GROOM
LAW GROUP
CHARTERED

BENEFITS BRIEF

March 28, 2014 www.groom.com

If you have questions, please contact your regular Groom attorney or any of the attorneys listed below:

Christie L. Babinski
(202) 861-0170
cbabinski@groom.com

Nancy F. McTyre
(202) 861-6631
nmctyre@groom.com

Edward J. Meehan
(202) 861-2602
emeehan@groom.com

Michael J. Prame
(202) 861-6633
mjp@groom.com

Sarah A. Zumwalt
(202) 861-5432
szumwalt@groom.com

Eighth Circuit Affirms $13.4 Million Judgment Against 401(k) Plan Fiduciaries for Excessive Recordkeeping Fees, But Overturns Mapping and Float Rulings

The Court of Appeals for the Eighth Circuit recently issued a significant decision in one of the 401(k) fee cases filed in 2006 by the Schlicter, Bogard & Denton law firm. *Tussey v. ABB, Inc.*, 2014 WL 1044831 (8th Cir. Mar. 19, 2014). Underscoring the importance of plan fiduciaries following a procedurally prudent process when engaging service providers, the Eighth Circuit affirmed the district court's ruling (entered after a 16-day trial) that the ABB fiduciaries failed to fully investigate and monitor the plans' recordkeeping fees. The Eighth Circuit also upheld the district court's $13.4 million damage award in connection with the recordkeeping fee claims.

While affirming the district court's judgment relating to the recordkeeping fees, the Eighth Circuit did not rule for plaintiffs on all counts. It vacated the district court's ruling that the plans' fiduciaries breached their duties when they decided to remove a certain mutual fund investment option and to "map" the assets that had been invested in the mutual fund into the replacement investment options. As discussed below, the Eighth Circuit concluded that the district court failed to apply the correct standard of review with respect to the fiduciaries' determinations. As such, it remanded these claims for further consideration by the district court.

In addition, the Eighth Circuit reversed the district court's judgment against Fidelity relating to "float" income. The Eighth Circuit concluded that the float was not an asset of the plans. Rather, under the account structure in place, the investment options – not the plans – had the property rights to the float.

We summarize the key rulings below.

Recordkeeping Fees

Fidelity was retained in 1995 as the recordkeeper for two 401(k) plans – one for ABB's union employees, the other for its unrepresented employees (collectively, the "plans"). Initially, Fidelity received a flat fee for each participant in the plans. The parties eventually adopted a revenue-sharing arrangement under which Fidelity would receive a percentage of the fees charged by the managers of the mutual funds that were selected as investment options for the plans. The district court had concluded that the plans' fiduciaries failed to monitor and control how much Fidelity was receiving as a recordkeeping fee under the revenue-sharing arrangement.

The Eighth Circuit recognized that revenue sharing as well as the bundling of recordkeeping and investment management services are widely accepted industry practices and that they can "frequently inure to the benefit of an ERISA plan." However, the Eighth Circuit found that the evidence adduced at trial supported the determination that the plans' fiduciaries failed to engage in a procedurally prudent process to evaluate the revenue-sharing arrangement. According to the court, the fiduciaries failed to (1) calculate the amount that the plan was paying Fidelity for recordkeeping through revenue sharing, (2) determine whether Fidelity's pricing was competitive with other recordkeepers, (3) adequately leverage the plans' size to negotiate reductions in Fidelity's fee, and (4) make a good faith effort to prevent the excessive recordkeeping fee from being used to subsidize the cost of non-plan related, corporate services that Fidelity also was providing for ABB, even after an outside benefit consulting firm warned the fiduciaries that the plans were overpaying for recordkeeping and might be subsidizing corporate services.

In affirming the $13.4 million judgment on plaintiffs' recordkeeping fee claims, the Eighth Circuit rejected defendants' argument that, under *Hecker v. Deere & Co. (Hecker I)*, 556 F.3d 575, 586 (7th Cir. 2009), the fiduciaries could not be held liable because the plans offered a wide range of investment options with a broad array of fees, including low-priced options. The Eighth Circuit distinguished *Hecker* on the grounds that this case involved "significant allegations of wrongdoing," including allegations that ABB used revenue sharing to benefit ABB and Fidelity at the plans' expense.

Selection of Plan Investment Options and Mapping

In 2000, the Pension Review Committee ("PRC") for the plans adopted an Investment Policy Statement ("IPS") that provided a framework for selecting, monitoring, and removing the plans' investment options. After adoption of the IPS, the PRC decided to offer as investment options certain target date funds managed by Fidelity (the "Freedom Funds"). The PRC also decided to remove the Vanguard Wellington Fund, a balanced fund, from the investment lineup and to "map" the funds that had been invested with the Wellington Fund into the Freedom Funds, unless a participant chose to have the assets invested elsewhere.

The district court had held that the ABB fiduciaries breached their fiduciary duties and engaged in a prohibited transaction by replacing the Wellington Fund with the Freedom Funds. According to the district court, the fiduciaries failed to follow the procedures outlined in the IPS for removing a plan investment option. The district court also identified that the Wellington Fund outperformed the Freedom Funds between 2000 and 2008. Finally, the district court found that the fiduciaries engaged in a prohibited transaction because they acted in accordance with what was best for ABB's corporate interest, and not in the best interests of the Plan, when they selected the Freedom Funds that paid more revenue sharing to Fidelity.

The Eighth Circuit held that the district court applied the wrong standard of review in evaluating the fiduciaries' decisions. Specifically, the Eighth Circuit ruled that the district court should have afforded a level of deference to the plan fiduciaries' determinations under the plan documents (the court refrained from ruling on whether an IPS is a binding plan document). The Eighth Circuit also concluded that the district court's evaluation of the fiduciaries' investment decisions must be based on what the fiduciaries knew at the time they made the decisions, not on the subsequent performance of the investment options. The Eighth Circuit, therefore, vacated the district court's decision and remanded the claim for further consideration by the district court.

Float

The Eighth Circuit also reversed the district court's decision that found that Fidelity breached its fiduciary duties when it failed to distribute float income to the plans. With regard to the account into which plan contributions were

This publication is provided for educational and informational purposes only and does not contain legal advice. The information should in no way be taken as an indication of future legal results. Accordingly, you should not act on any information provided without consulting legal counsel. To comply with U.S. Treasury Regulations, we also inform you that, unless expressly stated otherwise, any tax advice contained in this communication is not intended to be used and cannot be used by any taxpayer to avoid penalties under the Internal Revenue Code, and such advice cannot be quoted or referenced to promote or market to another party any transaction or matter addressed in this communication.

© 2014 Groom Law Group, Chartered • 1701 Pennsylvania Ave NW • Washington, DC 20006. All rights reserved.

deposited, the Eighth Circuit concluded that (a) Fidelity credited the participants' accounts and the plans became the owners of the shares of the investment options on the same day the contributions were made and the investment orders were placed; and (b) as the depository account was registered for the benefit of the investment options, the investment options held the property rights in the float earned in connection with the account. With regard to the float earned on amounts held in a redemption account pending the participants' cashing of distribution checks, the Eighth Circuit similarly concluded that the plaintiffs failed to establish that they had any ownership rights in the redemption account. Because the float was not a plan asset, the Eighth Court reversed the district court's judgment.

Observations

As the Eighth Circuit's ruling in *Tussey* highlights, the level of due diligence that plan fiduciaries undertake when making decisions regarding service providers and plan investments is often the central focus in a breach of fiduciary duty lawsuit. In *Tussey*, the court concluded that, with respect to recordkeeping fees, the plan fiduciaries should have been more thorough in conducting their due diligence, especially when they were informed by the benefit consulting firm that the plans may be paying too much for such services. The *Tussey* court's analysis of the plaintiffs' claims relating to the selection of investment options and mapping also emphasizes that the knowledge of the fiduciary resulting from its due diligence will be a principal focus when the district court, following remand, further evaluates the fiduciaries' conduct. Accordingly, *Tussey* underscores that fiduciaries should memorialize the steps taken and the information reviewed in selecting and monitoring plan service providers and plan investment options.

This publication is provided for educational and informational purposes only and does not contain legal advice. The information should in no way be taken as an indication of future legal results. Accordingly, you should not act on any information provided without consulting legal counsel. To comply with U.S. Treasury Regulations, we also inform you that, unless expressly stated otherwise, any tax advice contained in this communication is not intended to be used and cannot be used by any taxpayer to avoid penalties under the Internal Revenue Code, and such advice cannot be quoted or referenced to promote or market to another party any transaction or matter addressed in this communication.

© 2014 Groom Law Group, Chartered • 1701 Pennsylvania Ave NW • Washington, DC 20006. All rights reserved.