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DOL Final Fee Disclosure Rules May Have Consequences for Fiduciaries Beyond Fines—Could Result in Increased Litigation and Government Enforcement

BY CANDACE L. QUINN AND ROBERT J. GUITE

On Feb. 2, 2011, the Department of Labor ("DOL") issued the long-awaited final regulations under Section 408(b)(2) of the Employee Retirement Security Act of 1974 ("ERISA") that establish new disclosure requirements for "covered service providers" to pension plans.[1]

This new tool in DOL's arsenal to effectuate enhanced disclosure of fees and other compensation with respect to service providers creates real concern for plan fiduciaries beyond the service providers' legal obligation to make the required disclosures.

In certain circumstances, the final regulations may call for returning fees and paying excise fines for noncompliance. In addition, the final regulations could subject fiduciaries to increased claims of breach of fiduciary duties under ERISA and shareholder class actions.

[1] 29 C.F.R. § 2550.408b-2

Candace L. Quinn (Candace.quinn@squiresanders.com) is a partner in the Employee Benefits & Executive Compensation Tax Practice in the New York office of Squire Sanders (US) LLP. Robert J. Guite (Robert.guite@squiresanders.com) is a partner in the Litigation Department in the San Francisco office of Squire Sanders (US) LLP. The authors focus their practice on tax, legal, and litigation matters concerning qualified retirement plans, tax deferred plans, and nonqualified deferred compensation programs.

The extensive fee disclosure of direct and indirect compensation will put fiduciaries on notice, and test the strength of their monitoring of contracts and service provider arrangements for reasonableness. Failure to monitor the reasonableness of the service provider's arrangements is considered a breach of fiduciary duty and could result in personal liability. In the recent case of *Tussey v. ABB*, the fiduciaries' failure to monitor pension plan recordkeeping fees resulted in $35 million in losses, and the fiduciaries were held liable.[2]

New DOL Regulations

The disclosure requirements mandated by the new regulations under Section 408(b)(2) of ERISA relate to required fee disclosures of banks, broker-dealers, investment managers, custodians, record keepers, and other service providers. Fee disclosure is a critical aspect of ERISA, and the final regulations require plan fiduciaries, when selecting and monitoring service providers and plan investments, to act prudently and solely in the interest of all participants and beneficiaries. To that end, plan fiduciaries must ensure that arrangements with their service providers are "reasonable" and that only "reasonable" compensation is paid for services.

The amounts paid to brokers, managers, custodians, and service providers may surprise plan sponsors when the required disclosures are finally made by July 1, 2012. Then, within 60 days of that disclosure (or 60 days after the start of the plan year beginning on or after Nov. 1, 2011), plan sponsors are required to make disclosures to participants pursuant to Section 404(a)(5) of ERISA. Such disclosures include general information about the structure and operation of the plan, as well as investment options. Significantly, plan sponsors must also provide an explanation of fees and expenses that are charged or deducted from participant accounts.

[2] *Tussey v. ABB Inc.*, No. 2:06-cv-04305-NKL (W.D. Mo. Mar. 31, 2012)(63 PBD, 4/3/12; 39 BPR 697, 4/10/12) . "ERISA imposes high standards of fiduciary duty upon those responsible for administering an ERISA Plan and investing and disposing of its assets. An ERISA fiduciary is subject to a strict standard of care." The court was highly critical of fee revenue sharing arrangements that financially advantaged the service provider and/or the employer/sponsor without knowledge of the participants.

Retirement plan service providers must meet these disclosure obligations or the fees paid to the service provider could be deemed to be prohibited transactions under ERISA. If a prohibited transaction occurs, the plan fiduciaries can be liable for civil penalties and excise taxes as well as risk having the transaction unwound.[3]

ERISA Legal Framework—Requiring Disclosure. The final regulations under ERISA Section 408(b)(2) expand DOL's guidance on when a contract or arrangement is ''reasonable'' and require additional disclosures by a service provider to fiduciaries concerning all direct and indirect compensation that it will receive. The contract arrangement is important, as ERISA Section 408(b)(2) provides a statutory exemption from prohibitions for certain arrangements between plans and service providers if: (1) the contract or arrangement is reasonable,[4] (2) the services are necessary for the establishment or operation of the plan,[5] and (3) no more than reasonable compensation is paid for the services.[6] Without exemptions to these prohibitions, a plan could not operate.

Increased disclosure assists plan sponsors and DOL in ensuring compliance with ERISA's prohibitions regarding certain transactions between the plan and fiduciaries. With respect to fee transparency and compliance, fiduciaries' activities can be monitored to be sure they do not deal with the assets of the plan for their own interest; or act in a transaction adverse to the participants, or receive any kickbacks.

In that regard, not only must certain types of transactions not violate the statute, but ERISA prohibits certain transactions between a plan and a party in interest.[7] A party in interest would include, among others, a fiduciary, plan sponsor, or any person providing services to a plan.[8] As a party in interest, a service provider is prohibited by ERISA from engaging in services for a plan unless such services are necessary, provided under a reasonable contract, and compensated by a reasonable fee.[9] ''Reasonable'' is evaluated by comparing the amount at the time the contract is executed with an ''amount as would ordinarily be paid for like services by like enterprises under like circumstances.''[10]

DOL has emphasized that ERISA's general standards of fiduciary conduct require the fiduciary to enter into reasonable contracts and arrangements. Accordingly, the service providers should only receive reasonable compensation for their services. Under Section 404(a)(1) of ERISA, the employer, plan sponsor, or other responsible plan fiduciary must act prudently and solely in the interest of the plan participants and beneficiaries not only in providing benefits and defraying reasonable expenses of administering plans, but in reviewing file arrangements, deciding whether to enter into, or continue, the arrangement and agreement with the service provider, and in determining which investment options to utilize or make available to plan participants or beneficiaries. In this regard, DOL has opined that:

> ''the responsible Plan fiduciaries must assure that the compensation paid directly or indirectly by the Plan to [the service provider] is reasonable, taking into account the services provided to the Plan as well as any other fees or compensation received by the service provider in connection with the investment of Plan assets. In this connection, it is the view of the DOL that the responsible Plan fiduciaries must obtain sufficient information regarding any fees or other compensation that the service provider receives with respect to the Plan's investments in each mutual fund to make an informed decision whether the service provider's compensation for services is no more than reasonable. The Plan fiduciaries also must periodically monitor the actions taken by the service provider in the performance of its duties, to assure, among other things, that any fee offsets to which the Plan is entitled are correctly calculated and applied.'' [11]

Section 408(b)(2) Highlights. The Section 408(b)(2) regulations expanded the information that must be disclosed with regard to the service providers' receipt of direct and indirect compensation. Direct compensation refers to compensation that service providers receive from plans or plan sponsors. Indirect fees are compensation received from other than plans or plan sponsors for services provided to the plans. Indirect compensation arrangements occur when service providers outsource certain aspects of the required service arrangement.

With regard to indirect compensation paid in connection with a contract or arrangement, the new rules require a description of arrangements between the payer and the service provider, affiliate, or subcontractor to which the ''indirect compensation'' is received to highlight and identify any potential conflicts of interest. Care should be given to the mention in the preamble to the regulations that indirect compensation includes subsidized programs and other benefits received by the service provider from a financial institution or similar party. The service provider is making recommendations regarding plan asset investments that could be interpreted as a conflict of interest if they are made ''in connection with'' the service provider's contract or arrangement with the covered plan.

In reviewing the new regulations, service providers should be aware that:

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[3] ERISA § 502(i) authorizes DOL to assess a civil penalty of 5 percent of the amount involved in a prohibited transaction, with 100 percent of the amount involved if the prohibited transaction is not corrected. ERISA § 502(l) imposes a 20 percent penalty of the applicable recovery amount against a fiduciary who breaches his or her duty, or any knowing participation in a breach by another person. Service providers can also be subject to the prohibited transaction excise tax rules under tax code § 4975 due to a failure to disclose required fee information. Under § 4975(a), the rate of the excise tax is 15 percent of the prohibited transaction amount. The excise tax increases to 100 percent of the amount if the transaction is not corrected.

[4] See 29 C.F.R. § 2550.408b-2(c) for DOL's clarification on ''reasonable contract or arrangement.''

[5] See 29 C.F.R. § 2550.408b-2(b) for DOL's clarification on ''necessary service.''

[6] See ERISA § 408(b)(2), 29 U.S.C. 1108(b)(2); see 29 C.F.R. § 2550.408c-2 for DOL's clarification of ''reasonable compensation.''

[7] ERISA § 406(a), 29 U.S.C. § 1106(a). ERISA prohibits a fiduciary from causing a plan to engage with a party in interest in (1) the sale or exchange, or leasing, of any property; (2) the lending of money or extension of credit; (3) the furnishing of goods or services; and (4) the transfer to, or use by or for the benefit of, any assets of the plan. ERISA § 406(a)(1)(D), 29 U.S.C. § 11096(a)(1)(D).

[8] See ERISA § 3(14)(B), 29 U.S.C. § 1102(14)(B).

[9] ERISA § 406(a)(1), 29 U.S.C. § 1106(a)(1); ER1SA § 408(b)(2), 29 U.S.C. § 1108(b)(2).

[10] 26 C.F.R. § 1.102-7(b)(3) (1987).

[11] Advisory Opinion 97-15A (May 22, 1997); ''ERISA's Fiduciary Duties: Meeting the Reasonable Contract Fee Requirements'' (77 PBD, 4/22/08; 35 BPR 939, 4/22/08).

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■ DOL requires the disclosure of all compensation, both non-monetary and direct compensation, by service providers, affiliates, or subcontractors, that was reasonably expected to be received. With regard to items of monetary value such as gifts, trips, and awards, if the aggregate value is $250 or less during the term of the contract, it can be excluded.

■ Disclosure may be reflected as a dollar amount, formulas, percent of covered plan assets, or per capita amount. The regulations allow service providers to provide a "reasonable and good faith estimate" as long as the method/assumption is disclosed.

■ DOL provided a sample guide as an appendix to the final regulations for service providers to use to assist them in the disclosure requirements for plan fiduciaries. The regulations do not require service providers to supply a guide to plan fiduciaries at this time.

■ The final regulations include disclosure requirements for descriptions of annual operating expenses for investment options offered under a fixed menu for plans, but not for a brokerage window or the designated investment alternative (DIA). Disclosure of total annual operating expenses for a DIA may be expressed as a percentage, calculated in accordance with participant-directed plan regulations issued under ERISA Section 404, which involve disclosures that must be made to participants in participant-directed individual account plans. These participant-directed regulations will be effective 60 days after the final regulations.

■ The final regulations changed the focus of the pass through relief previously provided in the interim rules for disclosure of investment related information. Service providers may now comply with the requirements for investment related disclosures concerning directed investment accounts by providing current disclosure materials of the issuer of the directed investment accounts or information replicated from such material if the issuer is either a (1) registered investment company (mutual fund); (2) insurance company qualified to do business in the state; (3) issuer of publicly traded securities; or (4) financial institution supervised by a state or federal agency. The focus is now on whether an institution is regulated, not if disclosure is regulated. However, a service provider must act in "good faith," meaning it must not know materials are incomplete or inaccurate, and should state that it makes no representations as to completeness or accuracy.

■ With regard to the timing of disclosures for new contracts, the regulations do not specify a deadline but suggest disclosure needs to be provided "reasonably in advance" of entering into, extending, or amending any contract for services. Any changes in fees by a service provider must be disclosed as soon as practicable, but not later than 60 days from the date the service provider is advised of the change unless there are extraordinary circumstances beyond the reasonable control of the service provider. Disclosure of changes to investment-related information are to be made at least annually. Further, a plan fiduciary or administrator may request service provider disclose compensation related to service arrangements reasonably in advance of the date required to comply with disclosure under ERISA.

The final regulations allow service providers of certain types of annuity contracts and tax code Section 403(b) plan accounts to be excluded from the disclosure requirements. The exclusion applies where the sponsoring employer ceased making contributions to the annuity contracts and 403(b) accounts, and where the rights and benefits of individual owners of the contract or account are enforceable against the issuer or custodian without employer involvement and when the individual owners are fully vested in benefits provided under the accounts.

Risk of Fiduciary Liability

Potential for Personal Liability. Fiduciaries can be personally liable under ERISA for any losses to a plan resulting from a breach of their fiduciary duty. A fiduciary must restore to the plan any profits the fiduciary realized through the misuse of plan assets. Thus, plan fiduciaries should be aware of the requirements in these new rules and take action to ensure compliance with ERISA Section 408(b)(2) and these regulations.

If plan fiduciaries do not comply with the requirements under ERISA Section 408(b)(2), not only could they be considered to have engaged in a prohibited transaction that would be subject to a prohibited transaction tax, but if there is a breach of fiduciary duties, the fiduciaries could also be subject to the automatic benefit rule resulting in liability for excise taxes under tax code Section 4975. This section imposes liability on "disqualified persons" who engage in prohibited transactions with pension plans.[12]

If there is a prohibited transaction, each "disqualified person," i.e., each fiduciary and service provider, is jointly and severally liable for the tax penalties. The initial tax on a prohibited transaction is 15 percent of the amount involved for each year (or part of a year) in the taxable period. If the transaction is not corrected within the taxable period, an additional tax of 100 percent of the amount involved is imposed. The taxable period starts on the transaction date and ends on the earliest of the following days: the day the Internal Revenue Service mails a notice of deficiency for the tax; the day IRS assesses the tax; or the day the correction of the transaction is completed.

Moreover, under the automatic benefit rules, if the disqualified person as a result of the prohibited transaction causes an excess benefit to occur, the only way to correct the violation is to undo it. In addition to correcting the transaction, disqualified persons are subject to a penalty in an amount equal to 25 percent of the excess benefit. If the correction is not returned then the disqualified person can be liable for an additional tax of 200 percent of the excess benefit.[13]

With the fee disclosure regulations framework finalized, DOL has achieved its goal to increase the transparency in fees associated with plan investments under the contract or arrangement for plan services.

> ***Practice Tip:*** To measure compliance, plan fiduciaries should review existing contracts and arrangements to ensure that they satisfy the requirements and identify any changes that may be needed based on the final regulations. This is an important step, as the failure of a service provid-

[12] Quinn and Roundtree, " 'Automatic' Excess Benefit Transactions: Avoiding Intermediate Sanctions and Loss of Exempt Status," BNA Journal Reports, 2004.

[13] *Id.*

er's arrangement to qualify for the ERISA Section 408(b)(2) exemption will cause it to be a prohibited transaction. By participating in such an arrangement, the plan fiduciary will violate Section 406(b) of ERISA's prohibited transaction rules and the service provider, a disqualified person under tax code Section 4975, will be subject to excise taxes.[14]

Risk of Litigation. Review of these required disclosures may lead plan sponsors and/or participants and beneficiaries who believe that the fees were not ''reasonable'' to bring claims against plan administrators and fiduciaries to recoup those fees and seek damages for breach of fiduciary duty under ERISA's civil enforcement scheme. In light of the potential for claims, plan sponsors, fiduciaries and service providers may be well-served to commence review of their obligations under ERISA, plan documents, and service agreements as soon as possible.

Class action lawyers have brought numerous major lawsuits accusing *Fortune* 100 companies and members of their boards of directors and senior officers of violating ERISA by allowing their employees to be overcharged by their plan vendors for administrative services and investment management.[15] The Supreme Court in February 2008 unanimously ruled that participants can ''individually'' sue plan sponsors.[16]

In a recent case tried in the U.S. District Court for the Western District of Missouri, the court concluded that plan fiduciaries were liable for more than $35 million for failure to monitor recordkeeping costs and negotiate reasonable revenue-sharing payments. In *Tussey v. ABB Inc.*, the court held that the failure to monitor fees charged by the plan's service provider for recordkeeping and administrative services, and to replace one of the investment funds with the service provider's preferred fund (which generated more revenue for the service provider from the participants), constituted a breach of fiduciary duty. The court was highly critical of revenue sharing arrangements that financially advantage the service provider and/or the employer/sponsor without knowledge of the participants. Certainly, such concerns may be amplified in light of the final regulations.

Identify the Fiduciaries. The first step in protecting plan fiduciaries against liability is to identify who are the plan fiduciaries and what do the plan documents and related vendor agreements provide regarding administrative responsibility and liability. Under ERISA, persons are fiduciaries to the extent that they exercised discretionary authority or control regarding plan management, management of the plan's assets, or to the extent that they have any discretionary authority or responsibility in plan administration.[17] A plan may have named or designated fiduciaries, but the courts impose a functional test to determine fiduciary status by the actions taken and do not rely on the title.[18]

Under ERISA, plan fiduciaries are required to examine whether fees paid to service providers and other expenses of the plan are ''reasonable.'' It is important to review documents to determine who is overseeing these responsibilities. This is a critical fiduciary requirement and not only is there potential fiduciary liability for failure to review this issue, but also the ERISA Section 404(c) safe harbor provisions that protect a plan sponsor from ERISA liability may be lost by a failure to identify and disclose all plan fees and expenses to plan participants.

Verify Attorney-Client Privilege Not Limited by Fiduciary Exception As plan sponsors and fiduciaries follow steps to mitigate risk of losses in class actions and government audit enforcement, including utilizing legal counsel, they should review the limits of the attorney client privilege. The attorney-client privilege exists to protect communications between a client and an attorney. The attorney-client privilege is designed to protect communications that will disclose the key facts of a matter and that such disclosure will remain in confidence.[19] However, plan sponsors need to be aware that there is a fiduciary exception to this privilege. The exception is relevant in litigation regarding employee benefit plans subject to the fiduciary provisions of ERISA.

Under the fiduciary exception, a plan sponsor acting in the capacity of an ERISA fiduciary is prevented from asserting the attorney-client privilege against plan ben-

[14] ''ERISA's Fiduciary Duties: Meeting the 'Reasonable' Contract Fee Requirements'' (77 PBD, 4/22/08; 35 BPR 939, 4/22/08).

[15] *Tussey v. ABB Inc.*, No. 2:06-cv-04305-NKL (W.D. Mo. Mar. 31, 2012)(63 PBD, 4/3/12; 39 BPR 697, 4/10/12); *Kanawi v. Bechtel Corp.*, 590 F.Supp.2d 1213, 45 EBC 1470 (C.D. Cal. Nov. 3, 2008)(218 PBD, 11/12/08;35 BPR 2602, 11/18/08); *Spano v. Boeing Co.*, No. 06-0743-DRH, 44 EBC 2844 (S.D. Ill. Sept. 26, 2008)(190 PBD, 10/1/08; 35 BPR 2295, 10/7/08); *Martin v. Caterpillar Inc.*, No. 07-cv-1009, 49 EBC 2256 (C.D. Ill 2008)(156 PBD, 8/16/10; 37 BPR 1831, 8/17/10); *Hecker v. Deere & Co.*, 556 F.3d 575, 45 EBC 2761 (7th Cir. 2009)(28 PBD, 2/13/09; 36 BPR 357, 2/17/09); *Tibble v. Edison Int'l*, 639 F. Supp. 2d 1074, 47 EBC 1652 (C.D. Cal. 2009)(145 PBD, 7/31/09; 36 BPR 1824, 8/4/09); *Loomis v. Exelon Corp.*, 658 F.3d 667, 51 EBC 1705 (7th Cir. 2011)(173 PBD, 9/7/11; 38 BPR 1667, 9/13/11); *Will v. General Dynamics Corp.*, No. 06-698-GPM, 49 EBC 2032 (S.D. Ill. Aug. 9, 2010)(225 PBD, 11/24/10; 37 BPR 2592, 11/30/10); *Brewer v. General Motors Inv. Mgmt. Corp.*, 550 F. Supp. 2d 416, 43 EBC 3000 (S.D.N.Y. 2008); *Young v. General Motors Inv. Mgmt. Corp.*, 550 F. Supp. 2d 416, 43 EBC 3000 (S.D.N.Y. 2008)(61 PBD, 3/31/08; 35 BPR 732, 4/1/08); *George v. Kraft Foods Global*, 641 F.3d 786, 50 EBC 2761 (7th Cir. 2011)(104 PBD, 5/31/11; 38 BPR 1055, 6/7/11); *Beesley v. International Paper Co.*, No. 06-00703-DRH, 44 EBC 2837 (S.D. Ill. Sept. 30, 2008)(191 PBD, 10/2/08; 35 BPR 2295, 10/7/08); *In re Lockheed Martin Corp.*, No. 09-8019, 51 EBC 1031 (7th Cir. March 15, 2011)(52 PBD, 3/17/11; 38 BPR 595, 3/22/11); *Waldbuesser v. Northrop Grumman Corp.*, No. 2:06-cv-06213-MMM-JC, 51 EBC 1315 (C.D. Cal. March 29. 2011)(63 PBD, 4/1/11; 38 BPR 694, 4/5/11); *Maxwell v. RadioShack Corp.*, No. MDL 1875, 43 EBC 2059 (N.D. Tex. March 31, 2008)(66 PBD, 4/7/08; 35 BPR 779, 4/8/08); *Renfro v. Unisys Corp.*, No. 10-2447, 51 EBC 1609 (3d Cir. Aug. 19, 2011)(162 PBD, 8/22/11; 38 BPR 1541, 8/23/11); *Taylor v. United Tech. Corp.*, No. 3:06cv1494 (WWE), 46 EBC 1935 (D. Conn. March 3, 2009)(41 PBD, 3/5/09; 36 BPR 565, 3/10/09); *Leber v. Citigroup*, No. 08-CV-04546 (D. Minn. filed Oct. 18, 2007); *Columbia Air Servs. v. Fidelity Mgmt. Trust Co.*, No. 07-11344-GAO, 44 EBC 2782 (D. Mass. Sept. 30, 2008)(193 PBD, 10/6/08; 35 BPR 2298, 10/7/08); *Zang v. Paychex*, 728 F.Supp.2d 261, 49 EBC 1897 (W.D.N.Y. 2010)(148 PBD, 8/4/10; 37 BPR 1729, 8/10/10); *Braden v. Wal-Mart Stores*, 588 F. 3d 585, 48 EBC 1097 (8th Cir. 2009)(226 PBD, 11/30/09; 36 BPR 2743, 12/1/09); *In re Honda of Am. Mfg., Inc. ERISA Fees Litig.*, 661 F.Supp.2d 861, 47 EBC 2610 (2009)(197 PBD, 10/15/09; 36 BPR 2397, 10/20/09).

[16] *LaRue v. DeWolff, Boberg & Assocs.*, 552 U.S. 248, 42 EBC 2857 (2008)(34 PBD, 2/21/08; 35 BPR 467, 2/26/08).

[17] ERISA 3(21), 29 U.S.C. § 1002(21).

[18] See generally *Blatt v. Marshall & Lassman*, 812 F.2d 810, 812, 8 EBC 1495 (2d Cir. 1987); *Eaves v. Penn*, 587 F.2d 453, 458-59, 1 EBC 1592 (10th Cir. 1978).

[19] *Judson Atkinson Candies Inc. v. Latini-Hohberger Dhimantec*, 529 F.3d 371, 387 (7th Cir. 2008) (quoting *U.S. v. Defazio*, 899 F.2d 626, 635 (7th Cir. 1990)).

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eficiaries on matters of plan administration.[20] With regard to administration of the plan, the ERISA fiduciary's obligation is to provide full and accurate information to the plan beneficiaries concerning the administration of the plan.[21]The courts have determined that in cases regarding plan administration, the fiduciary exception to the attorney-client privilege applies to plan participants alleging breach of fiduciary duty because the plan participants are the attorney's ultimate clients.[22] The fiduciary exception applies only to communications that relate to fiduciary functions when an employer acts as plan sponsor in a ''settlor'' capacity such as adopting, amending, or terminating the plan and not in other instances where it is not subject to the fiduciary exception.[23]

The courts have held that the fiduciary exemption to the attorney-client privilege does not apply to situations that relate to the fiduciary's personal liability instead of plan administration.[24] The fiduciary's interests diverge from that of the beneficiaries so as to render the fiduciary exception inapplicable and protect the plan administrator's interest in the attorney-client privilege.

These decisions are important to plan sponsor fiduciaries who want to maintain confidential communication with independent legal counsel to ascertain compliance with ERISA fiduciary requirements. Establishing and preserving confidentiality in the event of participant litigation or government audits for excessive fees is crucial as plaintiff's counsel and auditors seek to have documents disclosed regarding the case.

Class Action Potential

Recent lawsuits involving investment selection under Section 401(k) plans against companies and their respective directors, officers, and plan committees provide a potential road map for additional claims based upon the Section 408(b)(2) regulations. The allegations in these cases center around the investment options made available to plan participants, attendant costs associated with such investment options, and correlating duties of plan fiduciaries. Disclosure to participants and beneficiaries of the costs and fees paid to brokers and administrators may well add fuel to these claims as well as give rise to civil penalties.

ERISA is intended to ''promote the interests of employees and their beneficiaries in employee benefit plans.'' ERISA imposes the highest fiduciary responsibility known to law upon individuals responsible for administering those plans. The duties of loyalty and prudence are owed by ERISA fiduciaries. Whether and how those broadly-stated duties are satisfied is the subject of substantial litigation throughout the United States.

Questions that still have to be answered by the courts include:

- May a plan fiduciary simply adopt the recommendations of the Section 401(k) plan trustee or advisor?
- Does a plan fiduciary have an obligation to affirmatively negotiate better investment terms?
- Does the plan fiduciary have an obligation to independently investigate the investment options presented?
- If such a duty exists, how does a fiduciary comply?

Although the goal of ERISA was to create a uniform body of federal law regarding employee benefits, substantial differences exist within the federal circuit courts. For example, the U.S. Court of Appeals for the Seventh Circuit may be the friendliest to employers and fiduciaries. The Seventh Circuit has held that plan fiduciaries may generally rely upon competition in the investment market to satisfy their duties of loyalty and prudence relative to the selection of investments offered under a 401(k) plan. In *Hecker v. Deere & Co.*,[25] the U.S. Court of Appeals for the Seventh Circuit found that the investment options offered to plan participants satisfied the obligations of the plan fiduciaries even if other investment options may have been less costly to the plan beneficiaries. The *Hecker* court concluded that ERISA's safe harbor, 29 U.S.C. § 1104(c), offered protection to the plan fiduciaries because the plan included a sufficient range of options so that the participants had control over the risk of loss. In light of this, the Seventh Circuit affirmed the dismissal of the action under Fed. R. Civ. P. 12(b)(6).

In contrast, the U.S. Court of Appeals for the Eighth Circuit declined to follow this approach in *Braden v. Wal-Mart Stores Inc.*[26] The *Braden* plaintiffs asserted violations of ERISA based upon Wal-Mart's alleged failure to properly evaluate investment options included in its 401(k) plan and consider the trustee's interest in including funds in the plan. The plaintiffs alleged that this evidenced a violation of the fiduciary duties of prudence and loyalty imposed by ERISA. Although the trial court dismissed the case based upon the Seventh Circuit's decision in *Hecker*, the Eighth Circuit reversed and held that the allegations sufficiently stated a claim for violation of ERISA.

In further contrast to *Hecker*, the U.S. District Court for the Central District of California imposed liability against a utility under a similar fact pattern in *Tibble v. Edison Intl*,[27] In *Tibble*, plaintiffs alleged that the company violated ERISA by failing to conduct sufficient due diligence with regard to the investments approved for inclusion in the 401(k) portfolio. Despite a formal investment policy that identified a number of different criteria for evaluating investments combined with the recommendations of the plan administrator, liability was imposed based upon the purported lack of any evidence that the company considered or evaluated different share classes within the various funds. As may be

[20] *United States v. Mett*, 178 F.3d 1058, 23 EBC 1081 (9th Cir. 1999); *see also In re Long Island Lighting Co.*, 129 F.3d 268, 271-72, 21 EBC 2025 (2d Cir. 1997).

[21] *In re Long Is. Lighting*, 129 F.3d at 271; see *Bland v. Fiatallis N. Am. Inc.*, 401 F.3d 779, 787, 34 EBC 1875 (7th Cir. 2005)(51 PBD, 3/17/05; 32 BPR 681, 3/22/05).

[22] *See, e.g., Mett*, 178 F.3d at 1063. In the case *In re Long Island Lighting*, the court found that the attorney-client privilege may not be available as a shield to prevent the disclosure of information relevant to an alleged breach of fiduciary duty.

[23] *Tatum v. R.J. Reynolds Tobacco Co.*, 247 F.R.D. 488, 493 (M.D.N.C. 2008)(35 PBD, 2/22/08; 35 BPR 477, 2/26/08)(citing *Wachtel v. Health Net, Inc.*, , 482 F.3d 225, 233 (3d Cir. 2007)(63 PBD, 4/3/07; 34 BPR 856, 4/10/07); *Long Island Lighting*, 129 F.3d at 271; *Hudson v. General Dynamics Corp.*, 73 F. Supp. 2d 201, 202 (D. Conn. 1999); *Bland v. Fiatallis N. Am. Inc.*, 401 F.3d 779, 34 EBC 1875 (7th Cir. 2005)(51 PBD, 3/17/05; 32 BPR 681, 3/22/05).

[24] *Tatum*, 247 F.R.D. at 493 (citing *Mett*, 178 F.3d at 1065).

[25] 556 F.3d 575 (7th Cir. 2009).

[26] 588 F.3d 585 (8th Cir. 2009).

[27] 639 F. Supp.2d 1074 (C.D. Cal. 2009).

relevant to the 408(b)(2) regulations, the court also concluded that the plan fiduciary had an obligation to attempt to negotiate better terms than arguably offered by the investment funds. Based upon the failure to engage in these acts, the court held the utility liable for significant damages to the class. In *Barboza v. California Ass'n of Prof'l Firefighters*,[28] the U.S. District Court for the Eastern District of California noted that a fiduciary's failure to discharge its duties in accordance with the plan documents is an independent basis for finding a breach of fiduciary duty, in finding that such a breach occurred and that the plaintiffs were entitled to summary judgment on certain issues.

Mitigating Losses from Class Actions There are at least three steps that employers and fiduciaries can take to mitigate the loss associated with the risk of class actions based on ERISA fiduciary claims.

Review and Audit for Compliance: Fix it Now. Uniform application of plan provisions and accurate and identical communication of information impacting benefits and choices are critical to ensuring that plan and claim administrators satisfy fiduciary obligations under ERISA. Timely and accurately conveying the required information is important; failure to communicate the information to participants and/or beneficiaries constitutes a violation of ERISA and potentially the imposition of civil penalties. Of course, the substance of the information disclosed could support an entirely different claim.

Plan sponsors or administrators should have procedures in place to timely provide the required notices, and notice should be uniformly provided to all participants and beneficiaries. Although ironic, accurate, uniform, and consistent communications from ERISA fiduciaries are more likely to support the typicality and commonality elements necessary for class certification. However, the potential for class certification should not lead ERISA fiduciaries to conclude that different communications or worksite specific informational sessions should be used to preclude class-wide claims. Such a decision may, in and of itself, support a claim for breach of fiduciary duty.

Fiduciaries should be prepared to support any decisions made to both DOL and, potentially, the courts, in the context of a class action. Prompt, accurate, and evenhanded application of plan terms and conditions are a fiduciary's best defense in avoiding claims of breach and appropriately administering the plan.

Be Aware of Media and Advertising Watch for events that may signal potential class claims. These include the disclosures mandated by the final regulations as well as corporate restructures, benefit changes, regulatory activity, or bad corporate headlines. But also be aware of solicitations by the plaintiffs' bar on television and the internet, and monitor websites devoted to the newest targets of class actions.

The Lawsuit and Initial Response If a purported class action lawsuit is commenced, quick and thorough assessment of the risks and issues must occur, forum issues should be analyzed, and preparation of the class certification issues should begin.

The certification hearing will occur early after the lawsuit is commenced. Prompt assessment of the claims and defenses is critical. Since class action litigation begins fast, develop as soon as possible a team that usually includes: (1) corporate counsel; (2) investor and public relations; (3) accounting and operations; (4) management liaison (that can be performed with corporate counsel); and (5) outside counsel.

Checklist for Fiduciaries

In light of the current environment, fiduciaries would be well advised to re-evaluate the plan's investment policies and procedures. Consideration of the following topics may be advisable:

- Review of plan documents, including investment policy statements, to ensure compliance with existing law and to determine if the plan in operation complies with its terms and the law;

- Review of insurance policies to ensure that coverage is in place for all executives who may have acted (or who are alleged to have acted) as fiduciaries with respect to any aspect of the plan and, potentially, obtain coverage enhancements;

- Review of plan documents and actual practices utilized by the company and investment committee to confirm that the practices are consistent with the documents;

- Review contracts with service providers to ensure full compliance with DOL requirements for disclosure of direct and indirect fees; and contact the service providers to confirm data is being compiled pursuant to disclosure regulations;

- Review service providers fee disclosure for captured information required and reasonableness; and

- Recommend strategies to minimize risk (and increase chances of dismissal) in the event a lawsuit is filed against the company and review of service agreements between the sponsor and service providers to determine the defense and indemnity obligations of the parties should a lawsuit arise.

Disclosure of fees and meeting the requirements of ''reasonableness'' is not easily ascertained. Service providers normally only disclose fees otherwise required to be disclosed, such as 12b-1 fees, but not indirect fees that they receive from mutual funds vendors, which are typically prevented from disclosure by agreements that service providers claim are confidential and/or proprietary in nature. However, pursuant to the requirements under the regulations, both direct and indirect fees must be disclosed.

Conclusion

It is imperative that service providers and fiduciaries comply with DOL's final regulations under Section 408(b)(2) of ERISA. Employers, plan sponsors, and other responsible fiduciaries must establish best-practice governance standards relating to compliance and be able to demonstrate to both the plan participants and DOL that the compensation paid directly or indirectly by the plan to investment and administrative service practices is no more than ''reasonable,'' and fees of

[28] No. S-08-02569 FCD/GGH, 50 EBC 2484 (E.D. Cal. Jan. 25, 2011)(18 PBD, 1/27/11; 38 BPR 227, 2/1/11)

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the service providers are monitored to assure they are properly reported.

In this regard, an independent ERISA attorney who specializes in this area can provide assistance with establishing both practice guidance standards and review procedures on a confidential basis. A review by independent counsel retained by the employer to assess potential liabilities in the event of litigation or a government audit can allow protection under the attorney-client privilege. In-house and plan counsel and consulting firms may not be able to offer this protection as a result of the ''fiduciary exception'' to the attorney-client privilege.[29] Undergoing efforts to establish and maintain confidentiality is crucial for fiduciaries in the event of participant and shareholder litigation as well as government enforcement action.

[29] ''Fee Disclosure of Defined Contribution Plans: The State of Fiduciary Duties'' (131 PBD, 7/12/10; 37 BPR 1610, 7/13/10).