ERISA LITIGATION MATTERS AND EVOLVING BEST PRACTICES

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ERISA LITIGATION MATTERS AND EVOLVING BEST PRACTICES

I. <u>Are You A Fiduciary?</u> At what point in its efforts to assist an employer with the employer's responsibilities in relation to a 401(k) plan does an investment professional take on a fiduciary role under ERISA? This is a critical question, since ERISA has rules governing fiduciaries that do not apply to non-fiduciary service providers.

ERISA fiduciaries are either named in the plan document or are identified by the function they perform for the plan. Since fiduciary status may be based on a person's conduct rather than his title, it is possible to be a fiduciary without being aware of it. Regardless of whether he has knowledge of his status, an ERISA fiduciary must (1) act for the exclusive purpose of providing retirement benefits to plan participants, (2) fulfill a duty of loyalty to the plan and its participants, (3) act prudently, and (4) avoid conflicts of interest and acts of self-dealing known as prohibited transactions.

The definition of a fiduciary includes any person who exercises any authority or control respecting the management or disposition of plan assets. Assuming that an investment professional lacks such control, he could also be a fiduciary to the extent that he renders advice for a fee or other direct or indirect compensation, with respect to any monies or other properties of the plan, or has any authority or responsibility to do so. In other words, if you receive compensation for which you have the responsibility to provide investment advice or for which you actually provide investment advice, you will be a fiduciary.

A. <u>Definition of Investment Advice Fiduciary</u>. Section 3(21)(A)(ii) of ERISA includes within the definition of "fiduciary" a person that renders investment advice for a fee or other compensation, direct or indirect, with respect to any monies or other property of a plan, or has any authority or responsibility to do so.[1] DOL regulations have amplified this definition by stating that a person will be viewed as rendering investment advice only if both of the following conditions are met: (1) the advice relates to the value of securities or other property or constitutes a recommendation as to the advisability of investing in, purchasing, or selling securities or other property, and (2) either (a) the person has discretionary authority or control with respect to purchasing or selling securities or other property for the plan, or (b) the person renders advice to the plan on a regular basis under an agreement or understanding (written or otherwise) that the advice will be a primary basis for investment decisions with respect to plan assets, and that it will consist of individualized investment advice to the plan based on its particular needs. The particularized needs of the plan include such matters as investment policy or strategy, overall portfolio composition, and diversification of investments.[2]

As noted, to characterize a person rendering investment advice as a fiduciary, he or she must be compensated for the advice. The compensation may take the form of a fee paid by the plan or the plan sponsor or some other form of indirect compensation paid by a third party, such as a mutual fund. The receipt of a commission may be sufficient for this purpose, even though

[1] Under ERISA Section 3(21)(A)(i), the definition of a fiduciary also includes anyone who "exercises any authority or control respecting management or disposition" of plan assets.
[2] DOL Regulation Section 2510.3-21(c)(1).

no payment has been specifically allocated to the provision of investment advice. Indirect forms of compensation, such as 12b-1 fees, soft-dollar arrangements and revenue sharing, pursuant to which an adviser receives something of value from an investment provider, would be taken into account for purposes of determining fiduciary status.

The test for determining fiduciary status is a functional one. In other words, if a person renders investment advice, as described above, for which he is compensated, he will be considered to be a fiduciary regardless of his title or official designation. The activities of many broker-dealers would cause them to be treated as plan fiduciaries.[3] Nevertheless, not every broker would come within this definition, and it should be noted that the regulation relating to investment advice fiduciaries has an exemption for stockbrokers that provides that a broker will not be deemed to be a fiduciary solely because he executes transactions for the purchase or sale of securities on behalf of a plan in the ordinary course of business pursuant to the instructions of a plan fiduciary.[4]

B. What is a Fiduciary's Basic Duty? The basic duty of a fiduciary under ERISA is to discharge his or her duties solely in the interest of the plan's participants and beneficiaries and for the exclusive purpose of providing benefits for the participants and their beneficiaries and defraying reasonable administrative costs of the plan. Affirmative fiduciary duties include such responsibilities as selecting proper investments and monitoring them to ensure that they yield a reasonable return, properly diversifying investments, seeing to it that the plan has sufficient liquidity, and managing the administrative aspects of the plan.[5]

II. Indirect 401(k) Plan Fees and Expenses

A. Background. An important part of a fiduciary's responsibility includes identifying, understanding, and evaluating fees and expenses associated with plan investments, investment options and services. When they initially consider a new investment, fiduciaries should be aware of all hard dollar payments made directly by plans as well as "revenue sharing" and similar payments made indirectly by third parties. The latter are sometimes referred to as "indirect fees", since they are ultimately charged back to a participant's account. Fiduciaries should also monitor such payments to determine if they continue to be reasonable. While the reasonableness of fees and expenses is a concern for all qualified plans, it is particularly important for 401(k) plans, because they generally bear a higher proportion of the fees and expenses. Monitoring fees and expenses is an ongoing fiduciary responsibility.

The recent Seventh Circuit Court of Appeals decision in Hecker v. Deere (February 12, 2009) has generated headlines for its holding that revenue-sharing is not prohibited by ERISA and that nothing currently requires that it be disclosed to plan participants. The decision is a significant development with respect to similar litigation which, at bottom, is based on claims of excessive fees. However, it is not an appropriate guide for future conduct and plan

[3] See Ellis v. Rycenga Homes, Inc., No. 1:04-cv-694, 2007 WL 837224 (W.D. Mich. 2007), in which a broker's consultations on investment matters over a plan's 20-year history resulted in a summary judgment concluding that the broker was a plan fiduciary.

[4] DOL Regulation Section 2510.3-21(d).

[5] ERISA Sections 403(c)(1) and 404(a).

administration. The DOL has already issued regulatory proposals that would require plan service providers to furnish plan administrators with written disclosure as to indirect compensation. Additional proposals would require plan fiduciaries to provide participants with an annual statement providing detail as to administrative, individual and investment related expenses. S.406, as filed by Senators Harkin and Kohl, would codify similar proposals as a statutory enactment.

B. Types of Indirect Fees. There are at least eight kinds of indirect 401(k) plan fees and expenses that fiduciaries should be aware of: (i) SEC Rule 28(e) Soft Dollars, (ii) Sub-transfer Agent Fees, (iii) 12b-1 Fees, (iv) Variable Annuity Wrap Fees, (v) Investment Management Fees, (vi) Sales Charges, (vii) Revenue Sharing Arrangements, and (viii) Float.

> *1. SEC Rule 28(e) Soft Dollars*. Brokerage firms may charge extra commission that can be used by investment advisors and others to purchase services, such as, valuable investment research. Such excess commission must be reasonable with respect to the services provided. Fees that are illegal under Rule 28(e) also violate ERISA Sections 403(c)(1), 404(a)(1) and 406(a)(1)(D). Fiduciaries should know whether they are being charged Rule 28(e) fees._
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> *2. Sub-transfer Agent Fees*. Brokerage firms and mutual funds often sub-contract recordkeeping and other services related to participant shares to a third party called a sub-transfer agent. Payments to these third parties are sub-transfer agent fees. The problem is not the receipt of such fees by the third parties, but whether the fee fairly represents the value of the services being rendered. The DOL, in its publication A Look at 401(k) Plan Fees, has made it clear that a plan sponsor must understand the value and associated compensation of each company providing services to the plan.
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> *3. 12b-1 Fees*. 12b-1 fees are, in general, distribution expenses paid by mutual funds from fund assets. They may include commissions to brokers, advertising or other marketing expenses, and fees for administrative services provided by third parties to fund shareholders. 12b-1 fees can be as much as 1% of a fund's assets on an annual basis. Fiduciary audits have revealed that plan sponsors who have invested in mutual funds with high 12b-1 fees could have invested in a similar mutual fund without paying any 12b-1 fee or a lower 12(b)-1 fee.
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> *4. Variable Annuity Wrap Fees*. Variable annuities are insurance products that invest in mutual funds. Internal investment gains in such annuities are tax-deferred but the product is subject to commissions. Therefore, one must ask if it is prudent to invest in a variable annuity and pay for commissions if gains under an ERISA-covered plan are already tax deferred. Also, variable annuities have expenses that may be greater than the costs charged by mutual funds. These are wrapped into a single aggregate fee called a "wrap fee." Wrap fees include investment management fees, surrender charges, mortality and expense risk charges, administrative fees, fees and charges for other features, and bonus

credits. Investing in a variable annuity could be considered imprudent if the same underlying mutual funds are available at a lower cost outside of the variable annuity.

5. *Investment Management Fees*. Investment management fees are fees for managing investment assets and they are usually charged as a percentage of the assets invested. These fees are usually deducted directly from the investment return.

6. *Sales Charges*. Sales charges are also known as loads or commissions. These are transaction costs for buying and selling investment products.

7. *Revenue Sharing Arrangements*. Revenue sharing is the practice by mutual funds or other investment providers of paying other plan service providers, e.g., the plan's recordkeeper or other third party administrator, for performing services that the mutual fund might otherwise be required to perform.

8. *Float*. Float refers to earnings retained by a service provider (usually a bank or brokerage company) that result from short-term investments in liquid accounts used to facilitate cash transactions. Funds held in these accounts could include funds to cover checks issued for benefit payments by benefit plans that are not yet presented for payment by the recipient, or uninvested funds awaiting investment instructions from a plan fiduciary. The Department of Labor requires service providers to inform plan fiduciaries of the existence of float and the circumstances under which it will be earned and retained. See FAB 2002-3.

Comment: There is a classification of mutual funds of which employers should be aware. These are so-called "R funds" which generally offer the same types of mutual funds that can be purchased through normal brokerage systems, but they are specifically designed for pension plan investments and often carry one or more of the above-referenced indirect fees.

C. Indirect Fee Litigation. A not unexpected by-product of the increased public and regulatory interest in 401(k) plan fees and expenses has been the filing of lawsuits against some of the nation's largest employers and investment providers charging that they breached their fiduciary duties by failing to identify and/or monitor indirect fees (as well as hard dollar payments) and to establish and follow procedures to determine whether such payments were reasonable. The complaints filed against plan sponsors allege that the defendants failed to monitor and control, or even to inform themselves, of such payments, failed to establish procedures to determine that they were justified, and also failed to disclose such fees to plan participants.

1. *The First Salvo*. Claims by plan fiduciaries against service providers contending that the providers violated ERISA Section 406(b)(1) (self-dealing) and 406(b)(3) (kickbacks).

a. Haddock v. Nationwide Financial Services, Inc. (D. Conn. 2006). This decision denied a motion for summary judgment by an investment provider that had been sued by the trustees of five employer sponsored retirement plans over the provider's receipt of fees from mutual funds offered as investment options under variable annuity contracts. The Court held that there were triable issues of fact as to the following issues:

i. Whether Nationwide was a plan fiduciary because it retained the discretion to add or delete fund options to the investment mix or whether it was a fiduciary merely as a result of initially choosing funds for its investment platform;

ii. Whether revenue sharing payments made to Nationwide were plan "assets" within the meaning of the prohibited transaction provisions of ERISA, notwithstanding an acknowledgement by the Court that assets held by mutual funds are not plan assets; and

iii. Whether Nationwide's receipt of revenue sharing could have involved prohibited transactions even if revenue sharing payments are not plan "assets." The Court noted that a trier of fact might be able draw the inference that Nationwide provided only nominal services to the plan and that service contracts with mutual funds pursuant to which revenue was shared were merely shelf space arrangements.

A motion to dismiss based on similar arguments was denied in 2007.

b. Ruppert v. Principal Life Insurance Company (S.D. Ill.). The complaint in this case alleges that Principal is a fiduciary by virtue of offering full service 401(k) plans to employers and by maintaining the ability to change plan investment offerings. It also alleges that Principal committed violations of Sections 406(b)(1) and 406(b)(3) of ERISA by receiving revenue sharing payments from mutual funds. The complaint contains additional allegations that Principal's failure to disclose the existence of its revenue sharing arrangements to the plans and to participants was a fiduciary breach.

The plaintiff's motion for class certification was denied on August 27, 2008, because an intense plan by plan inquiry would have been required to evaluate the plaintiff's claim that the defendant insurance company was a fiduciary as to each of the more than 25,000 different plans that plaintiff sought to include in the class.

c. Phones Plus, Inc. v. Hartford Financial Services (D. Conn.). The complaint was brought by a 401(k) plan fiduciary against the Hartford alleging that revenue sharing payments were for services that the Hartford was already obligated to provide to its plan clients. As in the Haddock and Ruppert complaints, there is an allegation that revenue sharing payments are plan assets.

In Phones Plus, Inc. v. Hartford Financial Services Group, Inc. 2007 WL 3124733 (D. Conn. 2007), issued on October 23, 2007, the district court denied a motion to dismiss, and in so doing adopted a lenient approach to the plaintiff's pleadings.

The plaintiff, a sponsor of a 401(k) plan, alleged that Hartford Life Insurance Company and its holding company parent, as well as the 401(k) plan's investment adviser, had breached their fiduciary duties as a result of revenue sharing agreements that Hartford had entered into with various mutual fund companies. Hartford moved for dismissal on the ground that it was not a fiduciary and that, in any case, revenue sharing payments are not plan assets. The investment adviser also moved for dismissal on the ground that investigating Hartford's receipt of revenue sharing payments was beyond the limited scope of its fiduciary obligations as an investment adviser and that, in any event, it did not know of and did not receive any of the revenue sharing payments. The motions to dismiss with respect to both defendants were denied.

The most significant aspect of the Phones Plus decision may lie in the court's conclusion that it is possible to allege a set of facts (to be proven in subsequent phases of the case) under which revenue sharing payments are plan assets. The Seventh Circuit in Hecker v. Deere recently ruled to the contrary on this point.

As to Hartford Life's status as a fiduciary, the court in Phones Plus ruled that the company's power to add, delete or substitute mutual funds to or from the plan's menu of funds could render it a fiduciary, notwithstanding Department of Labor Advisory Opinion 1997-16A that reached a contrary conclusion on similar facts. The court noted that the question of fiduciary status is inherently factual and depends on the particular actions or functions performed on behalf of the plan. The advisory opinion was held to be inapplicable, because its facts differed from the facts alleged by the plaintiff. For example, Hartford gave a plan only 30 days' advance notice when it proposed to make a change in its fund lineup, whereas under the advisory opinion the plan had been given 120 days to accept proposed changes or to reject them and terminate the contract.

As to the investment adviser's contention that it had no duty to investigate Hartford's receipt of revenue sharing, the court indicated that the scope of the adviser's fiduciary duties was a matter to be determined by interpreting the terms of the advisory agreement. This enabled the court to conclude that the plaintiff had made allegations as to the adviser's obligation to investigate, discover, and inform the plaintiff of allegedly unlawful or excessive fees that might be substantiated during a trial.

2. *The Main Thrust*. Participant claims against plan sponsors and related plan fiduciaries were filed in September and October of 2006 by the law firm of Schlicter, Bogard & Denton, LLP of St. Louis, MO. Defendants include sponsoring employers, plan committees, company officers, directors and employees, but not plan providers. The core allegation is that these defendants breached their fiduciary duties under Section 404(a) of ERISA by causing or allowing plan providers to be paid excessive fees for their services. The alleged excessive payments included hard dollar payments made directly by plans as well as revenue sharing payments made by third parties. A novel aspect of these complaints is the allegation that the plan fiduciaries failed to capture revenue sharing monies embedded in the expense ratios of mutual funds offered under the plans even though these funds were not paid to any service providers. Notwithstanding the fact that the mutual funds themselves were not joined as defendants, this claim is an indirect attack on excessive mutual fund expense ratios based on the contention that plan fiduciaries had a duty to challenge such fees.

a. Partial List of Cases:

i. Abbot v. Lockheed Martin Corp. (S.D. Ill.); motion to dismiss denied on August 13, 2007
ii. Beesley v. International Paper Company (S.D. Ill.)
iii. George v. Kraft Foods Global, Inc. (S.D. Ill.); motion to dismiss denied on March 16, 2007
iv. Kanawi v. Bechtel Corp. (N.D. Cal.); motion to dismiss denied on May 15, 2007
v. Loomis v. Exelon Corp. (N.D. Ill.) ; motion to dismiss granted in part and denied in part on February 21, 2007
vi. Martin v. Caterpillar, Inc. (W.D. Mo.); motion to dismiss second amended complaint denied on September 25, 2008
vii. Spano v. Boeing Co. (S.D. Ill.); motion to dismiss denied on March 16, 2007
viii. Taylor v. United Technologies Corp. (D. Conn.);motion to dismiss granted in part on August 9,2007 as to the claim that defendants breached the fiduciary duty to disclose revenue sharing
ix Will v. General Dynamics Corp. (S.D. Ill.)

b. Issues.

i. Whether defendants acted prudently in selecting investment options.

ii. Whether defendants are entitled to protection under Section 404(c) of ERISA.

i. Whether plan fiduciaries have a duty to seek mutual funds with the lowest expense ratios.

ii. Whether the protection of Section 404(c) of ERISA is lost as a result of the failure to fully disclose to participants the amounts and nature of direct as well as indirect fees.

iii. Whether the failure to disclose direct and indirect fees to participants constitutes a fiduciary breach.

3. New Tactics - Additional Complaints Joining Providers. In December of 2006, the Schlicter law firm filed new complaints against plan sponsors and related fiduciaries seeking the same relief as in the cases filed earlier. In addition, the new round of complaints made defendants of plan service providers such as Fidelity Management Trust Company and Fidelity Management & Research Company claiming that they had breached their fiduciary duties by (i) causing or allowing plans to pay plan service providers excessive fees either directly

or through revenue sharing and (ii) "secretly" charging and retaining revenue sharing payments that should have been used to benefit plans and participants.

a. List of Additional Cases:

i. Hecker v. Deere & Co. (W.D. Wis.)
ii. Renfro v. Unisys Corp. (C.D. Cal.)
iii. Kennedy v. ABB, Inc. (W.D. Mo.)

4. Fee Lawsuits: Courts Show Caution in Denying Motions to Dismiss. Litigation challenging the fees and expenses paid by 401(k) plans continues to proliferate and represents a major threat to the industry. With the notable exception of Hecker v. Deere, 496 F. Supp. 2d 967 (W.D. Wis. 2007), discussed in c. below, the trial courts have been cautious in dismissing these lawsuits at an early stage. Despite the fact that preliminary rulings are not the same as a judgment on the merits, the lack of early dismissals seems to have encouraged the plaintiff's bar to file even more class action lawsuits over fees. This should come as no surprise, since this type of litigation has the potential to generate enormous legal fees. This trend may intensify as participants seek to recover 401(k) plan losses exacerbated by the current economic downturn.

a. Favorable Defense Rulings. In the meantime, several courts have joined the Hecker court by granting motions to dismiss in 2008.

In Braden v. Wal-Mart Stores, Inc. (W.D. Mo. 2008), Wal-Mart was charged with breaching its duties of prudence and loyalty by selecting retail class mutual funds as investment options. These funds were generally more expensive than institutional class funds. The plaintiffs' complaint compared the plan's investment options with less expensive funds available in the marketplace. However, the court held that this was not sufficient to allow the action to move forward, because there were no factual allegations that Wal-Mart had failed to investigate the funds. The court reasoned that the mere existence of less expensive funds did not mean that the actual selection of more expensive funds was a breach of fiduciary duty. The court also dismissed claims that Wal-Mart had committed prohibited transactions involving revenue sharing, since this practice is not inherently illegal or unreasonable. Finally, the court dismissed the claim that Wal-Mart had failed to provide participants with complete and accurate information, since there was no duty to disclose revenue sharing and the information the plaintiffs sought was not material.

In Columbia Air Services, Inc. v. Fidelity Management Trust Co., 2008 WL 4457861 (D. Mass. 2008), the court also ruled favorably for the trustee-defendant which, it was claimed, had breached its duty of loyalty by receiving a share of mutual fund fees earned by funds advised by an investment adviser belonging to the same funds family as the trust company. However, the court held that the plaintiffs had failed to allege facts showing that the directed trustee was acting as a fiduciary in negotiating the terms of its engagement, including it compensation. Therefore, the claim was dismissed.

Kanawi v. Bechtel Corp, No. C 06-05566 (CRB) (N.D. Cal 2008) was also favorable to the defendant in that Bechtel's motion for summary judgment was granted with respect to the plaintiff's claim that it had caused the plan to pay unnecessary mutual fund fees. The court held that the plaintiffs had failed to show that the plan had paid unnecessary layers of fees, because most of the plan-level fees had been paid by the employer rather than the plan. The same reasoning applied to the claim that fees paid to the investment adviser constituted a prohibited transaction. The court also reasoned that since the plan's fiduciaries met regularly to discuss the plan's investments and sought the advice of an outside consultant in such matters, the evidence did not support a conclusion that that the fees were unreasonable.

Kanawi was a mixed result, however, since the court denied the defendant's motion for summary judgment with respect to a four month period when the plan paid advisory fees with plan assets. The court also denied defendant's motion for summary judgment based on a Section 404(c) defense, since there were factual issues as to whether the plan met the requirements of this defense.

b. Plaintiffs' Victories. More typical of early stage 401(k) fee litigation than the cases discussed above is the denial of defendant's motion to dismiss in Martin v. Caterpillar, No. 07-cv-1009 (C.D. Ill. 2008). The plaintiffs' claims in Martin were also typical in that they alleged a breach of fiduciary duty arising from investment options with excessive and unreasonable fees and the failure to make adequate disclosures to plan participants. The court upheld the viability of the central complaint that the defendants had charged excessive fees although it agreed with the defendant and the court in Hecker that ERISA does not require plan fiduciaries to disclose revenue sharing.

c. Failure to State a Claim in Deere. Defendants in fee litigation lawsuits have routinely filed pre-discovery motions to dismiss which have generally been denied. The arguments for dismissal are based on the contention that the complaint fails to set forth facts that could give rise to a breach of fiduciary duty. Courts have been reluctant to dismiss a case before there has been fact finding that could support a claim. A major exception to this trend is Hecker v. Deere, 2007 WL 1874367 (W.D. Wis. 2007), which granted early stage motions to dismiss made by the employer, Deere & Company, and two Fidelity entities that were plan service providers.

Deere sponsored and administered 401(k) plans for its employees. The plans offered 20 Fidelity investment options while trustee, recordkeeping, and administrative functions were handled by Fidelity Management Trust Company and Fidelity Management and Research Company. (Significantly, the Deere plan also made available a brokerage window that provided participants with access to more than 2,500 other mutual funds.) The complaint alleged that the defendants violated their fiduciary duties in two ways: first, by providing investment options with excessive and unreasonable fees and costs; and, second, by failing to adequately disclose information about the fees and costs to plan participants. The District Court granted the defendants motion to dismiss which the plaintiffs then appealed to the Seventh Circuit Court of Appeals.

The appellate court affirmed the dismissal, rejecting the plaintiff's first claim as to excessive fees on the ground that the mutual fund fees could not be excessive because they were offered to the general investing public with the result that expense ratios are set in response to market competition. The court stated that "[N]othing in ERISA requires every fiduciary to scour the market to find and offer the cheapest possible fund (which might, of course, be plagued by other problems)." The court also held that Deere's practice of limiting the funds' investment options to those offered by defendant Fidelity Investments was prudent given the diversity of those investment options, which included more than 20 Fidelity mutual funds as well as the brokerage window through which participants could invest in more than 2,500 other funds.

As to the plaintiff's second claim, the Seventh Circuit held that ERISA does not prohibit revenue sharing arrangements or compel their disclosure. The court also held that such payments did not constitute plan assets, because they were made from the assets of the mutual funds in question, not from the plan. The court also found that the disclosure of total aggregate fees in fund prospectuses was adequate, stating that "the total fee, not the internal, post-collection distribution of the fee [to Fidelity affiliates], is the critical figure for someone interested in the cost of including a certain investment in her portfolio and the net value of that investment."

Finally, the Seventh Circuit held that, given the array of investment options available through the brokerage window, the safe harbor defense provided by Section 404(c) of ERISA shielded the defendants from liability.

As noted above, Hecker v. Deere will have a far-reaching influence on existing litigation, but it is less important as to ongoing conduct because of changes in the law that are already underway. On December 13, 2007, the Department of Labor issued proposed regulations that condition exemption from ERISA's prohibited transaction rules on extensive disclosure by plan service providers to plan fiduciaries. The DOL had previously amended the Form 5500 instructions to require reporting of plan fees by the plan sponsor. This was followed on July 23, 2008 by proposed regulations that would require plan fiduciaries to furnish participants with information as to fees, including a breakdown of fees to various categories of expense. It is possible, however, that certain aspects of the Seventh Circuit' decision, such as its position on the 404(c) defense, will be legislatively overruled.

5. Class Certifications in 401(k) Fee Litigation. Most of the lawsuits over 401(k) fees are brought as class actions and, therefore, involve motions for class certification under Rule 23 of the Federal Rules of Civil Procedure. Rule 23(a) requires satisfaction of each of the following requirements: (1) a class of plaintiffs so numerous that joining all the members in the lawsuit is impracticable, (2) legal or factual questions that are common to the class, (3) claims or defenses that are typical of the class members, and (4) the representatives of the class that will fairly and adequately protect the interests of the class. Rule 23(b) contains additional detailed requirements that guard against inconsistent adjudications, provide that the sought after relief will be appropriate for the class as a whole, or ensure that questions of law or fact that are common to the class will predominate over questions only affecting individual members.

A number of courts ruled on class certification in 2008, almost all of them favorably. The stage was set in Tussey v. ABB, Inc. 2007 WL 4289684 (W.D. Mo. 2007), decided in December 2007, where the court was asked to rule on the question of standing and the closely related issue of class status. On the first of these questions, it rejected the defendant's argument that the plaintiff had not suffered an injury because the plaintiff had never invested in the funds that allegedly charged excessive fees. This result was based on the ground that the plan (substituted for the plaintiff) would have been injured if there had been excessive fees.

The court in Tussey then moved on to the defendant's numerous arguments against class certification. Among other things, it refused to accept the defendant's assertion that divergent interests among class members could defeat class certification where the plaintiffs claimed that plan investment options charged unreasonable fees. The court concluded that shared interests among the class members outweighed any divergence, but its analysis excluded factors such as affirmative defenses, causation, and materiality that may have differed among particular class members. It reasoned that class typicality is based on the defendant's actions, not on individualized defenses and issues raised with respect to particular class members.

Taylor v. United Tech Corp., 2008 WL 2333120 (D. Conn. 2008), decided in June 2008, reached a result that was similar to the holding in Tussey. In Taylor, the defendants were charged with causing the plan to pay excessive fees, making misrepresentations regarding those fees, allowing excess cash to be held in the company stock fund and failing to recapture "float" income. As in Tussey, the defendants argued that plaintiffs lacked standing to sue with respect to the company stock fund or on revenue sharing claims, because they had not been invested in the affected funds and, therefore, had not suffered any injury. The court concluded that the plaintiffs did not need to show that they had been individually harmed and that the alleged harm to the plan would suffice.

The class issues in Taylor were made somewhat more complicated by the fact that the plaintiffs had signed individual releases. The court concluded that this would not affect the typicality of claims required by Rule 23(a) and that the harm to the plan outweighed any divergence of individual damages. The court also held that as long as a proposed class representative understood his responsibilities, reviewed the pleadings and kept apprised of the case by conferring with counsel, his representation would be adequate even if he had a "sketchy" understanding of the case.

Taylor was followed by two class certifications from the southern district of Illinois on the same day. In Spano v. Boeing, 2008 WL 4449516 (S.D. Ill. 2008), issued on September 30, plaintiffs alleged that the defendants had breached their fiduciary duties by causing the plan to pay unreasonable and excessive fees and by concealing information about such fees as well as the risks posed by a company stock fund. The defendants opposed the certification of a class consisting of potentially 190,000 members by arguing that the proposed class failed to differentiate among participants who had invested in the plan's various investment options and also improperly included future participants as well as past participants. The court rejected these arguments on the ground that the primary focus of class certification is the defendants' conduct and not the plaintiffs' conduct. The court refuted the defendants' objections based on the

absence of commonality and typicality by reasoning that the commonality presented by the defendants' conduct trumped any need to separately analyze each investment option to determine the reasonableness of its fees. The argument that the plaintiffs' disclosure claims would have to be examined individually was similarly rejected, because the alleged misrepresentations were made on a plan-wide basis. Finally, the inclusion of future class members was held appropriate because the sought after injunctive relief would affect current as well as future participants.

On the same day as the Spano certification, Beesley v. International Paper Co., 2008 WL 4450319 (S.D. Ill. 2008) granted class certification to over 71,000 participants in International Paper's two 401(k) plans. As in Spano, the defendants had allegedly violated their fiduciary duties by causing unreasonable and excessive administrative fees and expenses to be charged against plan assets. The lawsuit also charged the defendants with maintaining a company stock fund that was an imprudent investment option and with concealing and misleading participants regarding the risks posed by the company stock fund as well as the excessive fees. The defendants objected to certification on the grounds that commonality and typicality were lacking but the court rejected these arguments for the same reasons that it did in Spano. As to the defendants argument that the class period should extend no further back than the reach of the statute of limitations, the court noted that ERISA's six year limitations period can be tolled if a plaintiff is able to demonstrate misrepresentation. Further, because assertion of the statute of limitations is an affirmative defense, it requires an examination of the merits of the case so that its consideration would be premature in a class certification.

Additional class certifications involving claims based on revenue sharing and excessive 401(k) fees came in George v. Kraft Foods Global, Inc., 251 F.R.D. 228 (N.D. Ill. 2008) and Kanawi v. Bechtel Corp., 2008 WL 4571947 (N.D. Cal,. 2008), each holding that the commonality and typicality requirements for a class action were satisfied. Kanawi (another aspect of which is discussed above), in particular, held that the section 404(c) defense is an affirmative defense that must be proven and is, therefore, not an appropriate basis for the denial of class certification.

A notable exception to the run of successful class certifications occurred in Ruppert v. Principal Life Insurance Company, 2008 WL 397082 (S.D. Iowa 2008), discussed above. In Ruppert, the trustee of a 401(k) plan filed a class action on behalf of a class consisting of all retirement plans to which the defendant insurance company was a service provider. The defendant had allegedly received and retained unlawful revenue sharing payments from mutual funds. If the class had been certified, it would have included more than 25,000 plans administered by the insurer. However, the court rejected certification on the ground that the commonality and typicality as to factual and legal issues required by Rule 23(a) were lacking.

The court in Ruppert reasoned that the fiduciary status of the defendant was critical to whether the plaintiff's claims could be litigated on a class-wide basis. Under ERISA, a fiduciary is a person who exercises authority or control regarding the management or disposition of plan assets or renders investment advice to a plan for a fee. The defendant successfully argued that the question of fiduciary status would require an examination of different facts for each plan, thereby contradicting the goals of class treatment. The defendant was able to show that the

degree of its involvement in selecting plan investment menus differed from plan to plan. For example, some plan trustees used independent investment advisers to assist in the selection of investment menus. Moreover, it was shown that the role of these advisers and their involvement with the choice of investment options tended to change over time. Accordingly, the defendant successfully argued that any ruling as to the violation of fiduciary duty would depend on individualized facts and, therefore, could not be decided on a class-wide basis. In contrast to cases like Tussey, Spano and Beesley, the plaintiff was unsuccessful in asserting that the failure to disclose revenue sharing was a uniform breach.

It should be noted that the fact pattern in Ruppert differed from the other class certification decisions. In Ruppert, the proposed class was not the participants of a single plan, but multiple unrelated plans whose commonality consisted of their use of the defendant as an investment provider. The marketing efforts of the defendant and the decision-making process of the proposed class members varied considerably from plan to plan. Thus, it is not clear that Ruppert will have much influence in cases involving a proposed class consisting of participants in plans maintained by a single employer.

6. *Implications of Indirect Fee Cases*.

a. Since most of the cases are in the preliminary phases of litigation, it is unclear whether they will result in significant recoveries for the plaintiffs.

b. Since the facts in these cases are very similar to those of many other employer sponsored 401(k) plans, victory by the plaintiffs would mean that these plans would face a significant exposure to liability.

c. Additional law suits are likely to be filed and some copycat claims have already been made.

d. Publicity generated by the litigation will increase the pressure to make regulatory as well as legislative changes that will require detailed fee disclosures by plan sponsors. In any event sponsors are, themselves, likely to demand more extensive disclosure from plan providers in order to protect themselves against claims.

D. Department of Labor Initiatives on Disclosure.

1. *Form 5500 Reporting.*

a. Plan Years before 2009. Fees and expenses paid by the plan are required to be disclosed on the Form 5500 using either the Schedule A to report commissions or related fees paid to insurance companies or the Schedule C to report fees paid to service providers. Service providers, such as insurance companies and mutual funds, have traditionally interpreted their duty to disclose narrowly. For example, investment management fees, soft dollars and internal

fund expenses were not disclosed on either Schedules A or C of the Form 5500, and there was little reporting of indirect fees.

b. Regulatory Change for 2009 Plan Year. The Department of Labor has issued final regulations that revise Schedule C of Form 5500 to require reporting by large plans of virtually all direct and indirect compensation of $5,000 or more to any person. This change will be effective for plan years beginning on or after January 1, 2009. The burden of obtaining such information rests on the plan administrator. By itself, this change would not require the cooperation of service providers. However, such cooperation would be strongly encouraged, if not required, when the proposed regulations under Section 408(b)(2) of ERISA are implemented.

c. Applicable Only to Large Plans. The requirement to file Schedule C applies only to plans that cover 100 or more employees.

d. Definition of Reportable Compensation. Money and any other thing of value, such as gifts, awards, and trips, received directly or indirectly from the plan, including fees charged as a percentage of assets and deducted from investment returns, must be reported.

i. Direct Compensation. Payments by the plan out of a plan account, charges to plan forfeiture accounts and fee recapture accounts, charges to a plan trust account before allocations are made to individual participant accounts, and direct charges to individual participant accounts.

ii. Indirect Compensation. Compensation from sources other than payments made directly from the plan or plan sponsor in connection with services rendered to the plan or the recipient's position with the plan. Examples of reportable indirect compensation include fees and expense reimbursement payments charged against the fund or account in which the plan invests and reflected in the value of the plan's investment. Other examples are finder's fees, float revenue, brokerage commissions, research or other products or services received from a broker-dealer or other third party in connection with securities transactions (i.e., soft dollars), and certain transaction-based fees.

iii. Excludible Non-Monetary Compensation. Gifts or meals that are deductible by the payor and not taxable to the recipient, provided that the gift or gratuity is valued at less than $50 and the aggregate value of such gifts from a single

source in a calendar year is less than $100. Gifts valued at less than $10 do not need to be counted toward the $100 limit. Gifts received by one person from multiple employees of one entity must be treated as originating from a single source.

iv. Special Rule for Payments to Bundled Service Provider. A bundled service arrangement includes a transaction in which the plan receives a range of services either directly from an investment provider, through affiliates or subcontractors or through a combination. Direct payments by a plan under such an arrangement need not be allocated among the affiliates or contractors unless the amount paid to an affiliate or contractor is set on a per transaction basis, such as a brokerage commission. Similarly revenue sharing payments by investment providers need not be so allocated unless they come within one of the exceptions described below.

v. Exceptions. The following compensation arrangements must be reported as separate compensation, even if paid from mutual fund management fees:

(A) Fees charged to the plan's investment and reflected in the net value of the investment. Included in this category would be management fees paid by mutual funds to their investment advisers, float revenue, commissions (including soft dollars), finder's fees, 12b-1 distribution fees, and shareholder servicing fees.

(B) Payments of commissions and other transaction based fees, finder's fees, float, soft dollars and other non-monetary compensation to the following recipients: plan fiduciaries, contract administrators, providers of consulting or investment advisory services either at the plan or the participant level, providers of investment management services, brokers, and recordkeepers.

e. Alternative Reporting Option. "Eligible indirect compensation" will not be reported on Schedule C. In lieu of reporting on Schedule C, information about eligible indirect compensation will be provided to the plan and only the fact that a service provider received this type of compensation will be reported.

i Indirect Compensation. Fees or expense reimbursement payments charged to investment funds and reflected in the value of the investment or return on investment of the participating plan or its participants are included in the definition. Also included are finder's fees, soft dollar revenue, float, and/or brokerage commissions or other transaction-based fees for transactions or services involving the plan that were not paid directly by the plan or plan sponsor (whether or not they are capitalized as investment costs).

(A) For purposes of the above definition, investment funds include mutual funds, bank common and collective trusts, insurance company pooled separate accounts, and separately managed investment accounts that contain assets of an individual plan.

(B) Indirect compensation may be reported on the basis of the service provider's fiscal year.

(C) The DOL has indicated that fees for compliance services received by a recordkeeper from a mutual fund agent are reportable as indirect compensation but do not qualify for the alternative reporting option.

ii. Written Disclosures. For indirect compensation to be eligible indirect compensation, written disclosures must be made to the plan. This disclosure must cover the following matters:

(A) the existence of the indirect compensation,

(B) the services provided for the indirect compensation or the purpose of the payment,

(C) the amount (or estimate) of the compensation or a description of the formula used to calculate or determine the compensation,

(D) the identity of the party or parties paying and receiving the compensation.,

(E) if the compensation relates to a bundled arrangement, a description each element of indirect compensation that would be required to be separately reported if there were no reliance on the alternative reporting option.

iii. Service providers who use the alternative reporting method will be responsible for maintaining records to demonstrate compliance with these requirements.

2. *Expanded Information Disclosure Requirements to Participants*.

On July 23, 2008, the Department of Labor issued proposed regulations which, if adopted, will expand the information which must be disclosed to participants and beneficiaries in participant-directed individual account plans. The DOL proposed that the regulations be effective for plan years beginning on or after January 1, 2009. Four categories of information will have to be disclosed to participants before or when they become eligible to participate in a plan and then annually. The first three are plan-related and the fourth is investment-related. In some cases dollar amounts actually charged against a participant's account will need to be disclosed quarterly after enrollment in the plan.

The four categories of information are:

a. General Plan Investment Information: This includes how participants and beneficiaries may give investment instructions. Participants will have to be notified of material changes to the plan within 30 days after the date of adoption of such changes.

b. Administrative Expenses: Participants and beneficiaries must be given an explanation of any fees and expenses such as for legal, accounting and recordkeeping services.

c. Individual Expenses: Disclosure for information relating to individual expenses such as for qualified domestic relations order, a participant loan or investment advice services.

d. Investment-Related Information: Participants and beneficiaries must be furnished with certain basic information regarding the plan's investment options, performance history and any fees and expenses associated with their investments.

These rules will apply to designated investment alternatives offered by a plan but do not apply to brokerage windows or self-directed brokerage accounts.

Certain information which is currently required, such as copies of investment prospectuses or summaries, would only have to be provided upon request.

III. Best Practices Evolving From 401(k) Fee Litigation

Law firms representing plan participants in class actions have alleged that some of the nation's largest employers[6] have failed to negotiate reasonable 401(k) fees. In light of these class actions, more employers are beginning to adopt best practices in monitoring and negotiating service provider fees. Broker-dealers and financial advisors need to be aware of these best practices as well as the 408(b) regulations.

A. Identifying Fees.

Plan sponsors will be making a more concerted effort to learn how much the plan and participants are actually paying in fees and expenses. Although the proposed 408(b)(2) regulations allow disclosure by formula, many plan sponsors will attempt to determine the actual dollar, even if it is an estimate.

B. Comparing Investment Management Fees or Expense Ratios against Benchmarks.

Plan sponsors will attempt to avoid paying above-average investment management fees or expense ratios unless the investment manager or mutual fund can demonstrate it is delivering above-average investment performance for the plan participants.

C. Continuous Monitoring.

Continuous monitoring will become a best practice standard. In addition to a broad range of qualitative and quantitative questions about the investment managers or mutual fund, plan sponsors will be asking whether the fees are reasonable with respect to investment performance and related services plan participants are receiving.

D. Documenting Reviews of Investment Vehicles and Fees.

Plan sponsors will be documenting their reviews of investment vehicles, including negotiations related to service provider fees paid directly by the plan or plan sponsor or indirectly by the plan participants through a reduction in investment earnings. The documentation should demonstrate a thoughtful process addressing key questions or discussions, and decisions made.

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[6] The large employers include the following: (1) Boeing Co., (2) Caterpillar, Inc., (3) General Dynamics Corp., (4) Kraft Foods Global, Inc., (5) Lockheed Martin Corp., (6) International Paper Company, in the S.D. Ill.; (7) Exelon Corp. in the N.D. Ill.; (8) Bechtel Corp. in the N.D. Cal.; (9) United Technologies Corp. in the D. Conn., (10) Deere & Co., in the W.D. Wis.; (11) Unisys Corp. in the C.D. Cal.; and (12) ABB, Inc. in the W.D. Mo.

E. Hiring Independent Third Party Investment Experts.

More plan sponsors will employ independent third parties (e.g., consultants) to assist with reviewing the investment performance and fees of investment managers and related service providers. While these vendors typically provide reports and recommendations for analysis by the plan sponsor, there is an inherent conflict of interest when vendors report on proprietary funds or even nonproprietary funds where long-term business relationships and revenue agreements may influence the reports and recommendations.

F. Conducting Fiduciary Audit.

When appropriate, more plan sponsors will be hiring an independent third party to conduct a fiduciary audit of the plan's outsider fiduciaries, particularly when vendors fail to adequately disclose fees or fees do not seem reasonable.

IV. ERISA Litigation

A. Supreme Court Decides that 401(k) Plan Participants Have Standing to Sue.

1. LaRue Case. The much anticipated question of whether an employee can sue to recover losses in his 401(k) plan account when the plan sponsor or other fiduciary mishandles his account has now been answered in the affirmative by the Supreme Court. Anticipating this decision, the Sixth Circuit Court of Appeals also decided a case making relief available for fiduciary breaches that only affect some of a plan's participants.

In LaRue v. De Wolff, Boberg & Associates, Inc., decided on February 20, 2008, the Supreme Court focused on Section 502(a)(2) of ERISA, a provision that allows participants and beneficiaries to sue for "appropriate relief under Section 409" of ERISA. Section 409, in turn, provides that any person who is a fiduciary with respect to a plan who breaches any of the responsibilities, obligations, or duties imposed on fiduciaries by Title I of ERISA "shall be personally liable t*o make good to such plan any losses to the plan* resulting from each such breach …." (Italics added.) In LaRue, a plan participant sought to use these provisions to recover a loss of $150,000 suffered when the plan administrator failed to properly implement the participant's instructions as to how his account should be invested.

In reviewing LaRue's claim against the plan administrator, the Fourth Circuit Court of Appeals had affirmed a district court judgment for the defendant administrator on the ground that recovery under Section 502(a)(2) of ERISA must inure to the benefit of the plan as a whole, not to particular persons with rights under the plan. Why this should be so as a matter of policy was a focal point of the oral argument before the Supreme Court, with Justice Breyer posing the hypothetical situation of a 401(k) plan consisting of 1,000 diamonds, half of which were stolen by a corrupt trustee. Justice Breyer asked why it should matter whether the diamonds came from one central safe deposit box or whether they were kept in separate boxes and labeled with the names of individual participants.

In ruling for LaRue, the Supreme Court's opinion (by Justice Stevens) picked up on this theme stating that, "[w]hether a fiduciary breach diminishes plan assets payable to all participants and beneficiaries, or only persons tied to particular individual accounts, it creates the kind of harms that concerned the draftsmen of §409" and for which recovery under Section 502(a)(2) is available. A concurring opinion by Justice Thomas (in which Justice Scalia joined) noted that, "[b]ecause a defined contribution plan is essentially the sum of its parts, losses attributable to the account of an individual participant are necessarily 'losses to the plan' for purposes of §409(a)."

Nevertheless, the LaRue saga is not over. As noted in Justice Stevens' opinion, LaRue must prove his allegations that the plan administrator breached its fiduciary obligations and that those breaches had an adverse impact on the value of plan assets. Further, LaRue will have to overcome any defenses raised by the administrator which might include the objections that LaRue did not give his alleged investment directions in accordance with the requirements of the plan, that he failed to exhaust the plan's administrative remedies before bringing his legal action and that he failed to assert his rights in a timely fashion. There seems to have been some question as to how diligent LaRue was in ensuring that his investment instructions were carried out which might become a factor if and when the case actually goes to trial.

As suggested by Chief Justice Roberts in another concurring opinion, there is also nothing to prevent the lower courts from considering an argument that LaRue's claim is more properly regarded as a claim for plan benefits under Section 502(a)(1)(B) of ERISA than a claim under Section 502(a)(2) based on a fiduciary breach. This could preclude the fiduciary claim and make available additional defenses, such as the exercise of the plan administrator's discretion to interpret plan terms and to determine benefit eligibility.

Comment: Plan sponsors and administrators should take the opportunity to review their plan and investment procedures and policies to ensure that participants' investment decisions are being implemented properly and in a timely manner. Plan sponsors and administrators should also take steps to ensure that appropriate investment records are being maintained. Self-audit procedures can be a helpful mechanism to ensure proper plan administration, both with regard to investments and as to the operation of the plan more generally.

2. *Sixth Circuit Gives An Affirmative Answer to the Standing Question*. In the meantime, the Sixth Circuit Court of Appeals, in Tullis v. UMB Bank, N.A., 2008 WL 215535 (6th Cir. 2008), has indicated its belief that a Section 502(a)(2) claimant need not seek relief in a representative capacity for the entire plan. In Tullis, two 401(k) plan participants sued a bank trustee, because it knew of, but failed to inform the participants of, fraud perpetrated by their investment advisors. The two participants requested the plan to bring suit against the bank for fiduciary breach, but the plan refused, citing an indemnity clause in the trust agreement holding the bank harmless. When the participants filed their own action, the district court granted a motion to dismiss, finding, among other things, that they lacked the standing to sue under Section 502(a)(2).

In reversing the lower court and upholding the plaintiffs' claims, the Sixth Circuit disagreed with the reasoning of the Fourth Circuit in LaRue and held that the goal of ERISA was to ensure that relief is available in cases of fiduciary breach. Basing its decision squarely on Section 502(a)(2) of ERISA, the Sixth Circuit concluded that the plain language of the statute compelled the conclusion that individual participants should have standing to seek recovery for plan assets without resort to a class action. There was no hint in the Sixth Circuit's opinion that the claim should have been made directly against the plan as a claim for benefits. This may be an early indication that the lower courts will not require claims of fiduciary breach by defined contribution plan participants to go forward only as an action against the plan.

B. Stock Drop Cases Churn On.

Courts have continued to review fiduciary responsibility in so-called stock drop cases targeting companies that required or allowed the investment of retirement plan assets in a nondiversified company stock fund offered as part of a plan. One of the most significant recent decisions in this category was DiFelice v. US Airways Inc., 497 F.3d 410 (4th Cir. 2007), decided in August of last year. The Fourth Circuit Court of Appeals held that US Airways did not breach its fiduciary duties by allowing 401(k) plan participants to continue investing in company stock during the period leading up to the company's bankruptcy filing.

The plan in US Airways offered 13 different investment options, including the company stock fund. The company's already tenuous financial condition was exacerbated by the attacks of September 11, 2001, and the price of its stock suffered a precipitous decline. The case focuses on the conduct of the company and its Pension Investment Committee, acting as the plan administrator, subsequent to this drop in the stock's price and up to the bankruptcy filing the following August. During this period, the company hoped to resurrect its fortunes by applying for a federally guaranteed loan, although its efforts in this regard eventually failed because of its inability to obtain concessions from labor, creditors and lessors. Shortly before applying for the loan, the company appointed an outside independent fiduciary for the company stock fund. During the critical period, the Pension Investment Committee continuously monitored the stock fund and held at least four meetings at which it considered whether to continue to offer the fund as a plan investment. The Committee also met with outside counsel who indicated that it was unnecessary to discontinue the fund at that time, perhaps relying on the fact that the stock price had experienced a slight rebound and, as of April, 2002, was holding steady. However, once US Airways filed for bankruptcy, the independent fiduciary directed the closure of the stock fund and transferred any of its remaining cash to the plan's money market fund.

US Airways employees brought a class action against the company, the independent fiduciary of the stock fund, and the plan's trustee. The claims against the trustee and the independent fiduciary were eventually dismissed, and after a six-day bench trial, judgment was granted to the company, as well. The employees appealed the lower court's judgment in favor of the company arguing that it had breached its ERISA duties of prudence by insufficiently monitoring the performance and prospects of the stock fund. The Fourth Circuit rejected this argument emphasizing that prudence is a matter of process not of hindsight. According to the Fourth Circuit, the relevant question is "whether the fiduciary engaged in a reasoned decision-making process consistent with that of a prudent man," and, based on the facts, it concluded that

this question could be answered affirmatively. It noted that, unlike other stock drop cases (e.g. the Enron litigation), the employees were not compelled to invest in the company stock fund and were free to trade in and out of the fund until it was closed.

The appellate court also found no evidence of a breach of loyalty, noting that an allegation of a conflict of interest cannot be based solely on the corporate position of a plan fiduciary.

The employees also argued that the lower court had erroneously based its conclusion that the company had not breached its fiduciary duties by improperly applying the modern portfolio theory. This theory holds that investing in a risky security as part of a diversified portfolio is an appropriate means of increasing return while minimizing risk, and it was noted that the US Airways plan offered varied investment options that covered the range of the risk/return spectrum. The Fourth Circuit ultimately concluded that there was no basis for reversing the lower court because the lower court's decision had not rested on the application of the modern portfolio theory. While the lower court's reference to the theory was not a reversible error, the Fourth Circuit felt that its relevance had been overstated, and it noted that, standing alone, the theory cannot provide a defense to a claimed breach of the duty to act prudently. Thus, the prudence of each investment or class of investments must be evaluated individually.

According to the Fourth Circuit, "a fiduciary cannot free himself from his duty to act as a prudent man simply by arguing that other funds, which individuals may or may not elect to combine with a company stock fund, could theoretically, in combination, create a prudent portfolio." The Fourth Circuit's view that investment options must be judged individually refutes the basis on which dismissal was granted in the Deere case, discussed above, where the possibility of investing in a wide range of alternative funds was thought to insulate a fiduciary from liability for selecting an investment option with excessive or unlawful fees for inclusion in the investment menu.

V. Rollover Matters – Potential Litigation

Responding to participant questions as to the advisability of taking a distribution or making an investment plan withdrawal is a fiduciary act that will be judged by the standards of prudence and loyalty to the participant's best interests. If such a fiduciary adviser causes the participant to take a distribution and roll over the proceeds into an IRA managed by the adviser, there may indeed be a prohibited transaction according to the DOL (DOL Advisory Opinion 2005-23A).

The key to avoiding a prohibited transaction in these circumstances is for the adviser to limit its comments to a participant to a general description of the participant's options with regard to taking a distribution or rolling a distribution over and investing it thereafter. In this way, the adviser avoids the "control" over plan assets that would otherwise result in the self-dealing that is prohibited.

Note: the restrictions do not apply if an adviser is not already providing participant or plan-level investment advice. In these circumstances, the adviser will generally not be a plan

fiduciary and a recommendation to take a distribution or one concerning a particular investment will not be viewed as advice given with respect to plan assets.

A federal district court allowed class action claims to proceed against a financial services company whose agents had allegedly breached their ERISA fiduciary duties by encouraging plan participants to roll over their 401(k) assets into IRAs invested in the company's proprietary mutual funds. The letter from the company instructed them to call a 1-800 number to discuss how the changes in their employment status might affect their plan accounts. The telephone numbers directed the participants to the company's sales personnel rather than to pension counselors and the participants were advised to rollover their plan accounts into IRAs that were restricted to the company's investment vehicles thereby causing the participants to earn less and pay higher fees than if they had left their money in the 401(k) plan. (Note: the court granted the defendant's motion to dismiss the participant's claims seeking recovery of losses to their 401(k) plan because the plan had not incurred any loss. However, the motion to dismiss fiduciary breach claims for which participants could seek an equitable remedy was denied.) Young v. Principal Financial Group, Inc. (S.D. Iowa, 2008)

VI. Supreme Court Rules On Conflicts Of Interest And Lower Courts Respond

A. MetLife v. Glenn. Aside from LaRue v. De Wolff, Boberg & Associates, 128 S.Ct. 1020(2008), which was discussed above, the most significant judicial decision of 2009 was MetLife v. Glenn, 128 S.Ct. 2343 (2008) which was issued on June 19 and dealt with the consequences of a conflict of interest by a plan administrator. Although it involved a health and welfare plan, the MetLife decision could also have implications for pension and 401(k) plans.

In its 1989 decision, Firestone Tire & Rubber Co. v. Bruch, 489 US 101 (1989), the Supreme Court had held that, where a severance plan provided that its plan administrator had the discretion to determine benefits, a court should review the administrator's decision under an arbitrary-and-capricious standard. However, Firestone left open the question of how much an administrator's conflict of interest resulting from the fact that it would benefit financially from a claims denial should affect the level of a court's deference to the administrator's decision.

The MetLife decision addressed this question, holding that an insurance company that both makes decisions as to benefit eligibility and pays benefits is conflicted and that courts should consider such a conflict as one of any number of factors in reviewing the insurer's decision to deny benefits. MetLife served as both the insurer and the claims administrator for a long-term disability plan maintained by Sears Roebuck & Company. In the latter capacity, it denied a claim for benefits made by an employee with a heart condition on the ground that medical treatment had improved her condition to the point where she was no longer disabled. After exhausting her administrative appeals, the employee sued in district court which applied the arbitrary and capricious standard and upheld the denial of her claim.

On appeal, the Sixth Circuit Court of Appeals overturned the lower court citing language in Firestone that the arbitrary and capricious standard does not apply where the plan administrator has a conflict of interest. The Sixth Circuit's decision was appealed to the

Supreme Court, a five-judge majority of which concluded that insurance companies that both decide and pay claims have an inherent conflict. On the issue of how the conflict should affect the Court reiterated its statement in Firestone that a conflict should "be weighed as a factor in determining whether there is an abuse of discretion." However, in the Court's view, the conflict should be just one factor among many in determining whether a plan fiduciary abused its discretion in making a claims determination. Thus, the standard of review need not automatically change from deferential to de novo merely because a conflict has been identified. The Court also declined to create any special rules shifting the burden of proof as a result of a conflict.

In a concurring opinion, Chief Justice Roberts stated that he would take a conflict into account only where there is evidence that the conflict affected the administrator's decision. Justice Scalia's dissent, which was joined by Justice Thomas, seemed to take this one step further by advocating that a conflict should be considered only where the conflict actually and improperly motivates the administrator's decision.

B. Circuit Courts Respond. Given the Supreme Court's failure to establish a bright-line test, some commentators wondered if much had changed as a result of the MetLife decision. However by the end of the year, at least three circuits had concluded that the MetLife decision required them to change their approach. In Doyle v. Liberty Life Assurance Co. of Boston, 2008 WL 4272748 (11th Cir. 2008), decided in September, the Eleventh Circuit concluded that MetLife had overruled its use of a heightened abuse of discretion standard that had shifted the burden to the plan administrator of showing that its decision was not affected by the alleged conflict.

In Champion v. Black & Decker (U.S.), Inc., 2008 WL 5377692 (4th Cir. 2008), the Fourth Circuit also found it necessary to abandon the modified abuse of discretion standard that it had previously applied to conflicted administrators. Further, all dual role administrators in the Eleventh Circuit will now be treated as conflicted whereas previously the Eleventh Circuit might not have found a conflict in such circumstances.

The most noteworthy example of changed standards may be found in the Second Circuit decision of McCauley v. First Unum Life Insurance Company, 2008 WL 5377680 (2nd Cir. 2008). The Second Circuit had previously applied a de novo standard of review when it was shown that a conflict existed and that the conflict affected the reasonableness of the administrator's denial of benefits. The court determined that in the future, these circumstances would not necessarily require de novo review. Under the new standard, the conflict must be weighed as a factor in determining whether the administrator abused its discretion. Applying this standard, the court granted the plaintiff's disability claim because the defendant insurance company's financial interest, its disregard of a medical report, and its history of biased claims administration required a finding that it had abused its discretion. The last factor is particularly significant, since it will likely be raised in subsequent claims denials by the same insurer.

If the reasoning in McCauley holds, a pattern of poorly reasoned decisions by a conflicted claims administrator could have a long life. It is one example of how MetLife and its offspring may make it more difficult for plans to defend claims for benefits. We note that one way of counteracting this effect would be to keep detailed records that refute the existence of

circumstances showing that a conflict affected a benefits decision or that an administrator has a history of biased decisions. Further, in the case of in-house claims review committees, consideration should be given to excluding those with an interest in company finances from committee membership.

Another effect of MetLife that is beginning to be felt stems from its direction to examine all of the surrounding factors to determine whether an administrator has abused its discretion. This has caused the lower courts to open the door to additional discovery. For example, in Gessling v. Group Long Term Disability Plan for Employees of Sprint/United Management Company, 2008 WL 5070434 (S.D. Ind. 2008), a federal district court concluded that the MetLife decision had superseded Seventh Circuit precedent which would have limited discovery in benefit cases to the administrative record. This potential development also highlights the importance of detailed recordkeeping that demonstrates unbiased decision making.

C. Kentucky Retirement Systems v. EEOC. The other ERISA decision from the Supreme Court's spring term was Kentucky Retirement Systems v. EEOC, 128 S.Ct.2361 (2008) which concluded that more generous benefits provided under a state pension plan to individuals becoming disabled before reaching retirement eligibility did not violate the Age Discrimination in Employment Act ("ADEA")

The plan in question based benefits on years of service times 2.5% of final pay. In the case of a disabled participant, it imputed service until the participant became eligible for normal retirement. The plaintiff in the Kentucky case had become eligible for retirement at age 55 but continued to work until age 61 at which time he became disabled and retired with 18 years of service. However, he was not awarded any imputed service because he was already eligible to retire when he was disabled. If he had become disabled before age 55, he would have received up to two years of imputed service to bring him up to a total of 20 years.

The EEOC brought suit on the participant's behalf arguing that the plan failed the ADEA on its face, because the reason he received no additional service credit was the fact that he became disabled after age 55. The Court's 5-4 decision rejected this claim, because the plan's decision was not "actually motivated" by age. Accordingly, disparate treatment based on pension eligibility (a separate concept) as opposed to age may be acceptable, assuming that pension eligibility is not serving as a proxy for age. The Court cited a number of reasons and factors as to why pension eligibility was not a proxy for age in this case. Because of these numerous qualifications, however, it is unclear how broadly the reasoning of the case will be applied in the future.