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In Post-Dudenhoeffer Decision, Class Action Plaintiffs Are Allowed to Pursue Their Claims For Fiduciary Breach Against Eastman Kodak Plans

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A federal district court has permitted plaintiffs to pursue class actions against the fiduciaries of two Eastman Kodak defined contribution plans on the ground that those fiduciaries failed to prudently manage the plan funds. *Gedek v. Perez*, No. 12-CV-6051L (W.D.N.Y December 17, 2014), involves claims that the fiduciaries continued to invest in Eastman Kodak stock even when it had become such a poor investment that such continued investment was objectively imprudent. This case?s facts differ from the ?bursting bubble? scenario discussed in the United States Supreme Court?s recent decision in *Fifth Third Bancorp v. Dudenhoeffer* (2014), and illustrate a broader scope of potential liability for retirement plan fiduciaries.

The Background. This ruling arose in an action consolidating seven complaints, all presenting class actions by participants and beneficiaries of two defined contribution plans sponsored by Eastman Kodak Company (?Kodak?), namely, Kodak?s Savings and Investment Plan (?SIP?) and the Eastman Kodak Stock Ownership Plan (?ESOP?). The cases involve two groups of defendants: (1) Kodak committees (comprised of the same individuals) administering the SIP and ESOP, respectively, and various persons who served on the committees during the ?class period? defined as January 1, 2010 to the date that the plans were liquidated, and (2) BNY Mellon Financial Corporation (?Mellon?), the successor trustee of the SIP.

The SIP is partly funded by both the participants themselves and Kodak. SIP participants are permitted, but not required, to invest in Kodak stock. By contrast, the ESOP is funded solely by Kodak, virtually all Kodak employees are eligible to participate, and that plan?s document states that its assets shall be invested primarily in Kodak securities. The ESOP?s trustee has limited discretion, however, to invest plan assets in savings accounts, certificates of deposit, high-grade short-term securities, equity stock, bonds ?or other investments desirable? for the ESOP?s trust, and the plan document also permits plan

assets to be held in cash.

Kodak filed for protection under Chapter 11 of the U. S. Bankruptcy Code on January 12, 2012. The plaintiffs filed these actions later that year, alleging that, during the class period, Kodak?s stock value was steadily declining, and, by the bankruptcy filing, Kodak stock was trading at a small fraction of its earlier levels. The plaintiffs alleged that the defendants nonetheless imprudently continued to permit both the SIP and the ESOP to offer Kodak funds to participants or continued to buy or hold Kodak stock, and, as a result, caused the participants to suffer losses to their individual plan accounts.

In cases such as that reviewed by the Supreme Court in *Dudenhoeffer*, ERISA plaintiffs have often alleged that fiduciaries imprudently invested in a plan sponsor?s stock after publicly available information (such as public stock market data) made clear that such stock was overvalued, the continued investment in that stock was imprudent, and the stock price then collapsed, causing losses to the participants. Some of those plaintiffs have tried to liken a plan sponsor?s stock collapse to falling over a precipice, or the bursting of an overvalued stock ?bubble?, or other sudden ?dire circumstances?. By contrast, the *Gedek* plaintiffs alleged that the SIP and ESOP fiduciaries breached their duty of prudence because Kodak?s stock price was in a very clear, public and steady decline over a period of years, resulting from Kodak?s dependence ?on a dying technology and the sale of antiquated products no longer sought by a consumer? (that is, photographic film and related camera technology), Kodak?s inability to bring viable new products to market and generate sufficient cash-flow to maintain the company, and a resulting severe lack of liquidity. Instead of a sudden fall over a precipice, one might liken their depiction of Kodak?s stock collapse to watching a slow but steady unfolding of an inevitable train wreck. The *Gedek* plaintiffs did not allege that the original decision to invest in Kodak stock was imprudent, nor that Kodak?s stock was overvalued (as alleged in *Dudenhoeffer*) and that the fiduciaries should have seen that its price was about to burst. ?Rather? (as the *Gedek* court noted), ?they allege that Kodak stock was on a steady decline due to fundamental problems with the company itself.?

The *Gedek* defendants filed motions to dismiss the case for failure to state claims of fiduciary breach upon which relief could be granted.

The Court?s Ruling.

The court found that *Dudenhoeffer*, given its different facts, provided little explicit guidance, except to make clear that there is no presumption that a fiduciary acts prudently by investing, as a plan document requires, in a plan sponsor?s company stock (the ?*Moench* presumption?); rather, except as required to satisfy ERISA?s duty of diversification, an ESOP fiduciary?s duty of prudence is ?no different and no less stringent than that of any other ERISA fiduciary?. The issue, said the *Gedek* court, was ?whether at some point Kodak stock became such an obviously poor investment, not just in hindsight but prospectively, that continued investment in Kodak stock was rendered objectively imprudent.? The *Gedek* complaints alleged a history ?not just of Kodak?s inexorable slide toward bankruptcy, but of publicly available information contemporaneously documenting that slide, step by painful step, and accurately forecasting Kodak?s bleak future.? If the plaintiffs? allegations proved to be true, then the plan fiduciaries should have shifted the plan assets into more stable investments, as the plan documents permitted and as ERISA?s duty of prudence would have required.

The district court therefore denied the defendants? motion to dismiss the complaint and allowed the case to proceed. It also held that, even under the *Moench* presumption rejected by *Dudenhoeffer*, the *Gedek* plaintiffs would have stated a claim sufficient to survive the motions to dismiss.

The court also denied Mellon?s motion to dismiss based on a contention that it was a ?directed trustee? of the ESOP and had followed the plan administrator?s instructions to invest in Kodak stock. While ?harbor[ing] serious doubts? about the claim, the court permitted it to proceed and allowed the plaintiffs to offer (if they could) evidence that Mellon should have seen that the administrator?s instructions were so imprudent that Mellon should have disobeyed them.

The Significant Lessons: The *Gedek* plaintiffs have yet to prove their claims, but the fact that their claims will go forward, in the post-*Dudenhoeffer* world, should catch the attention of all companies (a) whose retirement plans have funds invested primarily in their own company stock, and (b) who engage in what might fairly be characterized as ?dying technologies? and the ?sale of antiquated products no longer sought by the consumer?. One may say that, whether those characterizations accurately apply to a company?s products may depend on the eyes of a self-interested beholder, and that a long-established company may yet find new products or services to renew its vitality, thus substantiating a plan fiduciary?s prudence in continuing to permit investment in that company?s stock. Nonetheless, *Gedek* may also prove to be an early example of cases challenging a fiduciary?s refusal to question the continued prudence of investment in a company that is steadily declining over time, without waiting for the clanging alarm bells set off by a sudden, drastic decline. Cases such as *Gedek* may thus impose on retirement plan fiduciaries a higher expectation of close scrutiny of company stock funds, and, notwithstanding ERISA?s statutory permission for ESOP plans, those fiduciaries may find that, practically speaking, they will have a smaller window of time to identify and act upon circumstances requiring the freezing and/or divestment of such funds.

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