

April 1, 2010

## MEMORANDUM TO CLIENTS

### **Re: Class Certification Denied in 401(k) Rollover Lawsuit Against Principal; Court Rejects Arguments that Principal Acted as an ERISA Fiduciary**

A federal district court recently denied class certification in a lawsuit relating to the rollover of funds from 401(k) plans nationwide for which Principal Life Insurance Company provided retirement services. *Walsh v. Principal Life Ins. Co.*, -- F.Supp.2d. --, 2010 WL 1063738 (S.D. Iowa Mar. 24, 2010). As discussed below, in denying class certification, the court rejected many of the arguments that the plaintiff made in support of her claims that Principal Life and its affiliate, Princor Financial Services Corporation, were acting as ERISA fiduciaries in communicating with plan participants about the rollover of their 401(k) plan account balances into Principal Individual Retirement Accounts ("IRAs"). In addition to clarifying the duties of financial institutions that provide rollover services, the court's decision may impact the ongoing 401(k) fee lawsuits in which the courts are considering similar issues regarding whether plan service providers qualify as ERISA fiduciaries and whether there are appropriate grounds to certify a class consisting of a service provider's plan customers nationwide.

### **Background**

The lawsuit relates to what was referred to in the court's decision as a "benefit event" or "forced call" letter. According to the plaintiff, when a plan participant terminates employment, Principal sends a letter urging the participant to call Principal to discuss changes to the status of his or her 401(k) plan account. The plaintiff alleged that, when she called Principal, she was connected to a sales representative who discussed rolling her account balance into an IRA established with Principal. Plaintiff alleged that she suffered losses because the Principal proprietary investment products in which she subsequently invested through her IRA charged higher fees.

The plaintiff sought to have the court certify a plaintiff class consisting of participants in retirement plans nationwide for which Principal provided retirement services who responded to the letters that Principal sent and, between October 31, 2001 and October 31, 2007, established an IRA with Principal that included Principal affiliated investment products.

### **Principal's Fiduciary Status**

The court held that for the case to proceed as a class action, the plaintiff had to make a *prima facie* showing that the issue of whether Principal qualified as an ERISA fiduciary could be resolved on a class-wide basis. Plaintiff advanced five theories regarding how Principal could qualify as an ERISA fiduciary.<sup>1</sup>

The court rejected plaintiff's initial theory that Principal became a fiduciary because the benefit event/forced call letters were sent to the participants for Principal's own purposes, not for plan purposes. The court concluded that the plaintiff's theory was self-contradictory because a person is not a fiduciary unless the action at issue amounts to management or administration of the plan, which according to plaintiff's theory was not the case. The court also noted that a third-party service provider is not a fiduciary to the extent that it acts as a salesperson and does not provide investment advice or act as an agent for the plan administrator.

The court also rejected plaintiff's second theory that Principal was a fiduciary because, in sending the letters, it acted outside the framework of administrative policies established by the plan. According to the court, the question of whether a service provider acted within a framework of plan policies arises only after it has been established that the action at issue amounts to an exercise of plan management or administration. In other words, the fact that an action is taken outside the framework of plan policies is not alone enough to qualify a person as a fiduciary – the action itself must constitute an exercise of discretionary authority or control over plan management or administration.

Third, plaintiff argued that Principal's action in sending a letter styled "Official Notification" regarding a participant's retirement account was an exercise of discretionary plan management. The court rejected the argument, concluding that evidence that a service provider sent a notice to certain plan participants alerting them to a change in their status is not in and of itself sufficient to establish that the service provider undertook a discretionary act related to plan management. The plaintiff also would need to show that the substance of the subsequent phone communications between Principal and participants addressed future benefits under the plan, which the court concluded would require individualized inquiries inappropriate for resolution on a class basis.

Similarly, the court ruled that, even if the letters were sent to participants on behalf of a plan, the court would need to make an individualized inquiry into whether Principal's actions were ministerial (and not fiduciary) because at least some employers may have contractually agreed in their service agreement that Principal should send the letters to the participants. Finally, the court ruled that the fact that Principal had access to and used plan confidential

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<sup>1</sup> Under ERISA § 3(21), a person qualifies as a fiduciary to the extent that they (i) exercise discretionary authority or control over plan administration and management, (ii) exercise authority or control over the management or disposition of plan assets, or (iii) provide investment advice for a fee.

information for its mailings did not support a conclusion that Principal acted as a fiduciary even if it allegedly used the information for its own benefit.

The plaintiff also argued that Principal could be a fiduciary because it exercised "control" over the disposition of plan assets by inducing the participants to rollover their plan account balances. The court ruled that merely using its influence to persuade plan participants to make certain investment-related decisions with regard to the plan assets was not sufficient to make Principal an ERISA fiduciary. For Principal to qualify as a fiduciary, the court concluded that the plaintiff would need to establish that Principal, not the participant, controlled the decision to rollover the funds. As to plaintiff's fallback argument that Principal co-opted the decision making process, the court ruled that individualized issues relating to the specific interactions with each plan participant precluded class treatment.

Plaintiff's fifth theory was that Principal was a fiduciary because, in communicating with participants, it provided investment advice within the meaning of ERISA § 3(2)(A)(ii) and 29 C.F.R. § 2510.3-21(c). The court did not reject this theory outright. Rather, the court concluded that, under Department of Labor regulations, fiduciary status turns, in part, on whether the advice was regularly provided and whether there was a meeting of the minds that the participant would use the investment advice as a primary basis for making investment decisions. The court ruled that these questions could be not answered without looking at the individual interactions between Principal and the participants; thereby precluding the possibility that the case could proceed as a class action.

### **Disgorgement of Profits**

In evaluating the class issues, the court also provided a preview of its thinking on the potential applicability of the disgorgement of profits remedy available under ERISA § 502(a)(3). The plaintiff claimed that all fees and revenues that Principal received subsequent to the rollovers were "ill-gotten profits" that should be disgorged. The court did not agree that ERISA requires a breaching fiduciary to forfeit all of its rights to compensation for services in the event of a breach of fiduciary duty. The court indicated that it would be necessary for the plaintiff to establish that those revenues constituted profits, which would require the court to undertake an individualized inquiry into the fee structures of the plans and make fee comparisons to the various investment options chosen by the plan participants in rolling over their funds into the IRAs.

### **Other Class Issues**

The court also found that reliance and loss causation could not be established on a class-wide basis. The court explained that whether a participant relied on Principal's sales efforts depended on the individual interactions between the participants and Principal. The court noted that recordings of several phone calls between participants and Principal showed that the substance of the conversations varied extensively and that some participants placed minimal importance on the information provided by Principal. The court also noted that Principal submitted evidence that the rollover rate from plans into Principal IRAs was approximately the

same as the rollover rate industry-wide for 401(k) plans, which, according to the court, "carrie[d] some weight in rebutting [the] presumption of causation."

### **Observations**

This is the second time that a district court in the Southern District of Iowa has refused to certify a class consisting of ERISA plans for which Principal provided retirement services. Previously, the court denied class certification in a 401(k) fee case involving Principal. *Ruppert v. Principal Life Ins. Co.*, 252 F.R.D. 488 (S.D. Iowa 2008).

These decisions stand in contrast to the recent decision entered by a federal district court in Connecticut that granted class certification in a 401(k) fee case against Nationwide. A summary of the Nationwide decision case be found on our website at <http://www.groom.com/resources-440.html>. Nationwide has petitioned the Second Circuit for permission to proceed with an interlocutory appeal of the class certification ruling. The Second Circuit is expected to rule shortly on whether to permit an interlocutory appeal. The plaintiff in the Principal 401(k) rollover lawsuit may similarly seek an interlocutory review of this ruling.

As described above, the class certification rulings often address not only litigation procedure, but also provide insight as to the court's thinking on the substantive merits of the parties' claims and defenses. In this respect, the court's rulings regarding Principal's fiduciary status -- if affirmed on appeal by the Eighth Circuit -- are particularly informative in evaluating the relationship between plans and service providers.

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

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