ABB: Affirmed, Reversed, and Vacated

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In the continuing saga of class action lawsuits filed against 401(k) plan sponsors alleging excessive recordkeeping fees, the Court of Appeals for the Eighth Circuit recently issued a significant ruling in the case of *Tussey v. ABB, Inc.*, No. 12-2056 (8th Cir. 3-19-2014), which affirmed in part, reversed in part, and vacated in part, the district court's previous findings.

Background

The district court's 2012 ruling in *ABB* was the first excess fee case to award significant damages and resulted in a $36.9 million judgment for plan participants. [*Tussey v. ABB* (W.D. Mo. 3-31-2012).] The participants alleged that the defendant, ABB, Inc., as the plan sponsor of two similar 401(k) plans (one for nonunion members and the other for union members) failed to understand, monitor, and control revenue sharing payments received by service providers from plan investments. Other claims were that the fiduciaries improperly substituted one investment option for another on the plans' investment menu, and that the defendant, Fidelity, improperly retained the income earned on assets in the process of being transferred to, or redeemed from, plan investment options, otherwise known as "float."

$13.4 million of the damages were allocated by the district court to excessive recordkeeping fees on the ground that ABB breached its fiduciary duties by failing to monitor such fees, failing to ascertain whether such fees were reasonable, and failing to prevent the use of such fees to subsidize administrative costs unrelated to the ABB 401(k) plans. The district court also found ABB liable for $21.8 million in connection with its decision to remove a balanced fund from its investment line-up and map assets to a target-date fund. Finally, the district court found Fidelity liable for $1.7 million for its treatment of "float."

On appeal, the Eighth Circuit upheld the $13.4 million judgment, but reversed the district court's holding that float was a plan asset. The Eighth Circuit also vacated and remanded the district court's ruling that the plan's fiduciaries breached their duties when they decided to replace a Vanguard mutual fund with a Fidelity fund that was subsequently outperformed by the Vanguard fund it had replaced. The district court was instructed to reconsider this part of its decision in light of the appellate court's findings that the lower court neglected ABB's decision-making process and placed too much reliance on investment performance results, as seen in hindsight.

Recordkeeping Fees

A major issue in the case involved the amount of fees paid to the recordkeeper, Fidelity. Fidelity was compensated for its services to the ABB 401(k) plans through revenue sharing. Consistent with the findings of the district court, the Eighth Circuit noted that revenue sharing is a common method of compensation and is permissible under ERISA. However, both courts found that ABB's failure to engage in a deliberate process to evaluate the revenue sharing arrangement with Fidelity was a breach of fiduciary duty. The facts of the case demonstrate that the ABB fiduciaries failed to: (1) calculate the actual amount the plan was paying Fidelity for recordkeeping through revenue sharing; (2) determine whether Fidelity's pricing was competitive with other recordkeepers; (3) leverage the plans' size to negotiate reductions in Fidelity's fees; and (4) prevent the recordkeeping fees from being used to offset the costs of nonplan related services that Fidelity was also providing to ABB. In sum, the fiduciaries' failure to consider alternatives to Fidelity and its fee arrangement was so imprudent that both the trial court and appeals court easily found that ABB had breached its fiduciary duties.

In its review of the district court's ruling, the Eighth Circuit determined that the appropriate standard of review to use when reviewing fiduciary decisions is an "abuse of discretion" standard, rather than a *de novo* standard. Under a *de novo* standard, a court substitutes its own determinations without giving any deference to decisions made by a fiduciary. On the other hand, when applying an "abuse of discretion standard," a court will overturn a fiduciary's decision only if it is found to be unreasonable. Even applying the more lenient abuse of discretion standard to ABB's approval of Fidelity's recordkeeping fees, it was not difficult for the Eighth Circuit to find the ABB fiduciaries' conduct to be far below any standard of "fiduciary management."

The ABB fiduciaries' conduct also provided the basis for the Eighth Circuit to rule that the fiduciaries were not shielded from liability merely because they provided a wide variety of investment options with a range of fees. The ABB fiduciaries argued on appeal that, according to *Hecker v. Deere & Co.*, they could not be held liable because the ABB plans offered a wide range of investment options that included a number of low-cost funds. However, the Eighth Circuit rejected this argument given that the facts of the *ABB* case involved "significant allegations of wrongdoing," that could not be mitigated by the fact that ABB provided a range of fee

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options among a variety of investment alternatives.

Investment Selection

A second issue in *ABB* involved the fiduciaries' decision to remove a Vanguard balanced fund from the plan's investment line-up and replace it with a Fidelity target-date fund. Based on its interpretation of the plan document and the plan's investment policy statement, the district court, without allowing any deference to the ABB fiduciaries' decisions, found that the selection of the Fidelity fund and decision to map plan investments from the Vanguard fund to the Fidelity fund was imprudent and improperly influenced by conflicts of interest. As was the case with the recordkeeping issue, the Eighth Circuit noted that the fiduciaries were entitled to discretion in making an investment decision if the selection of an investment alternative was in fact reasonable, given what they knew at the time of selection and not in hindsight. The Eighth Circuit remanded the investment selection decision back to the district court for a more careful review of whether the ABB fiduciaries employed a proper process when making the decision to remove the Vanguard balanced fund.

The district court calculated damages based on the amount that participants would have made had their contributions been invested continuously in the Vanguard fund. On remand, the Eighth Circuit instructed the district court to reevaluate its method of calculating the damage award to participants in connection with the investment selection. Since participants who were interested in investing in a balanced fund had the ability to select investment options other than the Fidelity fund, a more reasonable measure of damages, according to the Eighth Circuit, would be to compare the difference between the performance of the Fidelity fund and the minimum return of the subset of managed allocation funds the ABB fiduciaries could have chosen without breaching their fiduciary duties.

Float

The Eighth Circuit reversed the trial court's $1.7 million judgment against Fidelity for failing to pay to the ABB 401(k) plans the float income generated by Fidelity. The appellate court found that the ABB 401(k) plans had no property rights in the float, because both the depository account and the redemption account were registered for the benefit of the plan's investment options. Once the ABB 401(k) plans became the owner of shares of a mutual fund, they were no longer the owner of the money used to purchase such shares. Thus, the plan investment options held the property rights to the float and were entitled to any float income. However, one of the three judges who heard the *ABB* case filed a dissenting opinion on the float issue, stating that he was persuaded by the ERISA regulations and other Department of Labor (DOL) guidance that float was in fact a plan asset.

Plan sponsors should be aware that according to DOL Field Assistance Bulletin 2002-2003, float should be regarded by plan fiduciaries as part of the service provider's compensation for services to the plan. Accordingly, float, like revenue sharing, can be an acceptable method to compensate a service provider, as long as the service provider discloses specific information regarding when float will be earned and retained, and the plan fiduciary undertakes an investigation to ensure that the estimated float income is reasonable with respect to the services provided.

Implications for Plan Sponsors

According to the DOL's 408(b)(2) fee disclosure regulations, a recordkeeper must provide an upfront fee notice that describes its direct fee, as well as any indirect compensation such as revenue sharing. A plan sponsor has a corresponding duty to evaluate the compensation payable to the recordkeeper as disclosed in a 408(b)(2) notice. As the Eighth Circuit's decision in the *ABB* case demonstrates, it is critical for the plan sponsor to understand and quantify the amount of revenue sharing that is being retained by the recordkeeper. This due diligence should be performed on an ongoing basis, especially since the amount of revenue sharing can vary considerably from year to year, depending on the investments selected by the plan and their performance. The most recent *ABB* decision acknowledges the discretionary nature of fiduciary decision-making and as a result, it places a greater emphasis on creating clear documentation of the decision-making process in all matters, but particularly in the selection of plan investment options. Following an established process and documenting its implementation will minimize potential liability in the event participants file a lawsuit alleging a breach of fiduciary duty. ❖

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