GROOM LAW GROUP

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Kraft Foods Prevails in 401(k) Fee Lawsuit

The 401(k) fee cases continue to wind their way through the courts. As discussed below, an Illinois district court recently granted summary judgment in favor of the defendants in the fee lawsuit brought against Kraft Foods Global, Inc. ("Kraft"). *George v. Kraft Foods Global, Inc.*, 2010 WL 331695 (N.D. Ill. January 27, 2010).

The claims in the Kraft fee lawsuit are similar to those asserted in other fee cases. The plaintiffs – current and former participants in Kraft's 401(k) plan – alleged that Kraft, an Administrative Committee ("KFAC"), a Benefits Investment Committee ("BIC"), and individual members of BIC breached their fiduciary duties to plan participants by structuring the company stock funds as unitized funds, paying excessive recordkeeping fees, failing to properly account for the trustee's receipt of float, and failing to make adequate disclosures of plan fees and expenses to the plan participants.

Fiduciary Status of Defendants

As an initial matter, the court ruled that KFAC was a fiduciary with respect to the administration of the plan, first as a delegatee of another committee and later as a named fiduciary. The court also found that Kraft was a fiduciary with respect to the administration of the plan because Kraft retained the authority to appoint and remove members of KFAC. In this respect, the court noted that Kraft had an obligation to monitor whether the members of the KFAC were fulfilling their fiduciary duties.

The court further concluded that the BIC was a fiduciary because the plan vested BIC with discretionary authority regarding the plan's investments. The court, however, found that neither BIC nor its members could be held liable for fiduciary breaches that occurred prior to the creation of BIC in 2004, unless they were aware of prior fiduciary breaches and failed to take remedial action. As with the KFAC, the court ruled that Kraft was a fiduciary with respect to plan investments because Kraft retained the authority to appoint and remove members of BIC. The court did not expressly note that Kraft's duty was limited to monitoring its appointees, but the scope of Kraft's fiduciary duty did not become an issue in the decision.

Company Stock Funds

The Kraft 401(k) plan offered two company stock funds – one involving Kraft stock; the other involving the stock of Kraft's former corporate parent, Altria Group (formerly Philip Morris). These stock funds were offered as unitized funds, meaning that they included some cash for liquidity purposes. The plaintiffs alleged that offering the company stock funds as unitized funds was imprudent because the cash buffer in each fund resulted in an "investment drag," in that the investment returns of the Kraft stock fund trailed that of the Kraft stock by $3.5 million and the investment returns of the Altria stock fund trailed that of the Altria stock by $80 million over the relevant time period. The court exposed the hindsighted nature of the plaintiffs' argument by noting that the cash buffer "also can act as a hedge against possible decline in stock value."

The plaintiffs also argued that unitized funds improperly favor heavy traders in that the transaction costs associated with the company stock funds are borne equally by all participants invested in the funds. The plaintiffs pointed to evidence of internal Kraft discussions regarding concern over this "transactional drag." The court, however, found that the internal discussions showed that defendants properly considered the pros and cons of offering the stock funds as unitized funds, and that such discussions were evidence of fiduciary prudence. The court concluded that defendants' decision to continue to offer the stock funds as unitized funds (although its corporate parent, Altria, decided to eliminate "transactional drag" by implementing a "real-time trading product") was prudent in that the defendants made the decision after considering the pros and cons of unitized funds. In this regard, the court cited to *Taylor v. United Technologies Corp.*, 2009 WL 535779 (D. Conn. Mar. 3, 2009), *aff'd*, 2009 WL 425519 (2d Cir. Dec. 1, 2009), as holding that a "fiduciary's evaluation of merits of retaining cash in unitized company stock fund satisfied the prudent person standard."

The court also found that unitized funds are commonly used in the industry and that common industry practice was relevant in that fiduciary prudence is to be determined by comparing defendants' actions to those of "a prudent man acting in a like capacity and familiar with such matters." The court also gave credit to defendants' assertion that using unitized funds allows participants to trade between the company stock funds and other plan investment options without delay.

As to plaintiffs' argument that defendants failed to disclose that the company stock funds were "mismanaged," the court ruled that defendants satisfied their disclosure obligations by stating in the SPDs that the company stock funds contained a cash buffer which will result in "small differences in the rate of return" compared to the underlying stock. The court also ruled that defendants did not need to provide to participants a comparison of returns between the company stock funds and the underlying stocks because such comparison would not be an "apples to apples" comparison and, in any event, the performance of the underlying stocks were publicly available.

The court also highlighted that participants were free to invest in investment options other than the company stock funds. Based on the Seventh Circuit's decision in *Hecker v. Deere*, the court ruled that, in the absence of evidence that the investment alternatives offered are "unsound or reckless," the provision of a large number of investment alternatives from which participants could make informed investment decisions would preclude a finding that defendants breached their fiduciary duties.

Recordkeeping Fees

The plaintiffs maintained that defendants allowed the plan to pay $28 million in excessive recordkeeping fees. In this regard, the plaintiffs argued that a RFP process is the only way to determine whether recordkeeping fees obtained by a plan are reasonable, and that, over the years, defendants failed to conduct a RFP when deciding to renew the recordkeeping arrangement with Hewitt.

The court rejected plaintiffs' argument, concluding that a fiduciary does not always need to conduct a RFP when selecting plan service providers. The court noted that Hewitt was originally selected after a RFP, and that the consultant used to perform the initial RFP did not recommend that defendants perform another RFP if defendants were satisfied with the services provided by Hewitt. The court also highlighted that the defendants used consultants to benchmark Hewitt's fees and services and to assist in negotiations to renew the recordkeeping arrangement. And when the number of plan participants increased significantly due to a plan merger, the defendants negotiated lower recordkeeping fees and additional services. The court discredited the evidence offered by plaintiffs' expert as to the excessiveness of the fees paid by the plan because his experience was primarily in the mid-sized plan, not large plan market for retirement services. Based on these findings, the court ruled that the "number of times [defendants] reviewed and renegotiated their contract with Hewitt and their utilization of various standard industry methods to determine the reasonableness of Hewitt's fees," compelled a conclusion that defendants did not breach their fiduciary duties.

With regard to plaintiffs' claim that defendants failed to properly disclose recordkeeping fees, the court noted the Seventh Circuit's ruling in *Hecker v. Deere* that the critical information for participants is the total fees charged by the investment options. The court determined that the fees were embedded in the expense ratios of the investment options, and that the expense ratios were disclosed to participants in quarterly reports provided to participants, which also highlighted that most of the plan's administrative expenses – including recordkeeping fees – were paid from plan assets. The court also found that recordkeeping fees were disclosed on the plan's Form 5500. Accordingly, the court held that defendants did not breach their fiduciary duties as to the disclosure of recordkeeping fees.

Float Received by the Trustee

The plaintiffs also argued that the defendants breached their fiduciary duties in allowing the plan's trustee, State Street, to retain float. The plaintiffs claimed that defendants did not obtain enough information about State Street's retention of float to make an informed decision about State Street's compensation. In this regard, the plaintiffs cited to the Department of Labor Field Assistance Bulletin 2002-03 which provides that a plan fiduciary must have an adequate understanding of the float arrangement to make an informed decision.

The court, however, determined that defendants had adequate information regarding float because State Street's invoices stated that State Street would retain float as part of its compensation and disclosed the circumstances under which float will be earned and retained, when the float period would commence and end, and the type of interest rate used to value the float. The court also found that defendants had a meeting with State Street to discuss float, and that discussions from that meting indicated that State Street was providing annual disclosures of float amounts. Based on these findings, the court concluded that defendants did not breach their fiduciary duty by allowing State Street to retain float.

Conclusion

In many respects, the court's decision demonstrates that evidence of prudent decision making process engaged in by the plan's fiduciaries can be an effective way to counter fiduciary breach claims. Despite this victory, however, Kraft still faces a separate lawsuit brought by the same plaintiffs when the court denied plaintiffs' request to add Altria-related parties as defendants in this lawsuit. In that separate lawsuit, *George v. Kraft Foods Global, Inc.*, No. 08-cv-3799 (N.D. Ill.) ("*Kraft II*") (Castillo, J.), the plaintiffs assert the same company stock funds and recordkeeping expense claims against the Altria defendants, and assert a claim that both Kraft-related and Altria-related defendants breached their fiduciary duties by selecting and retaining a growth equity fund and a balanced fund as plan investment options. On December 17, 2009, the court in *Kraft II* dismissed the company stock funds and the recordkeeping expense claims with respect to an Altria committee named as a defendant, based on the court's finding that the six-year limitations period was applicable since the committee stopped being a fiduciary over six years before the complaint was filed. However, the claims were not dismissed with respect to other Altria-related defendants, and *Kraft II* is otherwise still proceeding.

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Groom Law Group is representing defendants in several of the 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:

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