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UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

CIVIL MINUTES - GENERAL

Case No. SACV 07-01357-JVS (RNBx) Date July 14, 2008

Title In Re First American Corp. ERISA Litigation

Present: The Honorable James V. Selna

Nancy Boehme	Sharon Seffens
Deputy Clerk	Court Reporter
Attorneys Present for Plaintiffs:	Attorneys Present for Defendants:
Robert Harwood James Maro Mark Kindall Sabrina Kim Aryind Khurana	James P. Baker Richard Ruben

Proceedings: Defendants' Motion to Dismiss

Cause called and counsel make their appearances. The Court's tentative ruling is issued. The parties make their arguments. The Court DENIES the defendants' motion and rules in accordance with the tentative ruling as follows:

Defendants The First American Corporation ("FAF"), The First American Corporation Administrative Committee, Kelly J. Dunmore, Frank V. McMahon, III, Parker S. Kennedy, D.P. Kennedy, George L. Argyros, Gary J. Beban, J. David Chatham, William G. Davis, James L. Doti, Lewis W. Douglas, Jr., Frank E. O'Bryan, Roslyn B. Payne, D. Van Skilling, Herbert B. Tasker, Virginia M. Ueberroth, Mary Lee Widener, and Does 1-10 (collectively "the First American Defendants") move to dismiss each of the four claims in Plaintiffs and putative class representatives Denise Rogers, David Hillert, Jennifer Easton, and David Paul Giroux's (collectively "Plan Participants") Complaint for failure to state a claim, pursuant to Federal Rule of Civil Procedure 12(b)(6). The Plan Participants oppose the motion.

I. Legal Standard

Under Federal Rule of Civil Procedure 12(b)(6), a defendant may move to dismiss for failure to state a claim upon which relief can be granted. A plaintiff must state "enough facts to state a claim to relief that is plausible on its face." Bell Atlantic Corp. v. Twombly, -- U.S. --, 127 S. Ct. 1955, 1974 (2007). In resolving a Rule 12(b)(6) motion, the Court must construe the complaint in the light most favorable to the plaintiff and must

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accept all well-pleaded factual allegations as true. Cahill v. Liberty Mutual Ins. Co., 80 F.3d 336, 337-38 (9th Cir. 1996). The Court must also accept as true all reasonable inferences to be drawn from the material allegations in the complaint. Pareto v. F.D.I.C., 139 F.3d 696, 699 (9th Cir. 1998).

"A court may take judicial notice of 'matters of public record' without converting a motion to dismiss into a motion for summary judgment." Lee v. City of Los Angeles, 250 F.3d 668, 689 (9th Cir. 2001).

In this regard, First American Defendants request the Court to take judicial notice of FAF's stock prices during the putative class period, i.e. April 11, 2006 through May 2, 2008. (First RJN ¶¶ 1-2, Exs. A, B; FAC ¶ 56.) The stock prices are not "subject to reasonable dispute," and therefore are appropriate for judicial notice. Fed. R. Evid. 201(b). Accordingly, the Court grants the request to that extent.

II. Discussion

The Plan Participants are participants in or beneficiaries of FAF's 401(k) retirement savings plan ("the Plan"), which is an "employee pension benefit plan" within the meaning of the Employee Retirement Income Security Act ("ERISA"). (Complaint ¶¶ 43, 56; 29 U.S.C. § 1002(2)(A).) They bring this action to recover losses to the Plan caused by alleged breaches of fiduciary duty by the First American Defendants pursuant to ERISA sections 502(a)(2) and 409. (Complaint ¶¶ 180-86; 28 U.S.C. §§ 1132(a)(2), 1109.)

The Plan Participants allege that FAF engaged in a variety of unlawful activities, including "(a) dealing with reduced title insurance orders by boosting profits through unlawful conduct; (b) failing to institute appropriate internal controls to assure the accuracy of its financial reporting; (c) engaging in unlawful business activities; (d) engaging in a conspiracy and scheme to inflate the appraisal values of homes with the intent to artificially increase the estimated loan-to-value ratio of Washington Mutual, Inc.'s ("WaMu") Option-ARM portfolio, or adjustable rate mortgages; (e) causing the mortgages that WaMu had issued to be much riskier than represented, due to the improper appraisals of the mortgaged properties; and (f) attempting to conceal its unlawful conduct." (Complaint ¶ 90; see also, ¶ 174.)

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The Plan Participants allege that this unlawful conduct rendered investment in FAF's stock imprudent. (Id.) They further allege that the First American Defendants knew of the unlawful conduct, knew or should have known that investment in FAF's stock was imprudent because of it, and "did nothing to protect[] the heavy investment" of the Plan Participants' retirement savings in FAF stock. (Id.)

Based on these allegations, the Plan Participants claim that the First American Defendants breached their fiduciary duties to act with prudence, to disclose material information, to avoid conflicts of interest, and to monitor their co-fiduciaries, under ERISA sections 404 and 405. (Complaint ¶¶ 187-194, 195-205, 206-211, 212-221; 29 U.S.C. §§ 1104, 1105.)

As a preliminary matter, the Court notes that the Plan Participants have sufficiently alleged the requisite fiduciary status with respect to the allegations in the Complaint.

"[A] person is a fiduciary with respect to a plan to the extent . . . (iii) he has any discretionary authority or discretionary responsibility in the administration of such plan." 29 U.S.C. § 1002(21)(A). The First American Defendants' contend that the Plan required them to invest in FAF stock and therefore that they "did not have discretion to discontinue FAF stock as an investment vehicle." (Opening Br. p. 3; Opposition Br. p. 9.) This interpretation of the Plan language flies in the face of case law that holds that plan instructions calling for investment "primarily" in company stock leave room for discretion. See, e.g., In re Sprint Corp. ERISA Litig., 388 F. Supp. 2d 1207, 1220 (D. Kan. 2004); In re Enron Corp. Sec. Derivative & ERISA Litig., 284 F. Supp. 2d 511, 669-70 (S.D. Tex. 2003). Here, the Plan states: "The ESOP shall be invested primarily in Company Stock." (Complaint, Ex. A at FIR_ERI 000237.) This language leaves room for exercise of discretion by the Plan's fiduciaries. Thus, the First American Defendants are fiduciaries under ERISA.

A. Breach of Fiduciary Duty of Prudence

ERISA requires that "a fiduciary shall discharge his duties with respect to a plan . . . 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 a like character and with like aims." 29 U.S.C. § 1104(a).

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This duty is modified in the context of eligible individual account plans ("EIAPs") such as the Plan at issue here: "the prudence requirement (only to the extent that it requires diversification) . . . is not violated by acquisition or holding of . . . qualifying employer securities." 29 U.S.C. §1104(a)(2) (emphasis added).

The Ninth Circuit has recently explicated this statutory provision. It noted that the section "does not exempt fiduciaries from the first prong of the prudent man standard, which requires a fiduciary to act with care, skill, prudence, and diligence in any investment the fiduciary chooses." In re: Syncor ERISA Litig., 516 F.3d 1095, 1102 (9th Cir. 2008). "A violation [of the standard of care] may occur where a company's stock did not trend downward over time, but was artificially inflated during that time by an illegal scheme about which the fiduciaries knew or should have known, and then suddenly declined when the scheme was exposed." Id.

The allegations in the Complaint fall within the bounds outlined by Syncor. The Plan Participants allege that the First American Defendants knew or should have known that FAF stock was an imprudent investment, due to FAF's allegedly unlawful business practices. (Complaint ¶¶ 174, 191.) They allege that "First American's true response to losses resulting from the subprime mortgage collapse was to boost profits through continued and new unlawful business practices." (Id. ¶ 172.) Thus, the Plan Participants argue that FAF's unlawful and improper business practices resulted in an "artificially inflated" stock price, which reached a high of $55 in June 2007 and later fell to $26 in July 2008. (Opposition Br. p. 6; Complaint ¶ 10; Def's Second RJN Ex. A, pp. 4, 9.) Investment by the First American Defendants of Plan assets in FAF stock during this time was imprudent, because to pay the artificially inflated price would "inevitably result in significant losses to the Plan." (Complaint ¶ 10; Opposition Br. p. 7.) Thus, the allegations in the Complaint state a claim for breach of the fiduciary duty of prudence under controlling Ninth Circuit case law.

The First American Defendants attempt to distinguish Syncor based on the facts and procedural posture. (Reply Br. pp. 9-11.) However, the "peculiar procedural posture" of Syncor is irrelevant to its analysis of the requirements for a claim for breach of the duty of prudence.[1] (Id. p. 11.) Furthermore, the Court disagrees that the facts of

[1] The fact that the district court failed to conduct a fairness hearing on the parties' proposed settlement, and instead

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this case are distinguishable. Here, as in Syncor, the Plan Participants allege that the price of FAF stock was inflated, i.e. to $55 per share, and that the inflated price was caused by "an illegal scheme about which the fiduciaries knew or should have known," and that the price fell, i.e. to its current level of $26, after the scheme was "exposed." In re: Syncor ERISA Litig., 516 F.3d at 1102. Accordingly, the Court finds that Syncor controls this case.

Additionally, the First American Defendants argue that FAF's stock increased in value after news of its settlement of claims related to FAF's allegedly improper business practices brought by the states of New York, Michigan, California and Minnesota was released to the market. (Opening Br. p. 15.) Instead, the First American Defendants attribute the steady decline of FAF's stock price since its high of $55 per share in June 2007 not to any wrongdoing by FAF, but rather to the general "severe downturn in the real estate market." (Opening Br. p. 16.) These factual arguments simply provide an alternative interpretation of the events described in the Complaint that is inappropriate at the pleadings stage.

Similarly, the First American Defendants contend that the sums of money implicated by the alleged wrongful conduct, including the fines paid to the states of Washington, California, Michigan, and Colorado and the income derived from FAF's relationship with WaMu, are "insignificant" in comparison to FAF's annual revenue, so that the Plan Participants' allegations, even if true, are insufficient to support a claim for breach of fiduciary duty. (Opening Br. p. 17.) The Court is unwilling to conclude at this preliminary stage that the financial repercussions of FAF's alleged wrongful conduct can quantified in the manner suggested by the First American Defendants. Nor is the Court prepared to find that the economic impact of the wrongful conduct described by the First American Defendants is insufficient basis, as a matter of law, for a claim for breach of the fiduciary duty of prudence.[2]

The First American Defendants also contend that the claim that they breached their

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granted summary judgment, had no bearing on its erroneous analysis of the plan administrators' fiduciary duties and the Ninth Circuit's reversal thereof.

[2] Indeed, these are factual issues more appropriately resolved on summary judgment or at trial.

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duty of prudence is "nothing more than [a] thinly disguised argument[] that the . . . Defendants should have reduced the risk of loss by selling (i.e. diversifying) the FAF stock held by the Plan." (Opening Br. p. 10.) The Court disagrees.

It does not follow from the Plan Participants' allegation that investment in FAF stock was imprudent that the First American Defendants should have invested in other stocks. See, In re: JDS Uniphase Corp. ERISA Litig., Case No. 03-4743 CW (WWS), p. 12 (N.D. Cal. July 14, 2005). This is because "[t]he duty of prudence is broader than . . . the duty of diversification." In re McKesson HBOC, Inc. ERISA Litig., 391 F. Supp. 2d 812, 825 (N.D. Cal. 2005). Thus, "there is nothing inconsistent with section 404 simultaneously (1) imposing a multi-faceted duty of prudence upon ESOP fiduciaries and yet (2) exempting them from one particular aspect of it: the duty to diversify." Id. at 825-26. Accordingly, the Plan Participants can, and do, state a claim based on the allegation that the First American Defendants' investment in FAF was imprudent without implicating the duty to diversify.

Finally, the First American Defendants claim that the Plan Participants fail to state a claim for breach of the duty of prudence because they do not meet pleading standard articulated by the Third Circuit in Moench v. Robertson, 62 F.3d 553 (3rd Cir. 1995). Moench introduced the following rule: "an ESOP fiduciary who invests the [plan's] 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." Id. at 571. In order to rebut the presumption, the plaintiff must show that "the ERISA fiduciary could not have believed reasonably that continued adherence to the ESOP's direction was in keeping with the settlor's expectations of how a prudent trustee would operate." Id.

The First American Defendants cite cases that hold that a plaintiff cannot state a claim for breach of the duty of prudence under Moench as long as a company is not on the "verge of collapse" and is still financially viable. (Opening Br. p. 14.) See, e.g., Pedraza v. Coca-Cola Co., 456 F. Supp. 2d 1262, 1276 (N.D. Ga. 2006) (concluding that plaintiff failed to state a claim where defendant corporation was "financially robust"); Steinman v. Hicks, 252 F. Supp. 2d 746, 758 (C.D. Ill. 2003) aff'd 352 F.3d 1101 (7th Cir. 2003) (finding that plaintiff's evidence failed to show a breach of the duty of prudence where the company was "sound"); In re Duke Energy ERISA Litig., 281 F.

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Supp. 2d 786, 794-95 (W.D.N.C. 2003) (finding plaintiffs' claim failed where the company was "solid" and "viable"). This argument is flawed.

First and foremost, the Court notes that the Moench rule has never been adopted in the Ninth Circuit. See Wright v. Or. Metallurgical Corp., 360 F.3d 1090, 1097-98 & n.3 (9th Cir. 2004); In re: Syncor ERISA Litig., 516 F.3d at 1102.

Second, even if applicable in this Circuit, the interpretation of the Moench rule that requires a plaintiff to allege that the company is no longer financially viable in order to overcome the presumption is foreclosed by Syncor.

Under Syncor, "[w]hile financial viability is a factor to be considered, it is not determinative of whether the fiduciaries failed to act with care, skill, prudence, or diligence." In re: Syncor ERISA Litig., 516 F.3d at 1002. Accordingly, a plaintiff need not necessarily allege that the company's financial situation is "seriously deteriorating" in order to state a claim for breach of the duty of prudence. Compare, Wright, 360 F.3d at 1098.

In light of the above, the Court finds that, taking the Plan Participants' allegations as true, as it must as this stage, the First American Defendants did not act reasonably when they invested in FAF stock at an inflated price, knowing full well that FAF was engaged in unlawful practices and that the stock would surely decline in value once those practices were revealed to the market.[3] Thus, the Plan Participants adequately allege a claim for breach of the duty of prudence.

Accordingly, the Court denies the First American Defendants' motion to dismiss this claim.

B. Breach of Fiduciary Duty to Disclose

ERISA fiduciaries have a duty to disclose material information to plan participants.

[3] The First American Defendants' recitation of facts regarding the long-term stability of FAF and its financial well-being during the class period may be a factor bearing on the prudence of investment in FAF stock, but is hardly dispositive, in the context of this analysis. (Opening Br. pp. 5-6.)

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"[A]n ERISA fiduciary has both a duty not to make misrepresentations to plan participants, and an affirmative duty to inform when the [fiduciary] knows that silence might be harmful." In re Polaroid ERISA Litig., 362 F. Supp. 2d 461, 478 (S.D.N.Y. 2005) (internal quotation marks and citations omitted). Similarly, "an ERISA fiduciary has an affirmative duty to inform beneficiaries of circumstances that threaten the funding of benefits." Acosta v. Pacific Enterprises, 950 F.2d 611, 618-619 (9th Cir. 1991).

The Plan Participants allege that:

> Defendants made direct and indirect communications with the Plan's [P]articipants including statements regarding investments in Company stock. These communications included, but were not limited to, Securities and Exchange Commission ("SEC") filings, annual reports, press releases, and Plan documents (including Summary Plan Descriptions ("SPDs") and Prospectuses regarding Plan/participant holdings of Company stock), which included and/or reiterated these statements. In particular, at all times during the Class Period, First American's SEC filings were incorporated into and part of the SPDs, the Prospectus, and/or Form S-8 registration statements, and, therefore, were fiduciary communications. Defendants acted as fiduciaries in connection with these communications.
>
> (Complaint ¶ 83; emphasis added).

The Plan Participants also detail the particular SEC filings they allege contained "inaccurate, incomplete and materially misleading statements to Participants." (Complaint ¶ 164; see id. ¶¶ 163-170.) They further allege that these "statements, acts and omissions of the Defendants in this Complaint constituted misrepresentations and omissions that were fundamentally deceptive concerning the prudence of investments in the Company stock and were material to any reasonable person's decision about whether or not to invest or maintain any part of their invested assets of the Plan in the Company stock during the Class Period." (Id. ¶ 203.) The Plan Participants conclude that they "are therefore presumed to have relied to their detriment on the misleading statements, acts, and omissions of the Defendants." (Id.)

The First American Defendants argue that these allegations are insufficient for failure to adequately plead three elements: 1) a fiduciary communication; 2) reliance;

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and 3) materiality. (Opening Br. pp. 20-23; Reply Br. pp. 20-22.)

As quoted above, the Plan Participants allege that the SEC filings incorporated into the Plan documents were fiduciary communications under ERISA. (Complaint ¶ 83.) "[M]isrepresentations contained in official Plan documents or incorporated by reference in those documents [including "those that relate to SEC filings that were incorporated into the Plans' documents"] are actionable under ERISA." In re : Goodyear Tire & Rubber Co. Erisa Litig., 438 F. Supp. 2d 783, 795 (N.D. Ohio 2006).

While the First American Defendants' contend that "[t]hose who prepare and sign SEC filings do not become ERISA fiduciaries through those acts, and consequently, do not violate ERISA if the filings contain misrepresentations," they fail to point out that the cases that set forth this rule also note that "[t]hose who are ERISA fiduciaries, however, cannot in violation of their fiduciary obligations disseminate false information to plan participants, including false information contained in SEC filings." In re WorldCom, Inc. ERISA Litig., 263 F. Supp. 2d 745, 766 (S.D.N.Y. 2003) (emphasis added); see also, In re CMS Energy Erisa Litig., 312 F. Supp. 2d 898, 915 (E.D. Mich. 2004). Where, as here, Plan Participants adequately allege that the First American Defendants are ERISA fiduciaries independent of their participation in FAF's SEC filings, and that they communicated with Plan Participants by way of false or misleading SEC filings, they have adequately stated a claim for breach of the duty to disclose.

Further, the First American Defendants contend that they were permitted to withhold non-public information from the Plan Participants in order to comply with insider trading provisions of the securities laws. (Opening Br. p. 21.) While it is true that ERISA fiduciaries are not required "to convey non-public material information to Plan [P]articipants," In re WorldCom, Inc. ERISA Litig., 263 F. Supp. 2d 745, 767 (S.D.N.Y. 2003), they nonetheless "cannot transmit false information to plan participants when a prudent fiduciary would understand that the information was false." Id. (noting that "any information that is conveyed to participants be conveyed in compliance with the standard of care that applies to ERISA fiduciaries"). The Court is not persuaded either that compliance with securities laws excuses violation of these fiduciary duties under ERISA or that compliance with ERISA is necessarily inconsistent with compliance with the securities laws. See In re: JDS Uniphase Corp. ERISA Litig., Case No. 03-4743 CW (WWS), p. 15 (N.D. Cal. July 14, 2005) (citing In re: Enron Corp. Sec. Deriv. & ERISA Litig., 284 F. Supp. 2d 511, 565 (S.D. Tex. 2005)) ("reject[ing] the notion that the

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securities laws immunize ERISA fiduciaries against liability for imprudent investments, including failing to disclose information to participants"). Accordingly, the Plan Participants' allegations that the First American Defendants violated their duty to disclose by making misleading statements in SEC filings is adequate as a matter of law to state a claim for breach.

The First American Defendants also try to defeat the disclosure claim by arguing that the Plan Participants fail to adequately plead reliance. Their argument has been rejected by other courts faced with pleadings containing language identical to that in this Complaint. In re AEP ERISA Litig., 327 F. Supp. 2d 812, 833 (S.D. Ohio 2004); In re: Cardinal Health, Inc. ERISA Litig., 424 F. Supp. 2d 1002, 1046 (S.D. Ohio 2006). The Court agrees with the conclusion reach by these decisions, i.e. that where a plaintiff pleads nondisclosure by a fiduciary, the plan participants adequately plead reliance by alleging that they are presumed to have relied on that lack of information. In re AEP ERISA Litig., 327 F. Supp. 2d at 833; In re: Cardinal Health, Inc. ERISA Litig., 424 F. Supp. 2d at 1046. This is particularly so given that a claim for breach of fiduciary duty under ERISA is evaluated under the standard of Rule 8 and not that of Rule 9(b). In re AEP ERISA Litig., 327 F. Supp. 2d at 833.

Finally, the First American Defendants' contention that even if they failed to disclose information to the Plan Participants, any such information "was not material to the price of FAF's stock price," is a factual argument similar to those the Court rejects in connection with the claim for breach of the duty of prudence, above, that is not appropriately explored at the pleadings stage. (Reply Br. p. 22.)

Accordingly, the Court finds that the Plan Participants' second claim for breach of the duty to disclose is adequately plead and the denies the motion to dismiss it.

C. Breach of Fiduciary Duties to Avoid Conflicts of Interest and to Monitor other Fiduciaries

The Plan Participants' third and fourth claims for breach of the duties to avoid conflicts of interest and to monitor other fiduciaries, respectively, are derivative of the claim for breach of the duty of prudence. (Opening Br. p. 23; Opposition Br. pp. 23-25); see In re Duke Energy ERISA Litig., 281 F. Supp. 2d 786, 795 (W.D.N.C. 2003) (noting that claims for breach of duties to monitor and avoid conflicts of interest "do not provide

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independent grounds for relief, but rather depend upon the establishment of an underlying breach of fiduciary duty").

The First American Defendants provide no independent arguments in support of dismissal of the Plan Participants' third and fourth claims. (Opening Br. p. 23; Reply Br. p. 25.)

Accordingly, since the Court finds that the Plan Participants' first claim for breach of fiduciary duty is adequately pled, the third and fourth claims survive this motion to dismiss as well.

D. Loss Causation

The First American Defendants contend that all of the Plan Participants' claims fail for failure to adequately plead that the alleged breaches of duty caused any loss to the Plan. (Opening Br. pp. 19-20; Reply Br. pp. 23-25.)

ERISA provides that a fiduciary who breaches her duty "shall be personally liable to make good to such plan any losses to the plan resulting from such breach." 29 U.S.C. § 1109(a). The particularized pleading requirements of the securities laws do not apply in ERISA cases. See, In re: Cardinal Health, Inc. ERISA Litig., 424 F. Supp. 2d 1002, 1043-44 (S.D. Ohio 2006).

Here, the Plan Participants allege that the drop in FAF's stock price "caused at least tens of millions in losses to the Plan and the Class," and that "as a direct and proximate result of the breaches of fiduciary duties alleged herein, the Plan, and indirectly Plaintiffs and the Plan's other participants and [b]eneficiaries, lost a significant portion of their retirement investment." (Complaint ¶¶ 172, 193, 204, 210, 220.) They also allege that "[h]ad Defendants properly discharged their fiduciary duties, including the provision of full and accurate disclosure of material facts concerning [FAF] stock and divesting the Plan from Company Stock offered by the Plan when such investment became imprudent, the Plan would have avoided losses suffered as a result of imprudent investment in the Fund, as opposed to the returns they would have achieved with alternative prudent investments offered in the Plan." (Id. ¶ 223; see also id. ¶¶ 222, 224-26.)

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These allegations are more than adequate to allege loss under ERISA section 404. The First American Defendants' arguments regarding the burden of proof for losses and the sufficiency of proof of damages are premature at the pleadings stage. (Reply Br. p. 24.)[4]

Accordingly, the Court denies the motion to dismiss the Plan Participants' claims for failure to plead loss causation.

III. Conclusion

For the foregoing reasons, the Court DENIES the First American Defendants' motion to dismiss in its entirety.

The Court sets a Scheduling Conference for September 15, 2008, at 11:00 a.m.

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[4] Indeed, all but one of the First American Defendants' authorities discuss the rule in a trial setting. (Reply Br. p. 24.) In LaRue v. DeWolff, Boberg & Associates, Inc., 128 S. Ct. 1020, 1026 (2008), the Supreme Court reversed the district court's grant of judgment on the pleadings.