

August 5, 2010

MEMORANDUM TO CLIENTS

RE: Groom Law Group Secures Dismissal of 401(k) Fee Lawsuit

On August 2, the United States District Court for the Western District of New York dismissed the complaint filed in *Zang v. Paychex, Inc.*, one of several putative class actions challenging 401(k) fees, revenue sharing and float. As discussed below, the court concluded that Paychex could not be considered an ERISA fiduciary, which was a prerequisite to plaintiff's ERISA-based claims against the company.

Background

The plaintiff, Steven Zang, is the named fiduciary, trustee, and plan administrator of a 401(k) plan sponsored by his company, Luxon & Zang P.C. In the complaint, Mr. Zang alleged that Paychex made available "prototype" retirement plans and provided access to different lineups of mutual funds for use as plan investment options. Although Mr. Zang, as the fiduciary of his company's 401(k) plan, was responsible for selecting the particular subset of the mutual funds to be used in his plan, he claimed that Paychex "channeled" its plan clients into mutual funds that made revenue sharing payments to Paychex. Mr. Zang also alleged that Paychex similarly channeled its plan clients into a custodial arrangement with a bank that made payments to Paychex from the float that the bank earned on plan contributions pending investment.

The complaint asserted claims for breach of fiduciary duty and sought recovery of alleged plan losses under ERISA § 502(a)(2) as well as declaratory and injunctive relief under ERISA § 502(a)(3). In addition, Mr. Zang alleged that Paychex, as an ERISA fiduciary, had engaged in transactions prohibited under ERISA §§ 406(b)(2) and (b)(3).

Paychex Was Not A Fiduciary

The court dismissed the complaint in its entirety because, on the facts alleged, "Paychex could not be considered a fiduciary with respect to the Plan."

In support of its ruling, the court initially identified that, under the administrative services agreement that Mr. Zang executed, he agreed that Paychex was not a fiduciary under ERISA and that Paychex' services were limited to recordkeeping and non-discretionary administrative services. Although noting that this contractual agreement was not dispositive as to Paychex' fiduciary status, the court found that it was "nevertheless probative of the parties' intent and understanding."

The court then proceeded to analyze the four arguments that Mr. Zang made in support of his claim that Paychex qualified as an ERISA fiduciary. The court rejected his principal argument that Paychex was a fiduciary by virtue of its alleged control over which mutual funds are made available to its plan clients and by its receipt of revenue sharing from the funds. The court held that Paychex' mere creation and offering of mutual fund lineups to clients did not

make it an ERISA fiduciary because the lineups were created *prior* to the existence of any contractual relationship between Paychex and the plans. Specifically, the court ruled:

Paychex cannot be a fiduciary with respect to a plan with which it has no contractual relationship...Paychex is free to design the various plan templates and investment menus to offer to prospective clients, who can then decide to contract with Paychex or not. That does not make Paychex a fiduciary.

The court also found that, under the terms of the parties' administrative services agreement, Mr. Zang -- not Paychex -- was responsible for selecting the specific mutual funds used in his plan, albeit from lineups of investment options that Paychex made available to clients. In ruling in Paychex' favor, the court looked to the decision last year in *Hecker v. Deere & Co.*, in which the Seventh Circuit ruled that merely "playing a role" in the selection of investment options is not enough to give rise to fiduciary status. Applying *Hecker*, the court held that "[e]ven if Paychex could be said to have 'played a role' in plaintiff's decision (by presenting him with a set of options), in the end, that decision was plaintiff's to make."

Further, the court determined that, although Paychex had some ability to modify the mutual fund lineups it made available to plans, it was not an ERISA fiduciary. The court found that, under the administrative services agreement, Paychex was required to give Mr. Zang at least 60 days' advance written notice of proposed deletions or substitutions of mutual fund options and that Mr. Zang thereafter had the right to reject the change or terminate his agreement with Paychex. Citing to the "Aetna letter" that the Department of Labor issued in 1997 (DOL Advisory Opinion 97-16A (May 22, 1997)), the court concluded that the contractual arrangement for modifying the mutual fund lineups "does not bespeak fiduciary status on the part of Paychex."

The court similarly rejected Mr. Zang's argument that Paychex qualified as an ERISA fiduciary because it allegedly controlled how long contributions to the plan were held in the custodial account pending investment in the mutual funds. To qualify as an ERISA fiduciary with regard to the management or disposition of plan assets, the court concluded that a person must actually exercise authority or control over plan assets. In this respect, the court distinguished other parts of ERISA's definition of a fiduciary that trigger fiduciary status when a person merely has discretionary authority, regardless of whether such authority is actually ever exercised. Because the administrative services agreement between Mr. Zang and Paychex expressly provided that contributions to the plan generally would be held in the custodial account for five days and Mr. Zang did not allege that Paychex had deliberately kept amounts in the custodial account for a longer period of time, the court found that Mr. Zang failed to allege a basis for concluding that Paychex had actually exercised control over plan assets so as to qualify as an ERISA fiduciary.

Finally, the court rejected two theories regarding Paychex' fiduciary status that were not in the complaint, but rather were raised in Mr. Zang's memorandum of law submitted in opposition to Paychex' motion to dismiss. In addition to finding the arguments procedurally improper, the court concluded that they were without merit. Specifically, with regard to Mr. Zang's argument that Paychex pledged plan assets as collateral for the company's lines of credit,

the court determined that the 10-K filing on which Mr. Zang relied in making this argument did not state that Paychex used its clients' pension plan assets as collateral. The court similarly disposed of Mr. Zang's argument that Paychex "advises its clients on selecting mutual funds." The court concluded that the document he relied upon and the parties' administrative services agreement actually stated that Paychex does not provide investment advice.

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Mike Prame, Alex Ryan and Jason Lee led the defense of Paychex in this matter. Groom Law Group also is representing defendants in several other fee cases that have been filed and we continue to track developments in this area. If you would like further information or have question regarding the fee cases, please contact any of the attorneys listed below:

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