



# ERISA LITIGATION

## Spate of Class Action Lawsuits Targets 401(k) Fees and Expenses

*By Joe Faucher*

In February 2005, in our *ERISA Controversy* newsletter, we ran an article entitled "Excessive 401(k) Plan Fees and Costs: The Coming Storm in ERISA Litigation?" In that article, we wrote "[w]ith plan fiduciaries facing greater scrutiny than ever in the wake of the employer stock cases, what is the next ERISA litigation trap for corporate officers and directors that preside over their companies' retirement plans? The answer may be claims relating to payment of excessive fees and expenses." Our article proved prophetic.

On September 11 of this year, class action lawsuits targeting 401(k) plan fees and expenses were filed by a single law firm in courts across the country against several large companies – as well as officers of those companies and members of their 401(k) plan committees. Some of the companies sued include International Paper Corporation, Lockheed Martin Corporation, Bechtel Corporation and Caterpillar Corporation. (Suits against certain other large corporations also filed on September 11 have been voluntarily dismissed, at least for the moment, but may be refiled.)

The Complaints typically allege, among other things, that the defendants (1) entered into agreements with third parties that allowed the plans to pay unreasonable, excessive fees, (2) failed to inform themselves of, and understand, the various methods by which vendors in the 401(k), financial and retirement industry collect payments and other revenue from 401(k) plans, and (3) failed to monitor the fees and expenses of the plan.

The Complaints also allege that the defendants – plan fiduciaries – failed to adequately inform plan participants of the actual fees and expenses incurred in connection with the plans. That allegation, if true, may have an impact on whether the defendants – the companies and plan fiduciaries – can take advantage of the defense offered by ERISA §404(c) to immunize themselves against fiduciary responsibility for the plan's fees and expenses.

In addition, the Complaints allege that the defendants caused or allowed their service providers to receive excessive revenue either (1) through direct payment of "hard dollar" expenses by the plans, and/or (2) through "revenue sharing" arrangements with other service providers. The complaints allege in some instances that through the use of so-called "master trusts," the plan fiduciaries significantly understated the amount of hard dollar expenses paid, since fees paid to service providers by the master trusts (although actually paid by the plan) were not properly disclosed in government filings. Referring to revenue sharing as the "big secret of the retirement industry," the Complaints attack the practice of investment providers "sharing" portions of their asset based fees with other service providers. In order for plan fiduciaries to satisfy their obligation to determine whether service providers are receiving reasonable compensation, the Complaints allege, they must determine both the "hard dollar" payments and the revenue sharing payments service providers have received. The upshot, according to the Complaints, is that when revenue sharing payments are taken into account, "... the participants and beneficiaries of the Plans paid unreasonably high fees for the administrative and/or investment management services they received."

A more thorough analysis of the theories of liability alleged in these Complaints is beyond the scope of this bulletin. However, there are several "take away" points that plan sponsors, fiduciaries and service providers need to consider:

1. While the current round of complaints is aimed at very large companies, it is reasonable to assume that a wave of "copycat" litigation may hit small to mid-market employers. Indeed, perhaps the only factor triggering complaints against

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very large employers is that the dollars at issue in large plans – the difference between the fees and expenses paid, and what “reasonable” fees would have been – are greater in connection with large plans. Setting aside, however, the amount of money at issue, larger companies may be more likely than smaller companies to actively negotiate the fees and costs their plans incur, and to monitor those fees and costs on an ongoing basis. Therefore, proving liability against smaller employers, who may be less likely to methodically adhere to prudent processes in connection with their plans, may in fact be an easier proposition. Sooner or later, other companies – including smaller companies – are sure to find themselves in the crosshairs of plaintiffs’ attorneys. In the meantime, both large companies and smaller companies should consider offering only institutional shares of mutual funds, rather than retail shares, in order to reduce plans’ investment expenses. Smaller companies should insure that the mutual fund share classes they make available to their employees are appropriate for plans of their size, and that group annuity contract expenses are in line with expenses typically charged to smaller plans.

2. Service providers may find themselves being sued in these cases as well. The current cases focus on the “in house” fiduciaries of plans, perhaps in part because their fiduciary status is more easily established. However, outside service providers should not assume they are immune from ERISA litigation involving unreasonable compensation. Depending on their relationship to plans, they may be the focus of claims for breach of fiduciary duty, prohibited transactions (relating to receipt of unreasonable compensation), or both.

3. Liability in ERISA cases depends not on “Monday morning quarterbacking,” but on whether the fiduciaries follow a prudent process in selecting and monitoring plan service providers and the fees and costs paid to them. Now, more than ever, it is imperative for plan fiduciaries to formalize their procedures relative to their companies’ plans. Plan fiduciaries have an advantage in ERISA litigation – provided they avail themselves of it. If the plan fiduciaries adopt and follow a prudent process, they should be able to avoid liability under ERISA. Plan fiduciaries should begin by obtaining detailed written reports regarding the amount of fees, expenses and revenue sharing payments attributable to their plans. Once they obtain those reports, they should compare the fees to the range of fees commonly charged to plans of similar size, and attempt to renegotiate the fees or switch vendors if their analysis suggests the plan is being overcharged. The current wave of litigation will focus attention on whether the defendants in these cases follow appropriate, ongoing programs of ascertaining, analyzing, and monitoring the fees and expenses paid to plan service providers. That process must be adequately documented.

We welcome your questions regarding this latest round of ERISA litigation cases, and ways in which you can protect yourselves, your companies or your clients. Please contact Joe Faucher, Mike Vanic or Fred Reish.

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