Tatum v. RJR Pension Investment Committee: Fourth Circuit's "Would Have" Standard Exonerates Fiduciaries' Decision to Divest Company Stock After Corporate Spin-off

Employee Benefits Alert
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Reviewing the case for the third time, the U.S. Court of Appeals for the Fourth Circuit in *Tatum v. RJR Pension Investment Committee*[1] held that the fiduciaries of the R.J. Reynold Tobacco (RJR) retirement plan could not be held liable under ERISA for their decision to divest the plan of Nabisco stock after RJR Tobacco was spun off from RJR Nabisco. After a trial, the district court had found that the RJR fiduciaries failed to undertake a proper investigation of the divestment decision, thereby breaching their fiduciary duties under ERISA. Nevertheless, even though the stock later rebounded, the lower court held that the breach did not harm the plan. The Fourth Circuit affirmed, ruling that the "breach did not cause the losses because a prudent fiduciary ***would have*** made the same . . . decision at the same time and in the same manner."[2]

The case has been closely watched, with the Department of Labor filing an *amicus* brief in favor of the plaintiffs/plan participants bringing the case and the U.S. Chamber of Commerce filing in favor of the fiduciaries. The "reverse stock-drop" case centered on allegations that the RJR fiduciaries divested Nabisco stock held in the plan too quickly in its attempt to avoid losses after the Nabisco spin-off. At the time of the divestment, the stock had fallen to record lows, but a year later, it rebounded by nearly 250 percent, triggered in part by a take-over bid from Carl Icahn. The plan participants claimed that the RJR fiduciaries' decision to divest was imprudent and caused substantial losses by shutting them out from the huge gains that ensued after the sale and the take-over bid.

Filed in 2002, *Tatum*'s long road through the courts, including a petition for *certiorari* to the Supreme Court that was denied,[3] raised a multitude of issues, with the most recent being the question of how loss causation was to be measured: whether a prudent fiduciary "could have" or "would have" made the same decision. The Fourth Circuit previously corrected the district court for applying the "could have" standard and on remand instructed it to review the RJR fiduciaries' conduct under the more rigorous "would have" standard. Even so, the district court found that a prudent fiduciary "would have" made the same divestment decisions as the RJR fiduciaries. The appellate court has now affirmed the judgment, noting that "a fiduciary cannot be required to predict the future."[4]

Case History

To quote the district court, the "case involves the unwinding of what [was then] described as one of the biggest mergers and most fought-over leveraged buyouts of the 1980s"—the merger between RJR Tobacco and Nabisco.[5] Fourteen years later, the two companies determined that together was not better and decided to go their separate ways. Splitting the food business from the tobacco business seems to have been motivated in large part by concern that the tobacco litigation was adversely affecting Nabisco's stock value. As part of the spin-off, RJR amended its 401(k) plan documents to freeze participation in the Nabisco stock funds, meaning that participants could hold their current investments but could not invest additional amounts in those funds. Eventually, the RJR fiduciaries decided to completely eliminate the Nabisco stock funds from the plan, giving participants invested in the funds six months to sell their investments at a value that would, in hindsight, turn out to be nearly an all-time low for Nabisco stock. The participant class alleged that the RJR fiduciaries breached their ERISA fiduciary duties of prudence and loyalty

by eliminating the Nabisco stock "on an arbitrary timeline without conducting a thorough investigation," forcing the sale at a low point despite the "strong likelihood" that the stock would rebound.[6]

After a four-week trial in 2013, the Middle District of North Carolina found that the RJR fiduciaries failed to engage in a prudent decision-making process before eliminating the Nabisco funds.[7] Yet, the court still held that the plaintiffs did not establish loss causation from the breach because a reasonable and prudent fiduciary *could* have decided to make the same decision.[8] On appeal, the Fourth Circuit reversed and remanded the case back to the lower court, saying the district court's "could have" standard was incorrect and instructing it to apply the "would have" standard.[9]

On remand, after reviewing and weighing the relevant evidence from the bench trial, the district court arrived at the same ultimate outcome, again exonerating the RJR fiduciaries by finding that their decision "would have" been reached by a reasonable and prudent fiduciary.[10] The participants once more appealed to the Fourth Circuit.

Fourth Circuit Majority Opinion

In a 2-1 decision written by Circuit Judge Diana Gribbon Motz and joined by Circuit Judge J. Harvie Wilkinson, the majority rejected the participants' arguments that the lower court failed to adequately consider or over-emphasized certain factors, including risk, the plan documents, the expert testimony on proper investment research, and the divestment timing in reaching its decision to relieve the RJR fiduciaries from the fiduciary breach claims.[11] The appellate court ruled that the district court did not rely solely on risk and appropriately evaluated value and expected returns, among other factors, in assessing what a prudent fiduciary would consider; that a prudent fiduciary would properly fail to follow an imprudent plan amendment; and that the district court gave proper weight to expert testimony with respect to both investment research and the divestment timing.

Significantly, Circuit Judge Motz also rejected the participants' argument that different standards should apply to investment and divestment decisions.[12] The participants took the position that fiduciaries must offer a more compelling reason for *divestment* decisions than for *investment* decisions. Relying on both the statutory prudence requirement and the Supreme Court's reasoning in *Fifth Third Bancorp v. Dudenhoeffer*,[13] the majority concluded such a distinction was unwarranted.

The participants asked the Fourth Circuit to reconsider the lower court's decision in light of *Dudenhoeffer*'s support of the efficient market hypothesis, which states that a stock's market price accurately reflects all public information about the stock. The majority explained that the district court's findings showed that the market for Nabisco stock was efficient, so a prudent fiduciary would have acted reasonably in relying on the market price in deciding to divest the Nabisco funds. Further, the Fourth Circuit referenced the lack of evidence presented by the participants of the foreseeability the Nabisco stock would likely rebound, that a buy-out would boost the stock value, or that any other justification existed for a prudent fiduciary to delay the Nabisco fund divestment. Expecting a fiduciary to anticipate such unknowable events, the majority explained, would "create an impossible standard for fiduciaries."[14] The court concluded that while the "would have" standard places a higher burden on fiduciaries than the "could have" standard originally applied by the lower court in its 2013 opinion, the heightened standard does not require fiduciaries to "predict the future."[15]

Elaborating somewhat on how the "would have" standard should be applied, the Fourth Circuit stated that the fiduciaries' burden was to show "by a preponderance of the evidence that a prudent fiduciary would have acted" as they did. Such a showing "does not mean that ***all*** the evidence must support RJR's decision for RJR to prevail" and the court suggested that the burden could be met by "convincing" or "superior" evidence "that, though not sufficient to free the mind wholly from all reasonable doubt, is still sufficient to incline a fair and impartial mind to one side of the issue rather than the other ... however slight the edge may be."[16]

Fourth Circuit Dissent

Circuit Judge Albert Diaz filed a dissenting opinion in which he criticized the lower court for failing to follow its mandate and essentially relabeling its "could have" analysis under the heading of "would have."[17] In his view, the district court failed to explain whether a prudent fiduciary would have made the same decisions regarding the divestment timing and the disregard for the plan document (which required the Nabisco funds to remain as frozen funds).[18] By reasoning that the six-month divestiture timeline was "within a reasonable time frame" and "long enough" to give notice to participants, the district court gave too much deference to the RJR fiduciaries.[19] He rejected the district court's reasoning that a prudent fiduciary *would* have selected the six-month timeline simply because participants *could* have reallocated their investments in that time period.[20] Had the dissent carried sway, the case would have been remanded yet again.

Conclusion

Plan fiduciaries hoping that the Fourth Circuit would further define how to gauge whether a prudent fiduciary "would have" taken a particular action or the relationship between establishing a breach and loss causation will be left unsatisfied. These and other questions raised by the *Tatum* line of decisions are sure to be the subject of future litigation by others or even by the parties in *Tatum* as they evaluate whether to ask for rehearing or make another trip to the Supreme Court.

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[1] *Tatum v. RJR Pension Inv. Comm.* (*Tatum III*), No. 1:02-cv-00373-NCT-LPA, 2017 WL 1531578 (4th Cir. Apr. 28, 2017).

[2] *Id.* at *1 (emphasis added).

[3] *RJR Pension Inv. Comm. v. Tatum*, 135 S. Ct. 2887 (2015) (denying petition for *certiorari*).

[4] *Tatum III*, 2017 WL 1531578, at *11–12.

[5] *Tatum v. R.J. Reynolds Tobacco Co.* (*Tatum I*), 926 F. Supp. 2d. 648, 650 (M.D.N.C. 2013).

[6] *Tatum v. RJR Pension Inv. Comm.* (*Tatum II*), 761 F.3d 346, 355 (4th Cir. 2014).

[7] *Tatum I*, 926 F. Supp. 2d. at 678.

[8] *Id.* at 689.

[9] *Tatum II*, 761 F.3d at 368.

[10] *Tatum v. R.J. Reynolds Tobacco Co.*, No. 1:02CV00373, 2016 WL 660902 (M.D.N.C. Feb. 18, 2016).

[11] *Tatum III*, Case No. 16-1293, 2017 WL 1531578, at *3 (4th Cir. Apr. 28, 2017).

[12] *Id.* at *5.

[13] 134 S. Ct. 2459 (2014).

[14] *Tatum III*, 2017 WL 1531578, at *11.

[15] *Id.* at *11–12.

[16] *Id.* at *6 (emphasis in original).

[17] *Tatum III*, 2017 WL 1531578, at *12 (Diaz, J., dissenting).

[18] *Id.* at *12–13.

[19] *Id.* at *14.

[20] *Id.*