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Contemplating: Marla Kreindler said litigation spurs people 'to rethink best practices.'

Execs keeping an eye on major court cases

Outcome of ERISA fiduciary, fee disputes could mean changes for plan sponsors

By Robert Steyer
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Defined contribution plan executives and their plans' attorneys are monitoring several pending court cases for guidance on two ongoing ERISA issues: fiduciary duties and fees.

Lawyers involved in specific cases and those watching from the sidelines say a mixture of key recent decisions and settlements plus some expected 2011 rulings will influence sponsors and providers on how they offer investment options and will provide more insight into how to avoid losing a court case based on the Employee Retirement Income Security Act.

“While all of the litigation hasn't been conclusive on the reasonableness of fees and expenses, the sponsors and regulators have sharpened their focus for greater transparency on the DC side,” said Marla Kreindler, a partner with Winston & Strawn LLP, Chicago. “Litigation is causing people to rethink best practices.”

Even without the prospect of a precedent-setting case, lawyers say a continuing series of ERISA suits alleging — among other things — breach of fiduciary duty, excessive fees and lack of prudence will have a greater impact on the defined contribution industry as a whole than on any individual plan sponsor.

“The litigation process is as important in changing behavior as the ultimate resolution of the cases,” said Lynn Sarko, managing partner at Keller Rohrback LLP, Seattle, whose firm has represented plaintiffs in ERISA cases against Enron Corp., WorldCom Inc. and **Wal-Mart Stores Inc.**

“Defendants prefer to settle,” said Marcia Wagner, managing director of The Wagner Law Group, Boston, referring to sponsors and service providers. “Pro-plaintiff case law could have profound effects. The industry doesn't want pensions to be the next tobacco or mesothelioma.”

Recent settlements of class-action suits include the November agreement by **General Dynamics Corp.** and its investment consultant, **Fiduciary Asset Management** LLC, to pay $15.5 million to settle charges by participants against both companies relating to two General Dynamics 401(k) plans, which had $7.3 billion in assets as of Dec. 31, 2009.

Participants alleged that General Dynamics breached fiduciary duty by, among other things, “causing and allowing” the plans to pay “excessive fees and expense.” They alleged the consultant, as a “functional” fiduciary to the plans, also breached its fiduciary duty several ways, including allowing the excessive fees.

In August, **Caterpillar Inc.** agreed to pay $16.5 million to settle the allegations, including charges that company violated its fiduciary duty by offering investment options with “excessive management and other fees” and concealed administration costs for four 401(k) plans with assets of $6.35 billion as of Sept. 30.

In both instances, company executives agreed to institute several changes, including improving communication with participants and expanding fee disclosure. Caterpillar also agreed to exclude “retail mutual funds as core investment options for a period of time,” according to the settlement agreement.

Wider impact

The excessive fee cases touch on other issues, such as institutional vs. retail mutual funds, revenue sharing disclosure, adequate numbers of investment options and even how to prove that investments with the lowest fees aren't automatically the best or most appropriate options.

Attorneys say the next round of court rulings and/or settlements will continue to address these questions while building upon what is, for now, the ERISA litigation equivalent of the 800-pound gorilla in the room — Hecker vs. Deere*.*

In June 2007, a federal district court in Madison, Wis., dismissed a complaint by participants against **Deere & Co.** and two units of **Fidelity Investments** regarding two Deere 401(k) plans with assets of $3.3 billion as of Sept. 30, 2009.

In this class action, participants charged Deere violated its fiduciary duty for providing investment options that charged excessive fees and failed to adequately disclose the fee structure to participants. They sued the Fidelity units, which provided record-keeping services and was investment adviser for some funds offered by the Deere plan, arguing these units were “functional fiduciaries.”

The dismissal was upheld by the 7th U.S. Circuit Court of Appeals, Chicago, in February 2009. It said the Deere plans offered “a sufficient mix of investments” with a “wide range” of expense ratios, including 20 Fidelity mutual funds and a self-directed brokerage window offering 2,500 funds. The court said ERISA doesn't require fiduciaries to “scour the market” to find funds with the lowest fees. The U.S. Supreme Court declined to hear the case last January.

“Hecker has been invoked in every 401(k) fee case I've been involved in,” said James Fleckner, a partner at Goodwin Procter LLP, Boston, whose firm represented **Fidelity Investments**, a defendant in the Hecker case. “It remains to be seen what its long-term impact will be.”

Plaintiffs, on the other hand, are focusing on a June 2009 follow-up comment by the appeals court, saying its ruling “was not intended to give a green light” to absolving plans of fiduciary duties “by the simple expedient of including a very large number of investment alternatives.” The ruling in the Deere case “was tethered closely to the facts” of the case, the court added.

“The court's supplemental opinion greatly narrowed the original opinion,” said Jerome Schlichter, founding partner of Schlichter, Bogard & Denton, a St. Louis law firm that has represented plaintiffs in many fee-related lawsuits including those against Deere, Caterpillar and General Dynamics. “Because each case is factually unique, one view could be that there's no set of precedents.”

The Loomis vs. Exelon case could signal how broadly the Deere decision is interpreted in the future.

In December 2009, a judge for the U.S. District Court for the Northern District of Illinois dismissed a complaint by participants in the Exelon employee savings plan, alleging that the plan, with $3.4 billion in assets as of Sept. 30, charged excessive fees for investment options. In the decision, Judge John Darrah noted that some of the allegations against Exelon — such as failing to disclose the fee structure to participants and choosing retail rather than institutional funds — were the same as those against Deere.

Mr. Darrah dismissed the case because the Deere case “is not factually distinguishable from this case and (Deere) is controlling here.”

However, participants petitioned the 7th Circuit Court of Appeals to overturn the dismissal. They were backed by the Labor Department, which maintains the case against Exelon is different than the Deere case.

In a brief to the appeals court, the DOL said the supplemental ruling in the Deere case “clearly and deliberately left the door open for other cases like this one ...”

Appeals court judges heard arguments in September; a decision is pending.

Pricing issue

Retail vs. institutional pricing also is an issue in Braden vs. **Wal-Mart Stores Inc.** A participant in Wal-Mart's 401(k) plan, which had $12.8 billion as of Jan. 31, 2010, alleged the giant retailer breached its fiduciary duty by selecting retail mutual funds instead of less expensive institutional-priced funds. He contended Wal-Mart's plan was large enough to bargain for lower fees.

Judge Gary Fenner of the U.S. District Court for the Western District of Missouri dismissed the complaint in 2008, saying the participant failed to make any “plausible” claim that Wal-Mart had breached its fiduciary duties. The participant appealed the dismissal, and he was supported by the DOL, which filed a brief saying the district court had incorrectly interpreted ERISA.

In November 2009, the 8th Circuit Court of Appeals, St. Louis, sent the case back to the district court for trial. It said the Wal-Mart plan's use of retail mutual funds, how funds were selected and how fee information was described to plan participants deserved to be reconsidered by the district court. No trial date has been set.

A verdict against Wal-Mart could lead to what the legal profession calls a “circuit split” — when two or more federal appeals courts issue conflicting rulings on the same issue, said Lars Golumbic, a principal with Groom Law Group in Washington. That situation could eventually pull the Supreme Court into the arena.

“At some point, the Supreme Court will get involved ... if the (appeals-court) circuits are split,” said Ms. Wagner. “Braden is almost the exact opposite of Hecker.”

Contact Robert Steyer at ***rsteyer@pionline.com***