# ERISA Litigation Update

## *A Tale of Two Trials: The Neglible Impact of the* Tibble *and* Tussey *Decisions*

*Beginning in 2007, plaintiffs' class action law firms, including some that had not previously been involved in the ERISA sphere, began filing lawsuits against some very large companies including Boeing, Bechtel, United Technologies, and Deere, complaining about the fees charged to plan participants and the compensation of the plans' service providers. Many of these cases alleged that the plans' fiduciaries breached ERISA's fiduciary standards of prudence and loyalty, and engaged in prohibited transactions under ERISA and the Code, by choosing investment options for their plan's 401(k) lineup that had higher expense ratios than allegedly equally available options.*

By Tess J. Ferrera

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Many of the cases also alleged that the common practice of "revenue sharing" between investment service providers, recordkeepers, and/or the plans constituted prohibited transactions, and that plan fiduciaries who approved such contracts breached their fiduciary duties by agreeing to revenue sharing arrangements. These cases have come to be known as the "fee cases."

Defendants are generally considered to have had the better outcomes in these cases as a whole. Many of the defense victories have come on motions to dismiss. [*E.g.*, *Hecker v. Deere & Co.*, 569 F.3d 708 (7th Cir. 2009)] Two fee cases that actually went to trial, however, resulted in at least partial victories for the plaintiffs: *Tibble v. Edison* [No. CV 07-5359 SVW (AGRx), 2009 WL 6764541 (C.D. Cal. June 30, 2009)] and *Tussey v. ABB, Inc.* [No. 2:06–CV–04305–NKL, 2012 WL 1113291(W.D. Mo. Mar. 31, 2012), *as amended*, 2012 WL 2368471 (W.D. Mo. June 21, 2012) (amending relief provided but not addressing merits)] As explained below, however, these decisions have not yet resulted in any substantial gains for plaintiffs, or significant changes to the rules under which plan fiduciaries operate.

### ERISA Fiduciary Duties and Prohibited Transactions: The Legal Framework

ERISA Sections 404(a)(1)(A) and (B) impose what one court has referred to as "three different although overlapping standards." [*Donovan v. Bierwirth*, 680 F.2d 263, 271 (2d Cir.), *cert. denied*, 459 U.S. 1069 (1982)] In *Bierwirth*, the court stated that "a fiduciary must discharge his duties 'solely in the interest of the participants and beneficiaries.' He must do this 'for the exclusive purpose' of providing benefits to them. And he must comply 'with the care, skill, prudence, and diligence under the circumstances then prevailing' of the traditional 'prudent [person].'" These basic requirements constitute ERISA's duty of undivided loyalty and prudence. ERISA's fiduciary duties have been described by courts as "the highest known to law." [*Donovan v. Walton*, 609 F. Supp. 1221, 1240 (S.D. Fla. 1985), *aff'd sub. nom, Brock v. Walton*, 794 F.2d 586 (11th Cir. 1986)] Fiduciaries must carry out their responsibilities "with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise with like character and like aims." [*Id.*]

Department of Labor regulations interpreting ERISA's fiduciary obligations explain that the fiduciary, when selecting investments for the plan, has

met the prudence requirement if the fiduciary "has given appropriate consideration to those facts and circumstances that...the fiduciary knows or should know are relevant to the particular investment or investment course of action involved...[and] has acted accordingly." [29 C.F.R. § 2550.404a-1(b)] Whether a fiduciary decision is prudent is based upon the facts and circumstances of the particular case. [*Donovan v. Walton*, 609 F. Supp. 1221, 1240 (S.D. Fla. 1985), *aff'd sub. nom Brock v. Walton*, 794 F.2d 586 (11th Cir. 1986)] Thus, whether the particular process was prudent depends upon the particular facts and circumstances of each investment decision.

In judging whether a fiduciary breach has occurred, "[t]he court's task is to inquire whether the individual trustees, at the time they engaged in the challenged transactions, employed the appropriate methods to investigate the merits of the investment and to structure the investment." [*Donovan v. Mazzola*, 716 F.2d 1226, 1231 (9th Cir. 1983); *see, e.g.*, *Keach v. U.S. Trust Co., N.A.,* 313 F. Supp. 2d 818, 863 (C.D. Ill. 2004) (fiduciaries are required to exercise prudence, not prescience or omniscience); *Fink v. National Sav. & Trust Co.*, 722 F.2d 951, 957 (D.C. Cir. 1985) ("A fiduciary's independent investigation of the merits of a particular investment is at the heart of the prudent person standard."); *Donovan v. Cunningham*, 716 F.2d 1455, 1467 (5th Cir. 1983) (same); *Beck v. PACE Int'l Union*, 427 F.3d 668, 677 (9th Cir. 2005) ("Where it might be possible to question the fiduciaries' loyalty, they are obliged at a minimum to engage in an intensive and scrupulous independent investigation of their options to insure that they act in the best interest of the plan beneficiaries."); *DiFelice v. U.S. Airways*, 497 F.3d 410, 418 (4th Cir. 2007) (deciding whether a fiduciary acted prudently requires that a court inquire whether the individual trustees, at the time of the transaction, employed appropriate methods to investigate merits of the transaction); *In re Computer Sciences Corp. ERISA Litig.*, 635 F. Supp. 2d 1128, 1134 (C.D. Cal. 2009) (in analyzing claims of imprudence, focus of inquiry is how "the fiduciary acted, not whether his investments succeeded or failed")] Moreover, "plaintiff must show a causal link between the failure to investigate and the harm suffered by the plan." [*Id.* at 1134]

ERISA's loyalty provisions require that a fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and for the exclusive purpose of providing benefits and defraying plan expenses. [ERISA § 404(a)(1)(B)] As one court described it, this provision requires that in discharging his or her fiduciary duties, a fiduciary act with an "eye single" to the interests of the plan's participants and beneficiaries. [*Bierwirth*, 680 F.2d at 271]

In addition, to ERISA's prudence and loyalty provisions, ERISA sets forth prohibited transaction provisions that supplement these basic standards of fiduciary conduct and preclude a fiduciary from causing a plan to engage in certain transactions with parties that are related to the plan. [*See* ERISA §§ 406(a) and (b).] ERISA Sections 406(a) and (b) create prohibitions against certain transactions involving a plan and specified related parties, unless a statutory or administrative exemption is available. [*Keach v. U.S. Trust Co., N.A.*, 419 F.3d 626, 635 (7th Cir. 2005); *Wright v. Oregon Metallurgical Corp.*, 360 F.3d 1090, 1101 (9th Cir. 2004) (finding that retention of employer stock in the plan did not constitute a prohibited transaction because plaintiffs failed to show how that act constituted a "transaction" within the meaning of Section 406)] The prohibited transaction provisions of ERISA Section 406 were designed to prevent certain categories of insider transactions that Congress believed offered a high potential for abuse of plan assets. [*Keach*, 419 F.3d at 635; *Wright,* 360 F.3d 1090]

*Tibble* and *Tussey* challenge the application and interpretation of these provisions.

### The Case of *Tibble*

In one of the first fee cases to go to trial, the district court in *Tibble* found that the plan's fiduciaries breached ERISA's prudence standard when they invested in retail share classes of three mutual funds instead of the institutional share classes of those same funds. Institutional share classes are offered to institutional investors, such as 401(k) plans, and often require a minimum investment; they usually also charge lower fees than retail share classes.

In May 2009, both parties in *Tibble* filed motions for summary judgment. The court granted partial summary judgment for defendants on the majority of plaintiffs' claims, including dismissing all claims that the fiduciaries caused the plans to engage in prohibited transactions for including mutual funds with higher expense ratios and revenue sharing. [*See Tibble v. Edison International*, 639 F. Supp.2d 1074, 1086-1097 (C.D. Cal. 2009).] The court reserved for trial, however, plaintiffs' allegations that defendants violated ERISA Section 404's prudence and loyalty standards for deciding to offer certain funds as part of the 401(k) plan's lineup.

Following a bench trial, the district court found that the fiduciaries' process in selecting the fund classes that had more revenue sharing fees was not imprudent, because the defendants were not "motivated by a desire to capture revenue sharing" in making those selections. The court noted that the company's overall trend between the years 2002 to 2008 reflected a movement toward selecting funds with reduced revenue sharing.

The district court held, however, that the record was devoid of any "credible reason why the Plan fiduciaries chose the retail share classes of the… funds." Thus, in essence, the court concluded that fiduciary defendants failed to engage in a prudent process in selecting the higher expense-ratio retail share class of the specified three funds. With respect to the three additional disputed funds, however, the court held the plan fiduciaries had demonstrated prudent monitoring of each of these three funds and thus that the plaintiffs had failed to prove that the plan fiduciaries violated ERISA.

### The Case of *Tussey*

On March 31, 2012, a court in the western district of Missouri finally issued its decision in *Tussey v. ABB, Inc.* [No. 2:06-CV-04305, 2010 U.S. Dist. LEXIS 45240 (W.D. Mo. Mar. 31, 2012)] and determined that the plans' fiduciaries were jointly and severally liable for $35.2 million. The court, after a four-week bench trial that concluded a little over two years ago, held that the ABB, Inc. plans' fiduciaries violated ERISA's fiduciary standards of conduct when they:

1. Failed to monitor recordkeeping costs paid through revenue sharing and hard dollars, and to negotiate rebates for the plans;
2. Failed to prudently deliberate prior to deselecting and replacing investment options in the 401(k) line-up;
3. Selected more expensive share classes for the plans' investment line-up when less expense share classes were available; and
4. Permitted revenue sharing for the purpose of subsidizing corporate expenses unrelated to the administration of the 401(k) plans from which the revenue sharing was generated.

The court also found that certain Fidelity affiliates were fiduciaries because they exercised discretionary authority and that, in that capacity, they violated their fiduciary duties when they retained float income for their own benefit (and for the benefit of Fidelity investment options), instead of passing that income on to the plans.

As noted below, revenue sharing played a large role in this case, and although the court found the plans' fiduciaries had breached their duties with respect to the use of revenue sharing to compensate the plans' recordkeeper, the court did not conclude that the use of revenue sharing was itself a violation of ERISA's fiduciary standards of conduct. To the contrary, the court recognized that revenue sharing was an accepted way to compensate vendors in the industry. The plans' fiduciaries' problem in this instance, according to the court, was that they failed to administer the revenue sharing arrangement in a prudent manner.

#### Facts

ABB, Inc. sponsored two employee benefit pension plans: the Personal Retirement Investment and Savings Management Plan and the Personal Retirement Investment and Savings Management Plan for Represented Employees of ABB, Inc. (collectively the "Plans"). Both are ERISA-governed 401(k) defined contribution plans that offered nearly identical benefits. One Plan is or was offered to ABB's unionized employees and the other Plan to its nonunion employees. At the time the opinion was issued, the Plans were governed by a variety of committees, some of which were appointed by the board of directors and at least one of the committees served as the Plans' administrator. The committees and one individual were the named defendants and hereafter will be referred to as the ABB Defendants.

The Plans included mutual funds offered by Fidelity Investments. Fidelity Research was the investment advisor to these mutual funds. Fidelity Trust was the Plans' recordkeeper. As the recordkeeper, Fidelity Trust provided educational information, bookkeeping, and other services to the Plans. According to the court, during its relationship with the Plans, Fidelity Trust had been paid two different ways. Originally, it was paid in hard dollars based on a per-participant, per-month fee. Over time, Fidelity Trust was primarily paid through revenue sharing. Fidelity Research and Fidelity Trust are hereafter referred to as the Fidelity Defendants.

**Findings with Respect to the Plans' Fiduciaries**

**Claim One: The failure of the ABB Defendants to monitor recordkeeping costs and to negotiate rebates for the plans.**

The court found that, by April 2001, the nonunion Plan paid Fidelity Trust for its recordkeeping services solely through revenue sharing and that the union Plan compensated Fidelity through a combination of revenue sharing plus an $8 per-participant fee. It further found that, with the exception of one mutual fund, revenue sharing fees were paid to Fidelity Trust directly from the mutual funds offered through the Plans, many of which were Fidelity proprietary funds. With respect to the fiduciary oversight of these fees, the court found that the Plan fiduciaries (1) never calculated the dollar amount of the recordkeeping fees the Plan paid to Fidelity Trust through revenue sharing; (2) did not consider how the Plan size might be used to leverage lower fees; and (3) did not benchmark the expenses before they chose to pay the recordkeeping fees through revenue sharing.

Apparently, the Plan fiduciaries took no action with respect to the fees Fidelity Trust was paid even after their consultant, Mercer, reported to them in 2005 that they were overpaying Fidelity Trust for recordkeeping services and that it appeared that the Plans were subsidizing other corporate (i.e., non-Plan) services that Fidelity provided ABB. Based on these facts, the court specifically concluded that the "ABB fiduciaries were not concerned about the cost of recordkeeping unless it increased ABB expenses or caused the [] Plans to be less attractive to its employees as a result of hard-dollar, per-participant fees being charged." [*Tussey*, 2010 U.S. Dist. LEXIS at *31]

In addition, the court found that in these circumstances the ABB Defendants failed to comply with the terms of the Plan's Investment Policy Statement (IPS), which required that revenue sharing be used to offset or reduce the cost of providing administrative services to Plans' participants. [*Id.* at *39-*40] Based on expert witness testimony, the court concluded that the Plans had overpaid for their recordkeeping services by significant amounts. [*Id.* at *33]

The court observed that, while revenue sharing is commonly used in the industry, if a plan sponsor opts for revenue sharing as its method of paying for recordkeeping services, it must not only comply with its governing plan documents, but it must go through a deliberative process for determining why such choice is in the plan's and the plan participants' "best" interest. [*Id.* at *46]

**Claim Two: The failure of the ABB Defendants to prudently select and de-select investment options.**

The plaintiffs in this case had argued that the ABB Defendants' decisions concerning the selection and deselection of investments for the Plans' line-up were improperly influenced by conflicts of interests due to the relationship of ABB and Fidelity Trust (and the potential for enhanced revenue sharing attributable to the inclusion of certain funds on the Plans' investment platform). The court found such conflicts existed in two specific situations—one involving the replacement of the Vanguard Wellington mutual fund with a Fidelity target-date fund, and the second involving the decision to select or retain more costly classes of investments on the Plans' investment line-up when other less expensive classes of the same investments were available. [*Id.* at *47-*48]

In 2000, the Plans' fiduciaries swapped the Vanguard Wellington Fund for a Fidelity target-date or lifestyle fund. The court determined that the ABB Defendants violated their duty of prudence when they failed to follow in this instance the specific IPS requirements applicable to the selection and deselection of an investment fund, and more generally failed to engage in a deliberative assessment of the merits in determining which investment option to choose. [*Id.* at 65] The court held, based on the evidence presented at trial, that the recommendation of the Fidelity target-date fund to replace the Vanguard fund was a breach of one of the ABB Defendant's duty of loyalty. Furthermore, the defendant, the head of one of the Plans' fiduciary committees, knew that the recommendation would generate more revenue sharing for Fidelity Trust and reduce the Plan's hard-dollar costs, and because of the potential benefit to ABB, the court viewed this as a prohibited transaction. [*Id.* at *69]

The court also found as a general matter that, in 2005, after the Plan fiduciaries removed the Fidelity Magellan Fund from the Plans' investment line-up, the fiduciaries chose share classes that provided more basis points for revenue sharing in order to prevent the imposition of hard-dollar per participant monthly fees without making a determination that the selection was prudent for the Plans' participants. [*Id.* at *82]

The court found that this decision was contrary to the governing Plans' documents, which provided that "[w]hen a selected mutual fund offers ABB a choice of share classes, ABB will select the share class that provides Plan participants with the lowest cost

of participation." [*Id.* at *79] The court rejected the ABB Defendants' argument that this language should be interpreted to mean that the Plans' fiduciaries, when making investment decisions, should take into account how the choice of the investment option might affect the recordkeeping costs to the Plans' participants rather than that the Plans' fiduciaries are required to consistently select investment options with the lowest expense ratio. [*Id.* at *79] The court stated that, in this case, the hard-dollar costs would not have shifted to participants because ABB intended to pay all hard-dollar recordkeeping costs that resulted from negotiations with Fidelity Trust. In addition, the court noted that the ABB Defendants had failed "to explain how it is prudent to require participants choosing managed funds (those that produce revenue sharing) to pay for the recordkeeping expenses of the participants who chose more conservative investments that did not produce revenue sharing." [*Id.* at *79-*80]

**Claim Three: The use of revenue sharing for the purpose of subsidizing corporate expenses unrelated to the administration of the plan.**

In connection with the deselection of the Magellan Fund and selection of funds that provided more basis points for revenue sharing, the court found that the ABB Defendants had been informed by Fidelity as to the revenue and cost information for all of its services to ABB (including recordkeeping for the company's defined benefit plan, its deferred compensation plan, its health benefits, and its payroll). The court also noted that the 2005 report by the ABB consultant, Mercer, had indicated that the Plan's recordkeeping payments via revenue sharing appeared to be subsidizing the cost of administration for ABB's other employee benefit plans and nonqualified plans. The court determined that once ABB was aware of the cross-subsidy inherent in the Plan's revenue sharing arrangement, it nonetheless continued to maintain the current arrangement, and further concluded that the decisions and actions taken by ABB in negotiating a recordkeeping fee on behalf of the Plan were motivated by the discounts ABB received for its corporate services. The court found that this evidence supported a finding that the overpayment of revenue sharing fees was used to subsidize the administration of unrelated plans and that the fiduciaries "failed to make a good faith effort to prevent the subsidization of administration costs" for these other unrelated plans. [*Id.* at *85-*86] This, the court concluded, violated ERISA's duty of loyalty. [*Id.* at *88]

**Findings with Respect to Fidelity Defendants**

Before the Plans' assets were allocated to their proper investments based on participant directions, the assets were parked in interest earning accounts for short periods. The interest earned during this period is known as "float income" or "float." The court noted that this float income that was earned in the accounts was credited against any bank expenses incurred in maintaining the accounts. Because maintaining the accounts was integral to the trust services rendered by Fidelity Trust, the float income was effectively being used to pay Fidelity Trust's operating expenses for recordkeeping and administering the Plan. This was so even though the applicable trust agreement provided that Fidelity Trust would be paid only through revenue sharing. [*Id.* at *99] In other words, it appears from the court's conclusions that Fidelity's retention of the float income was not disclosed to the ABB Defendants. [*Id.* at *103] The court found that Fidelity Research decided that any remaining float income would be distributed on a pro-rata basis to the mutual funds in the Plans' investment line-up and thus benefit all shareholders of the mutual funds, not just the Plans' participants. [*Id.* at *99-*100]

The court held that any float income generated from the Plans' assets was itself an asset of the Plans. [*Id.* at *100-*101] The court then concluded that, since Fidelity Trust and Fidelity Research decided how to use the float income, they were fiduciaries because they exercised discretionary authority and control over assets of the Plans. [*Id.* at *100-*103] The court further concluded that, since the Fidelity Defendants had decided to use the assets of the Plans to benefit entities other than Plan participants or beneficiaries, the Fidelity Defendants violated ERISA's duty of loyalty. [*Id.* at *103]

**Relief**

By way of relief, the court concluded that the ABB Defendants owed the Plans $13.4 million for their failure to monitor recordkeeping expenses and $21.8 million for the imprudent selection of the Fidelity target-date funds and the removal of the Vanguard Wellington fund, which resulted in lower returns to participants. [*Id.* at *107-*109] With respect to the other claims against the fiduciaries, the court concluded that the total of $35.2 million already assessed against the ABB Defendants included compensation for losses attributed to the other allegations (e.g., the selection of classes of investments with higher

expenses). [*Id.* at *110-*111] The Fidelity Defendants were ordered to pay the Plans $1.7 million for improper use of the float. [*Id.* at *113]

### Fallout from *Tibble* and *Tussey?*

Following the decisions in *Tibble* and *Tussey*, some have imagined that these cases have given the plaintiffs' bar a shot in the arm and that the holdings have increased the potential exposure of 401(k) plan fiduciaries. To date, however, those effects have not been proven necessarily true.

These cases, for example, do not appear to have motivated the plaintiffs' bar to rush to the courthouse and file a plethora of new cases alleging breach of fiduciary duty over the payment of fees to plan service providers. To the contrary, the filing of these types of cases generally have been down in the two years since the *Tibble* decision, and there is no evidence that the decision in *Tussey* has had any such effect in the months since its issuance. Moreover, although plaintiffs had some small victories in each of the cases, the monetary recovery in each case was a paltry sum compared to the hundreds of millions of dollars that plaintiffs alleged in the Complaints that the Plans had lost and were owed.

It is important to underscore that neither case condemns the use of revenue sharing as a means of compensating service providers. Indeed, the *Tussey* court explained that it was not "stating that revenue sharing was an imprudent method for compensating a plan's recordkeeper. . . ." [*Id.* at *45-*46] As noted above, the *Tussey* court did caution, however, that if revenue sharing was selected as a method of compensating a recordkeeper, then the fiduciaries must go "through a deliberative process for determining why such a choice is in the Plan's and participants' best interest." [*Id.* at *46]

Neither case is groundbreaking. Both cases simply underscore the pitfalls fiduciaries face if they fail to engage in a prudent process when making decisions for employee benefits plans and fail to follow the governing plan documents. This is standard ERISA jurisprudence. In the context of selecting investment options for a retirement plan, being a prudent fiduciary means employing an objective, thorough, and analytical process. The "prudent man standard" of ERISA is concerned with the process by which a fiduciary reaches a decision. Did the fiduciary gather the information necessary to consider all of the relevant factors? Did the fiduciary determine whether it possessed the necessary expertise to evaluate the relevant factors, and seek outside advice or assistance as necessary? Did the fiduciary then make a decision based on this information and analysis? In *Tibble* and *Tussey*, the courts decided, based on the facts presented, that the fiduciary defendants failed to discharge those obligations in a manner consistent with ERISA's high standards of fiduciary conduct. ■