

## ABB Blockbuster

By Marcia S. Wagner, Esq.

In 2006, a series of class action lawsuits began to be filed against very large sponsors of 401(k) plans and related plan committees, managers, and investment providers. The plaintiffs in these cases complained that the defendants breached their fiduciary duties by failing to negotiate reasonable fees for administrative and investment services. The complaints further alleged that the defendants failed to understand, monitor, and control hard dollar and revenue sharing payments made directly or indirectly by plans, and that they failed to establish and implement procedures to properly determine whether such expenses were reasonable and incurred solely for the benefit of participants. The complaints often contain additional allegations that the selection of retail class mutual funds as plan investment options was inappropriate because retail class funds are more expensive than institutional class funds. Turning their attention to the plans' investment and service providers, the excess fee cases frequently assert that the plan's trustee has failed to properly account for earnings on plan contributions before they are they are invested, otherwise known as "float."

Many of these cases have been dismissed at the pleadings stage—*Hecker v. Deere* being a leading example of this trend. The Seventh Circuit Court of Appeals in *Deere* did not find it necessary to examine the inner workings of the challenged fee arrangement, because market forces would act to protect the interests of plan participants. To date, only two of the excess fee cases have gone to trial. The first was *Tibble v. Edison*, which resulted in a modest award for the plaintiffs based on the failure of the plan sponsor to properly evaluate three retail class funds that had been selected for inclusion on the plan's investment menu.

The second excess fee case to be tried was the recent *Tussey v. ABB, Inc.*, which not only resulted in a \$36.9 million judgment for the plaintiffs, but revealed a mother lode of conflicted dealings that call into question the thesis of the *Deere* case that the market is capable of policing the relationship between plan sponsors and investment providers.

*Revenue Sharing Held Imprudent.* ABB's use of revenue sharing to pay the recordkeeping costs of two 401(k) plans was a major issue in the case. While the court held that this was not *per se* imprudent, the failure to engage in a deliberative process that compared the amount of revenue sharing paid to Fidelity Trust, the plans' recordkeeper, with actual recordkeeping costs was imprudent. The court rejected ABB's argument that it could satisfy its duty of prudence merely by reviewing the expense ratios of funds on the ABB plans' investment platform, although it noted that this might be justified in some circumstances. The court also held that ABB breached its fiduciary duties by failing to comply with the plans' investment policy statement which required that revenue sharing be used to "offset or reduce the cost of providing administrative services to plan participants."

Revenue sharing is the payment by a mutual fund (which has been chosen to offer its product to plan participants) of a fixed percentage of revenue to the plan's recordkeeper or other service provider. The revenue sharing percentage varies from fund to fund with some funds paying more than others, with the ultimate economic burden passed on to plan participants in the form of reduced earnings. In the *ABB* case, Fidelity Trust had initially been paid with a per-participant

hard dollar fee, but the arrangement eventually shifted so that Fidelity Trust was compensated for its services to the main ABB 401(k) plan solely through revenue sharing, while services to a 401(k) plan for union members were paid by a combination of revenue sharing and a per-participant hard-dollar fee. Since ABB was responsible for paying a portion of the hard dollar fees charged to the plans, it had an interest in maximizing payment by means of revenue sharing. Notwithstanding, ABB made no effort to determine the amount of the revenue sharing that was actually paid to Fidelity Trust for which failure it was faulted by the court.

*Investment Selection and Deselection.* ABB's conflict of interest was demonstrated by its removal of Vanguard's Wellington fund from the ABB plans' investment platform and its replacement by Fidelity's Freedom Funds without conducting any analysis of the relative merits of the two investments. In fact, the Vanguard fund had a lower expense ratio than its Fidelity replacement and, in hindsight, proved to have superior performance. In addition to finding that ABB breached its fiduciary duty in failing to follow a prudent process in selecting a new fund, the court held that ABB violated those duties by failing to follow the investment policy statement's procedure for deselecting the Vanguard fund. The most damning aspect of this issue, however, was the court's conclusion that ABB was improperly influenced by the effect that fund selection would have on recordkeeping costs it might have to pay. Thus, the court observed that "the Wellington Fund's removal was not due to any

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failure of its merits, but because the Freedom Funds that replaced it generated more revenue sharing for Fidelity Trust." In addition, the court found that ABB breached its duty of prudence whenever the plans' investment menu was changed by choosing share classes on the basis of maintaining a neutral effect on Fidelity's revenue sharing income.

*Subsidization of Corporate Services.* ABB also violated its duties by agreeing to overpay for recordkeeping in order to subsidize

the administrative costs of other corporate plans, such as health and welfare and nonqualified deferred compensation plans, as well as payroll services performed by Fidelity. The court focused on electronic communications between ABB and Fidelity personnel showing that ABB personnel turned a "purposeful blind eye" to the subsidies so that ABB could continue to receive discounted services at the expense of plan participants.

The court was unable to conclude that Fidelity was aware of the factors driving ABB's decision-making, and therefore did not hold that Fidelity was acting as a fiduciary in negotiating its

fees. However, it did hold that Fidelity Trust had discretionary control over plan assets for certain purposes (thereby making it a fiduciary) which it used to retain a portion of the float income earned by plan funds, thereby resulting in a breach of fiduciary duty by Fidelity Trust.

The conflicted fee arrangement revealed in the ABB case will strengthen the argument that courts should not dismiss excess fee cases until discovery permits closer examination. ♦

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