

Case suggests that RFPs may be necessary to fulfill fiduciary duties

By Marcia S. Wagner, Esq.

Department of Labor regulations regarding fiduciary responsibility require that fees paid by a 401(k) plan to its service providers be reasonable. Most 401(k) sponsors probably believe that hiring consultants to advise them on whether a recordkeeper's fee schedule is excessive is sufficient to satisfy the sponsor's fiduciary responsibility. Other approaches to ensuring that fees are reasonable would be to monitor the recordkeeping industry, consult with peer companies, or use a fee benchmarking service. A recent decision by the U.S. Court of Appeals for the Seventh Circuit concluded, however, that relying on consultants was not adequate to support a motion for summary judgment in favor of the defendant plan sponsor where the plaintiffs argued that a prudent fiduciary would have solicited competitive bids for recordkeeping services about once every three years.

The case, *George v. Kraft Foods*, 2011 WL 134563 (7th Cir. 2011), is one of the many class actions challenging the conduct of plan fiduciaries with regard to 401(k) fees. Kraft's recordkeeper had been hired in 1995, and its contract had been extended several times. The plaintiffs' lawyers presented expert testimony that these extensions should not have occurred without soliciting bids from other providers. The defendants attacked the relevance of the expert's opinion, because the expert's experience was limited to medium-sized plans rather than the very large Kraft plan. However, the court found the opinion to be relevant and admissible, thereby creating a factual issue that could be considered by a jury.

The divided opinion held that, while a consultant's advice as to the reasonableness of fees is evidence of prudence, it is not a complete defense. As a result, if a plan sponsor were to rely solely on the advice of a consultant as to the reasonableness of a service provider's fees and its decision to retain the service provider were challenged in court with the support of an expert witness, the case could be sent to a jury for a determination of whether the sponsor's failure to solicit bids was imprudent. This does not mean that plaintiffs will ultimately win on their claim that the plan sponsor acted imprudently in not conducting a request for proposal ("RFP"), but it does require the plan sponsor and other defendant fiduciaries to defend themselves in a very expensive trial to prove the point. As pointed out by the *Kraft* dissent, the implications of this ruling make it hard to determine what must be done to avoid fear of litigation. If consultants are not good enough to avoid trial, the question is whether engaging in an RFP process has, for practical purposes, become mandatory.

Commentators on the *Kraft* decision and amicus briefs by industry lawyers were quick to point out that soliciting and evaluating competitive bids is expensive, time consuming, and not necessarily a substitute for rigorous negotiations with an existing recordkeeper or other service provider. Further, a majority of plan sponsors appear to use procedures other than an RFP to evaluate the market for plan services.

That the court arrived at the result it did was somewhat of a surprise, since the same court had famously ruled in *Hecker v. Deere* that the duty of prudence does not require a fiduciary to "scour the market" to find the lowest cost provider. On the other hand, plaintiffs in cases such as *Kraft* are likely to support their argument by citing the Department of Labor's assumption in the preamble to recent final regulations regarding disclosure of service provider compensation that "changes in plan disclosures will occur at least once every three years, because plans normally conduct requests for proposal (RFPs) from service providers at least once every three to five years." However, even if the Department's observation were accurate (and industry surveys would contest that triennial RFPs are far from the norm), it does not amount to the imposition of a new fiduciary standard.

The *Kraft* decision also held that the plaintiffs could proceed to trial on their claim that the plan's unitized company stock fund was imprudently designed. Like many other 401(k) plans, Kraft plan participants held units of the company stock fund rather than directly holding shares of company stock. This accounting structure meant that a small portion of the fund was invested in a cash buffer that allegedly impeded full realization of appreciation on the company's stock and also increased trading costs. The court ruled that Kraft was not entitled to summary judgment on this issue because it failed to introduce evidence that plan fiduciaries made a conscious decision to maintain a unitized structure after Kraft's parent company had abandoned the design.

Kraft filed a petition for rehearing in the case in early May 2011. However, on May 26, 2011, the same panel of judges that had initially decided the case denied the petition for rehearing without comment, thus leaving intact the holding that plan fiduciaries that do not conduct a triennial RFP process may be required to stand trial in order to defend their decision. Given that there is a competitive market for 401(k) services that presumably operates to establish an objectively determinable range of fees that may be

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considered reasonable, it is questionable whether one process for identifying this range should take precedence over

all the others. Plan sponsors should be diligent in documenting the steps taken to ensure that plan fees are reasonable, keep themselves apprised of developments if *Kraft* is appealed, and whether similar claims prevail in other courts. ❖

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