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Editor's Overview

In this month's Newsletter, we begin with an examination of the district court's decision in *George v. Kraft Foods Global, Inc.*, which both continued the defense bar's string of success in defending "excessive fee" claims brought against 401(k) plans and their administrators, and also stopped in its tracks a challenge the use of unitized fund arrangements for employer stock funds.

And in a decision that we can only hope will be limited to its unique facts, we take a look at the Third Circuit's decision in *Battoni v. IBEW Local Union 102 Employee Pension Plan*. At the center of the dispute was a welfare plan amendment that conditioned receipt of health care benefits on the nonreceipt of a lump sum benefit under a pension plan. The Third Circuit examined the intent of the trustees in amending the welfare plan and concluded that the amendment to the welfare plan constituted an illegal cut-back of pension benefits.

As always, be sure to review the Rulings, Filings and Settlements of Interest section. The topics this month include the attorney-client privilege, class issues, invalidating plan amendments and the *State Street* and *Hartford* settlements.

District Court Dismisses Claims against Kraft 401(k) Plan Fiduciaries, Continuing String of Successful Defenses to Suits Challenging 401(k) Plan Fees and Expenses

By Amy Covert and Michael Spencer

Last month, the United States District Court for the Northern District of Illinois dismissed, on a motion for summary judgment, a class action suit brought on behalf of participants of a 401(k) plan sponsored by Kraft Foods Global, Inc. *George v. Kraft Foods Global, Inc.*, No. 2010 WL 331695 (N.D. Ill. Jan. 27, 2010). The suit challenged various aspects of the operation and administration of the plan, including the fees charged for various administrative and investment services, and the structuring of two company stock fund investment options as "unitized funds." The ruling follows a recent trend favoring plan administrators in "excessive fee" suits,[1] but also breaks some new ground insofar as it dismissed some of the more unique aspects of plaintiffs' claims.

Factual Background

The Kraft Foods Global Inc. Thrift Plan, Plan No. 125 ("Plan"), is a 401(k) plan that, during the period addressed in the complaint, offered several multistock investment options, as well as two company stock funds:the Kraft Foods Stock Fund and the Altria Group Stock Fund. The Stock Funds were "unitized funds," meaning that the funds held both the company common stock and some cash or short-term investments. Plan participants owned "units" of the fund rather than specific, identifiable shares of stock.

The Plan afforded the investment committee discretion to keep any portion of an investment fund in cash or short-term investments for liquidity purposes, pending the distribution of dividends or the selection and purchase of permanent investments for the investment fund. At one point, the Plan was amended to provide that, in addition to the option of holding cash for "liquidity purposes," the cash reserves were to be "held solely as needed for administrative purposes." The cash buffer for the two Stock Funds never exceeded 5.16%.

In 1995, Kraft hired Hewitt Associates, pursuant to a formal request for proposal ("RFP"), to serve as the Plan's recordkeeper. The Plan's fiduciaries reviewed the contract with Hewitt on multiple occasions, including its provisions on Hewitt's fees. Kraft also hired two different advisers at various times to examine Hewitt's fees; each time the adviser concluded that the fees paid to Hewitt fell within the range of the fees that could be expected to be charged by other recordkeepers.

The fees paid to Hewitt were disclosed to Plan participants in several communications, including: (1) fund fact sheets, which informed participants of the total annual operating expenses of each investment fund as a percentage of fund assets; (2) quarterly account statements, which informed participants that most of the Plan's administrative expenses, including recordkeeping fees, were paid from the Plan's assets; and (3) summary plan descriptions, which advised participants to consider "each investment fund's expenses or expense ratio and management fees," explained that those fees were reported on the fund fact sheets, and informed participants that they could request a description of the "annual operating expenses of each of the investment funds, including investment management and administrative fees. . . ." The Plan also disclosed the amount it paid to Plan service providers in the annual Form 5500 it filed with the Internal Revenue Service and in summary annual reports provided to participants.

In 2003, the Plan retained State Street Bank and Trust Company as trustee to hold, manage and invest the Plan's funds. Pursuant to its written agreement with State Street, the Plan compensated State Street with: (1) a base fee, (2) per-item fees for services such as preparation of participant distribution checks, and (3) "float," which is revenue earned from the short-term use or interest earned on plan assets in transit, such as checks for distribution or transfer issued by a plan but not yet presented for payment or transfer.

Procedural History

The complaint, filed in October 2006 in the United States District Court for the Southern District ofIllinois, alleged that the Plan sponsor, the Plan's administrative and investment committees, and the members of those committees, violated ERISA's fiduciary duty provisions by: (1) paying unreasonable and excessive fees to Hewitt and failing to adequately monitor and inform Plan participants of those fees, (2) failing to monitor or account for the float retained by State Street, and (3) structuring the Stock Funds as "unitized funds," mismanaging those Funds, and failing to inform participants of alleged losses resulting from the manner in which those Funds operated. An initial motion to dismiss, which contended that the complaint failed to meet the pleading requirements of *Fed. R. Civ. P.* 8, was denied.

In March 2007, the Court granted defendants' motion to transfer venue to the United States District for the Northern District of Illinois. The Court later certified the case as a class action. Prior to moving for summary judgment, the parties engaged in over two years of extensive discovery, including third-party and expert discovery.[2] On January 27, 2010, the Court granted defendants' motion for summary judgment, dismissing all of plaintiffs' claims. The Court's findings and rulings with respect to each claim are discussed below.

The Court's Opinion on Summary Judgment

The Plan's fiduciaries did not breach their fiduciary duties in negotiating and monitoring the Plan's recordkeeping fees or in disclosing required information to participants.

Plaintiffs alleged that defendants imprudently caused the Plan to pay excessive recordkeeping fees to Hewitt. Plaintiffs contended that the only prudent measure of the reasonableness of a recordkeeper's fees was through a competitive RFP process, which defendants allegedly failed to do each time they renegotiated the recordkeeping contract with Hewitt.

The Court rejected this argument, finding "no support" for the plaintiffs' contention that an RFP is the exclusive legitimate means of determining the reasonableness of recordkeeping fees. The Court found that there was no fiduciary breach by defendants because they regularly reviewed and renegotiated the contract with Hewitt, a process which resulted in a reduction of fees on at least two occasions.

The Court also rejected plaintiffs' claims that defendants failed to adequately disclose the fees paid to Hewitt. The Court determined that this claim was undermined by the Seventh Circuit's decision in *Hecker v. Deere*, 556 F.3d 575, 586 (7th Cir. 2009), which held that it was sufficient for plan fiduciaries to disclose the total fees for the funds, as that "is the critical figure for someone interested in the cost of including a certain investment in their portfolio and net value of that investment." The Court concluded that Plan participants were adequately informed of the total fees – of which recordkeeping fees were a part– through various communications, including, the fund fact sheets, quarterly account statements, and summary plan descriptions. The Court also noted that the Plan disclosed the fees paid to Hewitt in the Plan's annual Form 5500 and that it disclosed the total fees paid to all service providers in its summary annual reports provided to participants.

The Plan's fiduciaries properly allowed State Street to retain investment "float."

Plaintiffs alleged that defendants acted imprudently in failing to monitor "float" and in allowing State Street to retain the "float" as part of its compensation. In rejecting these claims, the Court noted that State Street's agreed upon fee schedule disclosed that it retained float as part of its overall compensation for trustee services. The Court explained that this disclosure, as well as evidence of at least one meeting where the Plan's fiduciaries discussed the issue, demonstrated that defendants properly allowed and adequately monitored the float. Moreover, the Court found that plaintiffs offered no evidence that State Street's retention of float led to excessive fees or losses to Plan participants.

Defendants did not breach their fiduciary duties in maintaining the unitized Stock Funds and disclosed adequate information to participants about the Stock Funds.

Plaintiffs alleged that defendants breached their fiduciary duties by structuring the Stock Funds as unitized funds, by maintaining excessive cash in the Stock Funds, by not properly allocating among participants the costs of administering their investments, and by failing to adequately disclose information to Plan participants about the Funds, including the prospects that the Funds would perform less well than the stock itself.

The Court first rejected plaintiffs' contention that unitized funds are inherently imprudent. The Court noted that more than half of the 401(k) plans that offer employer stock funds used a unitized fund structure and at least twenty-four percent (24%) of Dow Jones Industrial Average companies, like Kraft, used a unitized structure. The Court explained that "plaintiffs' argument that industry standards are 'entirely irrelevant' . . . is contrary to the standard set forth under ERISA, which assesses fiduciary duty by comparing a defendant's actions with those of a "prudent man acting in a like capacity and familiar with such matters . . . ." The Court found that plaintiffs had "offer[ed] no evidence of any industry-wide conditions that undermine the validity of unitized funds."

The Court next rejected plaintiffs' claim that defendants failed to adequately monitor the amount of cash in the Stock Funds and that the Plan's authorization to use the cash buffer for liquidity or administrative purposes was too broad. The Court held that defendants did not breach their fiduciary duties because they had evaluated the pros and cons of maintaining the unitized structure of the Funds and evaluated and monitored the amount of cash necessary to cover participant transactions.

The Court also rejected plaintiffs' argument that the Stock Funds were mismanaged because trading costs – such as brokerage and trading fees – were borne by the Stock Funds as a whole rather than the individual making the trades. Plaintiffs referred to the alleged losses caused by trading costs as "transactional drag."Plaintiffs contended that because trading costs were allocated evenly among all participants and because the Plan did not limit the number or frequency of trades participants could make, frequent traders bore only a fraction of the costs of their trades at the expense of less active participant-traders.

In rejecting this challenge, as well as the various other challenges to the Stock Funds, the Court, relying on Seventh Circuit precedent, explained that ERISA's fiduciary duty of care "requires prudence, not prescience," and "investment losses are not proof that an investor violated his duty of care." The Court found that the undisputed evidence showed that the Plan's investment fiduciaries had considered the problems associated with unitized trusts, including transactional drag, and the potential solutions, and ultimately determined, for legitimate reasons, that the advantages of maintaining the existing structure of the Stock Funds outweighed the benefits of changing to a real-time trading system. The Court accordingly held that defendants' reasoned decision-making process satisfied ERISA's fiduciary duty requirements.

The Court also rejected plaintiffs' claims that defendants breached their fiduciary duties by failing to disclose, and to a limited extent actively concealing, the performance of the Stock Funds relative to the underlying stock. In rejecting this argument, the Court first held that plan fiduciaries do not have a duty to disclose more information than ERISA's notice provisions require, but noted that a fiduciary will be found liable for breach of fiduciary duty under ERISA for failing to disclose if the fiduciary made an intentionally misleading statement or a material omission. The Court concluded that there was no genuine issue of material fact as to whether defendants intended to omit material information or provide misleading information about the performance of the Stock Funds.

In reaching its conclusion, the Court noted that the "performance of the unitized stock funds does not lend itself to an 'apples to apples' benchmark comparison with the value of the common stock because the common stock will never have a cash component." The Court also observed that the Plan provided participants with detailed information on the Stock Funds, including information that the Funds consisted of a combination of company stock and a cash buffer for liquidity or administrative purposes; and (through the quarterly fund fact sheets) information on the performance returns of the Stock Funds during the preceding three months, one year, three years (annualized and cumulative) and five years (annualized and cumulative). The Court also noted that information on the performance of both Kraft and Altria common stock was publicly available, thus enabling participants to compare the performance of the Stock Funds to the performance of the stock itself.

In addition to concluding that defendants used a reasoned decision-making process to determine the structure of the Stock Funds and to maintain adequate cash reserves in the Funds, and that defendants disclosed adequate information to participants about the Funds, the Court, citing the Seventh Circuit's recent decision in *Hecker v. Deere*, held that "in the absence of evidence that [the Plan's seven other investment] alternatives were unsound or reckless, the provision of a large number of investment alternatives, with disclosures allowing participants to make an informed decision as to their investment choices, would preclude a finding that defendants breached their fiduciary duties."

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This decision demonstrates again the importance of engaging in, and documenting, a reasoned decision-making process to defeat breach of fiduciary duty claims under ERISA. The Court repeatedly took note of the reasonableness of that process as a basis for dismissing the claims. As the Court observed, ERISA's prudence requirement mandates the use of a reasoned decision-making process; it does not require that the choice resulting from that process be universally regarded as the optimal decision.

The decision is also significant because of the Court's findings that the defendants did not breach their ERISA fiduciary duties in structuring and operating unitized stock funds; and, consistent with the ruling in *Hecker*, that only the total fees need to be disclosed to participants to avoid liability on a failure to disclose claim. On the basis of this ruling and like rulings, these types of claims may in the future be more susceptible to dismissal in the initial stages of the case, thus averting the type of extensive discovery that the parties engaged in here.

Case of Mistaken Identity? Third Circuit Applies Statutory Prohibition on Pension Benefit Cutbacks to a Welfare Plan

By Russell L. Hirschhorn

Can an amendment to a welfare plan violate ERISA's anti-cutback rule? A plain reading of the statute would suggest the answer is no, but the Third Circuit has concluded otherwise. The anti-cutback rule, Section 204(g) of ERISA, 29 U.S.C. § 1054(g), is housed in Part 2 (Participation and Vesting) of Title I of the statute, which explicitly excludes "welfare plans" from coverage. ERISA § 201(1), 29 U.S.C. § 1051(1). Nevertheless, the Third Circuit recently affirmed the district court's ruling in *Battoni v. IBEW Local Union 102 Employee Pension Plan*, 2010 WL 395823 (3d Cir. Feb. 5, 2010), that a welfare plan amendment which conditioned receipt of health care benefits on the non-receipt of an accrued benefit as a lump sum under a pension plan violated Section 204(g).

In *Battoni*,an underfunded Taft-Hartley pension plan cosponsored by IBEW Local 675 merged with an overfunded pension plan cosponsored by IBEW Local 102. The two unions' welfare plans also were merged. Prior to the merger, the Local 675 pension plan permitted participants to take their pension benefits in a lump sum, but Local 102 did not. After the merger, the Local 675 plan participants could still take a lump-sum pension with respect to the benefit accrued prior to the merger. However, as a result of an amendment to the welfare plans coinciding with their merger, participants electing a lump sum forfeited their right to retiree health benefits.

As reported in the September 2008 ERISA Litigation Newsletter, the district court concluded after a bench trial that the welfare plan amendment violated Section 204(g) and entered judgment in favor of the plaintiffs. *See* 2008 WL 3166697 (D.N.J. Aug. 8, 2008). The stipulated facts and testimony adduced at trial confirmed that the intent of this amendment was to accomplish indirectly what could not be done directly, *i.e.*, to impose a financial penalty for exercising the accrued right to take a

lump-sum pension payment. The district court relied on Treas. Reg. Section 1.411(d)-4, A-4(a), which prohibits the denial of protected accrued benefits through the "direct or indirect" exercise of discretion, and concluded that the welfare plan amendment constituted a "constructive, indirect and/or de facto amendment" to the pension plan. The welfare plan amendment, according to the court, indirectly effectuated an impermissible cutback to the accrued right to take a lump-sum benefit under the pension plan.

The Third Circuit agreed with the district court and affirmed judgment in favor of the plaintiffs. The court first observed that it has broadly construed actions that constitute an amendment in order to protect pension recipients. Next, the court observed that under ERISA § 3(2)(A), 29 U.S.C. § 1002(2)(A), an amendment amends a pension plan "*to the extent* that by its express terms or as a result of surrounding circumstances [it] provide[s] retirement income to employees, or . . . results in a deferral of income by employees for periods extending to the termination of covered employment or beyond[.]" (Emphasis added.) The court determined that the words "to the extent that" indicate that Congress intended to allow any plan or part of a plan to be considered a pension plan or a welfare plan and thus the "meaning and function" of the amendment determined whether it modified a pension plan, a welfare plan, or both. Here, the court concluded that the amendment was part of the welfare plan "to the extent" that it pertained to welfare benefits, *and* part of the pension plan "to the extent" that it pertained to pension benefits.

Having concluded that the amendment amended the pension plan to the extent it impacted pension benefits, the Third Circuit then determined that the amendment constituted an unlawful cutback in violation of Section 204(g), insofar as it conditioned the receipt of a lump sum benefit — an accrued benefit — on surrendering the right to retiree health benefits. In so ruling, the court relied on the Supreme Court's decision in *Cent. Laborers' Pension Fund v. Heinz*, 541 U.S. 739 (2004), which held that the imposition of a new condition on the receipt of an accrued benefit constitutes an impermissible cutback.

* * * *

At the moment, the decision in *Battoni* appears to be a single anomalous ruling. If other plaintiffs pursue the theory that a welfare plan may be used as a vehicle for indirectly cutting back pension benefits, however, there is a potential for this unprecedented expansion of the scope of Section 204(g) to proliferate. It is hoped that, in the face of such claims, the Third Circuit's decision would be limited to its unique facts, so that the "genie" is put back in its bottle.

Rulings, Filings and Settlements of Interest

- In *Unisys Corp. v. Adair, et al.*, (U.S. Feb. 22, 2010), the U.S. Supreme Court denied Unisys Corp.'s petition for *certiorari*, thus leaving intact the Third Circuit's ruling

that Unisys Corp. breached its fiduciary duties by failing to adequately disclose that it could terminate its retiree health plan. A detailed discussion of the Third Circuit's decision appears in the October 2009 ERISA Litigation Newsletter.

- On February 24, 2010, the Supreme Court issued a notice dismissing the petition in *Pollitt v. Health Care Serv. Corp.*, 558 F.3d 615 (7th Cir. Mar. 10, 2009), *certiorari granted* (Oct. 13, 2009). The notice stated that the parties agreed to dismiss the case, but did not describe the details of the parties' agreement. A detailed discussion of the Seventh Circuit's decision appears in the February 2010 ERISA Litigation Newsletter.
- In *Overby v. Nat'l. Assoc. of Letter Carriers*, 2010 WL 668852 (D.C. Cir. Feb. 26, 2010), the D.C. Circuit Court of Appeals held that a plan amendment that would have rendered plaintiff ineligible to receive benefits as a surviving spouse was not properly adopted and was therefore inoperative. In so ruling, the court concluded that the trustees did not follow all of the procedures required for adopting a plan amendment, which, in this case, included submitting the amendment to the fund's actuaries for an evaluation and cost estimate. The court rejected the trustees' argument that such a "procedural irregularity" did not warrant the amendment's invalidation unless there was evidence of "bad faith" or "active concealment."
- In *Trustees of the Electrical Workers Local No. 26 Pension Trust Fund v. Trust Fund Advisors, Inc.*, 2010 WL 558719 (D.D.C. Feb. 12, 2010), a district court held that the attorney-client privilege could apply to communications between the trustees and the fund's attorney that were made, or shared, in the presence of two of the fund's unpaid consultants. In order for the communications to be privileged, the court held, the consultants needed to have "specific functions and responsibilities that required hearing the advice of counsel and participating in privileged discussions with the Board and counsel." The court rejected defendants' argument that there could be no reasonable expectation of privacy for the communications because the consultants were unpaid, finding that, regardless of the contractual or financial arrangements, there is an expectation of privacy where the person "acts for the [client] and possesses the information needed by attorneys in rendering legal advice." Accordingly, the court ordered the documents be produced for an *in camera* review and a ruling on whether they were, in fact, privileged.
- In *SEC v. State Street Bank and Trust Co.,* No. 10-CV-10172 (D. Mass. Feb. 4, 2010), and *In re State Street Bank and Trust Co.* SEC, Admin. Proc. File No. 3-13776 (Feb. 4, 2010), State Street Bank and Trust Co. agreed to pay over $300 million to settle charges brought by the SEC and state regulators alleging that during the subprime mortgage crisis, State Street sent investors "misleading communications" concerning its exposure to subprime mortgage-backed securities. One of the principal allegations in the SEC's complaint was that State Street marketed

investments as more diversified than ordinary money market portfolios when, in actuality, these investments were invested heavily in subprime mortgage-backed securities. The settlement includes a civil penalty of $50 million, disgorgement in the amount of $7,331,020, pre-judgment interest in the amount of $1,019,161, and compensation to harmed investors in the amount of $250,240,472. According the SEC's press release, this payment is in addition to the approximately $350 million State Street has paid investors in settlement of private lawsuits.

Plaintiffs filed a motion for preliminary approval of a $13.8 million settlement in *Phones Plus, Inc. v. Hartford Life Ins. Co.*, No 3:06-cv-1835 (D. Conn. Feb. 11, 2010). In this suit a 401(k) plan administrator alleged that the revenue-sharing agreements between Hartford Life and the mutual funds it offered as investment vehicles to its plan administrator clients violated ERISA's fiduciary duties. In addition to cash, the proposed settlement includes several structural changes to Hartford Life's business practices, including: (i) removing from plan documents any language restricting a plan's ability to select investment options; (ii) adding language to plan disclosure documents noting the revenue-sharing agreements; and (iii) providing detailed information regarding the revenue-sharing rates paid by each mutual fund company to each putative class member.

[1] *See*, *e.g.*, *Hecker v. Deere & Co.,* 556 F.3d 575 (7th Cir. 2009) (affirming dismissal of plaintiffs' "excessive fee" claim at pleadings stage); *Young v. General Motors Investment Corp.,* 325 Fed. Appx. 31 (2d Cir. 2009) (same); and *Taylor v. United Technologies Corp.*, 2009 WL 4255159 (2d Cir. Dec. 1, 2009) (affirming summary judgment in favor of defendants on plaintiffs' "excessive fee" claim).

[2] In May 2008, nineteen months after the complaint had been filed, plaintiffs sought leave to amend the complaint to add additional claims and defendants. The Court denied this request, prompting plaintiffs to file a second, separate action against the same defendants as well as a number of additional defendants. This separate action, *George v. Kraft Foods Global, Inc.*, No. 08-cv-03799 (N.D. Ill.), is currently pending in the same court but before a different judge. One month prior to the Court granting summary judgment in defendants' favor in the first suit, the Court denied, in part, the defendants' motion to dismiss some of the very same claims in the second suit. *George v. Kraft Foods Global, Inc.*, 2009 WL 4884027 (N.D. Ill. Dec. 17, 2009).

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