

Benefits Briefing:

Recent Plan Litigation and the Impact on Legislative, Regulatory and Plan Sponsor Activity



Christopher J. Rillo
Bradford P. Campbell
Schiff Hardin LLP



Christopher J. Rillo
Partner
415.901.8631/202.778.6443/crillo@schiffhardin.com

Mr. Rillo concentrates his practice in ERISA and employee benefit litigation, fiduciary counseling and plan administration. He has extensive experience with:

- 401(k) plans, cash balance and other defined benefit plans
- Profit sharing and ESOPs
- Taft-Hartley trust funds and benefit plans
- Health and welfare plans
- COBRA
- Severance pay plans
- In addition, Mr. Rillo has been extensively involved in defending sponsors involved in large fiduciary class actions, including 401(k) fee cases, cash balance conversion and company stock issues. The cash balance conversion cases — recent ERISA variants — combine the Age Discrimination in Employment Act (ADEA) with ERISA's defined benefit provisions, creating complex, high-stakes litigation.



Bradford P. Campbell
Of Counsel
202.778.6402/bcampbell@schiffhardin.com

Mr. Campbell concentrates his practice in Employee Benefits/Executive Compensation and ERISA litigation, specializing in ERISA Title I issues, including fiduciary conduct and prohibited transactions. While Assistant Secretary of Labor for Employee Benefits and head of the Employee Benefits Security Administration, Mr. Campbell played a key role in every significant ERISA retirement and health reform of the past decade, and his regulatory and policy decisions had a fundamental impact on the structure and operation of ERISA plans:

- Orchestrated implementation of the most sweeping changes to pension regulations in 30 years, issuing nearly 30 regulations and major guidance documents
- Directed policy in major litigation, including filing amicus briefs in *RILA v. Fielder* and *LaRue v. DeWolff*
- Issued final regulations on QDIAs, electronic fee disclosure, and participant access to investment advice.
- Issued final HIPAA regulations governing wellness programs and nondiscrimination requirements
- Administered an enforcement program resulting in more than \$2.6 billion in monetary results and more than 200 criminal indictments

New Paradigm – Executive, Legislative and Judicial Branch Considering Related Issues at the Same Time

- **In the past, litigators worried about cases, benefits lawyers worried about DOL and IRS regulations, and no one worried about Congress except every five or ten years**
- **Since PPA and economic system meltdown, increased activity and interconnectivity**
- **Now, for example, litigators have to know what DOL and Congress are doing on plan fees, and benefits attorneys have to worry about what the courts are doing, as with cash balance plans**
- **What's a plan sponsor or fiduciary to do?**

Current Issues

1. **Plan Fee Cases – As the litigation winds its way through the courts, related regulatory and legislative activity continues**
2. **Stock Drop Cases – DOL’s litigation positions and issues facing sponsors and fiduciaries regarding company stock in pension plans**
3. **Pay or Play Cases – can proposed DOL regulations trump Supreme Court consideration?**

Plan Fee Litigation Issues

1. Appropriateness (prudence) of plan fees
2. Active v. passive management of investments
3. Who is a fiduciary?

Plan Fee Litigation – Prudence

Legal Standard

- **ERISA section 404(a):**

Prudent man standard of care

(1) [A] fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and—

(A) for the exclusive purpose of:

(i) providing benefits to participants and their beneficiaries; and

(ii) defraying reasonable expenses of administering the plan;

(B) 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;

Plan Fee Litigation – Prudence

Legal Standard - Continued

(C) by diversifying the investments of the plan so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so; and

(D) in accordance with the documents and instruments governing the plan insofar as such documents and instruments are consistent with the provisions of this subchapter and subchapter III of this chapter.

- **29 C.F.R. § 2550.408b-2, requires that arrangement to be “reasonable,” services are “necessary and appropriate” and no more than “reasonable compensation” paid**

Plan Fee Litigation - Prudence

- **Although prudence of plan expenses has always been a concern for fiduciaries, litigation took off when St. Louis firm filed seven actions in September 2006**
- **Other plaintiffs' firms joined in**
- **Generally, plaintiffs have not had huge success with these claims**

Plan Fee Litigation - Prudence

- **Cases brought against plan sponsors and service providers**
- **DOL has not brought its own suits (yet) but often supports cases, such as through SOL's amicus program**
- **Cases allege various theories, including:**
 - Fees charged are too high
 - Revenue sharing and similar payments are plan assets, resulting in prohibited transactions for service providers
 - Fiduciaries and service providers have failed to disclose fees and compensation
 - Investment options were improper:
 - Active v. passive management
 - Retail v. institutional shares

Plan Fee Litigation- Prudence Investment Company Act Standard

- **The Investment Company Act standard**
 - Investment Company Act of 1940, 15 U.S.C. § 80a-1, *et seq.* regulates investment companies, including mutual funds
 - Section 36(b) provides “[T]he investment adviser of a registered investment company shall be deemed to have a fiduciary duty with respect to the receipt of compensation for services, or of payments of a material nature, paid by such registered investment company, or by the security holders thereof, to such investment adviser or any affiliated person of such investment adviser” and authorizes an action for breach of such duty.

Plan Fee Litigation- Prudence Investment Company Act Standard

- ***Gartenberg v. Merrill Lynch Asset Management, Inc.*, 694 F.2d 923 (2d Cir. 1982)**
 - “[T]he test is essentially whether the fee schedule represents a charge within the range of what would have been negotiated at arm’s-length in light of all the surrounding circumstances.”
 - To violate statute “must charge a fee that is so disproportionately large that it bears no reasonable relationship to the services rendered and could not have been the product of arm’s-length bargaining.”
 - “all pertinent facts must be weighed” including the cost in providing services, economies of scale and the volume of orders processed; price charged by other similar advisers is one but not principal factor; fees charged to dissimilar clients, such as pension funds are not relevant
- **On March 30, 2010, Supreme Court endorsed *Gartenberg* test in *Jones v. Harris Assocs. L.P.*, 2010 WL 1189560**

Plan Fee Litigation- Prudence Investment Company Act Standard

- **Applicable to ERISA Cases?**
- **One court has applied *Gartenberg* standard in ERISA excessive fee case**
 - *Young v. General Motors*, 325 Fed. Appx. 31, 2009 WL 1230350 (2d Cir. May 6, 2009)
- **Mutual funds and the Investment Company Act are treated favorably by ERISA and DOL regulations**

Plan Fee Litigation – Prudence

Legislative and Regulatory Initiatives

- **Legislative Initiatives on Disclosure**
 - HR 1984, “The 401(k) Fair Disclosure for Retirement Security Act”
 - Introduced by Congressman George Miller in past two Congresses
 - Three new requirements with respect to the fees that plans pay:
 - Service Provider Disclosure
 - Notice of Investment Options
 - Participant Annual Benefit Statement
 - Include one indexed fund
 - New DOL enforcement

Plan Fee Litigation – Prudence Legislative and Regulatory Initiatives

- **Regulatory Initiatives on Disclosure**
 - Form 5500 Overhaul
 - Disclosure to Participants
 - On July 23, 2008, EBSA proposed regulations under ERISA section 404(a) on required disclosures to participants in individual account plans
 - Regulations were never made final in Bush Administration
 - Revised regulations expected to be published in summer 2010

Plan Fee Litigation – Prudence

Legislative and Regulatory Initiatives

- Service Provider Disclosure to Sponsors
 - DOL’s ERISA Section 408(b)(2) regulation
 - Because a service provider is a party in interest, transactions with plan requires exemptive relief
 - Current regulation, 29 C.F.R. § 2550.408b-2, requires only that arrangement to be “reasonable,” services are “necessary and appropriate” and no more than “reasonable compensation” paid
 - On December 13, 2007 DOL published proposed regulation
 - Tracked approach to 5500 reform
 - Required detailed disclosure from service providers to plan sponsors
 - After hearings, DOL sent final regulations to OMB, but were never finalized
 - Obama Administration sent Interim Final Rule to OMB on March 3, 2010, likely will be published in May or June

Plan Fee Litigation – Prudence Active/Passive Management

- **Some cases allege that inclusion of actively-managed vehicles in a plan’s line up is imprudent**

- *E.g., Taylor v. United Technologies Corp.*, No. 3:06cv1494 (WWE), 2009 WL 535779 (D. Conn. March 3, 2009):

“Plaintiffs argue that a prudent fiduciary should engage in extensive investigation prior to selecting an actively-managed mutual fund given the ‘near certainty’ that an actively-managed mutual fund will not outperform lower-fee index funds.”

- Court ruled for defendants; Court of Appeals for Second Circuit affirmed. *Taylor v. United Technologies Corp.*, 2009 WL 4255159 (2d Cir. Dec. 1, 2009)

Plan Fee Litigation – Prudence Active/Passive Management

- **Claims Echo Congressional Concern**

- At House Committee on Education and Labor's March 6, 2007 hearing on "Are Hidden 401(k) Fees Undermining Retirement Security?" witness Matthew D. Hutchison testified:

"Recent studies reveal (and many more continue to substantiate), that a passive 60% stock, 40% bond portfolio outperformed 90% of the nation's largest corporate pension plan portfolios, 'run by the world's best and brightest investment minds.' ... From a true fiduciary perspective, it is difficult to justify their existence considering a passive indexing approach requires no research and also consistently outperforms 90% of actively managed approaches that do require research. Considering this, a prudent fiduciary might question the value of such research. The 10% that do outperform an indexing approach statistically are temporarily fortuitous."

Plan Fee Litigation – Prudence Active/Passive Management

- **Claims Echo Congressional Concern**
 - Congressman George Miller's "401(k) Fair Disclosure for Retirement Security Act," H.R. 1984, requires a plan to include an indexed fund in line up to receive section 404(c) protection
 - Would be the first time ERISA mandated a particular investment

Plan Fee Litigation – Prudence Active/Passive Management

- **Now Under Consideration at DOL**
 - On March 2, DOL published in the Federal Register a revised proposed regulation on investment advice to plan participants and IRA holders. The proposed regulation would replace the Bush Administration final rule withdrawn by the Obama Administration.
 - The new proposed rule implements the Pension Protection Act “level fee” and “computer model” prohibited transaction exemptions for providing participant advice.
 - The proposal would prevent a computer model from taking into account the investment performance of two funds within the same asset class, but would require the model to take into account fees. The rationale is that fees are “likely to persist” in the future, but investment returns are not.
 - The preamble invites comment on a series of questions, including several inquiring whether past performance is an appropriate consideration for computer models and whether actively-managed funds should be assigned a different level of risk than passive investments

Plan Fee Litigation – Who is a Fiduciary

- **Preliminary Issue – when service provider is involved in selection of investment options, is it a fiduciary?**
 - Plan sponsor has fiduciary obligation to select and monitor investment choices, ERISA § 404(c); 29 CFR 2550.404c-1
- **Two cases take apparently different approaches to service providers**
 - *Haddock v. Nationwide Financial Services, Inc.*, 419 F. Supp.2d 156 (D. Conn. 2006)
 - Denying motion for summary judgment
 - Allegations that Nationwide allegedly exercised some control over the selection and offering of particular mutual funds as investment options for plans and participants is sufficient to create question of material fact
 - Court reiterated its inclination in decision granting summary judgment *Haddock v. Nationwide Financial Services, Inc.*, 262 F.R.D. 97 (D. Conn. 2009)

Plan Fee Litigation – Who is a Fiduciary

- *Hecker v. Deere & Co.*, 496 F.Supp.2d 967 (W.D. Wis. 2007):
 - Granting Fidelity’s motion to dismiss, because plan sponsor had ultimate responsibility for selecting investments
 - Relying on the fact that the plan’s brokerage window gave participants many choices
 - Affirmed by Court of Appeals by Seventh Circuit, *Hecker v. Deere & Co.*, 556 F.3d 575 (7th Cir. 2009), rejecting argument that Deere’s approval of investment options was merely “rubber stamp” of Fidelity’s decisions
 - Clarifying opinion in response to request for rehearing, largely responding to DOL’s amicus brief, *Hecker v. Deere & Co.*, 569 F.3d 708 (7th Cir. 2009), limiting opinion to facts of case

Plan Fee Litigation – Who is a Fiduciary

- **DOL Activity**
 - **Litigation**
 - SOL not pleased with *Hecker*
 - Filed amicus brief in support of reconsideration of *Hecker* warning of dire consequences
[http://www.dol.gov/sol/media/briefs/deere\(A\)-03-17-2009.htm](http://www.dol.gov/sol/media/briefs/deere(A)-03-17-2009.htm)
 - DOL amicus brief in *Loomis v. Exelon*
[http://www.dol.gov/sol/media/briefs/loomis\(A\)-03-10-10.htm](http://www.dol.gov/sol/media/briefs/loomis(A)-03-10-10.htm)
 - **Regulatory Activity**
 - EBSA has indicated an intention to issue a proposed revision to regulation defining “fiduciary investment advisor;” was expected in June 2010
 - Intended to include consultants and investment advisers who currently avoid fiduciary duties by stating in their contracts that they provide information and non-fiduciary advice to plan sponsors who have fiduciary responsibility over the plan.

Stock Drop Litigation – A Fiduciary’s Dilemma

- Individual account plans frequently require or permit investment in securities issued by the plan sponsor; employee stock ownership plans exist for the purpose of investment in such employer stock
- When the securities decline in value, ERISA breach of fiduciary duty claims are filed, often in tandem with securities actions
 - More than 200 such cases have been filed since Enron’s collapse in 2001

Stock Drop Litigation

Legal theories

- Cases allege that continuing to offer the stock fund, or holding company stock, is imprudent
 - Cases often include claims that fiduciaries misrepresented the prudence of the securities
 - Cases often arise when company is alleged of financial wrongdoing or misstating financials

Stock Drop Litigation – A Fiduciary’s Dilemma

- **Is there a duty to override plan language expressly providing for employer stock investments, and if so, when and under what circumstances?**
- Courts have adopted a presumption of prudence for ESOP and EIAP fiduciaries. That presumption treats a fiduciary's decision to continue offering company stock investments under such a plan as being consistent with ERISA's standard of prudent care, unless circumstances unforeseen by the plan's settlor somehow create the type of dire economic situation that would make continued company stock investments defeat the plan's purpose.
 - *Moench v. Robertson*, 62 F.3d 553 (3d Cir. 1995) *Kuper v. Iovenko*, 66 F.3d 1447, 1458 (6th Cir.1995); *Kirschbaum v. Reliant Energy, Inc.*, 526 F.3d 243, 253 (5th Cir.2008)

Stock Drop Litigation – The Presumption of Prudence

- Courts have increasingly applied the presumption at the pleadings stage, granting motions to dismiss, and in cases in which plan did not mandate employer stock option
 - *Fisher v. JP Morgan Chase & Co.*, No. 03 Civ. 3252, 2010 WL 2010 WL 1257345 (S.D.N.Y. March 31, 2010)
 - *Herrera v. Wyeth, et al.*, No. 08 Civ. 4688 (RJD), 2010 WL 1028163 (S.D.N.Y. Mar. 16, 2010)
 - *In re Citigroup ERISA Litig.*, No. 07 Civ. 9790, 2009 WL 2762708 (S.D.N.Y. Aug. 31, 2009)
- *Sims v. First Horizon Nat'l Corp.*, No. 2293-STA-cgc,2009 WL 3241689 (W.D. Tenn. Sept. 30, 2009)
 - Although the court denied Defendants' motion to dismiss, it granted their motion for interlocutory appeal to Court of Appeals for Sixth Circuit on whether the presumption of prudence a pleading, as well as evidentiary standard

Stock Drop Litigation – New DOL Position

- In the past, DOL has argued that the presumption does not apply if the fiduciaries made no attempt to investigate the prudence of holding employer securities, and should not apply at the pleadings stage, but did not attack the validity of the presumption itself
 - Amicus Brief of Secretary of Labor in *Agway Inc. Employees' 401(k) Thrift Investment Plan v. Magnuson*,
[http://www.dol.gov/sol/media/briefs/agway\(A\)-6-18-2004.htm](http://www.dol.gov/sol/media/briefs/agway(A)-6-18-2004.htm)
- In *Citigroup* amicus brief DOL makes a more direct challenge against the presumption of prudence:

[The presumption] should not apply to a case, like this one, that challenges the prudence and loyalty of purchasing company stock in light of information that the stock's price was "unlawfully and artificially inflated." . . . In this context, presuming that the fiduciaries acted prudently is unwarranted, and the company's viability is irrelevant. Knowingly overpaying for an asset is neither prudent nor in the interest of plan participants and beneficiaries. . . . This follows from the well-established rule that a fiduciary breaches his duties by knowingly paying too much for an asset for the plan.

Questions?