

Client Alert.

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Ruling Highlights Importance of Fiduciary Process Surrounding 401(k) Plan Fees and Services

By Paul Borden and Mike Frank

On March 31, 2012, the U.S. District Court for the Western District of Missouri awarded plaintiffs more than \$35 million in a class action suit over certain breaches of duty related to 401(k) plan expenses.

The case was brought on behalf of participants in two 401(k) plans sponsored by a major manufacturer of power and automation equipment with operations in around 100 countries and more than 135,000 employees.

In *Tussey v. ABB, Inc.*,¹ the District Court held that ABB, Inc. and its benefit and investment committees (collectively, "ABB") violated their fiduciary duties to the plans when they failed to monitor record-keeping costs, failed to negotiate rebates from investment companies on the plans' investment platform, selected mutual fund share classes that were more expensive than necessary, and replaced a mutual fund with a fund offered by an affiliate of the record keeper for the plans. In addition, the District Court found that the employer and its benefits committee violated their fiduciary duties to the plans by agreeing to pay the record keeper above market record-keeping fees in order to subsidize other corporate services provided to the employer by the record keeper, such as payroll and record keeping for other employee benefit plans.

FAILURE TO MONITOR RECORD KEEPING EXPENSES

The District Court found that the employer never calculated the dollar amount of the fees paid to the record keeper via revenue-sharing arrangements for record-keeping services, nor did it consider how the plans' size could be leveraged to lower record-keeping costs. The District Court further noted that, in fact, the employer never obtained a benchmark cost of record-keeping services before choosing revenue sharing as the method for compensating the record keeper (even when an outside consulting firm told the employer that it was overpaying and that it appeared the record-keeping fees were subsidizing other corporate services provided to the employer by the record keeper).

FAILURE TO NEGOTIATE REBATES

Noting the Investment Policy Statement for the plans, which stated that rebates would be used to offset or reduce the cost of providing administrative services to participants, and the employer's failure to monitor record-keeping fees, the District Court held that the employer violated its fiduciary duty to the plans by failing to leverage its "purchasing power" to negotiate rebates from the record keeper. The District Court noted that the employer never asked about, and never discussed, rebates with the record keeper.

SELECTION OF SHARE CLASSES

Noting that the Investment Policy Statement of the plans required the employer to choose the share class that had the

¹2012 U.S. Dist. LEXIS 45240 (W.D. Mo. Mar. 31, 2012).

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lowest expense ratio, the District Court held that the employer violated its fiduciary duty by selecting or keeping more costly classes of investments on the plans' investment platform, when less expensive classes of those same investments were available, in order to maintain the revenue-sharing level to the record keeper, and not because of a difference in their merit or value to the participants. The District Court noted that, standing alone, the use of revenue sharing to pay record-keeping fees is not imprudent.

MAPPING FROM ONE FUND TO ANOTHER

The District Court held that the employer failed to engage in a deliberative assessment of the merits when it removed assets from a "well-known" fund offered by Vanguard with a 70-year track record and "mapped" them to a fund offered by an affiliate of the record keeper, which the District Court found "routinely underperformed" and believed was chosen because of the employer's relationship with the recordkeeper. The District Court also noted that that, in de-selecting the original fund, the employer failed to follow the process outlined in the plans' Investment Policy Statement.

SUBSIDIARY OF CORPORATE ADMINISTRATIVE SERVICES WITH EXCESSIVE REVENUE SHARING GENERATED BY 401 PLAN ASSETS

While suspicious, the District Court did not find sufficient evidence to conclude that the employer knew that the record keeper and its affiliates provided the employer corporate services at a discount because of the "lucrative" record-keeping fees. However, the District Court noted that an employee was put on notice, via an email from the record keeper, that the amount of the plans' fees was the reason why no fees were assessed to the employer for administering other corporate services and he had a fiduciary obligation to investigate and prevent any future subsidy, which he failed to do.

WHAT SHOULD EMPLOYERS DO?

In light of the *Tussey* case, we recommend that employers with a 401(k) plan:

- Identify and fully understand fees incurred by plans
- Evaluate whether the plan fees are reasonable
- Confirm periodically that the plan includes the lowest-cost-available fund classes
- Leverage plan size to reduce plan expenses
- Document fiduciary analysis and conclusions
- Review plan documents regularly and verify that potential actions are consistent with plan documents
- Review and revise the plan's investment policy to avoid making commitments that may be difficult to fulfill

QUESTIONS?

Please contact your MoFo attorney or any member of the Compensation, Benefits & ERISA Group.

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