GROOM LAW GROUP

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Update on 401(k) Fee Litigation

I. INTRODUCTION

1. Beginning in September 2006, one plaintiffs' firm, Schlichter, Bogard & Denton, began filing a series of class action lawsuits on behalf of plan participants in 401(k) plans sponsored by major corporations, alleging that the plan participants paid unreasonable and excessive fees for investment and administrative services in their 401(k) plans.

a. These complaints focused on "revenue sharing" as a source of compensation for plan service providers. According to these complaints, revenue sharing payments were not properly disclosed and accounted for in determining compensation paid to plan service providers.

b. Although 401(k) plan fees and expenses, including revenue sharing arrangements, have been a focus of DOL and media attention for several years, these class action cases signaled the start of a significant wave of new litigation involving 401(k) plan fee and expense issues.

2. More recently, amended complaints have been filed in many of these cases to further allege, among other things, that plan fiduciaries acted improperly in: (1) not accounting for sources of revenue for plan service providers (in addition to the revenue sharing already complained of) such as finder's fees, float, fees from securities lending, and profits from foreign currency exchange; and (2) offering as investment options (i) actively-managed mutual funds rather than index funds and (ii) mutual funds instead of separate accounts.[1]

3. In sections II and III below, we provide an overview of claims brought by participants against plan sponsor/fiduciaries and by plan sponsors and fiduciaries against plan service providers.

II. CLASS ACTIONS ON BEHALF OF PLAN PARTICIPANTS

A. CASES AGAINST PLAN SPONSOR FIDUCIARIES

1. At least 14 lawsuits have been brought on behalf of plan participants, alleging that plan fiduciaries imprudently allowed plan service providers to receive "revenue-sharing" payments.

2. Generally, these cases hinge on the application of ERISA section 404(a), and raise the following issues:

[1] For a case brought against the plan sponsor and challenging the offering of mutual funds as investment options, but not challenging revenue sharing, *see Boeckman v. A.G. Edwards, Inc.*, 2007 WL 4225740 (S.D. Ill. 2007).

a. Procedural Prudence – Did the plan fiduciaries exercise due diligence in their consideration of the plan's compensation arrangement with service providers, including any revenue sharing component?

b. Reasonable Compensation– Did the plan fiduciaries cause the plan to pay excessive compensation to service providers because of revenue sharing or other circumstances?

c. Disclosure – Did the plan fiduciaries violate ERISA in how and what they disclosed to plan participants about revenue sharing and other fees charged to the plan?

Corporations that have been sued include: Bechtel Corp.; The Boeing Co.; Caterpillar Inc.; CIGNA Corp.; Exelon Corp.; General Dynamics Corp.; International Paper Co.; Kraft Foods Global, Inc.; Lockheed Martin Corp.; Northrop Grumman Corp.; United Technologies Corp.; ABB, Inc. (with Fidelity); Deere & Co. (with Fidelity); Unisys Corp. (with Fidelity)

3. Most of these lawsuits claim that plan fiduciaries failed to consider (in evaluating a service provider's compensation) or capture (for the plans) fees a service provider receives from sources of revenue (besides revenue sharing). Plaintiffs argue that plan service providers received undisclosed compensation by receiving finder's fees from investment managers, float from trustees or custodians, fees from securities lending, and profits from foreign currency exchange (with respect to foreign investments). *E.g., Spano v. The Boeing Co.*, Civil Action No. 3:06-CV-00743 (S.D. Ill.); *Martin v. Caterpillar, Inc.*, Civil Action No. 07-CV-01009 (C.D. Ill.); *Renfro v. Unisys Corp.*, Civil Action No. 2:07-CV-02098 (E.D. Pa.).

4. Some lawsuits include claims that plan fiduciaries caused plans to pay excessive fees by offering actively-managed mutual funds as investment options. Plaintiffs argue that actively-managed mutual funds do not outperform index mutual funds when held as long-term investments. *E.g., Spano v. The Boeing Co.*, Civil Action No. 3:06-CV-00743 (S.D. Ill.); *Martin v. Caterpillar, Inc.*, Civil Action No. 07-CV-01009 (C.D. Ill.); *Renfro v. Unisys Corp.*, Civil Action No. 2:07-CV-02098 (E.D. Pa.).

5. Some of the lawsuits claim that plan fiduciaries caused plans to pay excessive fees by offering mutual funds instead of separate accounts as investment options, based on the argument that separate accounts have lower fees than mutual funds. *E.g., Spano v. The Boeing Co.*, Civil Action No. 3:06-CV-00743 (S.D. Ill.); *Martin v. Caterpillar, Inc.*, Civil Action No. 07-CV-01009 (C.D. Ill.); *Renfro v. Unisys Corp.*, Civil Action No. 2:07-CV-02098 (E.D. Pa.).

6. Some of these complaints also include claims relating to the plan's company stock investment alternative. Plaintiffs assert that unitizing the plan's company stock fund improperly dilutes participants' gains when the stock rises because the cash held within the company stock fund depresses the fund's overall returns. Some complaints also allege that plan fiduciaries caused excessive fees to be assessed against participants' accounts in the unitized company stock fund. *E.g., Grabek v. Northrop Grumman Corp.,* Civil Action No. 2:06-CV-06213 (C.D. Cal.); *Abbott v. Lockheed Martin Corp.,* Civil Action No. 3:06-CV-00701 (S.D. Ill.).

7. Some cases include an allegation that the plan sponsor corporation improperly used plan assets for its own benefit in connection with the sale of the plan sponsor's affiliate. *E.g., Nolte v. CIGNA Corp.*, Civil Action No. 2:07-CV-02046 (C.D. Ill.) (alleging that CIGNA improperly benefited from the sale of its retirement business); *Martin v. Caterpillar Inc.,* Civil Action No. 1:07-CV-01009 (C.D. Ill.) (alleging Caterpillar improperly benefited from sale of its investment management subsidiary).

B. <u>CASES AGAINST PLAN SPONSOR FIDUCIARIES AND SERVICE PROVIDERS</u>

1. Some of the class actions brought by participants against plan sponsors include claims against Fidelity Management Trust Company and Fidelity Management & Research Company (together, "Fidelity"), as directed trustee and plan recordkeeper. *E.g., Hecker v. Deere & Co.,* 496 F.Supp.2d 967 (W.D.Wis. 2007); *Tussey v. ABB, Inc.,* Civil Action No. 2:06-CV-04305 (W.D. Mo.); *Renfro v. Unisys Corp.*, Civil Action No. 2:07-CV-02098 (E.D. Pa.)

a. In these complaints, plaintiffs allege that Fidelity is an ERISA fiduciary based on its trustee status, investment manager status, and allegations that Fidelity generally limited investments that plans may offer to participants to primarily proprietary funds.

b. Based on allegations that Fidelity is a fiduciary, these complaints alleged that the plan sponsor fiduciaries and Fidelity did not disclose actual plan expenses to participants, including revenue sharing, allowed plan participants to pay excessive fees, and that all revenue sharing is “plan assets,” which should be restored to participants.

2. Two lawsuits have been brought by participants as plaintiffs against a plan's investment manager. So far, the plan sponsor itself is not a defendant. *Brewer, et al. v. General Motors Investment Management Corporation, et al.*, Civil Action No. 1:07-CV-02928 (S.D.N.Y.); *Young, et al. v. General Motors Investment Management Corp., et al.,* Civil Action No. 1:07-CV-01994 (S.D.N.Y.). In these cases, participants in employer-sponsored defined contribution plans sued the plans' investment managers alleging that (1) the defendants breached their fiduciary duties under ERISA § 404 by allowing or causing the plans to maintain investments in undiversified and imprudent investment vehicles, which the plaintiffs allege caused the plans to lose hundreds of millions of dollars; and (2) the defendant General Motors Investment Management Corporation breached its fiduciary duties under ERISA § 404 by causing or allowing the plans to maintain investments in certain mutual funds when similar investment products were available at much lower costs, which the plaintiffs allege caused the plans to pay millions of dollars in excess fees.

C. <u>INITIAL COURT DECISIONS</u>

A few initial decisions have been issued by district courts and, so far, there is no clear trend.

1. In *Hecker v. Deere & Co.*, the court dismissed all claims against the plan sponsor and Fidelity. 496 F.Supp.2d 967 (W.D.Wis. 2007). Plaintiffs have appealed the dismissal to the Seventh Circuit Court of Appeals.

a. Deere had engaged Fidelity to provide "bundled" 401(k) plan services under an arrangement centered on the use of Fidelity mutual funds. Deere selected the plan's primary investment options from a menu of Fidelity's retail mutual funds and included a plan brokerage window through which participants could invest in more than 2500 different publicly-available investments. The Fidelity funds charged asset-based fees and shared some of that asset-based fee revenue with Fidelity as trustee and recordkeeper.

b. The plaintiffs claimed that Deere and Fidelity breached their fiduciary duties under ERISA by failing to disclose the revenue sharing arrangement to plan participants and allegedly causing the plan to overpay for the bundled services.

(1) On the disclosure claim, the court ruled that "[n]othing in the statute or regulation directly requires such a disclosure" and that the mutual fund prospectuses admittedly given to the plan participants "accurately reflect the expenses paid to the fund manager." The court was skeptical that participants would gain any practical benefit by knowing precise details about how fund fees were subdivided among profits, revenue sharing and other expenses. The court also cited DOL's proposal to amend existing regulations possibly to require further fee disclosures as proof that disclosures are not required under current law.

(2) On the excessive fee claim, the court ruled that defendants could not be liable because ERISA section 404(c) operates to shield fiduciaries from liability where the alleged loss or breach results from a participant's exercise of control over his or her plan account. Citing the fee disclosures provided by the mutual fund prospectuses, and the plan's brokerage window, the court held that "[t]he only possible conclusion is that to the extent participants incurred excessive expenses, those losses were the result of the participants' exercising control over their investments within the meaning of [ERISA § 404(c)'s] safe harbor provision."[2]

(3) As an alternative ground for its dismissal of claims against Fidelity, the court ruled that Deere had responsibility for choosing plan investment options, so that Fidelity was not a fiduciary with respect to the disclosure and fund-selection issues.

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[2] The court in *Hecker v. Deere & Co.* thus rejected the DOL's longstanding position that ERISA section 404(c) is never a defense to the selection of investment alternatives. In this regard, *Langbecker v. Elec. Data Sys. Corp.*, 476 F.3d 299, 312 (5th Cir. 2007), reaches substantially the same conclusion.

2. In *Tussey v. ABB, Inc.*, Civil Action No. 2008 WL 379666 (W.D. Mo. Feb. 11, 2008), the court denied ABB and Fidelity's motions to dismiss.

(1) As in *Hecker v. Deere & Co.*, the court held that ABB was not required to disclose revenue sharing arrangements. However, the court differed with *Hecker* in concluding that whether revenue sharing was disclosed to plan participants was relevant to whether ERISA section 404(c) defense is applicable. In this regard, the court held that where a participant makes investment decisions without knowledge of revenue sharing agreements, the participant may not be exercising investment decisions within the meaning of section 404(c).

(2) The court also ruled that Fidelity could qualify as a fiduciary. Plaintiffs had alleged that (1) "Fidelity Trust directly manages Fidelity mutual fund" options, and (2) that "Fidelity Trust plays a central role in the selection of the investment options . . . because Fidelity Trust does the first-cut screening of investment options, and has veto authority over the inclusion of investment options available in the [p]lan" (internal quotation marks omitted). The Trust Agreement also provided that the plan sponsor/fiduciary could select as plan investment options only "(i) securities issued by the investment companies advised by Fidelity Management . . . [or] (ii) securities issued by [other] investment companies . . . as long as Fidelity Trust approves those elections." Based on these allegations, the court ruled that "[e]ven if Fidelity Trust is not the final arbiter of [p]lan decisions, it may still be a fiduciary with respect to choosing [the] funds."

(3) In denying Fidelity Management's motion to dismiss, the court acknowledged Fidelity Management's argument that "an investment adviser to a mutual fund is not a fiduciary to an ERISA plan that invests in the mutual fund[,]" but noted that "[p]laintiffs['] allegations sufficiently state that Fidelity Management 'indirectly' exercised discretion over [p]lan assets because, according to the revenue sharing scheme, it paid its affiliate, Fidelity Trust, to steer the [p]lan toward mutual funds it advised." The court also held that "if Fidelity Management set fees paid by [p]lan assets, then [p]laintiffs may prove that Fidelity Management acted as a *de facto* fiduciary."

3. Other defendants have had partial success on motions to dismiss.

a. In *Taylor v. United Technologies Corp.*, 2007 WL 2302284 (D. Conn. Aug. 9, 2007), the court dismissed plaintiffs' failure to disclose claims, holding that "ERISA fiduciaries are under no present duty" to disclose revenue sharing and citing the district court order in *Hecker v. Deere & Co.* However, the court held that plaintiffs satisfied the federal notice pleading requirement by alleging that "the fiduciaries' conduct included failure to take steps to inform themselves [of trends and developments in the retirement industry] and to provide adequate oversight [over plan activities], which if proven, could plausibly entail a breach of fiduciary duty." The court stated that the plaintiffs were not required to allege "specific facts" to survive a motion to dismiss.

b. In *Grabek v. Northrop Grumman Corp.*, Civil Action No. 2:06-CV-06213 (C.D. Cal.), the court dismissed Northrop Grumman and all director defendants from the action, but left certain committees as defendants.

c. A prayer for investment losses was struck from the complaint in *Loomis v. Exelon Corp.*, Civil Action No. 1:06-CV-04900 (N.D. Ill.). The court ruled that the plaintiffs failed to allege a causal nexus between the allegedly excessive fees and the "losses attributable to the ups and downs of the financial market."

4. Other Defendants' motions to dismiss have been denied in other cases.

a. Defendants' motions have also been denied in the following cases: *Kanawi v. Bechtel Corp.*, Civil Action No. 3:06-CV-05566 (N.D. Cal.) (noting that compliance with statutes and regulations regarding fee disclosures would not preclude a fiduciary breach claim and that failure to disclose revenue sharing agreements is relevant to whether a participant exercised investment control within the meaning of ERISA § 404(c)) ; *Spano v. The Boeing Co.*, 2007 WL 1149192 (S.D. Ill. Apr. 18, 2007) (holding that determining fiduciary status requires a factual inquiry and rejecting defendants' assertion that plaintiffs' ERISA § 502(a)(3) claim is limited by trust law principles which allow an "accounting" claim to be brought only against a plan trustee); *George v. Kraft Foods Global, Inc.*, 2007 WL 853998 (S.D. Ill. Mar. 16, 2007) (denying defendants' request to dismiss the complaint for failing to comply with Fed. R. Civ. P. 8 which requires a "short and plain" statement of the claim); *Abbott v. Lockheed Martin Corp.*, 2007 WL 2316485 (S.D. Ill. Aug. 13, 2007) (same as *George v. Kraft Foods Global, Inc.*)

5. Motions to certify class have been granted in *Loomis v. Exelon Corp.*, 2007 WL 2981951 (N.D. Ill. June 26, 2007) and *Tussey v. ABB, Inc.*, 2007 WL 4289694 (W.D. Mo. Dec. 3, 2007), but denied in *Grabek v. Northrop Grumman Corp.*, Civil Action No. 2:06-CV-06213 (C.D. Cal.) (denial of class certification has been appealed to the Ninth Circuit Court of Appeals).

6. Motions to strike jury demands have been granted in the following cases: *Spano v. Boeing Co.*, 2007 WL 1149192 (S.D. Ill. Apr. 18, 2007); *Loomis v. Exelon Corp.*, Civil Action No. 1:06-CV-04900 (N.D. Ill.); *Will v. General Dynamics Corp.*, Civil Action No. 3:06-CV-00698 (S.D. Ill.); *Abbott v. Lockheed Martin Corp.*, 2007 WL 2316481 (S.D. Ill. Aug. 13, 2007); *Grabek v. Northrop Grumman Corp.*, Civil Action No. 2:06-CV-06213 (C.D. Cal.); *Kennedy v. ABB, Inc.*, 2007 WL 2323395 (W.D. Mo. Aug. 10, 2007).

D. <u>CASES AGAINST PLAN SPONSORS THAT ARE FINANCIAL INSTITUTIONS</u>

1. More recently, several lawsuits have been brought by participants against plan sponsors that are financial institutions. These complaints allege that plan fiduciaries violated their fiduciary duties by selecting "proprietary" mutual funds to be the plan's investment options. *E.g.*, *David v. Alphin*, Civil Action No. 3:07-CV-00011 (W.D.N.C.) (alleging that plan fiduciaries violated ERISA by causing plans to purchase and pay for investment products and services from Bank of America and its affiliates, which charged higher fees than comparable

mutual fund options); *Leber v. CitiGroup, Inc.*, Civil Action No. 1:07-CV-09329 (S.D.N.Y.) (plan fiduciaries chose investment products and plan services offered and managed by Citigroup subsidiaries and affiliates); *Gipson v. Wells Fargo & Co.*, Civil Action No. 1:07-CV-01970 (D.D.C.)(alleging that plan fiduciaries put Wells Fargo's interests ahead of the plan's interests by choosing investment products and services offered and managed by Wells Fargo and affiliates); *McCullough v. Aegon USA, Inc.*, Civil Action No. 06-CV-00068 (N.D. Iowa) (alleging that plan fiduciaries chose investment products offered by Aegon USA subsidiaries and affiliates).

2. One court recently addressed the investment of plan assets in plan sponsor-affiliated investment products in connection with a pension plan that is not participant-directed. In *Dupree v. Prudential Life Insurance Co. of America*, 2007 WL 2263892 (S.D. Fla. Aug. 10, 2007), the court found that in-house plan fiduciaries were prudent in making investments in the plan sponsor's investment products where there was "appropriate due diligence and procedural prudence in selecting proposed investments and monitoring the Plan's performance." In a detailed set of factual findings, the court noted the procedures followed by fiduciaries, including consideration of non-sponsor-managed products when deciding to make investments, regular reviews of investment performance, and periodic reviews of fees. The court also accorded some weight to the fiduciary investment committee's retention of an independent consultant to provide advice on investment matters.

3. There have been two notable settlements regarding in-house plan cases:

a. *Mehling v. N.Y. Life Ins. Co.*, 2007 WL 3145344 (E.D. Pa. 2007) approving a $14 million settlement in a case involving allegations that in-house plan assets were imprudently used as seed money for new mutual fund products affiliated with the plan sponsor.

b. *Franklin v. First Union Corp.*, Civil Action No. 99-CV-344 (E.D. Va.) $26 million settlement of claims that in-house plan assets were used as seed money and that participants were charged excessive fees by the plan sponsor.

III. ACTIONS BROUGHT BY PLAN SPONSORS AGAINST SERVICE PROVIDERS

A. *HADDOCK V. NATIONWIDE FINANCIAL SERVICES, INC.*

1. In September 2001, a class of 401(k) plan sponsors filed a lawsuit against Nationwide Financial Services and Nationwide Life Insurance Company ("Nationwide") in connection with revenue sharing payments received by Nationwide from mutual funds offered as investment options under its group annuity contracts issued to plans. *Haddock v. Nationwide Fin. Services, Inc.*, Civil Action No. 3:01-CV-01552, 419 F.Supp.2d 156 (D. Conn.). The plaintiffs alleged that Nationwide's contractual arrangements with and retention of revenue sharing payments from the mutual funds gave rise to Nationwide's breach of fiduciary duties and constituted prohibited transactions under §§ 404(a) and 406(b) of ERISA.

2. In March 2006, the district court denied Nationwide's motion for summary judgment. *Haddock v. Nationwide Fin. Services, Inc.*, 419 F.Supp.2d 156 (D. Conn. 2006). The court held that —

a. Nationwide may have been a plan fiduciary because it retained discretion to select, add and delete the fund options offered to plans under its variable annuity products.

b. Revenue sharing payments from funds could be "plan assets" on the basis of Nationwide's receiving payments from the mutual funds in exchange for offering the funds as investment options to the plans and participants, at the expense of such participants. Further, even if revenue sharing payments are not "plan assets," Nationwide's receipt of revenue sharing could have involved illegal "kickbacks" prohibited by ERISA.

B. ADDITIONAL CASES BY PLAN SPONSORS AGAINST SERVICE PROVIDERS

1. Although the *Nationwide* case was filed in 2001, lawsuits by plan sponsors became more common only after the initial wave of lawsuits were filed against plan sponsors relating to plan fees and expenses and revenue sharing payments. Plaintiffs' class action law firms turned their attention in the direction of the insurance companies providing plan administration and recordkeeping services to plans. *See Phones Plus, Inc. v. The Hartford Financial Services, Inc.*, Civil Action. No. 3:06-CV-01835-AVC, 2007 WL 3124733 (D. Conn); *Ruppert v. Principal Life Ins. Co.*, Civil Action No. 06-903-DRH (S.D. Ill.); *Beary v. Nationwide Life Ins. Co.*, Civil Action No. C2-06-967, 2007 WL 4643323 (S.D. Oh.). Since then, additional cases have been filed against insurance companies and other plan service providers. *See*, e.g., *Charters v. John Hancock Life Insurance Co.*, Civil Action No. 07-11371-NMG, 2007 WL 4874807 (D. Mass.); *Columbia Air Services, Inc. v. Fidelity Management Trust Co.*, Civil Action No. 1:07-CV-11344 (D. Mass.); *Zang v. Paychex , Inc.*, Civil Action No. 6:08-CV-06046-DGL (W.D. N.Y.).

2. As in the lawsuits filed against plan sponsors, plaintiffs in these provider cases challenge various types of "revenue sharing" payments by mutual funds, mutual fund advisers, and other investment providers to plan recordkeepers and other service providers. These cases typically argue that plan recordkeepers or other service providers are fiduciaries, that "revenue sharing" payments constitute assets belonging to the service provider's plan customers, and that a service provider's receipt of revenue sharing payments is a prohibited transaction.

3. *Phones Plus, Inc. v. The Hartford Financial Services, Inc.*, Civil Action. No. 3:06-CV-01835-AVC, 2007 WL 3124733 (D. Conn). In this case, the plan sponsor plaintiffs alleged that the Hartford was a fiduciary to its plan customers because it advertises itself as a "full-service" provider, the Hartford and its affiliates review and evaluate the mutual funds available on its investment platform, and the Hartford has authority to remove investment alternatives from its platform. On October 23, 2007, the court denied Hartford's motion to dismiss, rejecting Hartford's argument that it was not a fiduciary.

a. The complaint alleged that revenue sharing payments from mutual funds to the Hartford and its affiliates were not for services provided to the mutual funds, as the revenue sharing agreements provided, but were in fact payments for services the Hartford was already obligated to provide to its plan clients. Because the revenue sharing payments were asset-based rather than being charged on a per-participant basis, plaintiffs argued that the payments bore no reasonable relationship to the services that the Hartford provides to the plans. The plaintiffs also alleged that the revenue sharing payments constituted plan assets because the payments resulted from the Hartford's fiduciary status and were made at the expense of plan participants and because they were generated by plan investments.

b. In the complaint, the plaintiffs sought relief based on Hartford's (1) failure to adequately disclose the receipt of revenue sharing payments from mutual funds included in the line-up of mutual funds offered to plans; (2) failure to adequately disclose the amount of revenue sharing payments; and (3) acceptance of revenue sharing payments that bore no reasonable relationship to the services that the Hartford provided to the plans. The plaintiff plan sponsors also argued that the Hartford's receipt of revenue sharing payments constituted prohibited self-dealing and illegal "kickbacks" under ERISA §§ 406(b)(1) and 406(b)(3).

c. Hartford principally moved to dismiss the lawsuit on the grounds that it was not a fiduciary under ERISA and, therefore, could not be held liable for breaches of fiduciary duty or ERISA's prohibited transaction rules. Plaintiffs argued that Hartford qualified as a fiduciary because it had discretionary authority to unilaterally change the lineup of investment funds available to plan clients by adding or removing funds to or from the lineup. Hartford argued that it was not a fiduciary because the plan client had the ultimate authority to accept or reject any such change, citing the DOL advisory opinion issued to Aetna in 1997. *See* DOL Adv. Op. 1997-16A (May 22, 1997) ("Aetna Letter").

d. The court held that whether a defendant is a fiduciary is a factual question and that the plaintiffs had alleged enough facts to state a plausible claim for relief. Although the court did not mention the *Haddock v. Nationwide* decision, it reached essentially the same conclusion. Importantly, in denying Hartford's motion to dismiss, the court noted that (i) the Aetna Letter was not entitled to deference, but was merely persuasive authority; and (ii) in any event, because Hartford did not make all the same fee disclosures and follow the exact same notification procedures when changing a fund line-up as described by the Aetna Letter, there were sufficient factual differences to "render moot whatever persuasive authority [the Aetna] opinion might of carried."

e. The court also refused to conclude that revenue sharing is not a plan asset, deciding instead that the plaintiffs had alleged enough facts in support of their theory to allow them to proceed with such a claim.

f. The plaintiffs also brought claims against Neuberger Berman Management, Inc., which selected plan investment options from the investment funds offered by Hartford. Plaintiffs claimed that Neuberger failed to properly advise the plan in light of the revenue sharing payments. Neuberger sought dismissal on the grounds that it was not an ERISA fiduciary with respect to the revenue sharing payments. The court ruled that it could not conclude as a matter of law that Neuberger had no duty to investigate and inform the plaintiff about the revenue sharing payments. Further, the court concluded that Hartford could be liable as a *non-fiduciary*, for knowingly participating in Neuberger's alleged fiduciary breach.

4. *Charters v. John Hancock Life Insurance Co.*, Civil Action No. 07-11371-NMG, 2007 WL 4874807 (D. Mass.). Plaintiff, the trustee of a 401(k) plan, brought this action on behalf of his own plan and on behalf of all trustees, sponsors, and administrators of all ERISA plans that owned variable annuity contracts provided by John Hancock. The plaintiff alleged that Hancock, which managed the plans' assets in separate accounts, received revenue sharing payments to which it was not entitled, because the amount of such payments exceeded the amount by which Hancock reduced certain administrative fees and/or exceeded the fees authorized in the group annuity contracts issued by Hancock to its plan clients. The plaintiffs claimed that Hancock breached its fiduciary duty under ERISA by charging excessive fees and by retaining revenue sharing payments for its own benefit. The plaintiffs further claimed that Hancock engaged in ERISA prohibited transactions in doing so.

a. In denying Hancock's motion to dismiss the plaintiff's action, the court held that a reasonable fact finder could determine that Hancock's contractual right to substitute or delete mutual funds from the lineup of investment options offered to its client plans and participants gave rise to fiduciary status under ERISA. The court also acknowledged that, under DOL regulations, Hancock might be deemed a fiduciary based upon its role in issuing variable annuity contracts, though the court declined to decide whether an insurance company that issues such contracts is automatically an ERISA fiduciary.

b. In its motion to dismiss, Hancock also argued that the plaintiff lacked standing to assert claims on behalf of sponsors, trustees and administrators of other plans with which the plaintiff is not associated. The court rejected Hancock's argument as to trustees of other plans, and it deferred deciding whether suit was proper on behalf of administrators of other plans until the class certification stage.

5. *Ruppert v. Principal Life Ins. Co.* This action involves allegations that Principal is a fiduciary to its plan customers and has breached its fiduciary duty and engaged in prohibited transactions.

a. The complaint alleges that Principal is fiduciary because it (i) offers "full service" 401(k) retirement plans, including a menu of mutual funds from which employers can plan investment options; (ii) retains the authority to substitute funds or close funds to new investment; and (iii) has discretion to negotiate with mutual funds for revenue sharing payments. The complaint also alleges that Principal provides "investment advice" as defined by ERISA section 3(21)(A)(ii) because Principal (x) represents that the mutual funds on its platform are appropriate for plans; (y) recommends mutual funds that are similar to funds previously offered under a plan; and (z) provides investment advice to participants through interactive investment materials and matches specific mutual funds to plan participants' risk tolerance as identified by the interactive tools.

b. The complaint alleges that revenue sharing payments received by Principal are "plan assets" because the payments are a percentage of a plan's assets invested in a fund or family of funds.

c. Based on these allegations, plaintiffs claim that Principal breached its fiduciary duties by (i) failing to disclose that it negotiates revenue sharing fees with, and accepts revenue sharing fees from, the mutual funds included its menu of investment options; (ii) failing to disclose the amount of revenue sharing it receives; and (iii) keeping revenue sharing "kickbacks" from mutual funds. The plaintiffs also claim that Principal violated ERISA section 406(b)(1) by using plan assets to generate revenue sharing and retaining revenue sharing payments for its own account. The plaintiffs seek disgorgement of any revenue sharing amounts that Principal accepted in serving the plan and similarly situated plans.

6. *Columbia Air Services, Inc. v. Fidelity Management Trust Co.*, Civil Action No. 1:07-CV-11344 (D. Mass.). This lawsuit was brought by a plan sponsor on behalf of a class of plan trustees, plan administrators, and trustees of plans for which Fidelity served as trustee.

a. Plaintiff alleges that Fidelity obtained revenue sharing payments in addition to amounts expressly agreed as compensation, without providing any additional services. In particular, plaintiff alleges that Fidelity had no duty to select the final investment options provided to the plans. Therefore, according to the plaintiff, Fidelity was not entitled to any fees for investment selection or management services.

b. Plaintiff alleges that, in making revenue sharing payments to Fidelity, the mutual funds actually performed their services to the plans for the amount of fees charged to the plans *less* the amount of the revenue sharing payments to Fidelity. As a result, plaintiff alleges that, by virtue of Fidelity's receipt of revenue sharing payments, the plan overpaid for services provided to it, and that the plan's expenses should have been reduced by the amount of "kickbacks" Fidelity received.

c. Plaintiff alleges that, in receiving, retaining, and using the revenue sharing payments, Fidelity breached its duty under ERISA § 404(a) to act for the exclusive purpose of providing benefits to the plans' participants and beneficiaries and defraying reasonable expenses of the plans. Plaintiff also alleges that Fidelity's receipt of revenue sharing payments constituted prohibited transactions under ERISA § § 406(b)(1) and 406(b)(3).

7. *Zang v. Paychex, Inc.*, Civil Action No. 6:08-CV-06046-DGL (W.D.N.Y.). In this putative class action lawsuit, the plaintiff, a plan trustee, seeks relief on behalf of his plan and all other similarly situated plans, alleging that Paychex breached its fiduciary duties and

engaged in prohibited transactions by, among other things, receiving and retaining revenue sharing payments from the mutual funds made available to the plans' participants.

a. The plaintiff sets forth multiple allegations in support of his claim that Paychex is a fiduciary. Specifically, the plaintiff alleges that Paychex is an ERISA fiduciary (1) by exercising the powers of a plan administrator; (2) by designing and implementing prototype plans that channel client-plan assets to Paychex; (3) by having the discretion to determine which mutual funds are included in the Paychex-designed 401(k) platforms and how much to charge those funds; (4) by negotiating with mutual funds for the amount of revenue sharing payments Paychex will receive; (5) by receiving "float" payments from its client plans' assets pending investment of plan contributions; (6) by having discretion to select the financial institution and account where plan contributions will be held; (7) by having discretion as to the length of time the contributions will be held in such account; and (8) because Paychex' affiliate, Paychex Securities Corporation, exercises discretion and control over plan assets when investing plan investments in mutual funds and serving as nominee for such assets.

b. The plaintiff alleges that Paychex breached its fiduciary duties under ERISA § 404(a)(1) by (1) steering its client plans into mutual funds that paid Paychex revenue sharing in return; (2) negotiating to receive "float" payments while steering its client plans into mutual funds on the basis of whether such funds were willing to make revenue sharing and other payments to Paychex; and (3) by failing to offer lower-cost investment options for its client plans' contributions, such as aggregating plan assets, purchasing less expensive share classes, meeting investment minimums, or investing in lower fee alternatives to mutual funds, such as collective investment funds.

c. The plaintiff also alleges that Paychex engaged in ERISA §§ 406(b)(2) and 406(b)(3) prohibited transactions by steering its client plans' assets to mutual funds and financial institutions that made revenue sharing and float payments to Paychex.

8. *Beary v. Nationwide Life Ins. Co., et al.*, Civil Action No. 2:06-CV-00967, 2007 WL 4643323 (S.D. Ohio). This lawsuit, brought by a plan sponsor, was not brought under ERISA, but, rather, under state fiduciary law, on behalf of his Internal Revenue Code § 457(b) plan and all similarly situated plans. The plaintiff claimed that Nationwide breached common law fiduciary duties by arranging for, receiving, and keeping revenue sharing payments from mutual funds and mutual fund advisers for its own use. In the alternative, the plaintiff claimed that, even if Nationwide's actions did not constitute a breach of fiduciary duty, Nationwide's retention of the revenue sharing payments was unjust, obligating it to make restitution to the class members. The court granted Nationwide's motion to dismiss on September 17, 2007, holding that the plaintiff's action was preempted by the Securities Litigation Uniform Standards Act of 1998 ("SLUSA"). The plaintiff filed a motion to vacate the court's judgment seeking leave to file an amended complaint on October 1, 2007, which is pending.

9. *Beary v. ING Life Ins. & Annuity Co., et al.*, Civil Action No. 3:07-CV-00035, 520 F.Supp.2d 356 (D. Conn.) This lawsuit was also brought under state common law, and claimed that ING breached its fiduciary duties by keeping revenue sharing payments for services

provided to IRC § 457(b) plans. As in the *Nationwide* § 457(b) plans case, discussed above, the plaintiff also claimed, in the alternative, that even if ING's actions did not give rise to a breach of fiduciary duty, ING was obligated to make restitution to the class members. The court dismissed this action on November 5, 2007, ruling that the plaintiff successfully pled around SLUSA preemption, but at the cost of conceding away any viable claim. In doing so, the plaintiff failed to state a claim upon which relief could be granted, entitling ING to a dismissal of the action. Specifically, the court found that the plaintiff had full knowledge of ING's revenue sharing arrangement for several years prior to filing suit and that the plaintiff's failure to initiate timely legal action constituted an acquiescence to the revenue sharing arrangement, barring his breach of fiduciary duty claim. The court also found that the service contract between the plaintiff's plan and ING covered the subject matter of the plaintiff's claim for restitution, *i.e.*, the revenue sharing payments, and, therefore, that the claim was properly dismissed.

10. *Stark v. American Skandia Life Assurance Corp.*, Civil Action No. 3:07-CV-01123-CFD (D. Conn.). Plaintiff voluntarily dismissed this action without prejudice on November 13, 2007.[3]

C. IRA ROLLOVER LAWSUIT

1. On August 28, 2007, two former participants of 401(k) plans administered by Principal Financial Group ("Principal") filed a class action suit against Principal and its broker/dealer subsidiary, Princor Financial Services ("Princor"), alleging ERISA fiduciary violations. In this lawsuit, styled *Young, et al. v. Principal Fin. Group, Inc., et al.*, Civil Action No. 4:07-CV-386 (S.D. Iowa), plaintiffs allege that Principal sent letters to participants in Principal-managed 401(k) accounts who were nearing retirement age, "urging" them to call Principal about their accounts. Concurrently, Plaintiffs filed a separate lawsuit against Principal and Princor alleging violations of federal securities laws. *Young, et al. v. Principal Fin. Group, Inc.*, *et al.*, Civil Action No. 4:07-CV-387 (S.D. Iowa).

2. The suit alleges that Principal intentionally misled the plaintiffs into believing that they would be calling Principal's plan administration department when, instead, the number they were given was for sales agents at Princor. Plaintiffs allege that Principal instructed Princor sales agents to encourage plaintiffs and other 401(k) participants not to leave their money in their retirement accounts, but to "rollover" their accounts to Principal IRAs offering "J-Share" class Principal mutual funds, which were more expensive than other funds, (including the funds in their plans). Plaintiffs claim that Princor sales agents received bonuses and commissions for persuading participants to move their retirement accounts over to Principal IRAs.

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[3] Plaintiff, a plan administrator, brought ERISA section 404 and 406 claims on behalf of all trustees, sponsors, and administrators of employee benefit plans that owned variable annuity contracts offered by American Skandia, which provided recordkeeping services and investment options to such plans. The plaintiff alleged that American Skandia breached its fiduciary duties by receiving revenue sharing payments from the mutual funds in which the plan participants invested. According to the plaintiff, American Skandia's compensation was specified according to the terms of the contract between the plan and American Skandia, and any additional compensation received from the mutual funds should have inured to the benefit of the plan.

3. The Principal complaint alleges that – like many financial institutions – Principal is a "fiduciary" to the 401(k) plans in which the participants had accounts, for several reasons. First, Principal offers "full service" retirement plans to sponsoring employers, including a menu of mutual funds. According to the complaint, once an employer has made its selections, Principal retains the authority to substitute mutual funds from those selected by the employer and to close funds to new investment. The complaint also alleges that Principal exercised discretion by sending letters urging participants to call Principal about their retirement accounts and by instructing Princor sales agents to encourage participants to rollover their accounts to Principal-managed IRAs. Plaintiffs also allege that Principal and Princor provide "investment advice" to plans within the meaning of section 3(21)(A)(ii) of ERISA because (1) Principal represents that all the mutual funds on its platform are appropriate for its plan customers; (2) Principal provides investment advice to plan sponsors when it recommends mutual funds on the Principal platform; and (3) Princor recommends that participants rollover their retirement accounts and invest in Principal J-Shares.

4. A new twist in this case is the allegation that Principal/Princor acted as fiduciaries by "advising" participants to take plan distributions and roll the proceeds into Principal IRAs. In late 2005, the Department of Labor ("DOL") addressed this issue in an advisory opinion to Deseret Mutual Benefit Administrators. Advisory Opinion No. 2005-23A (Dec. 7, 2005)

a. In the Deseret Advisory Opinion, DOL concluded that, where a person who is not otherwise a fiduciary advises a participant to take an otherwise permissible plan distribution and to invest the proceeds in an IRA, such advice does not make the person a fiduciary. DOL cautioned, however, that the propriety of the non-fiduciary's investment advice may be subject to non-ERISA (e.g., securities) laws and regulations. With respect to an existing plan fiduciary, on the other hand, the DOL indicated that, if the fiduciary were to advise participants to roll over their accounts to an IRA, the advice would be subject to ERISA's fiduciary provisions and could involve self-dealing.

b. The reasoning behind the Deseret Advisory Opinion remains unclear. The crux of the opinion appears to be that, by itself, advising a participant to take a distribution is not a fiduciary act, as it is not advice regarding the management or disposition of plan assets, but relates to a "settlor" decision. At the same time, advising a participant to roll the proceeds over into an IRA cannot be a fiduciary act, as the proceeds are still "outside" the IRA when the recommendation is made (indeed, the IRA may not yet exist). Informally, senior DOL staff members have generally confirmed that this is their reasoning. Nonetheless, those staff members somehow reach a different conclusion when the person making the recommendations is already a plan fiduciary. Under those circumstances, they indicate that the combined acts of recommending a distribution and recommending the rollover of the distributed assets are tantamount to providing (fiduciary) advice as to the investment of plan assets (notwithstanding the fact that they will cease to be plan assets before the investment occurs). In other words, an otherwise non-fiduciary act somehow can be "converted" into a fiduciary act merely because it is performed by a fiduciary. Beneath the surface, DOL appears to be reluctant to let a fiduciary take advantage of its position of authority to "mislead" participants into believing that it is looking out for their best interests, when it is really making a sales presentation.

5. We expect this area of the law to develop significantly in the coming years, alongside 401(k) fee, revenue-sharing and similar claims.

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Please call the following, or the Groom attorney you regularly contact, if you have any questions about plan fee and expense litigation:

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