Proskauer

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Editor's Overview

Happy New Year! Because 401(k) plans play an increasingly prominent role as an employee's principal retirement investment vehicle, fiduciaries overseeing those plans face increased pressure to see them perform well. This month we take a look at issues surrounding the surge in ERISA litigation challenging the selection of mutual funds and like investments offered in 401(k) plans, and the fees associated with the recordkeeping and management of those investments.

As always, be sure to review this month's Rulings, Filings, and Settlements of Interest wherein we take a look at: the retroactive application of *Windsor*, tax relief to pre-data breach identity theft protections, fiduciary status in excessive fee cases, continued fall-out in retiree healthcare litigation after *Tackett*, and issues pertaining to constitutional standing.

View From Proskauer: 401(k) Fee Litigation: Practices to Mitigate Fiduciary Risk

Robert Rachal, Lindsey Chopin, & Robert Sheppard

Because 401(k) plans play an increasingly prominent role as an employee's principal retirement investment vehicle, fiduciaries overseeing those plans face increased pressure to see them perform well. This same pressure has led to steadily increasing Employee Retirement Income Security Act (ERISA)-based litigation challenging the selection of mutual funds and like investments offered in these plans, and the fees associated with recordkeeping and the management of funds' investments. Because of its dynamics (small individual losses but high litigation costs), most fee litigation is entrepreneurial, and offers the possibility of "incentive awards" to named plaintiffs many times greater than any claimed losses.

Further incentivizing litigation in the ERISA arena, some recent attorneys' fees awards may encourage the plaintiff's bar to take hard looks at plans to determine whether to bring such litigation. For example:

- In December 2015, on remand from the Eighth Circuit, the court in *Tussey v. ABB, Inc.* awarded $11.6 million in attorneys' fees and expenses.[1]
- In November 2015, both Novant Health and Boeing agreed to settle fee-related suits, pending court approval, for $32 million and $57 million respectively.[2]
- In April 2015, in *Haddock v. Nationwide Financial Services, Inc.*, the court approved a $140 million settlement that included attorneys' fees and expenses of more than $50 million.[3]
- In July 2015, the parties in *Krueger v. Ameriprise* received final approval of a $27.5 million settlement with $9.2 million in attorneys' fees.[4]

These recent awards and settlements are likely to encourage more lawsuits; however, these cases can also provide valuable insights to employers and fiduciaries on defenses to these claims.

To preview, *Tatum v. RJR Pension Investment Committee* illustrates the typical fee-litigation risks and the importance of a prudent process, *i.e.*, of procedural prudence. In *Tatum*, the court found the fiduciaries had not conducted a prudent process in deciding to eliminate Nabisco stock from the plan. As a result, it applied a "would have" standard, which requires a fiduciary to show that the decision made was not merely permissible (all that would be needed with a prudent process), but the best or compelled one.[5]

In *Tibble v. Edison International*, the Supreme Court recently made clear that ERISA imposes some duty to periodically monitor plan investments, even if the investment was initially selected outside the fiduciary six-year statute of limitations period.[6]

And in *Tussey v. ABB, Inc.*,[7] although numerous claims were dismissed, the Eighth Circuit affirmed a determination that ABB violated ERISA by failing to consider the reasonableness of fees charged by its fund recordkeeper, finding that "ABB never calculated the dollar amount of the recordkeeping fees the Plan paid [. . .] via revenue sharing arrangements," even after an outside consulting firm told ABB that it was overpaying for recordkeeping fees. In determining the $13.4 million that the plan overpaid for recordkeeping costs, the district court credited plaintiffs' expert witness, who used fees paid by a similarly sized retirement plan for Texas employees as the comparator, and that this was in line with trends as to what were reasonable revenue-sharing earnings for other plans.[8]

Potential Practices to Mitigate Risk

The outcomes of these and other cases, and the incentives they create for potential plaintiffs, demonstrate the importance of properly managing and administering plans. By illustrating areas of potential exposure, these cases provide guidance for developing prudent fiduciary practices that can help lessen that exposure. With these decisions in mind, there are some general practices that all plan fiduciaries should consider adopting or strengthening—all with the critical caveat that the fiduciary process leading to, and implementing, these (and other) decisions needs to be well documented.

As cases like *Tatum* and *Tussey* teach, having a well-documented, prudent fiduciary process is "rule one" that can control the defense. Further, as part of general practices, the plan fiduciary with responsibility over plan investments should consider developing and following an investment policy statement.

The applicable plan fiduciaries should conduct periodic reviews of investments and plan service providers, which for investments is common to do quarterly, with a major one annually. Plan fiduciaries may also want to consider periodic benchmarking or requests-for-proposals for major service providers such as recordkeepers. Cases like *Tussey* illustrate the danger if the plan fiduciary does not periodically monitor fees paid to recordkeepers (in that case, revenue-sharing payments) and failing to evaluate the recordkeeper's overall compensation. Note, though, that a fiduciary does ***not*** have to go with the lowest-cost provider; as part of proper fiduciary documentation, quality and service can and should be considered in evaluating any service provider.[9]

The same need for prudent investigation and process applies to selection and monitoring plan investments. For example, in *Tatum*, the plan fiduciary faced continued risk of liability (after 12 years of litigation the case has been remanded for trial) for eliminating an orphan single-stock fund without a prudent process, even though the decision to liquidate an orphan stock fund is not, in and of itself, imprudent. In contrast, in *Tussey*, replacement of one fund with another that (with hindsight) turned out to perform more poorly was not a breach because the plan fiduciary had followed a prudent fiduciary process in making that decision.

Other areas that have created liability include the selection of share classes. Cases like *Tibble* illustrate the need (perhaps judged with a bit of unfair hindsight) for plan fiduciaries, as part of their prudent process, to investigate ways to save fees, such as by asking whether institutional share classes are available for the plan. Conversely, *Tibble* also shows the value of a prudent process, dismissing claims challenging the selection of a money-market fund because the plan fiduciaries had:

- Researched and compared the fees of four comparable funds;
- Reviewed the comparable funds (including fees) of seven candidates that responded to a request for proposals;
- Consistently monitored the fund's performance net of fees, which revealed that the fund performed consistently well (net of fees) throughout the period from 1999 to 2008;
- Periodically reviewed the reasonableness of the fees, which were reduced in 2005 and 2007; and
- Conducted an extensive review of the fund in 2008.

Finally, a practical way to lessen risk regarding plan investments is to offer a mix of investments, including target-date funds and lower-cost index funds. A prudent process documenting plan fiduciaries' offering of a mix of index funds to provide participants low-cost investment options can be a powerful rebuttal to hindsight-based claims that actively managed funds cost too much and performed relatively poorly. For example, in *Hecker v. Deere & Co.*,[10] the Seventh Circuit agreed with the district court's statement that "[i]t is untenable to suggest that all of the more than 2,500 publicly available investment options had excessive expense ratios" and affirmed dismissal of plaintiffs' claims at an early stage in litigation. Dismissal of fiduciary breach claims was likewise affirmed in *Loomis v. Exelon Corp.*, in which the defendant "offered participants a menu that includes high-expense, high-risk, and potentially high-return funds, together with low-expense index funds that track the market, and low-expense, low-risk, modest-return bond funds." The Seventh Circuit stated that the defendant "left choice to the people who have the most interest in the outcome, and it cannot be faulted for doing this."[11]

There are additional issues that may arise for small and midsize firms. Not all small to mid-size companies will have the investment and provider management expertise in house, or have the time to properly document and monitor the 401(k) plan and its various providers. Therefore, they may want to consider outsourcing fiduciary management of 401(k) plans to outside fiduciary professionals. Further, if adopted as proposed, the U.S. Department of Labor's new fiduciary rule will strongly encourage adoption of this "professional manager" approach for small plans under 100 participants, because the proposed rule, otherwise, makes it difficult for financial advisors to sell products and services directly to these small plans.

Proskauer's Perspective

Recent decisions and settlements have shown that fee litigation operates like hydraulic pressure, probing for liability in any weak part in plan management and administration, *even if* the 401(k) plan is, overall, sound and well managed. Simply put, any failure of procedural prudence—to be more precise, any failure to document procedural prudence—on any material aspect of plan management and administration will put fiduciaries at increased risk on claims challenging higher fees, and any *ex post* subpar investment performance.

But there are powerful defenses available. Although the recent fee-litigation rulings put substantial pressure on fiduciary practices, they also provide teachings identifying areas of potential exposure, and of fiduciary practices that can lessen that exposure. Documented prudent processes addressing the issues that have created risk (for example, recordkeeping fees and the relative costs of comparable funds) will provide powerful defenses to any fee claim.

Rulings, Filings, and Settlements of Interest

Is a Qualified Retirement Plan Required to Apply Windsor Retroactively?

By Roberta Chevlowe and Elizabeth Down

- Following the Supreme Court's 2013 decision in *U.S. v. Windsor* (in which the Court held that Section 3 of the federal Defense of Marriage Act ("DOMA") was unconstitutional), one of the questions facing sponsors of tax-qualified retirement plans was whether the plans were required to recognize same-sex spouses on a retroactive basis for purposes of entitlement to spousal benefits. The IRS answered that question in Notice 2014-19, in which it stated that, for tax-qualification

purposes, such plans are required to treat same-sex marriages in the same manner as opposite-sex marriages effective as of June 26, 2013 (the date of the *Windsor* decision). The IRS also clarified that plans could be amended to recognize same-sex marriages prior to that date, but such earlier recognition was not required for qualification purposes.

A recent federal district court decision in the Northern District of California suggests that some courts might have a different view. In *Schuett v. FedEx Corporation,* the court denied FedEx's motion for judgment on the pleadings on a breach of fiduciary duty claim brought by a deceased employee's same-sex spouse, whose claim for a qualified preretirement survivor annuity ("QPSA") under FedEx's retirement plan was denied. The employee passed away one week before *Windsor* was decided, and FedEx denied the claim based on the plan's pre-*Windsor* definition of "spouse," which incorporated the DOMA definition of marriage (i.e., a union between a man and a woman). The spouse's administrative appeal also was denied by FedEx's Appeals Committee, which found that, under the terms of FedEx's plan, the employee was not "married" under the plan definition of "spouse" at the time of her death (before Section 3 of DOMA was held to be unconstitutional*)* and did not have a surviving spouse at that time*.*

In the spouse's lawsuit against FedEx, she asserted three causes of action in the alternative under ERISA: (i) a claim for benefits, (ii) a claim for breach of fiduciary duty for failure to administer the Plan in accordance with applicable law, and (iii) a claim for breach of fiduciary duty for failure to inform and/or for providing misleading communications. The court denied in part the defendants' motion for judgment on the pleadings, allowing the plaintiff to proceed on the claim for breach of fiduciary duty under section 502(a)(3) of ERISA due to a failure to administer the plan in accordance with applicable law. The court found that the plaintiff adequately alleged that FedEx violated ERISA by acting contrary to applicable federal law and failing to provide a benefit mandated by ERISA (the QPSA), and that she is entitled to pursue equitable relief to remedy that violation.

In reaching this conclusion, the court noted that ERISA requires a fiduciary to follow plan documents only to the extent that they are consistent with ERISA and pointed to a plan provision stating that federal law would govern in the event that a plan term was inconsistent with federal law. The court also reasoned that the *Windsor* case appeared to invalidate DOMA retroactive to its 1996 enactment, and noted that the *Windsor* decision itself applied retroactively. In addition, the court relied to some extent on an earlier post-Windsor case, *Cozen O'Connor P.C. v. Tobits*, in which a federal district court concluded that *Windsor* applied retroactively in the context of a surviving spouse benefit where the plan document did not explicitly define the term "spouse" to exclude same-sex spouses.

It is important to note that the court's decision in *Schuett* merely allows the surviving spouse to proceed with her breach of fiduciary claim against FedEx (in which she seeks declaratory and injunctive relief amounting to payment of the QPSA); it does not require FedEx to apply *Windsor* retroactively or pay a benefit to the spouse. Also notable is the fact that the court granted FedEx's motion to dismiss the spouse's other two claims. With regard to the claim for wrongful denial of benefits under section 502(a)(1)(B) of ERISA, the court concluded that the spouse had not alleged facts demonstrating that FedEx had abused its discretion in interpreting the plan's definition of spouse, because the definition was unambiguous and nondiscretionary. On the claim for breach of fiduciary duty under section 502(a)(3) of ERISA alleging that FedEx failed to provide complete and accurate information about survivor benefits that may have been available to the employee's designated non-spouse beneficiary under the plan if the employee had retired prior to her death, the court found that the spouse lacked standing to pursue this claim because she was not designated as the employee's beneficiary.

Proskauer will continue to monitor this case and other decisions and guidance relating to the application of the Supreme Court decisions regarding same-sex marriage to employee benefit plans.

An Ounce of Prevention…Is Tax-Free: IRS Expands Tax Relief to Pre-Data Breach Identity Theft Protection Services

By Tzvia Feiertag

- As reported on Proskauer's Tax Talks Blog, after last year's customer data security breaches at major U.S. corporations, the IRS announced special tax relief for identity protection services provided to individuals ***affected*** by a security breach.

> In response to comments solicited in connection with that announcement, the Treasury Department and IRS have in Announcement 2016-02 extended that relief to no-cost identity protection services provided ***before*** a data breach.

In statements to the IRS, commenters stated that data security is a major concern for many organizations and cited statistics showing a significant increase in the number of data breaches that result in unauthorized access to information systems containing personal information of employees and other individuals. Commenters also stated that some organizations are making security decisions based on the belief that breaches of their information systems are inevitable. In addition, commenters stated that an increasing number of organizations are combating data breaches by providing identity protection services to employees or other individuals before a data breach occurs in order to help detect any occurrence of a breach in their information systems, and to minimize the impact to their operations.

Citing these considerations as the basis for its extension of its former tax relief on identity protection services, Announcement 2016-02 provides that the IRS will **not** assert:

- that an individual must include in gross income the value of identity protection services provided by the individual's employer or by another organization to which the individual provided personal information (for example, name, social security number, or banking or credit account numbers), or
- that an employer providing identity protection services to its employees must include the value of such services in the employees' gross income and wages.

Nor will the IRS assert that the value of such service needs to be reported on information returns such as Forms W-2 or 1099.

However, this relief does not apply to cash that an individual may receive in lieu of identity protection services, or to proceeds received under an identity theft insurance policy.

Proskauer's Perspective: This guidance is welcome news for employers that want to offer identity protection services to employees as part of their data security strategy. They may now offer these services without increasing their (or their employees') federal tax liability. However, employers should be mindful of state and/or local tax laws as they may differ from federal tax law.

Eighth Circuit Holds Service Provider Is Not A Plan Fiduciary In Excessive Fee Case

By Neil Shah

- Continuing a trend in other Circuits, the Eighth Circuit held that a service provider that was contracted to provide the 401(k) plan's investment options does not act as an ERISA fiduciary when, consistent with the terms of a contract it negotiated at arms' length, it passes through operating expenses to participants. The Court also rejected the plan's remaining arguments that Principal was a fiduciary because there was no nexus between the fiduciary services and the plan's allegations that Principal had charged it excessive fees. The case is *McCaffree Financial Corp. v. Principal Life Ins. Co.*, No. 15-1007, slip op. (8th Cir. Jan. 8, 2016).

Another Post-Tackett Ruling Denying Retiree Health Benefits

By Madeline Chimento Rea

- A district court in West Virginia recently held that retirees were not entitled to lifetime health benefits under the clear and unambiguous language of the relevant collective bargaining agreements. Shortly after Constellium modified retiree health benefits to provide less favorable coverage, the retirees sued, alleging that they had a vested right to the prior level of health benefits. The court held that the retirees were not entitled to lifetime benefits in light of clear and unambiguous durational clauses in the CBAs that limited retiree health benefits to the term of the labor agreement. Since the language was clear, the court also found that it should not consider extrinsic evidence. The case is *Barton v. Constellium Rolled Products-Ravenswood, LLC*, 13-cv-03127, 2016 WL 51262 (S.D. W. Va. Jan. 4. 2016).

Defined Benefit Plan Participant's Action Mooted by ERISA Plan's Improved Financial Condition

By Neil Shah

- A federal district court in Minnesota dismissed a plan participant's allegations that plan fiduciaries mismanaged a defined benefit plan — and thus caused it to be underfunded — because the plan's financial condition improved during the course of the litigation. As reported here, the court previously held that these allegations were sufficient to establish that plaintiffs suffered an injury in fact sufficient to confer Article III standing. In its most recent opinion, the court held that plaintiffs' claims were now moot because the plan had become overfunded. As a result, "any money that could be awarded would simply add to the Plan's now-existing surplus,

in which Plaintiffs have no legal interest." The court also held that "to the extent that the Plan becomes underfunded again in the future, raising anew concerns about the security of Plan participants' future stream of benefits, the causal connection between the new increased risk of default and the Defendants' alleged violations in 2007 through 2010 would be tenuous at best." The case is *Adedipe v. U.S. Bank, N.A.*, No. 13-2687, slip op. (D. Minn. Dec. 29, 2015).

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A version of this article will be published in the Winter 2015 edition of Benefits Law Journal. *See* Robert Rachal & Lindsey Chopin, *401(k) Fee Litigation: Recent Case Teachings on Exposures and Practices to Mitigate That Risk*, Benefits Law Journal, Vol. 28, No. 4 (Winter 2015).

Robert Rachal is a Senior Counsel and Lindsey Chopin and Robert Sheppard are associates in Proskauer's New Orleans, Louisiana office. The views expressed herein are the authors' alone.

[1] *Tussey v. ABB, Inc.*, No. 2:06–cv–04305–NKL, slip op. at 17 (W.D. Mo. Dec. 9, 2015), ECF No. 782.

[2] Joint Motion for Preliminary Approval of Class Settlement, *Kruger v. Novant Health, Inc.*, No. 1:14-cv-00208 (M.D.N.C. Nov. 9, 2015), ECF No. 43; Joint Motion for Preliminary Approval of Class Settlement and Plaintiff's Memorandum in Support of Joint Motion, *Spano v. Boeing Co.*, No. 06-cv-743-NJR-DGW (S.D. Ill. Nov. 5, 2015), ECF Nos. 554 and 555.

[3] *Haddock v. Nationwide Fin. Servs., Inc.*, No. 3:01-cv-1552 (SRU), slip op. at 1-2, ECF No. 526 (D. Conn. Apr. 9, 2015).

[4] *Krueger v. Ameriprise Fin. Inc.*, No. 11-cv-2781, slip op. at 1-2 (D. Minn. July 13, 2015), ECF No. 623.

[5] *Tatum v. RJR Pension Inv. Comm.*, 761 F.3d 346, 365-66 (4th Cir. 2014).

[6] 135 S.Ct. 1823, 1828-29 (2015). In *Tibble*, the selection of retail instead of institutional share classes, as well as the timing of that decision, came under fire. Issues remaining for trial included whether the inclusion of retail class shares was imprudent. Plaintiffs claimed that the defendants breached their duty of prudence when they invested in the retail share classes rather than the institutional share classes offered by several of the mutual funds. Following trial, the evidence showed that: At the time of the initial investment decision, both retail and institutional share classes were available, with the only difference being that the retail share classes charged higher fees; the district court concluded that the evidence presented at trial established that the defendants never considered or evaluated the different share classes for these funds, and that if they had requested the institutional share class, because of the size of the plan, they likely would have received that class. The district court found that this failure to investigate acquiring the institutional share class was a breach of fiduciary duty of prudence, but found the claims were time-barred for the funds added more than six years before the lawsuit was filed.

[7] *Tussey v. ABB, Inc.*, 746 F.3d 327, 337-41(8th Cir. 2014). In December 2015, on remand, the district court awarded $11.6 million in attorneys' fees. *Tussey v. ABB, Inc.*, No. 2:06-cv-04305-NKL, slip op. at 17 (W.D. Mo. Dec. 9, 2015), ECF No. 782.

[8] *Tussey v. ABB, Inc.*, No. 2:06-CV-04305, 2012 WL 1113291, *39-40 (W.D. Mo. Mar. 31, 2012).

[9] *See, e.g., Hecker*, 556 F.3d at 586.

[10] 556 F.3d 575, 581 (7th Cir. 2009).

[11] *Loomis v. Exelon Corp.*, 658 F.3d 667, 673-75 (7th Cir. 2011).

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