GIBSON DUNN

February 3, 2011

SEVENTH CIRCUIT PLACES IMPORTANT LIMITS ON CLASS CERTIFICATION OF ERISA CLAIMS IN DEFINED CONTRIBUTION PLANS

To Our Clients and Friends:

On January 21, 2011, the United States Court of Appeals for the Seventh Circuit ruled that a challenge to the operation of The Boeing Company's 401(k) plan had been improperly certified as a class action. *Spano v. Boeing Co.*, No. 09-3001. In its opinion, the Seventh Circuit highlighted important aspects of defined contribution plans that can pose considerable hurdles to class certification of ERISA actions involving claims on behalf of participants in such plans.

The named plaintiffs in *Spano*, participants in Boeing's 401(k) plan, brought suit under ERISA Section 502(a)(2), alleging that the plan's fiduciaries had breached their duties by including imprudent investment options in the plan, causing the plan to pay excessive fees, and concealing material information about the plan's investment options. At the plaintiffs' request, the district court certified a class of all participants in the 401(k) plan under Federal Rule of Civil Procedure 23(b)(1), which does not require notice to class members or allow class members to opt-out. The class contained of over 189,000 members—the largest ERISA class ever certified. Boeing asked the Seventh Circuit to review the class certification order on interlocutory appeal, and the Seventh Circuit agreed.

In vacating the class certification order, the Seventh Circuit stated that that the "question whether to certify a class asserting [ERISA] section 502(a)(2) claims is . . . a complex one if the underlying plan takes the defined-contribution form" (slip op. 16), and "there is no denying the fact" that defined contribution plans raise serious problems for class certification. Slip op. 35. According to the Seventh Circuit, the first step "[t]o determine whether class treatment is appropriate, [is to] distinguish between an injury to one person's retirement account that affects only that person, and an injury to one account that qualifies as a plan injury. The latter kind of injury potentially would be appropriate for class treatment, while the former would not." Slip op. 14.

Noting the "breathtaking [] scope" of the class certified by the district court, the Seventh Circuit first held that the class failed to meet the typicality requirement of Rule 23(a) because there was not "enough congruence between the named representative's claim[s] and th[ose] of the unnamed members of the class." Slip op. 25. In reaching this conclusion, the court emphasized that many plan participants had not even invested in the challenged investment options, and that the dates when class members entered and exited each option would have to be considered to prevent certification of a class that included members who would be harmed by the relief sought by the named plaintiffs. *Id*. at 27.

The Seventh Circuit also held that the district court had erred in certifying the class under Rule 23(b)(1) because the alleged mismanagement of the plan apparently had harmed some participants and helped others; this destroyed the "common interest" necessary to bind the plan participants together in a mandatory class action. Slip op. 27-29. The court concluded its opinion by observing that "short-cuts in the class certification process are not permissible" and "the class representative must, at a meaningful level of detail, stand in the same position as the absentee members of the class." *Id*. at 36.

The Seventh Circuit's decision is an important development in the evolving law of ERISA class actions. It is one of the very few appellate decisions to scrutinize carefully whether and how ERISA claims brought by participants in defined contribution plans can be certified as a class action under the standards of Rule 23. And the court's opinion highlights several significant impediments that plaintiffs in defined contribution plans must overcome to obtain class certification, particularly under the mandatory provisions of Rule 23.

For example, the court recognized that participants in defined contribution plans may be differently situated with respect to the challenged conduct by plan fiduciaries—some participants may not have been affected by the conduct, some participants may have been harmed by the conduct, and some participants may even have benefited from the conduct. Because differently situated plan participants lack a "common interest" in remedying the challenged conduct, mandatory classes comprising all plan participants will rarely if ever be appropriate. Indeed, the Seventh Circuit noted that "the Supreme Court [has] cautioned strongly against overuse of (b)(1) classes" because "[t]oo liberal an application of the mandatory-class device risks depriving people of one of their most important due process rights: the right to their own day in court." Slip op. 27-28.

Differences in how the challenged conduct affected plan participants also may create significant hurdles to class certification under Rule 23(a). For example, in order to meet Rule 23(a)'s typicality and adequacy requirements as described by the Seventh Circuit, any class challenging the selection of investment options would have to be narrowly defined so that only those plan participants who invested *and had losses* in the challenged investment option are included in the class. After all, "a fund that turns out to be an imprudent investment over a particular time for one participant may be a fine investment for another participant who invests in the same fund over a slightly different period. If both are included in the same class, a conflict will result and class treatment will become untenable." Slip op. 35-36. This requirement of separating the "winners" from the "losers" likely means that plaintiffs would have to engage experts to analyze the investment histories of plan participants, and to opine that the class definition is sufficiently narrow to encompass only those plan participants that were harmed by the challenged conduct.

Only if the proponents of class treatment can clear all these hurdles may an ERISA breach-of-fiduciary-duty claim brought by participants in a defined contribution plan proceed on a representative basis. In addition, such a class likely would have to proceed under Rule 23(b)(3) with its additional requirements of predominance and superiority, as well as notice to the class and an opportunity for class members to opt-out.

Gibson, Dunn & Crutcher's Class Actions and Labor and Employment Practice Groups have extensive experience litigating class certification issues in all types of actions, including complex ERISA actions such as Spano. Gibson Dunn lawyers are available to assist in addressing any questions you may have regarding these issues. Please contact the Gibson Dunn attorney with whom you work, or any of the following attorneys:

William J. Kilberg P.C. - Washington, D.C. (202-955-8573, wkilberg@gibsondunn.com)
Mark A. Perry - Washington, D.C. (202-887-3667, mperry@gibsondunn.com)

GIBSON DUNN

Paul Blankenstein - Washington, D.C. (202-955-8693, pblankenstein@gibsondunn.com)
Daniel J. Davis - Washington, D.C. (202-955-8245, ddavis@gibsondunn.com)
J. Nicci Adams - Washington, D.C. (202-887-3567, nadams@gibsondunn.com)