OH, WHEN WILL THEY EVER LEARN? PROTECTING YOURSELF FROM ERISA FIDUCIARY LIABILITY

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To Our Clients and Friends:

It's Time to Reassess. Whether or not you have been following the brouhaha surrounding the new fee disclosure rules for 401(k) plans, you will soon be receiving a lot of paper explaining, among other things, plan fees and expenses for administrative services. What should you do with this information (in addition to providing it to plan participants as required)? Well, one thing you should not do is ignore it. Instead, because the additional information will help you understand the fees paid by your plans, you should seize this opportunity to reassess whether the fees are prudent given the services being performed. This review is especially important in light of a recently decided case, *Tussey v. ABB, Inc.*, which provides a cautionary lesson on the ERISA obligations facing plan fiduciaries when it comes to plan administration fees.

Let's All Say it Together: "Process Matters." ABB, Inc., the employer, maintained a 401(k) plan in which participants could invest in an array of mutual funds. The trustee and record keeper for the plan, who was an affiliate of the mutual fund manager, was paid by the common practice of "revenue sharing" (that is, sharing the administration fees received by the mutual funds instead of charging the 401(k) plan a per-participant fee for the trustee and record keeping services it performed for the plan). While the court found the revenue sharing fees excessive, the mere fact that the plan agreed to the revenue sharing arrangement or that the fees were too high was not, in and of itself, what led to the conclusion that the plan's fiduciaries had breached their ERISA duties. Rather, the process — or more to the point, the lack of process — by which ABB, Inc. agreed to compensate the plan's service provider through revenue sharing is what doomed the fiduciaries.

Under ERISA, the people responsible for administering a 401(k) plan and managing its assets must consider all of the relevant facts and circumstances to make prudent decisions for the plan. They also have a "duty of loyalty" and must be vigilant to act "solely" in the best interests of the plan and its participants; they may not act to protect the well being of the employer (although an incidental benefit to the employer is not prohibited, if the primary motivation is to benefit the plan). Finally, plan fiduciaries have a duty to follow the procedures set forth in the plan documents.

The court in *Tussey* found that the excessive fees resulted from a breach of the ERISA duties owed to the 401(k) plan by the employees responsible for administering the plan. There were many bad facts in *Tussey*: the committee responsible for the plan established an investment policy statement expressly requiring the plan fiduciaries to use revenue sharing as a means to reduce plan administration costs; the fees paid through revenue sharing were significantly higher than the market rate for plan administration fees; the plan fiduciaries ignored the advice of an independent consultant, retained to advise the fiduciaries in their fee negotiations with the plan's service providers, that the revenue sharing fees were considerably higher than market rate fees; the plan fiduciaries accepted "free" corporate services from the plan's service provider for the benefit of the employer, which the service provider was willing to provide because of the high plan fees; and the plan fiduciaries knowingly used the revenue sharing structure to reduce the company's expenses. The plan fiduciaries were ultimately found to have breached the duties of prudence, loyalty and to follow a plan's documents by:

- failing to monitor the recordkeeping costs;
- failing to follow the policies in their "investment policy statement" for negotiating recordkeeping fees and for changing the investments made available to plan participants; and
- choosing fee structures and investment options that had the effect of benefiting the company to the detriment of plan participants.

Must Administrators Use the Plan as Leverage? In addition to these bad facts, the *Tussey* court also appears to blaze surprising new ground. The court noted that, since being able to put a large plan on a platform is a valuable benefit, this leverage "gives a large plan the opportunity to negotiate rebates in exchange for that benefit." The court found that because ABB failed to monitor the revenue sharing fees, "it was not in a position to negotiate [rebates]" with the service provider "by leveraging the Plan's size to offset or reduce recordkeeping costs." The court therefore ruled that the ABB defendants violated their fiduciary duties to the plan by failing to negotiate appropriate rebates.

The court's decision may be limited to its facts; that is, that the ABB fiduciaries may have assumed a higher duty by adopting an investment policy statement that required them to use revenue sharing as a means to lower the administrative costs of the plan. Indeed, one can contend that other courts have exonerated plan fiduciaries who did not fully scrutinize revenue sharing arrangements. But, it is probable that plaintiffs' lawyers will seek to apply the court's discussion in *Tussey* more broadly, and can be expected to assert claims based on the failure of a fiduciary to leverage the plan's size when negotiating administration fees, even without an express mandate in the plan documents to do so.

You Break It, You Buy It. The employees administering the ABB plan likely thought they were appropriately doing their job in securing "free" administrative services by using fees that would otherwise have been paid for investment management services. While some of the actions they took were clearly problematic in hindsight, they would have asserted that, in many ways, they were administering the plan similarly to many other 401(k) plans. One can surmise that they were surprised when the claim was made that they had done something wrong. However, the unnerving fact underlying many ERISA fiduciary cases is that the defendants – who can incur millions of dollars in damages – did not properly identify the ERISA duties they owed to the plan and its participants. *Tussey* highlights the importance of recognizing and properly abiding by one's obligations to an ERISA-governed plan: damages for these breaches of duty were assessed at $35 million dollars.

The Bottom Line. While this new wave of ERISA fiduciary breach claims involves administration fees, what underlies these claims is similar to prior breach cases: the failure to follow a proper process. Poor process often was at the heart of the claims made in the so-called Enron and WorldCom "stock drop" cases and their progeny. Thus, the lessons to be learned are to:

- identify properly the ERISA duties owed to a plan;
- establish and record a proper process to comply with those duties; and
- follow that process (and most importantly, do not establish a process and then fail to follow it).

And since a tsunami of expense data is coming, now is the time to ensure that the process to address the data will withstand the scrutiny of plaintiffs' lawyers who would use that data against a plan's fiduciaries.

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Please feel free to contact us if you would like to discuss any of the forgoing.

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