 4958829, at *11-*15.
[20] *Id.* at *14.
[21] *Saumer v. Cliffs Natural Resources Inc.*, 853 F.3d 855 (6th Cir. 2017).
[22] *Wright v. Oregon Metallurgical Corp.*, 360 F.3d 1090 (9th Cir. 2004).
[23] *Pioneer Centres Holding Co. Emp. Stock Ownership Plan & Tr. v. Alerus Fin., N.A.*, 858 F.3d 1324 (10th Cir. 2017), *cert. dismissed per stipulation*, No. 17-667, 2018 WL 4496523 (U.S. Sept. 20, 2018).
[24] *Willett v. Blue Cross & Blue Shield of Ala.*, 953 F.2d 1335 (11th Cir. 1992).

[25] As the First Circuit noted, the Second Circuit appears to have conflicting holdings on the issue. 2018 WL 4958829, at *11 n.15 (citing *New York State Teamsters Council Health and Hosp. Fund v. Estate of DePerno*, 18 F.3d 179, 180 (2d Cir. 1994); *Silverman v. Mutual Ben. Life Ins. Co.*, 138 F.3d 98, 104 (2d Cir. 1998)).

[26] *Id.* at *14. The First Circuit affirmed the district court's dismissal of one of the prohibited transaction claims, but vacated the dismissal of the second prohibited transaction claim. The court also affirmed the district court's dismissal of plaintiffs' breach of the duty of loyalty claim.