ERISA LITIGATION AND TRENDS UPDATE

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I. Emerging ERISA Litigation Trends.

A. Renewed Emphasis on Deference to Plan Administrator. While it does not directly touch on plan investments, in the long run the most important case of the last six months will probably be the Supreme Court's ruling in Conkright v. Frommert, 2010 WL 1558979 (U.S. 2010) that a plan administrator is entitled to judicial deference even if the administrator has previously made a mistake in the same case. Conkright should deter lower courts from excessive involvement in plan administration and from overriding reasonable decisions of plan administrators. It appears that the decision is applicable to a broad array of benefits claims, including those where the administrator is attempting to fashion a remedy when there has been a breach of legal requirements, such as the anti-cutback rules involved in Conkright. An extended discussion of Conkright appears in section IV.A.4, below.

B. Settlements in Fee Litigation. In August 2010, General Dynamics joined Caterpillar and Hartford Financial in settling the 401(k) fee claims lodged against it. It is to be noted, however, that the General Dynamics case included unique claims that focused on the role of a plan investment manager run by former General Dynamics officials. Therefore, some may question whether it represents the continuation of a trend toward settlement of fee cases.

C. Influence of Hecker v. Deere. The Seventh Circuit Court of Appeals decision resulting in dismissal of the plaintiffs' claims in the Deere case remains a powerful influence. The Seventh Circuit's analysis that relies on the efficacy of market forces and the significance of offering a wide array of investment options appears in several recent cases, including Renfro v. Unisys, discussed in Section III.D.1.f, below and F.W.Webb Company v. State Street Bank and Trust Company at Section III.D.2.f. Even if Deere is not directly cited, the thinking which underlies it can be seen in many cases, such as Zang v. Paychex, decided in August and discussed at Section III.D.1.g.

D. Elimination of Retail Class Mutual Funds as Investment Options. Most of the 401(k) fee cases include a claim alleging that excessive investment fees resulted from offering retail class mutual funds as a plan investment option. The Caterpillar settlement, which received final court approval in August, included a provision that Caterpillar would not use such funds as core investment options for two years. In addition, Tibble v. Edison, decided in July on the merits after a three-day bench trial and discussed below at Section III.D.2.e, held the defendants in that case liable for including such funds in the plan's investment line-up without sufficient justification. It may be time to conclude that, where it is possible, replacing retail class funds with less expensive investment options has become a best practice.

E. Clarification on Consequences of Faulty Plan Communications. A major Supreme Court decision is likely to be decided this year on the issue of whether a plan participant who claims to have suffered harm from an inaccurate summary plan description ("SPD") must demonstrate that she detrimentally relied on that faulty communication. In Amara v. Cigna Corporation, 2008 WL 450421 (D. Conn 2008), aff'd 2009 WL 3199061 (2nd Cir. 2009), the district court had held that the SPD's disclosure of a wear-away provision implemented pursuant to a cash balance conversion was deficient and that it was only necessary to show that the plaintiff class was "likely harmed" as opposed to requiring a showing that class members were detrimentally harmed. The Supreme Court granted the defendants' petition for certiorari on the issue of the proper standard for showing harm. The defendants have argued that the terms of the plan, not the SPD, should govern but that, even if this were not the case, the plaintiffs should be required to prove that they detrimentally relied on the faulty SPD. The reason the case is being closely watched is that, in addition to ruling on the applicable standard when there are conflicting plan documents, there is a potential for a broader scope to the court's ruling. Thus, the standard that emerges from the ruling could have applicability to claims of fiduciary breach arising from alleged misrepresentations or omissions. There may be further implications for the relief that is potentially available in class actions where many members of the class would have done nothing different even if they had understood the consequences of the wear-away provision.

F. Spread of Moench Presumption. A judicial doctrine first adopted in Moench v. Robertson, 62 F 3d 553 (3rd Cir. 1995) holds that a rebuttable presumption of reasonableness applies to the actions of a fiduciary of an ESOP or other plan that specifically provides for the acquisition and holding of employer stock. Where applicable, this doctrine applies Section 404(a)(2) of ERISA which relieves the fiduciary of such a plan from ERISA's diversification of investments requirement and from its prudence obligation to the extent it would otherwise require diversification. The Moench presumption has been the basis for dismissal of many employer stock-drop claims. In Quan v. Computer Sciences Corp., 623 F. 3d 870 (9th Cir. September 2010), the Ninth Circuit became the fifth appellate court to adopt Moench. Earlier in the year, in an amicus curiae brief filed in the *Citigroup ERISA Litigation* (see item IV.B.2, below), the DOL argued that the Second Circuit should reject the *Moench* presumption in stock drop cases. Then, in December, in Brown v. Medtronic, Inc. 2010 WL 5059594 (8th Cir. December 2010) the Eighth Circuit side stepped the issue of whether it should adopt Moench when it ruled that the plaintiff had failed to allege facts that could result in a conclusion that the plan's company stock investment was imprudent. As it is asserted with increasing frequency, the issue of Moench's viability appears to be coming to a head.

II. Overview of Participant Complaints in 401(k) Fee Litigation. Increased public and regulatory interest in 401(k) plan fees and expenses has resulted in lawsuits against some of the nation's largest employers and investment providers charging that they breached their fiduciary duties. Class action law suits brought against such defendants make the following allegations against the targeted employers, as well as against investment and service providers:

A. Failure to negotiate reasonable fees for administrative and investment services.

1. The class action complaints allege that the defendants failed to inform themselves of, understand, or monitor and control the hard dollar and revenue sharing payments made directly or indirectly by the plans.

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

b. Claims are sometimes made that revenue sharing is illegal or that revenue sharing is a plan asset. A variant on this theme is the claim that revenue sharing should, at the very least, be taken into account in evaluating the reasonableness of plan fees.

2. Plaintiffs argue that the selection of retail class mutual funds as investment options is inappropriate because they are more expensive than institutional class funds.

3. Finally, the complaints allege that the defendants failed to establish, implement or follow procedures to properly determine whether hard dollar and revenue sharing payments were reasonable and incurred solely for the benefit of plan participants.

B. Failure to adequately disclose fees and expenses to plan participants.

C. It is argued that investment alternatives consisting of company stock funds are improperly structured as unitized funds resulting in higher transactional costs and lower investment returns due to the higher level of cash in the fund.

D. Failure to properly account for float retained by institutional trustees.

III. 401(k) Fee Litigation. The complaints challenging investment and service provider fees were filed in several waves that reflected evolving and broadening theories as the plaintiffs' bar became more familiar with the nature of its target.

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

1. Haddock v. Nationwide Financial Services, Inc. (D. Conn. 2006). The court in this case initially 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:

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

   b. 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

   c. 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 was denied in 2007.

   More recently, on November 6, 2009, the district court certified a class action in which the class would be made up of the trustees of approximately 25,000 plans holding Nationwide annuity products. With respect to the typicality of claims, the court held that the annuity contracts were sufficiently similar to justify a class, even though there were potential differences with respect to a defense and counterclaim based on each class member's alleged ratification of the revenue sharing payments made to Nationwide. The class certification in Haddock conflicts with Ruppert v. Principal Life (discussed below) where, under similar circumstances, the Ruppert court found numerous individualized fact issues for each plan and had, therefore, refused class certification. Nationwide appealed the class certification on the ground that the fiduciary breach claims require individualized proof.

Nationwide has also moved for class certification of its own counterclaim against the individual plaintiff trustees. This counterclaim asserted that the ultimate responsibility to identify and monitor revenue sharing belonged to the trustees. However, on July 23, 2010, the court not only denied class certification for the counterclaim, but dismissed it in its entirety. Nationwide's claim for indemnification from the trustees having previously been dismissed, the court indicated that it would be a contradiction for a trier of fact to first find Nationwide liable to the plans for breach of fiduciary responsibility and then, on the counterclaim, to find the plan trustees wholly responsible for the plans' losses.

2. Ruppert v. Principal Life Insurance Company (S.D. Iowa.). The complaint in this case contains 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 complaint asserts that Principal is a plan 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 in its capacity as a fiduciary.

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 plaintiffs' 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. The denial of class status was appealed to the Eighth Circuit Court of Appeals which rejected the appeal on procedural grounds.

Principal subsequently moved for dismissal which was granted on November 5, 2009. As to the disclosure claim relating to Principal's receipt of revenue sharing, the court followed the Seventh Circuit decision of Hecker v. Deere (discussed below) in concluding that, while ERISA may require fiduciaries to inform plan participants and beneficiaries as to the aggregate amount of fees, it does not required specific identification of revenue sharing payments. This holding appears to conflict with the position taken by the Eighth Circuit Court of Appeals two weeks later in Braden v. Wal-Mart (discussed below). It is to be noted that the Principal court is within the jurisdiction of the Eighth Circuit.

As to the plaintiffs' prohibited transaction claim, the Principal court, again relying on Hecker v. Deere, held that revenue sharing payments made from the assets of registered mutual funds are not plan assets and that, therefore, they cannot be the basis for a prohibited transaction claim. As to plan investments in unregistered funds, whose underlying assets generally are plan assets, the court held that if revenue sharing payments were reasonable in relation to Principal's services, there would be no violation of the prohibited transaction rules. The court then concluded that the plaintiffs had failed to plead that Principal's fees were unreasonable or too high.

As to the unregistered mutual funds, on March 31, 2010, the court granted the plaintiff's motion for reconsideration. However, this did not affect the dismissal of claims relating to the registered funds.

3. Phones Plus, Inc. v. Hartford Financial Services (D. Conn.).

a. Plaintiffs' Allegations. 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 was 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 typically 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 Hartford 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 has ruled to the contrary on this point, as has the district court in Principal v. Ruppert, discussed above.

As to Hartford Life's status as a fiduciary, the court 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.

The investment adviser's contention that it had no duty to investigate Hartford's receipt of revenue sharing was also rejected. 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. The investment adviser (Neuberger) notified the court that it had reached a settlement with the plaintiffs in November 2008 which was subsequently approved.

b. Settlement. In February 2010, The Hartford settled its long-running dispute with disaffected plan trustees over allegations that it had received payments from mutual funds that were allegedly made in exchange for offering the funds as investment options under Hartford's variable annuity contracts, rather than for Hartford's rendering of administrative services.

i. Payment to Plaintiffs. Under the terms of the settlement, Hartford will deposit $13,775,000 in a fund to be divided among the 401(k) plans that used Hartford as a service provider from November 14, 2003 through the date of the settlement's approval. An additional $300,000 will be paid for administrative costs in effectuating the settlement.

ii. Modification of Business Practices. The Hartford is also required to make a number of changes to its business practices relating to the allegations made by the plaintiffs. Accordingly, under the settlement, The Hartford will eliminate language in its plan documents that restricts the type of property in which plan assets may be invested and will not enforce such language as a means of restricting the selection of investment options from the overall menu. In addition, Hartford will not enforce language in its annuity contracts or funding agreements that would otherwise allow it to invest assets in short-term money market instruments, cash or cash equivalents and will revise such contracts and agreements to clarify that Hartford does not have the right to substitute other investment options for those chosen by a plan, except in certain narrow circumstances, such as the unavailability of the option. The Hartford settlement further provides that all dividends and capital gains distributions on the shares of any mutual fund will be paid as additional shares of that fund, if available, and that Hartford will disclose such fact, as well as provide for customer instruction on the issue.

iii. Disclosure of Revenue Sharing. On the issue of revenue sharing, the Hartford settlement provides that new and existing customers will receive disclosure documents explaining that all of the mutual fund investment options on the Hartford overall menu make revenue sharing payments to Hartford or its affiliates. Further, Hartford must make available a list of all investment options offered to each particular plan, as well as the revenue sharing rate for such options, the published expense ratio for each option, an estimate of the dollar amount of revenue sharing per plan, and explanation of how the estimate was calculated, a narrative description of the revenue sharing and certain fees broken out by participant.

The court approved the settlement on June 23, 2010, bringing four years of litigation to a close. On the other hand, 19 plans that had been included in the class action chose not to be included in the settlement. In approving the settlement, the court indicated that it was finding that, in light of the structural changes made by The Hartford, it was not a fiduciary with respect to the receipt of revenue sharing payments.

B. The Second Wave – Cases Against Plan Sponsors. More than a dozen 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 some 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.

1. Partial List of Cases

a. Abbot v. Lockheed Martin Corp. (S.D. Ill.); on March 31, 2009, the court granted a partial summary judgment for the defendants pursuant to which the plaintiff's revenue sharing claims were dismissed.

b. Beesley v. International Paper Company (S.D. Ill.); the claims contain the usual revenue sharing allegations with the difference that the investment vehicles consisted of separate accounts rather than mutual funds which are arguably governed by market forces, as argued in Hecker v. Deere. In January 2009, both sides moved for summary judgment.

c. George v. Kraft Foods Global, Inc. (N.D. Ill.); On January 27, 2010, the defendants in this case obtained summary judgment dismissing the claims made against them. For a fuller discussion see III.D.1.c, below

d. Kanawi v. Bechtel Corp. (N.D. Cal.); this case was settled on November 20 2008. See Item III.D.l.d.

e. Loomis v. Exelon Corp. (N.D. Ill.); although class certification had been previously granted, the district court dismissed the case on December 9, 2009 relying on Hecker v. Deere which was controlling precedent for the court. The initial complaint had been similar to the complaint in Hecker and the facts were somewhat more favorable to the defendants, since the range of expense ratios offered was slightly lower than in Hecker. Therefore, the chief issue was whether the amendment of the complaint subsequent to Hecker would enable the case to continue. The gist of the amended complaint was that plan fees were excessive because, as newly detailed, no additional services were rendered to the plan.

Moreover, the amended complaint asserted that the fees were excessive because they were asset-based. Nevertheless, this attempt to differentiate the claim from Hecker failed. Among other things, the court found that Hecker had expressly approved of a plan which calculated fees as a percentage of assets within a range similar to the range of fees in the Excelon case. In March 2010, the DOL filed an amicus brief in support of the plaintiffs' appeal of the dismissal, arguing that Hecker v. Deere was limited to its facts and did not establish that a particular range of fees was prudent. The DOL brief also asserted that the trial court in Excelon had imposed an unjustifiably high standard of pleading and in the process had incorrectly decided unresolved factual issues in favor of the defendants.

f. Martin v. Caterpillar, Inc. (W.D. Mo.); motion to dismiss second amended complaint denied on September 25, 2008 and class certification was subsequently granted; the defendants' motion for judgment on the pleadings was made in February 2009. A settlement of the Caterpillar case was announced on November 5, 2009. The terms of the settlement and its implications are discussed below in Item III.D.2.b.

g. Spano v. Boeing Co. (S.D. Ill.); motion to dismiss denied on March 16, 2007; on August 17, 2009, the Seventh Circuit Court of Appeals issued an order consolidating the Boeing and International Paper cases with two other cases for purposes of reviewing class certification.

h. Taylor v. United Technologies Corp. (2d Cir.); summary judgment in favor of the defendant was granted on March 3, 2009; among other things, the court held that information on revenue sharing was not material and that the defendants did not breach their fiduciary duty in not disclosing its use to reduce the defendant's subsidization of plan expenses. On December 1, 2009, the Second Circuit Court of Appeals affirmed the district court's grant of summary judgment. A fuller discussion of the case appears at Item III.D.1.b, below.

i Will v. General Dynamics Corp. (S.D. Ill.). After denial of the defendants' motion for summary judgment was denied in March 2009, a $15.15 million settlement of the General Dynamics case was announced on August 4, 2010. The settlement is discussed below in Section III.D.2.c.

2. Issues.

a. Whether service provider defendants are fiduciaries that owe certain duties to the plan and its participants

b. Whether defendants acted prudently in selecting investment options.

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

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

e. 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.

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

C. *New Tactics - Additional Complaints against Plan Sponsors 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.

1. List of Additional Cases:

a. Hecker v. Deere & Co. (W.D. Wis.); see discussion at Item III. D.1.a.

b. Renfro v. Unisys Corp. (E.D. Pa.). The plaintiffs alleged that offering Fidelity retail mutual funds in the Unisys 401(k) plan was a fiduciary breach. On April 26, 2010, the court dismissed claims against the employer as well as the service and investment providers. A fuller discussion of the case is at III.D.1.f.

c. Tussey v. ABB, Inc. (W.D. Mo.); Fidelity's motion to dismiss was denied in February 2008. All parties moved for summary judgment in March 2009.

D. <u>Select Developments in 401(k) Fee Cases</u>. 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 cases, such as <u>Hecker v. Deere</u>, <u>Taylor v. United Technologies</u> and <u>Loomis v. Excelon Corp.</u>, 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 plaintiffs' 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 seemed to intensify as participants sought to recover 401(k) plan losses exacerbated by the current economic downturn. However, it may have been blunted by recent losses in the <u>Deere</u> and <u>Excelon</u> cases.

1. <u>Favorable Defense Rulings</u>. Motions to dismiss or summary judgment in favor of defendants have been granted in the following cases:

a. <u>Failure to State a Claim in Hecker v. Deere</u>. 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 <u>Hecker v. Deere</u>, 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 at least 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 <u>Deere</u> 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: <u>first</u>, by providing investment options with excessive and unreasonable fees and costs; and, <u>second</u>, 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.

On February 12, 2009, the appellate court, in a landmark opinion, 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 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 appeared to hold 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.

Although the Seventh Circuit quickly dismissed the case, the plaintiffs, supported by briefs from the DOL and other groups filed a petition for a rehearing by the full circuit. On June 24, 2009, the appeals court denied the petition, but, in so doing, it issued an addendum to its original opinion which appears to limit some of the more extreme implications of its analysis.

The DOL has taken a strong position that ERISA fiduciaries are always liable for the imprudent selection of investment options in 401(k) plans and that Section 404(c) is no defense against such liability. Accordingly, it vigorously argued that the Seventh Circuit's original Deere opinion had not give due deference to this point. The addendum responded by noting that the 404(c) issue was not involved in its primary holding that there was "no duty to scour the market to find the fund with the lowest imaginable fees" and that the fees in the particular funds that were the subject of the complaint "could not be deemed imprudent because they were offered at the same prices to the general public." The addendum indicated that these rulings did not necessarily contradict the Department's position with which the court nevertheless refused to agree. The court noted that it had intentionally avoided a broad ruling on the issue of 404(c) protection and that it had left the area open for future development. In the addendum, the court stated that, contrary to the Department's fears, its ruling was not broad enough to immunize from accountability a fiduciary that acts imprudently by selecting an overpriced portfolio of funds.

As to the Department's concern that, under Deere, a fiduciary can insulate itself from liability by the simple expedient of including a very large number of investment alternatives in the plan portfolio, the Seventh Circuit addendum, quoting the Department's brief, observed that the Deere opinion "was not intended to give a green light to such 'obvious, even reckless, imprudence in the selection of investments.'" The court explained that its opinion had been "tethered closely to the facts" that were before it and that the plaintiffs had failed to allege that any of the Deere plan's investment alternatives were unsound or reckless.

Notwithstanding its effort to narrow the Deere holding, when the dust settles, it appears that, in the Seventh Circuit's view, the selection, pursuant to a prudent and reasonable process, of a liberal number of investment options to be made available to plan participants would provide an impregnable defense to assertions of liability by participants.

As noted above, the Deere opinion 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 into 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.

On January 19, 2010, the U.S. Supreme Court declined to review the case, so for the moment, Deere stands as precedent which must be followed in the Seventh Circuit (Illinois, Indiana and Wisconsin) and which may be followed by courts elsewhere.

b. Summary Judgment for Defendants in Taylor v. United Technologies. As in other 401(k) fee cases, the plaintiffs in Taylor v. United Technologies Corp. 2009 WL 535779 (D. Conn., March 3, 2009) alleged that the company and the plan's investment and administrative committees breached their ERISA fiduciary duties by offering actively managed mutual funds with excessive fees and expenses as plan investment options and did not disclose the full information about such fees or otherwise investigate them. The district court granted summary judgment in favor of the defendants which was subsequently affirmed by the Second Circuit Court of Appeals on December 1, 2009 in a Summary Order that adopted the lower court's opinion. As a Summary Order, the Second Circuit's decision has limited precedential value, although it may be influential in stiffening the resolve of certain plan sponsors to defend their selection of plan investments. In the meantime, it is anticipated that the plaintiffs will seek a rehearing *en banc*, particularly in light of the Wal-Mart decision in favor of plaintiffs which was issued a few days before the Second Circuit's Summary Order and was not considered therein.

The United Technologies plaintiffs argued that the defendants had failed to engage in the extensive investigation that arguably should be required before the selection of any actively managed fund in view of the fact that an actively managed fund is not likely to outperform a lower priced index fund. However, the district court found that the plaintiffs had placed too much reliance on expert opinion and had failed to challenge the prudence of the actual selection process for any particular actively managed fund. Further, the court found that the defendants had, in fact, followed such a process in their selection of investment options.

Similar reasoning was applied to the plaintiffs' assertion that the mutual fund fees were excessive. Thus, the district court found that the plaintiffs had failed to challenge the fees of any particular plan investment option and that the defendants' fund selection process had included consideration of fees and expenses.

On the issue of sub-transfer agent fees, which were used to compensate the plan recordkeeper, the district court (and presumably the Second Circuit by virtue of its adoption of the district court opinion) ruled that such fees were not plan assets, but that, in any event, other service providers charged comparable fees. Consequently, the recordkeeper's fees were not unreasonable in light of the fact that the defendants had considered the sub-transfer agent fees, as well as fees paid directly to the recordkeeper, in evaluating the contract for recordkeeping services.

The district court rejected the plaintiffs' claims as to the inadequacy of disclosure regarding fees by holding that, in order to prevail, plaintiffs were required to establish that communications to participants were affirmatively false or misleading. Thus, the defendants' disclosure of the total expense ratio for each mutual fund was deemed to be sufficient.

c. George v. Kraft Foods Global, Inc. 2010 WL 331695 (N.D. Ill. Jan. 27, 2010) is a case in which the defendants successfully relied on Hecker v. Deere to obtain summary judgment. However, equally important, it shows the benefits of engaging in a prudent decision making process. This case is referred to as Kraft I to distinguish it from a similar but separate lawsuit (Kraft II) involving the same plaintiffs but adding defendants associated with the Altria Group, Inc., Kraft's former corporate parent. On December 17, 2009, the court in Kraft II dismissed certain claims against the Altria defendants based on the six year statute of limitations.

The claims in Kraft I were similar to those of other 401(k) fee cases, i.e., various plan administrative and investment bodies and their individual members had breached their fiduciary duties by (i) structuring the company stock funds as unitized funds, (ii) paying excessive recordkeeping fees, (iii) failing to properly account for float retained by the trustee, and (iv) failing to adequately disclose plan fees and expenses.

i. Unitized Company Stock Fund. The plaintiffs argued that the cash in the unitized company stock funds reduced investment returns and that such funds unfairly imposed the transactional costs incurred by frequent traders on all participants. However, the court concluded that the defendants' internal discussions showed that they had properly considered the pros (e.g., the ability to trade without delay) and cons of offering the stock as unitized funds and that these discussions were evidence of fiduciary prudence.

ii. Following Hecker v. Deere on Selection of Investment Options. The court also observed that participants had the ability to select at least seven investment alternatives other than the company stock funds. Based on Deere, it ruled that, in the absence of evidence that an investment alternative is "unsound or reckless, the provision of a large number of investment alternatives, with disclosures allowing participants to make an informed decision as to their investment choices, would preclude a finding that defendants breached their fiduciary duties."

iii. Procedure for Selecting Plan Service Providers. The Kraft I plaintiffs also argued that the defendants were responsible for allowing the plan to pay $28 million in excessive recordkeeping fees and were deficient in failing to request an RFP when deciding to renew the plan's recordkeeping arrangement with Hewitt. The court also rejected this argument, concluding that an RFP is not always necessary, particularly when the defendants had used consultants to benchmark Hewitt's fees and services. Once again focusing on the defendants' procedure, the court found that "based on the number of times they reviewed and renegotiated their contract with Hewitt and their utilization of various standard industry methods to determine the reasonableness of Hewitt's fees," there was no triable issue as to whether defendants used a reasonable decision-making process in making their contracts with Hewitt.

iv. Fee Disclosure. As to the claim that recordkeeping fees were inadequately disclosed, the court, again resorting to Deere, concluded that the critical information was the total fee charged by an investment option and that the quarterly reporting of investment option expense ratios, in which recordkeeping fees were embedded, was sufficient for this purpose. Further recordkeeping fees were disclosed on the Plan's Form 5500. Thus, the defendants' fiduciary duties with regard to disclosing recordkeeping fees had been satisfied.

v. Float. Finally, the Kraft I plaintiffs argued that the defendants had not obtained enough information about the trustee's (State Street Bank & Trust) float program to make an informed decision about State Street's compensation, as required by Department of Labor guidance. The court, however, concluded that the defendants had acquired adequate information about the float from State Street's invoices which indicated the circumstances in which float would be earned and retained as compensation, when float periods would begin and end, and the nature of the interest rate that would be applied to determine the float. While the invoices did not show float amounts, this was furnished by annual reports. Further, there had been at least one meeting with State Street to discuss float. Thus, defendants had not breached their fiduciary duty by allowing State Street to receive part of its compensation as float.

d. Kanawi v. Bechtel Corp. No. C 06-05566 (CRB) (N.D. Cal 2008) (subsequently settled, as noted above) 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.

e. Columbia Air Services, Inc. v. Fidelity Management Trust Co., 2008 WL 4457861 (D. Mass. 2008), the district court 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.

f. Renfro v. Unisys Corporation, 2010 WL 1688540 (E.D. Pa 2010). In Renfro, the primary allegation was the investment of nearly 1.9 billion of 401(k) plan assets in Fidelity-branded retail mutual funds resulting in the payment of excessive administrative and investment management fees to Fidelity. On April 26, 2010, the claims against the Fidelity defendants were dismissed on the ground that the Fidelity entities were not plan fiduciaries. In so ruling, the court rejected the plaintiffs' argument that Fidelity had a "veto power" over plan investment choices by virtue of trust provisions that limited mutual fund investments to Fidelity approved investment vehicles. In fact, the court said, the employer fiduciaries had the power to select investment options and could have added non-Fidelity funds to the mix by finding another administrator for such funds.

The court also dismissed claims against Unisys, the employer. Relying on Hecker v. Deere, the court concluded that the 70 investment options in the Unisys 401(k) plan offered a sufficient mix to satisfy the requisite standard of care. The court's reasoning relied heavily on the notion that the operation of market forces ensured that plan investment fees would be set at reasonable rates. As to the plaintiffs' claim that Unisys failed to disclose that the Fidelity investment and service providers were engaged in revenue sharing, the court ruled that it was enough that plan participants were made aware of the fees they would actually pay, it being irrelevant what happened to such fees once they were taken from the participant's account.

g. Zang v. Paychex, No. 08-CV-6046L (W.D.N.Y. 2010). As in Renfro v. Unisys, the question of whether the creation and offering of a menu of mutual funds can give rise to fiduciary status was at issue in Zang v. Paychex. In this case, a plan trustee sought to hold the provider of prototype plans responsible for revenue sharing payments. Paychex, the provider, picked the mutual funds menu and employers made the decisions as to which funds would be included in their plans. On reasoning similar to that applied to the Fidelity defendants in Renfro v. Unisys, the Zang court held that Paychex was not an ERISA fiduciary. The court noted that ultimately, it remained up to the plaintiff to decide on the funds in which to invest. In addition, the administrative service agreement with Paychex provided that before Paychex could delete or substitute a fund, it was required to give a plan sponsor at least 60 days notice of the proposed change. Should the plan sponsor disagree with the change, it had the right to reject the change or terminate the agreement. The plan sponsor's authority in this regard signified that Paychex was not a plan fiduciary

2. Notable Plaintiffs' Victories.

a. Braden v. Wal-Mart Stores, Inc. In this case, Wal-Mart was charged with breaching its duties of prudence and loyalty by selecting retail class mutual funds as plan 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, in October 2008, the district 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 or that the fund selection process was otherwise flawed. The district 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 revenue sharing is not inherently illegal or unreasonable. Finally, the district 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.

On November 25, 2009, the Eighth Circuit Court of Appeals vacated the district court's judgment and remanded the Wal-Mart case to the lower court for further proceedings. Braden v. Wal-Mart Stores, Inc., 2009 WL 4062105 (8^{th} Cir. 2009). Generally, the appeals court faulted the lower court for imposing on the plaintiffs an overly rigorous standard of pleading. It concluded that the district court had drawn too many inferences in favor of the defendants and incorrectly placed on the plaintiffs the burden of rebutting possible lawful explanations as to why higher-cost mutual funds had been selected as plan investment options.

The Eighth Circuit held that the complaint's allegations, read as a whole, plausibly stated a claim that Wal-Mart's selection process for plan investment options was flawed. These allegations included assertions that (1) a plan the size of the Wal-Mart plan (one million participants and nearly $10 billion in assets) had the ability to obtain institutional class shares, but, instead, offered its participants higher-cost retail shares; (2) the majority of Wal-Mart plan funds charged 12b-1 fees, (3) the more expensive funds were retained even though they did not meet their performance benchmarks (4) funds made revenue sharing payments to the plan trustee, not for trustee services, but to be included in the investment line-up.

The Eighth Circuit distinguished Hecker v Deere on the ground that the plan in that case provided access to over 2,500 mutual funds, making it untenable to suggest that all of such investment options had excessive expense ratios. In contrast, the Wal-Mart plan offered a far narrower range of investments, making it more plausible that the Wal-Mart plan was imprudently managed.

On the disclosure issue, the Eighth Circuit held that plan fiduciaries are required to furnish plan participants with material information that could adversely affect the participants' interest in the plan and that a reasonable trier of fact could find that such material information includes the fact that plan funds charged higher fees than comparable funds to which an employer, such as Wal-Mart, had access.

As to the plaintiffs' prohibited transaction claim involving the receipt of undisclosed amounts of revenue sharing funds by the plan trustee, the Eighth Circuit held that that the complaint alleged sufficient facts to aver an arrangement amounting to the provision of services to a plan by a party in interest, and that this shifted the burden to Wal-Mart to show that no more than reasonable compensation was paid. The court observed that the trust agreement between Wal-Mart and the trustee required that the amount of revenue sharing be kept secret and that, in view of their monopoly on information, the defendants were in the best position to demonstrate the absence of self-dealing.

The Wal-Mart decision had an immediate effect. Thus, the plaintiffs in the Second Circuit case of Taylor v. United Technologies, discussed above at III.D.1.b, whose appeal of a lower court dismissal had been denied on December 1, 2009, petitioned for a rehearing by the Second Circuit in light of Wal-Mart which had not been considered in the United Technologies decision. In the Wal-Mart case itself, the defendants' petition for rehearing was denied on January 5, 2010.

b. Caterpillar Settlement. 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 the Caterpillar case 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. In addition, the plaintiffs alleged self-dealing arising from the plans' offering investment options that were advised by a wholly owned Caterpillar subsidiary. 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 v. Deere that ERISA does not require plan fiduciaries to disclose revenue sharing. In a surprising development, on November 5, 2009, the Caterpillar parties announced a $16.5 million settlement of the case without the admission of any wrongdoing by the defendants.

i. Payment of Settlement Proceeds. The net proceeds of the settlement (after deduction of attorneys' fees, expenses and settlement administration) will be allocated to the accounts of participants and former participants based on the length of time that a participant maintained an account in one of the Caterpillar plans. Distributions to the class will begin after the court grants final approval of the settlement and all appeal rights have been exhausted.

ii. Restriction on Retail Mutual Funds. As part of the Caterpillar settlement, the parties agreed that during a two-year settlement period, Evercore Trust Company, an independent fiduciary, will monitor the Caterpillar plans. Further, during this period, retail mutual funds will not be included as core investment options under the plans. The use of retail mutual funds, which generally have a higher fee structure than wholesale funds, separate accounts and collective trusts, is a common complaint in 401(k) fee cases. The Caterpillar settlement, once again, raises the question of whether plan sponsors should be using such funds if other investment options are available.

iii. Communications with Participants. During the two year settlement period, Caterpillar must also increase and enhance communications with employees about 401(k) investment options and associated fees.

iv. Company Stock Fund. Caterpillar must continue to limit its cash holdings in the company stock fund investment option.

v. Procedures for Engaging Plan Service Providers. Under the settlement, Caterpillar will undertake a request for proposal to select or retain the plans' recordkeeper. Further, if service contracts come up for renewal, Caterpillar will undertake requests for proposal.

An independent fiduciary must review and approve the settlement on behalf of the affected plans. Some wondered whether the settlement would encourage further 401(k) fee litigation while motivating some plan sponsors to settle their own cases. The early answer seems to be in the affirmative. The court granted final approval of the Caterpillar settlement on August 12, 2010.

c. Phones Plus, Inc. v. Hartford Financial Services (D. Conn.). See discussion of settlement at III.A.3, above.

d. Will v. General Dynamics Corp. (S.D. Ill.) Similar to claims in other fee litigation, the General Dynamics plaintiffs alleged that the defendants had failed to consider or capture additional revenue streams and had made certain imprudent investments. However, revenue sharing claims were not asserted and the centerpiece of the case was the claim that General Dynamics had breached its fiduciary duties and engaged in prohibited transactions by turning over investment management functions to Fiduciary Asset Management Company ("FAMCo"), a company created by a group of former General Dynamics officers. Further, it was alleged that FAMCo had been improperly allowed to designate other investment managers with whom it would compete.

Under the terms of a settlement announced August 4, 2010, $15.15 million will be paid by General Dynamics' fiduciary liability insurers to a settlement fund to be allocated to the accounts of current and former participants on the basis of the length of time accounts were maintained under the plan. The proposed settlement also calls for General Dynamics to implement certain practices to maximize participant returns on their 401(k) investments. These practices include use of an outside consultant to review certain aspects of the 401(k) plans and report to General Dynamics, as well as an independent fiduciary. Another revision to General Dynamics practices involved enhanced disclosure to participants regarding plan fees and expenses associated with investments. Further, General Dynamics is required to maintain its long-standing practice of paying for the plans' record-keeping services on a per-participant basis, rather than an asset basis. Further, General Dynamics will not provide subsidies to other plan through the 401(k) plans, presumably a reference to the allegation that General Dynamics had allowed certain fund managers to charge the 401(k) plans first before charging other plans where a graduated fee structure that was in effect so that the 401(k) plans paid fees at a higher rate. General Dynamics will also provide volume discounts from investment managers that also provide services to other General Dynamics plans. Finally, the settlement prohibits FAMCo from recommending itself as investment manager or recommending the allocation of plan funds to investment accounts it manages.

e. Tibble v. Edison International (C.D. Cal. 2010). This case is one of the first 401(k) fee cases to go to trial and it resulted in a judgment for plaintiffs on their claims that ERISA's fiduciary duty of prudence had been violated by investments in the retail share class of a mutual fund when the same investment could have been obtained in the form of institutional shares with lower investment fees. The court evaluated the process used to select the retail share class and noted that there was no evidence that the defendants had considered or evaluated different share classes. Further, although the advice of a third party investment advisor was some evidence of a thorough investigation, it was not a complete defense to a charge of imprudence and at the very least, the court said, the plan fiduciaries must make certain that reliance on the expert's advice is reasonably justified. The court also rejected other arguments, particularly those based on the availability of the retail class of funds in light of investment minimums. The court noted that the Edison plan was large enough to have successfully requested a waiver of such minimums. Thus, it is not clear if a smaller plan might have been excused.

The Tibble plaintiffs also claimed that the defendants had breached their duty of loyalty by selecting the retail class of fund investments so that they could secure revenue sharing payments. On these claims, the court concluded, based on the evidence presented, that plan fiduciaries did not make fund selections with the objective of increasing revenue sharing even though they were aware of its existence.

f. F.W. Webb Company v. State Street Bank and Trust Company. Many retirement plan investors experienced losses in the recent financial crisis that resulted from exposure to subprime-mortgage backed securities. In some cases, money managers led investors to believe that their investments were more diversified than a typical money market portfolio, when instead they were invested almost entirely in subprime investments that ultimately caused hundreds of millions of dollars in losses. Such was the basis of an SEC complaint against State Street Bank that resulted in a $313 million settlement with regulators in February 2010.

Private legal actions by plan sponsors against State Street have also been lodged. Once example of such a claim that has recently survived a motion to dismiss is F.W. Webb Company v. State Street Bank and Trust Company, 2010 WL 3219284 (S.D.N.Y. 2010) in which State Street, serving as a directed trustee, and two other defendants that provided recordkeeping and administrative services were accused of misrepresenting an investment's mortgage-heavy investment strategy to the plan sponsor in violation of their fiduciary duties.

As to the defendants' fiduciary status, the court held that allegations that they had regularly advised the plaintiffs about the funds and provided them with analysis of the plan investment portfolio were, if true, sufficient to establish that the defendants provided investment advice and were, therefore, fiduciaries. On the issue of whether the plaintiffs had stated a plausible claim of fiduciary breach by the defendants, the court held that allegations that CitiStreet (one of the other defendants) had misrepresented the investment fund as a safe conservative investment tantamount to a money market fund was sufficient to plead that CitiStreet had violated its duty to act prudently. However, because State Street was merely a directed trustee whose recommendations had preceded the fund's conversion to a riskier investment strategy and CitiStreet allegedly provided the plan sponsor with advice as to investment options, the claims against State Street were dismissed.

E. 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.

Most courts have almost routinely granted class certification in litigation over 401(k) fees. See III.A.1 & 2, above, for particular judicial decisions. However, the Supreme Court's LaRue decision, discussed below, has given rise to the argument that, in view of participants' new ability to bring suits for individualized losses, it is no longer appropriate to certify such claims as class actions.

As noted in Items III.B.1b and III.B.1.g, above, Beesley v. International Paper Company and Spano v. The Boeing Company, each involving allegations of excessive fees, imprudent investment options and miscommunications to participants in defined contribution plans that allowed participant direction of investments were consolidated by the Seventh Circuit Court of Appeals for the purpose of reviewing class certification orders that had been issued by the district court. On January 21, 2011, in Spano v. The Boeing Company, 2011 WL 183974 (7^{th} Cir. 2011), the appellate court vacated the class certifications in each case and sent the cases back to the lower court for further proceedings. In the appellate Court's view, the defined class in each case was so broad that the class failed the typicality of claims and adequate representation of the class requirements of Federal Rule of Civil Procedure 23(a). As stated by the Court, "Anyone in the history of Time, who was ever a participant in the ..[plan] or who in the future may become a participant in the … [plan], is swept into this Class." According to the Court a class representative needs to have invested in the same funds as the class members, but in these cases many of the plan participants in the past, not to mention the future, will have never held a single share in the investment funds that were the subject of the complaint. Thus, the typicality requirement was not met. As to adequacy of representation, the court noted that certain members of the class would have no complaint about such funds, depending on when they first invested and when they exited the fund. Those members might actually be harmed by the relief being sought, thereby giving rise to conflicts of interest between members of the overly broad class. The remand to the lower court entailed directions to narrow the class. The case is likely to result in greater scrutiny by trial court judges as to whether a proposed class shares a common interest.

F. Implications of Indirect Fee Cases.

1. 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.

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

3. Some copycat claims have been made and additional law suits making similar claims are likely to be filed.

4. 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.

5. A number of cases have now been settled, e.g., Phones Plus v. Hartford Financial Services, Will v. General Dynamics Corp. and Martin v. Caterpillar. In addition to cash payments from the plan sponsor or its insurer, the terms of the settlement involve changes to business or administrative practices, such as restrictions on the use of retail mutual funds. It is likely that a number of the practices mandated by settlement terms will be widely adopted by most plans.

IV. Other ERISA Litigation

A. Standing to Sue.

1. LaRue Case. The much anticipated question of whether an employee can sue to recover individual 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.

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)."

2. Comment on Lessons of LaRue: 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.

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

MetLife v. Glenn. Aside from LaRue v. De Wolff, Boberg & Associates, 128 S.Ct. 1020(2008), discussed above, the most significant judicial decision of 2008 was MetLife v. Glenn, 128 S.Ct. 2343 (2008) which was issued in June 2008 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.

4. Conkright v. Frommert, 2010 WL 1558979 (U.S. 2010). Conkright may be viewed as a follow-up to the Supreme Court's MetLife decision, and, therefore, affects the administration of all plans. In Conkright, which involved a Xerox pension plan, the Court held that a plan administrator with discretionary authority to interpret the plan is entitled to deference from the courts even if the administrator made prior determinations with respect to the same claim that were invalid. This result is consistent with MetLife, discussed above, which had held that even a systemic conflict of interest by the plan administrator did not automatically result in the administrator's loss of deference.

The plaintiffs in Conkright were employees who had previously terminated employment, received lump sum distributions from the plan and been subsequently rehired. These employees alleged that an adjustment to their current pension benefits to avoid duplication was incorrectly calculated and that the adjustment methodology used by the employer violated anti-cutback rules. The district court had deferred to the plan administrator as to the methodology for calculating this benefit offset and granted summary judgment for the defendant. However, the Second Circuit Court of Appeals ruled in favor of the plaintiffs and reversed. On remand, the district court substituted its own "straightforward" methodology for another proposed by the plan administrator, and on a second appeal to the Second Circuit, the appellate court approved the lower court's choice of remedy. In reversing the Second Circuit and reinstating the plan administrator's offset methodology, the Supreme Court said that the case was about whether a single honest mistake in plan interpretation strips the plan administrator of deference with regard to subsequent related interpretations and held that it does not. The Court reasoned that such deference protects and promotes "efficiency, predictability and uniformity."

Conkright appears to be an attempt to reduce the role of the courts in plan administration. At the same time, the authority of plan administrators is both strengthened and broadened. District courts will be expected to remand benefit claims to the plan administrator, possibly even in those cases involving the determination of the remedy for a fiduciary breach.

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 401(k) plan or ESOP. When such stock suffers a significant decline in value due to business exigencies, the employer is often sued based on the twin claims that the inclusion of an employer stock fund as an investment alternative was imprudent and that the employer failed to disclose to participants the business issues that led to such decline.

1. DiFelice v. US Airways Inc. One of the most significant recent decisions in this category was DiFelice v. US Airways Inc., 497 F.3d 410 (4^{th} Cir. 2007), decided in August 2008. 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.

US Airway'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 Fourth Circuit rejected this claim, 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.

2. Citigroup Case. Another significant decision is the holding in In re Citigroup ERISA Litigation (S.D.N.Y. 2009) that Citigroup did not breach its fiduciary duties when it continued to offer its stock as a 401(k) investment when the company was incurring losses as a result of the subprime mortgage crisis. The sharply worded opinion concluded that the plan document mandated that Citigroup's stock be offered as an investment option and that the plan fiduciaries had no discretion to eliminate the stock from the plan. The ruling appears to sanction the notion that an absolute defense to fiduciary claims in stock drop cases can be drafted into the plan document. Department of Labor officials were not long in reacting to the Citigroup decision, voicing their disagreement with the premise that employer stock funds could be excepted from fiduciary standards by a drafting technique.

3. Howell v. Motorola, Inc, 2011 WL 183966 (7th Cir. 2011). This case is the consolidation of two cases involving the Motorola stock fund that was an investment option in the Motorola 401(k) plan. The plaintiffs had alleged fiduciary violations by virtue of (i) the imprudent selection of the company stock fund as a plan investment option, (ii) either negligent or intentional misrepresentation of material information as to a bad business transaction or failure to disclose that information to plan participants and

(iii) failure to appoint and monitor competent plan fiduciaries. However the district court had granted summary judgment for all of the defendants on all claims, because there had been no fiduciary breach and because all defendants were entitled to rely on the Section 404(c) safe harbor. The Seventh Circuit affirmed this result concluding that the safe harbor defense was available for the disclosure and monitoring theories, although the initial selection and decision to continue offering a plan investment option was not subject to protection under Section 404(c). This portion of the decision reaffirms the importance of ensuring that a plan is in compliance with Section 404(c).

Although the safe harbor defense was not available, Seventh Circuit also denied the imprudent selection claim, noting that participants had been repeatedly warned of the risks of investing in an undiversified investment option and had the ability to invest in other options, that Motorola was fundamentally sound and never on the verge of collapse and that the volatility experienced by its stock was within the bounds described in the plan documents. Thus, there was no fiduciary breach.

One other aspect of Howell deserves comment. The lead plaintiff had signed a general release which he repudiated on the basis of an exception that read: "I am not releasing any claims for benefits under the Motorola employee benefits plan." Howell argued that a lawsuit complaining about a breach of fiduciary duty under ERISA could still be such a "claim for benefits." However, as a matter of contractual interpretation, the Court felt that a more sensible reading of the release was that "Howell remained entitled to sue to recover the money that was in his retirement account at the time he signed the release, but he cannot now claim that his account would have been worth even more had the defendants not breached a fiduciary duty." Thus, the release barred Howell from suing Motorola. This aspect of the case demonstrates the importance of careful drafting in the matter of settlements and releases.

C. Varying Appellate Court Approaches to Reforming Scrivener's Error

1. Cross v. Bragg. Fairly or not, life sometimes offers no second chances and the same may be said of certain decisions by ERISA advisers. Care must be taken to get it right the first time, as illustrated by Cross v. Bragg, 2009 WL 2196887 (4th Cir. 2009) in which the Fourth Circuit Court of Appeals refused to allow the reformation of a plan document which had been amended to include an erroneous benefit formula. When the error was recognized, the plan administrator, with the support of the plan's actuary, sought to characterize the inclusion of the erroneous formula as a scrivener's error. This action received IRS approval when the plan was submitted for a ruling under the IRS Employee Plans Compliance

Resolution System. Nevertheless, several participants sued for the higher benefit resulting from the erroneous benefit formula.

The participants' prevailed at both the district court and the appellate level. The Fourth Circuit held that the power to correct a scrivener's error rests solely with the courts by virtue of their equity powers. In exercising this jurisdiction, courts are guided by principles of contract and trust law which, in the Fourth Circuit's view, require the party seeking reformation to show that the mistake was mutual, i.e., that the participants, as well as the plan sponsor had had a different intent as to the effect of the plan amendment when it was adopted. Evidence that the participants had not relied on the plan documents that included the error was not sufficient to establish a mutual mistake. (This approach seems to have an uninformed view of the amendment process which generally does not have participant involvement, other than in the case of multiemployer plans.) Nor was the reformation's approval by the IRS given deference by the court. The Cross decision will make it more difficult to correct scrivener's errors and, at least in the Fourth Circuit, eliminates reliance on IRS sanctioned document corrections.

2. Young v. Verizon. In August 2010, the Seventh Circuit took a more liberal approach to reformation of a scrivener's error in Young v. Verizon's Bell Atlantic Cash Balance Plan, 2010 WL 3122795 (7th Cir. 2010). The controversy arose from the calculation of a participant's opening account balance under a cash balance plan. The participant contended that plan language required a transition factor to be multiplied twice, resulting in an increase of the opening balance of nearly $400,000. The district court ruled that the plan committee had abused its discretion in disregarding the scrivener's error that led to this result and should have sought to reform the documents in court. This caused Verizon to counterclaim for equitable reformation of the plan which was granted. On appeal to the Seventh Circuit, the appellate court concluded that ERISA authorizes "equitable reformation of a plan that is shown by clear and convincing evidence to contain a scrivener's error that does not reflect participants' reasonable expectation of benefits." The court noted that the "clear and convincing evidence" standard would mitigate the impact on the rule that the plan document, as written, should control. The Young decision provides limited relief for drafting mistakes but still requires judicial review of scriveners' errors, apparently without deference to the plan administrator.

D. Rollover Advice – Legal Challenge to Cross Selling.

Young v. Principal Financial Group, Inc. (S.D. Iowa, 2008). In the Principal case, a federal district court allowed claims by 401(k) plan participants 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. While the court granted the defendant's motion to dismiss the participants' claims seeking recovery of losses to their 401(k) plan, because the plan had not incurred any loss, Principal's motion to dismiss fiduciary breach claims for which participants could seek an equitable remedy was denied. In March 2010, however, the court refused to certify a class action for such remaining claims. The denial of class certification was based on the fact whether or not the defendant was a fiduciary depended on its interactions (e.g., follow-up phone calls) with each individual plaintiff.

V. Best Practices Arising from 401(k) Fee and Other ERISA Litigation. In light of 401(k) fee litigation and similar class actions, employers are beginning to adopt best practices that involve more aggressively negotiating and monitoring service provider fees. Employers have taken proactive steps to adopt the following standards which recognize that fiduciaries are judged not on the results they achieve but on the processes they follow and that such processes evolve over time. Financial advisers and broker-dealers should be aware of these best practices and prepared to assist in their implementation.

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 which include the actual expenditure of hard dollars, as well as indirect fees. Although the recently finalized regulations under section 408(b)(2) of ERISA allow disclosure by formula, many plan sponsors will attempt to determine the actual dollar amount, even if it is an estimate. Under the new regulation, service providers will be automatically obligated to make fee disclosures to plan sponsors. The new rules are effective July 16, 2001.

1. Services. The services to which fees relate may include the following:

(a) Trustee services, (b) recordkeeping, (c) administration, (d) investment advisory, (e) investment management, (f) and brokerage.

2. <u>Types of Indirect Fees</u>. There are at least eight kinds of indirect 401(k) plan fees and expenses of which plan fiduciaries should be aware. These include: (a) SEC Rule 28(e) soft dollars, (b) sub-transfer agent fees, (c) 12b-1 fees, (d) variable annuity wrap fees, (e) investment management fees, (f) sales charges, (g) revenue sharing arrangements, and (h) float. So-called "R funds" are mutual funds specifically designed as pension plan investments and often carry one or more of the above-referenced indirect fees.

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

1. <u>Duty to Evaluate Services</u>. Plan sponsors should engage in an objective process that elicits the information necessary to assess the qualifications of service and investment providers, the quality of the services offered and the reasonableness of the fees charged in light of the services provided. A provider should never be selected simply because it is the cheapest.

2. <u>Objectives of Benchmarking</u>. In meeting their duty to evaluate the services being provided to a plan, 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. Benchmarking services can help employers meet their obligations under ERISA with respect to plan fees in the following ways:

   a. Assist the employer in its efforts to identify and calculate all plan fees, including any "hidden" indirect compensation paid by the plan's investments (or investment providers).

   b. Equip the employer with the ability to use benchmarking services as part of a prudent review process to evaluate and monitor the plan's services and fees on an ongoing basis.

   c. Provide the employer with the competitive pricing information that a prudent expert might have, to help assess the reasonableness of the plan's current service arrangement.

3. <u>Guidelines for Selecting Benchmarking Services</u>. Benchmarking services are offered in many forms. Financial advisers should inform their plan sponsor clients that the decision to engage a benchmarking service provider is itself subject to the same fiduciary standards under ERISA which would apply to selecting service providers for the plan generally. In addition, financial advisers who work with plan sponsors should

encourage them to make the following inquiries with respect to any prospective provider of benchmarking services:

a. What are the qualifications and credentials of the provider? How long and to how many clients has the provider been offering benchmarking services?

b. Does the provider offer benchmarking analyses for all of the plan's investment and administrative service fees? To what extent are benchmarking analyses provided separately for each individual fee (as opposed to total fees)?

c. Will the provider be able to identify all indirect compensation paid to the plan's service providers from the plan's investments and investment providers? Does the provider consider all indirect compensation paid with respect to the benchmark group of plans?

d. How reliable is the provider's data for the benchmark group of plans? Is data obtained directly from the various plans' recordkeepers? Does the data gathering method used by the provider prevent inaccurate data submission? Is stale and outdated data disregarded?

e. What is the size and profile of the plans included in the benchmark group? How many plans are included in the benchmark group? Can the benchmark group be customized?

f. Does the provider offer any benchmarking analyses with respect to the quality of the investment and administrative services provided to the plan?

g. In order to make a direct comparison, the actual fees of the various plans are often converted into a per-participant fee or asset-based fee. Does the provider use both per-participant fees and asset-based fees as baselines for its comparisons? If not, why?

h. After the benchmarking analyses are completed, what type of consulting services and support will be available to the plan fiduciary in interpreting such analyses?

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 should ask 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 document their periodic 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. When selecting a new provider, documentation will show the solicitation of bids from multiple providers.

E. Hiring Independent Third Party Investment Experts. More plan sponsors will employ independent third parties (e.g., benchmarking services or other 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.

G. Fiduciary Manual. Use of a fiduciary manual is intended to help fiduciaries reach a better understanding of their responsibilities and to help them comply with ERISA's fiduciary standards. When properly designed, it serves as a reference tool (i.e., a guide for plan fiduciaries when they have questions, such as identifying fiduciaries or determining the scope of their responsibilities and liabilities). A fiduciary manual can also provide compliance tools that fiduciaries may use to monitor investments and service providers.

H. Disclosure to Participants. As new Department of Labor requirements become mandatory in the near future, plan sponsors and their advisers should be prepared to administer any new participant communication requirements. This includes meaningful fee information which entails participant education as to the various factors which can influence fees.

VI. Best Practices in Response to Rollover Litigation and DOL Guidance.

A. In Young v. Principal Financial Group, Inc. (S.D. Iowa, 2008), discussed at Item IV.D, 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.

B. DOL Advisory Opinion 2005-23A addresses rollovers and distinguishes between two groups: (i) "a plan officer or someone who is already a plan fiduciary" and (ii) someone who is:

a. "neither chosen nor promoted by plan fiduciaries,"

b. "not otherwise a plan fiduciary,"

c. "not a plan fiduciary on some other basis," and

d. "not connected with the plan."

The advisory opinion then states that an advisor in the second group (i.e., someone who is not already a fiduciary) can recommend that a plan participant roll over his or her account balance to an IRA, even if the investment professional will earn fees on the IRA assets after the rollover. In this situation, ERISA's conflict of interest rules do not apply to the investment professional's rollover recommendation.

An adviser in the first group (i.e., "someone who is already a fiduciary") that recommends that a plan participant roll over his or her account balance to an IRA (or that "responds to participant questions concerning the advisability of taking a distribution or the investment of amounts withdrawn from the plan") could violate ERISA's conflict of interest rules, if the adviser will earn fees on the IRA assets after a plan participant rolls over his or her account balance to the IRA.

C. Interpretive Bulletin 96-1 constitutes the DOL's recognition of a distinction between investment advice and investment education. The bulletin explains how investment education could be provided without providing investment advice that would make the provider an investment advice fiduciary. For example, the bulletin states that investment education includes informing plan participants about the impact of preretirement withdrawals on retirement income. The preamble to the bulletin further explains the importance of rollover education as follows: "Plan participants also need to be informed about the impact on retirement savings of preretirement withdrawals . . . The Department, therefore, encourages educational service providers to emphasize that participants should . . . if they change employment refrain from withdrawing their retirement savings, and opt instead to directly transfer or roll over their plan account into an IRA or other retirement vehicle. . . ." This indicates that an adviser providing a plan participant with general educational information about the availability of rollovers would not be providing investment advice.

D. Best Practice to Avoid Litigation or Regulatory Challenges in Rollover Matters. As discussed above, ERISA's conflict of interest rules prohibit an investment professional advising a plan sponsor or plan participants from recommending an IRA that will generate fees or other compensation for that investment professional. However, such an adviser may provide investment education about availability—not advisability—of a rollover, even if the adviser will earn fees or other compensation from the participant's rollover IRA assets. To help investment advisers apply the distinction between investment education and advice, consideration should be given to adding language to investment advisory agreements and/or other documents along the following lines:

> "Rollovers to IRAs. If an adviser provides investment advice to a retirement plan sponsor or participants, the adviser cannot recommend an affiliated IRA. However, an adviser can educate participants concerning rollovers in general and describe the ability to withdraw funds from the retirement plan and to roll them over into affiliated and nonaffiliated IRAs generally. If a participant elects to work with the adviser outside of the plan regarding the participant's IRA assets, the adviser may receive variable compensation from third parties while working with the participant."

This disclosure language is based on DOL Advisory Opinion 2005-23A and Interpretative Bulletin 96-1.