BNA, INC.

PENSION & BENEFITS

BNA Employee-Owned Since 1947

DAILY



# New Plausibility Standard Impacts Pleading in Employee Benefits Cases

BY JONATHAN K. YOUNGWOOD AND HIRAL D. MEHTA

## Introduction

For 50 years, civil plaintiffs in federal court have been subject to the pleading standard of Rule 8 of the Federal Rules of Civil Procedure as enunciated by the U.S. Supreme Court in *Conley v. Gibson*.[1] According to *Conley*, ''a complaint should not be dismissed for failure to state a claim unless it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief.''[2] Federal courts, in addressing the sufficiency of a complaint's allegations on a motion to dismiss, including cases alleging breaches of the Employee Retirement Income Security Act of 1974 (''ERISA''), have applied this liberal pleading standard.

However, after the Supreme Court's recent decisions in *Bell Atlantic Corp. v. Twombly*,[3] and *Ashcroft v. Iqbal*,[4] courts and litigants have been confronted with a plausibility test. As the court in *Iqbal* stated, ''To survive a motion to dismiss, a complaint must contain sufficient factual matter, accepted as true, to 'state a claim to relief that is plausible on its face.' ''[5]

The application of this plausibility standard has affected the pleading of fiduciary status and has also become relevant in cases involving allegations of imprudent investment. What exactly is required under the plausibility standard has predictably been a subject of debate among litigants and courts.

## The Plausibility Standard

In 2007, the Supreme Court revisited the long-standing ''no set of facts'' language from *Conley* in *Twombly*,[6] holding that *Conley's* language ''is best forgotten as an incomplete, negative gloss on an accepted pleading standard . . . .''[7] Instead, the court announced a more rigorous pleading standard for plaintiffs facing a motion to dismiss.[8] The court explained that plaintiffs cannot defeat a motion to dismiss merely by alleging circular or conclusory facts consistent with their legal claims. Rather, plaintiffs must allege facts sufficient to suggest that their claims are *plausible* as against other theories explaining the alleged conduct.[9]

In *Twombly*, plaintiff consumers alleged that incumbent local telephone exchange carriers violated the Sherman Antitrust Act by engaging in an antitrust conspiracy.[10] The Supreme Court held that plaintiffs failed to meet the pleading standard under Rule 8 of the Federal Rules of Civil Procedure because they alleged only

[1] 355 U.S. 41 (1957).
[2] *Id.* at 45-46.
[3] 550 U.S. 544 (2007).
[4] 129 S.Ct. 1937 (2009).

*Jonathan K. Youngwood (jyoungwood@stblaw.com) is a partner in the litigation department at Simpson Thacher & Bartlett, New York. Hiral D. Mehta (hmehta@stblaw.com) is an associate in the litigation department at Simpson Thacher & Bartlett, New York.*

[5] *Id.* at 1949 (quoting *Twombly*, 550 U.S. at 570).
[6] 550 U.S. at 556-65.
[7] *Id.* at 563.
[8] *Id.* at 555-56.
[9] *Id.* at 556-57.
[10] *Id.* at 550-51.

 ISSN

that the various carriers engaged in parallel conduct and made a bare assertion that a conspiracy existed among the carriers.[11] The Supreme Court ruled that the claims should be dismissed because the plaintiffs could not establish that their conspiracy charge provided a plausible explanation of the defendants' behavior when compared with other legal explanations.[12]

On May 18, 2009, in *Iqbal*, the Supreme Court made it clear that *Twombly's* pleading standard applied to all claims pled under Rule 8 of the Federal Rules of Civil Procedure, and not simply to antitrust cases.[13] The plaintiff in *Iqbal*—a Pakistani Muslim arrested on criminal charges and detained under restrictive conditions after September 11, 2001—alleged that his detention was pursuant to an unconstitutional government policy of detaining Muslims because of their religion and ethnic backgrounds.[14] The Supreme Court dismissed the plaintiff's claims on the authority of *Twombly* and held that the plaintiff had not ''nudged his claims of invidious discrimination across the line from conceivable to plausible.''[15]

Even prior to *Iqbal*, a number of courts had applied the *Twombly* pleading standard outside of the antitrust context, including ERISA cases.[16] For example, in *Bishop v. Lucent Technologies Inc.*,[17] the Sixth Circuit applied the plausibility standard to an ERISA breach of fiduciary duty claim, rejecting plaintiffs' contention that ''the district court failed to construe the complaint liberally in their favor,'' and affirmed the district court's dismissal of the complaint for failure to state a claim.[18]

[11] *Id.* at 555-56.

[12] *See id.* at 556-57. (''[W]hen allegations of parallel conduct are set out in order to make a § 1 claim, they must be placed in a context that raises a suggestion of a preceding agreement, not merely parallel conduct that could just as well be independent action.'').

[13] *See Iqbal*, 129 S.Ct. at 1953.

[14] *Id.* at 1943-44.

[15] *Id.* at 1951 (quoting *Twombly*, 550 U.S. at 570) (internal quotations omitted).

[16] *See, e.g., ATSI Communications, Inc. v. Shaar Fund Ltd.*, 493 F.3d 87, 98 (2d Cir. 2007) (stating, in the context of a Securities Exchange Act Section 10(b) suit, that ''[t]o survive dismissal, the plaintiff must provide the grounds upon which his claim rests through factual allegations sufficient 'to raise a right to relief above the speculative level'. . .[and] [o]nce a claim has been adequately stated, it may be supported by showing any set of facts consistent with the allegations in the complaint.''); *Financial Security Assurance Inc. v. Stephens Inc.*, 500 F.3d 1276, 1282 (11th Cir. 2007) (stating, in a Section 10(b) suit and citing *Twombly*, that ''[i]n order for the plaintiff to satisfy his obligation to provide the grounds of his entitlement to relief, he must allege more than labels and conclusions; his complaint must include factual allegations adequate to raise a right to relief above the speculative level.'') (internal quotes omitted); *Tucker v. Middleburg-Legancy Place*, 539 F.3d 545, 550 (6th Cir. 2008) (applying *Twombly* to claims under the Family & Medical Leave Act); *McKnight v. Gates*, 282 Fed. Appx. 394, 396-97 (6th Cir. 2008) (applying *Twombly* to an age discrimination claim); *Gilles v. Garland*, 281 Fed. Appx. 501, 503 (6th Cir. 2008) (applying *Twombly* in a case involving the alleged violation of First and 14th Amendment rights); *B. & V. Distributing Co. v. Dottore Cos.*, 278 Fed. Appx. 480, 484 (6th Cir. 2008) (applying *Twombly* to a breach of contract claim).

[17] 520 F.3d 516, 519, 43 EBC 1787 (6th Cir. 2008)

[18] *See id.* at 518, 520.

## Application of *Twombly* and *Iqbal* to ERISA Stock-Drop Actions

In the ERISA context, at least two trends have emerged following the Supreme Court's decisions in *Twombly* and *Iqbal:* (1) courts are increasingly dismissing so-called ''stock-drop'' cases, especially imprudent investment claims, at the initial pleading stage, and (2) the plausibility standard is affecting the pleading of fiduciary status in a range of ERISA breach of fiduciary duty cases, including stock-drop actions, fee litigation, and denial of benefits suits.

**Plausibility Standard and Imprudent Investment Claims.** ERISA stock-drop actions usually involve plan participants in an employer-sponsored defined contribution retirement plan where the employer offers (or in some cases requires) investment in a company stock fund, such as Eligible Individual Account Plans (EIAPs), including Employee Stock Ownership Plans (ESOPs). Although pled in different manners, plan participants in ERISA ''stock-drop cases'' typically assert claims that arise out of ERISA Section 404.

Plaintiffs often allege that:

- The fiduciaries of the plan breached their duty to prudently manage the plan by allowing participants to invest in company stock even though the stock was allegedly too risky an investment option (''imprudent investment'' claim).
- Plan fiduciaries misrepresented or failed to disclose material information affecting the value of the company stock (''disclosure'' claim).
- Plan fiduciaries breached their duty of loyalty by failing to avoid a conflict of interest (''loyalty'' claim).
- Plan fiduciaries failed to monitor the actions of the plan administrator (''duty to monitor'' claim).

***Moench* Presumption of Prudence.** ERISA Section 404 requires fiduciaries to discharge their duties (1) ''solely in the interest of the participants and beneficiaries and for the exclusive purpose of providing benefits to participants and their beneficiaries'' and (2) with the ''care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of like character with like aims.''[19] Additionally, Section 404 requires fiduciaries to ''diversify the investments of the plan so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so.''[20] However, Section 404 also provides an exemption for EIAPs and ESOPs. The ''acquisition or holding'' of company stock by EIAPs and ESOPs does not violate the ''diversification requirement'' and ''the prudence requirement (only to the extent that it requires diversification.''[21]

In *Moench v. Robertson*,[22] the U.S. Court of Appeals for the Third Circuit considered the relationship between these provisions and Congress' intent to encourage employee ownership of company stock. The court held that in considering whether or not a plan administrator should have offered employer stock as an invest-

[19] 29 U.S.C. § 1104(a)(1)(A), 1104(a)(1)(B).

[20] 29 U.S.C. § 1104(a)(1)(C).

[21] 29 U.S.C. § 1104(a)(2).

[22] 62 F.3d 553, 19 EBC 1713 (3d Cir. 1995).

  ISSN

ment option, a presumption of prudence is granted to the plan administrator's actions.

The court in *Moench* stated, ''An ESOP fiduciary who invests the assets in employer stock is entitled to a presumption that it acted consistently with ERISA by virtue of that decision. However, the plaintiff may overcome that presumption by establishing that the fiduciary abused its discretion by investing in employer securities.''[23] This presumption of prudence has become known as the *Moench* presumption and has been widely adopted by other courts.

**Effect of Plausibility Standard on *Moench* Presumption.** Although *Moench* is a summary judgment decision, since *Twombly* and *Iqbal*, more courts addressing stock-drop cases have been willing to apply a presumption of prudence in favor of the plan administrator on a motion to dismiss.[24]

For example, in *Gearren v. McGraw-Hill Cos.*,[25] a recent U.S. District Court for the Southern District of New York decision, the court applied the presumption on a motion to dismiss. In applying *Moench*, the court expressly linked the plausibility standard to the presumption of prudence, noting that ''the applicability of the presumption of prudence directly affects the plausibility of an allegation that a particular action was imprudent.''[26] The court also noted that ''post-*Iqbal*, it is not enough simply to make a conclusory allegation that the defendants breached their fiduciary duties.'' Instead the ''plaintiff must allege facts that make it plausible that a breach of fiduciary duty actually occurred.''[27]

Those courts that apply the *Moench* presumption will only allow cases to go forward where plaintiffs have pleaded that defendant-fiduciaries knew or should have known about a company's impending collapse or other dire situation.[28] This trend has continued post-*Twombly* and *Iqbal*.[29]

For example, in *In re Huntington Bancshares Inc. ERISA Litigation*,[30] the plaintiffs alleged that the defendant's merger with another company resulted in exposure to risky subprime mortgage investments, and that the defendant failed to protect the assets of the defendant's retirement plan and its participants' retirement savings.[31] Plaintiffs alleged that defendants knew or should have known of this risk since the ''subprime sector'' was already well into the process of collapse and because of their employment positions.[32]

After discussing the new standard of review under *Twombly*, the court found that plaintiffs had not sufficiently pled facts to support their allegation that defendants failed to protect plan participants and therefore acted imprudently.[33] The court noted that under *Twombly*, an allegation that ''[d]efendants knew or should have known the extreme risk of subprime lending because of their positions at the company and because it was publicized by the financial and popular press are insufficient to factually support the contention that they knew or should have known that they were required to investigate the continuing offering and holding of [company] stock.''[34] Such an allegation amounts to nothing more than a ''conclusory statement, one that is 'generally insufficient to state a claim.' ''[35]

## Application of *Twombly* and *Iqbal* to the Pleading of Fiduciary Status

In addition to its effect on ''stock-drop'' actions, the plausibility standard has also affected the issue of pleading fiduciary status in cases involving ERISA breach of fiduciary duty claims. In every ERISA breach of fiduciary duty action, the ''threshold question'' is whether the defendant ''was acting as a fiduciary when taking the action subject to complaint.''[36] Since ERISA's definition of ''fiduciary'' can be functional in nature,[37] the plausibility standard espoused by *Twombly* and *Iqbal* has had an impact on how courts address the pleading of fiduciary status.

Given that fiduciary status is a threshold question, the plausibility standard has been helpful to defendants in breach of fiduciary duty actions because plaintiffs must plead fiduciary status to get past the motion to dismiss. The U.S. Court of Appeals for the Seventh Circuit's recent decisions in *Hecker v. Deere & Co.*,[38] and *Sharp Electronics Corp. v. Metropolitan Life Insurance Co.*,[39] are illustrative.

***Hecker v. Deere & Co.*** In *Hecker v. Deere & Co.*, the Seventh Circuit addressed the issue of whether a ''manager and investment advisor for a [tax code Section] 401(k) plan, or for some of the plan's investment options, owe fiduciary duties to the sponsor's employ-

[23] *Id.* at 571.

[24] *See, e.g., Edgar v. Avaya*, 503 F.3d 340, 41 EBC 2249 (3rd Cir. 2007) (applying the presumption at the pleading stage post-*Twombly*); *In re Lehman Brothers Securities & ERISA Litigation*, Nos. 08 Civ. 5598, 09 MD 2017, 2010 WL 354937, 48 EBC 1838 (S.D.N.Y. Feb. 2, 2010) (same); *In re Citigroup ERISA Litigation*, No. 07 Civ. 9790, 2009 WL 2762708, 47 EBC 2025 (S.D.N.Y. Aug. 31, 2009) (same); *Herrera v. Wyeth*, No. 08-cv-4688 (RJS), 2010 WL 1028163 (S.D.N.Y. March 17, 2010) (same).

[25] No. 08-cv-7890, 2010 WL 532315, 48 EBC 2057 (S.D.N.Y. Feb. 10, 2010).

[26] *Id.* at *12.

[27] *See id.*

[28] *See Wright v. Oregon Metallurgical Corp.*, 360 F.3d 1090, 1096, 1098, 32 EBC 1417 (9th Cir. 2004) (ill-fated merger, reverse stock split, and 75 percent drop were insufficient to rebut the *Moench* presumption of prudence); *Kuper v. Iovenko*, 66 F. 3d 1447, 1451, 19 EBC 1969 (6th Cir. 1995); (company-wide financial woes and 80 percent drop in stock price were insufficient to rebut the *Moench* presumption of prudence).

[29] *See Avaya,* 503 F.3d at 348 (the presumption is only overcome ''when developments created the type of dire situation which would require defendants to disobey the terms of the Plans by not offering [the Company's] stock''); *In re Bausch & Lomb Inc. ERISA Litigation*, No. 06-CV-6297, 2008 WL 5234281 at *6, 45 EBC 1977 (W.D.N.Y., Dec. 12, 2008) (the *Moench* presumption is rebutted only when ''a company's overall viability appears to be in jeopardy.'').

[30] No. 2:08-cv-0165, 2009 WL 330308, 45 EBC 2773 (S.D. Ohio Feb. 9, 2009).

[31] *Id.* at *3.

[32] *Id.*

[33] *Id.* at *7-8.

[34] *Id.* at *8.

[35] *Id.* (internal citation omitted).

[36] *Pegram v. Herdrich*, 530 U.S. 211, 226, 24 EBC 1641 (2000).

[37] *See* 29 U.S.C. § 1002(21)(A).

[38] 569 F.3d 708, 47 EBC 1097 (7th Cir. 2009).

[39] 578 F.3d 505, 47 EBC 1725 (7th Cir. 2009).

ees.''[40] Plaintiffs alleged that their employer, a Section 401(k) plan trustee and an investment adviser, breached fiduciary duties ''under ERISA by providing investment options that required the payment of excessive fees and costs and by failing adequately to disclose the fee structure to plan participants.''[41] Plaintiffs contended that the plan trustee, Fidelity Management Trust Co., and investment adviser, Fidelity Management & Research Co., were ''functional fiduciaries'' under 29 U.S.C. § 1002(21)(A).[42]

In addressing the issue of fiduciary status, the court looked at ''whether Fidelity Trust or Fidelity Research exercised discretionary authority or control over the management of the Plans, the disposition of the Plans' assets, or the administration of the Plans.''[43] After closely reviewing plaintiffs' allegations, the court held that the ''complaint fails to state a claim against either Fidelity Trust or Fidelity Research based on the supposition that either one is a 'functional fiduciary.' ''[44] The court also held that Deere, the only remaining defendant, had offered a variety of investment alternatives, the same investment options available to the general public and had not breached any fiduciary duty.[45]

On rehearing of its order affirming the district court's dismissal of the complaint, the court explained the fact that the *Iqbal* opinion had been issued since its original decision did not change the result, noting that *Iqbal* reinforces *Twombly's* message that ''[a] claim has facial plausibility when the plaintiff pleads factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged.''[46] The court explained further that ''where the well-pleaded facts do not permit the court to infer more than the mere possibility of misconduct, the complaint has alleged—but it has not 'show[n]'—'that the pleader is entitled to relief.' Fed. R. Civ. P. 8(a)(2).''[47]

***Sharp v. MetLife.*** In *Sharp v. MetLife*, plaintiff, an employee of Sharp Electronics Corp. sued Metropolitan Life Insurance Corporation for wrongfully denying long-term disability benefits. During a settlement conference, however, MetLife represented to the plaintiff that one reason it had refused to pay her any long-term benefits was that Sharp had failed to make required payments to it on her behalf.[48]

The plaintiff then joined Sharp as a co-defendant, and in response Sharp filed a cross-claim against MetLife alleging that MetLife breached its fiduciary duties ''when it stated in [plaintiff's] presence that Sharp's nonpayment of premiums influenced its decision about her benefits; (2) MetLife was equitably estopped from relying on Sharp's alleged nonpayment as a reason for denying [plaintiff's] benefits; and (3) if Sharp were found liable to [plaintiff] on any of her claims, MetLife had to indemnify Sharp.''[49] The court found that MetLife was not a fiduciary with respect to Sharp given that their relationship was purely contractual. ''MetLife agreed to perform certain services for Sharp, with respect to this benefits plan,'' the court said.[50]

Sharp also argued that under ''the liberal pleading standard in the federal court,'' its request for relief that the court enter an order requiring MetLife to reimburse the Plan for losses resulting from MetLife's breach of fiduciary duty is sufficient to demonstrate that it was seeking relief on behalf of the plan.[51] The court rejected Sharp's view of the pleading standard, holding that Sharp's ''conclusory statements that MetLife is a fiduciary, that Sharp is a plan fiduciary, that MetLife breached its fiduciary duties to Sharp, that Sharp has suffered damage from that breach, and that MetLife must reimburse the Plan for its losses, . . . falls short'' because ''[w]hile Rule 8(a)(2) does not require detailed factual allegations, the Supreme Court now requires it to include 'more than an unadorned, the-defendant-unlawfully-harmed-me accusation.' ''[52]

Both *Hecker* and *Sharp* reflect the application and impact of *Twombly* and *Iqbal*. Given the importance of the fiduciary status issue as a threshold question in ERISA breach of fiduciary duty cases, *Hecker* and *Sharp* highlight the significance of the plausibility standard with respect to pleading in employee benefits cases.

## Accessing the Contours of the Plausibility Standard

Courts continue to grapple with applying the plausibility standard, the degree to which the pleading of supportive facts is required and the weight of the burden on plaintiffs' pleadings. The U.S. Court of Appeals for the Eighth Circuit in *Braden v. Wal-Mart Stores Inc.*,[53] addressed the plausibility standard in this context, as well as the significance of ERISA's remedial scheme in construing the pleading standard under Rule 8 of the Federal Rules of Civil Procedure.

In *Braden,* a case involving ERISA fee litigation claims, the court criticized the district court for applying what it deemed to be a too burdensome pleading standard. The plaintiff alleged breach of fiduciary duty in the way that Wal-Mart managed its profit-sharing and tax code Section 401(k) plans, specifically failing to consider trustee Merrill Lynch & Co.'s interest in including funds as investment options that shared their fees with the trustee.[54] The result of these failures, according to the plaintiff, was that a number of these investment options charged excessive fees.[55]

On appeal, the Eighth Circuit took issue with the standard the district court used to analyze the complaint. ''We conclude that the district court erred in its application of Rule 8. Accepting Braden's well pleaded factual allegations as true, he has stated a claim for breach of fiduciary duty. The district court erred in two ways. It ignored reasonable inferences supported by the facts alleged. It also drew inferences in appellee's favor, faulting Braden for failing to plead facts tending to contradict those inferences. Each of those errors violates

[40] 556 F.3d 575, 578, 45 EBC 2761 (7th Cir. 2009).
[41] *Id.*
[42] *Id.* at 583.
[43] *Id.*
[44] *Id.* at 584.
[45] *See id.* at 587-88.
[46] *Hecker*, 569 F.3d at 710 (internal citation omitted).
[47] *Id.* (internal citation omitted).
[48] *Sharp*, 578 F.3d at 508.
[49] *See id.* at 509.
[50] *See id.* at 512.
[51] *See id.*
[52] *Id.* at 512.
[53] 588 F.3d 585, 48 EBC 1097 (8th Cir. 2009).
[54] *Id.* at 590.
[55] *See id.*

  ISSN

the familiar axiom that on a motion to dismiss, inferences are to be drawn in favor of the non-moving party,'' the court said.[56]

The court also stated that the district court had incorrectly placed the burden on the plaintiffs to rebut all the possible reasons why the defendants may have chosen the investment options in question. The court stated that ''a plaintiff may need to rule out alternative explanations in some circumstances in order to survive a motion to dismiss.''[57] The court explained that ''[i]t is in this sort of situation—where there is a concrete, 'obvious alternative explanation' for the defendant's conduct—that a plaintiff may be required to plead additional facts tending to rule out the alternative.''[58] But the court explained that ''[s]uch a requirement [wa]s neither a special rule nor a new one.''[59] According to the court, ''[i]t [wa]s simply a corollary of the basic plausibility requirement. An inference pressed by the plaintiff is not plausible if the facts he points to are precisely the result one would expect from lawful conduct in which the defendant is known to have engaged.''[60]

The court did acknowledge that the ''significant costs of discovery in complex litigation and the attendant waste and expense that can be inflicted upon innocent parties by meritless claims'' is a concern that must be addressed when construing the pleading standard under Rule 8 of the Federal Rules of Civil Procedure.[61] The court nevertheless noted ''that we must be attendant to ERISA's remedial purpose and evident intent to prevent through private civil litigation, 'misuses and mismanagement of plan assets.' ''[62] The court also stated that in the context of ERISA litigation, ''plaintiffs generally lack the inside information necessary to make out their claims in detail unless and until discovery commences.''[63]

While district courts in the Eighth Circuit have cited *Braden*, it is unclear what affect the *Braden* court's ruling will have in other courts and other ERISA cases outside the Eighth Circuit.

## The Effect of the Plausibility Standard to ERISA Practice

When drafting a complaint, plaintiffs must ensure that their legal conclusions are supported by nonconclusory factual allegations sufficient to make their claims plausible. This is particularly important when asserting claims that require factual inquiries by the court on a motion to dismiss. Imprudent investment claims, because they are increasingly subject to the *Moench* presumption on a motion to dismiss, must allege facts that overcome the presumption.

Moreover, in any case alleging ERISA breach of fiduciary duty, plaintiffs will have to do more than track the statutory language of ERISA in asserting fiduciary status. Plaintiffs now have to plead that defendants exercised discretionary authority or control with respect to the action subject to the complaint. Courts will continue to address the fiduciary status question before considering other issues.

---

[56] *Id.* at 595.
[57] *See id.* at 596.
[58] *Id.* (quoting *Iqbal*, 129 S. Ct. at 1951; citing *Twombly*, 550 U.S. at 566).
[59] *Id.*
[60] *Id.*
[61] *See id.* at 597.
[62] *See id.* (internal citation omitted).
[63] *Id.* at 598.