Class certification requirements in 401(k) fee litigation

By Marcia S. Wagner, Esq.

The reverberations of the January 2011 decision by the Seventh Circuit Court of Appeals in Spano v. The Boeing Company with regard to class certifications in 401(k) fee cases continue to be felt, making it significantly more difficult for plaintiffs' counsel to define a class. The latest illustration of this difficulty came in the district court's rejection of plaintiffs' proposed class definition in George v. Kraft Foods Global, Inc., decided in October 2011. It is useful, therefore, to step back and review the requirements for class certification under the Federal Rules of Civil Procedure.

Rule 23(a) requires that one or more members of a class may sue on behalf of all class members only if: (1) the class is so numerous that joining all its members would be impracticable; (2) the case involves questions of law or fact common to the class members; (3) the claims of the class representative are "typical" of the claims of the class; and (4) the class representative will "fairly and adequately protect the interests of the class."

The plaintiffs in *Spano* alleged violation of fiduciary responsibilities resulting from excessive fees, imprudent investment options, and misrepresentation. As originally constituted, the class in *Spano* included all participants or beneficiaries who were or may have been affected by the defendants' conduct, as well as future participants and beneficiaries. This definition met the first two requirements for class certification, specifically the number of the class members and common factual and legal questions, even though not all of the factual and legal issues were the same. However, the Seventh Circuit held that the defined class failed the typicality requirement since many of its members would not have held investments in the funds that were subject to the complaint. As noted by the court, "a class representative in a defined contribution case would at a minimum need to have invested in the same funds as the class members."

The Seventh Circuit also ruled that the class failed the adequacy of representation requirement given the potential for intra-class conflict arising from the fact that, "A fund that turns out to be an imprudent investment over a particular time for one participant may be a fine investment for another participant who invests over a slightly different period." Thus, it is not enough for a court to base membership in a class only on participation in a plan, and those participants who might be harmed by the requested relief must be excluded from the class.

In the *Kraft* case, the district court vacated its previous grant of class certification in July 2011 based on the *Spano* decision. The plaintiffs responded by proposing modified class definitions. The newly defined class would only have contained members who invested in one of the two actively managed mutual funds subject to the complaint. Further, the class definitions were amended to include only those participants who had invested in these funds between specified dates. Accordingly, not every past, present, and future plan participant would have been a class member, as had been problematic in *Spano*. Finally, in an attempt to meet the Seventh Circuit's criticism in *Spano* that membership in a class should not include those who had no complaint with the funds at issue, only those participants whose investments in the complained of funds underperformed a prudent alternative were to be covered by a class. The two funds chosen for making this comparison were specifically identified Vanguard mutual funds which were passively managed and provided a better investment result during the specified period.

The district court in the *Kraft* case thought that the redefined classes were an improvement in that they sought to include only participants who had been harmed by the defendants. Nevertheless, the court held that the redefined classes still did not meet the class certification tests as interpreted by *Spano*. The problem with the new definitions lay with the use of the Vanguard funds as comparators.

To state a claim for fiduciary breach, the plaintiffs were required to show that the defendants had breached their fiduciary duty and that the breach resulted in harm to the plaintiffs. In the court's view, an underlying assumption of the proposed class definitions was that all of the class members would have invested in the Vanguard funds in place of the actively managed funds subject to the complaint if the Vanguard funds had been available as a plan investment option. The court thought that this was "less than obvious" and ruled that class certification resting on this assumption was not appropriate for the loss and causation issues.

The court was also troubled by the implication that a class certification relying on references to the Vanguard funds would mean that a comparison with those funds would be appropriate for purposes of measuring losses in the case. Since the appropriate calculation of damages was an unresolved issue, the court warned against using class certification as a backdoor way of resolving this matter. Accordingly, the motion for class certification was denied and plaintiffs were given 21 days to file an amended motion which their counsel indicated they would do.

Until recently, district courts overseeing 401(k) excess fee and stock drop litigation have routinely granted class certification without rigorous attention to Rule 23 of the Federal Rules of Civil Procedure. The basis for granting

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certification has frequently been the offhand observation that the class was complaining of the plan's structure as a whole. *Spano* and *Kraft* indicate that, while class certification remains possible in cases involving 401(k) plans, the potential conflict between various categories of plan participants requires narrower definitions of the class that align the interests of the class representative and the class members.❖

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