EMPLOYEE BENEFITS UPDATE

By

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I. Year-End Plan Amendments for Retirement Plans

A. Taxable Rollovers to Designated Roth Accounts. A provision in the Small Business Jobs Act of 2010 added Code Section 402A(c)(4), which permits Section 401(k) plans and Section 403(b) plans which include a qualified Roth contribution program to allow individuals to rollover amounts from their accounts other then designated Roth accounts to their designated Roth accounts in the plan. Although such rollovers are taxable, the taxable amount for such rollovers that were made in 2010 may be divided so that half of the taxable amount may be reported in 2011 and half in 2012, unless the taxpayer elects to include the taxable amount in gross income in 2010. To give plan sponsors sufficient time to adopt plan amendments and thereby enable plan participants to make in-plan Roth rollovers before the end of 2010, the Internal Revenue Service extended the deadline for adopting a plan amendment authorizing in-plan Roth rollovers to December 31, 2011, provided that the amendment by its terms is effective as of the date the plan first operated in accordance with the amendment. Thus, plan sponsors which permitted participants to make in-plan Roth rollovers within their plans in 2010 must adopt the amendment authorizing such rollovers by the end of the year.

B. Waiver of 2009 Required Minimum Distributions. A section of the Worker, Retiree, and Employer Recovery Act of 2008 added Section 401(a)(9)(H) to the Internal Revenue Code, which provides that the uniform minimum distribution requirements that generally apply to participants who have attained age 70½ do not apply to defined contribution plans and individual retirement arrangements (IRAs) for 2009. For plan sponsors which permitted their participants to waive the uniform minimum distribution requirements that would otherwise have been imposed by the required provisions of their plan, the statute permits plan amendments authorizing such waivers to be adopted until the end of the plan year beginning in 2011, which for plans with calendar-year plan years is December 31.

II. Changes in Annual Dollar Limits for Qualified Retirement Plans and IRAs. Each year applicable to various plan contributions and benefits are adjusted for the cost-of-living. On October 20, 2011, the Internal Revenue Service announced the dollar limitations for retirement plans for 2012. Tab 1 of this outline sets forth those annual dollar limits, together with the dollar limits that have applied over the past few years. Among the more significant changes are the following:

A. Compensation limit: $250,000.00
B. Elective deferral limit: $17,000.00
C. Annual contribution limit for defined contribution plans: $50,000.00
D. Annual benefit limit for defined benefit plans: $200,000.00
E. Threshold for highly compensated employees: $115,000.00
F. Social Security taxable wage base: $110,100.00

III. Fiduciary Duties under ERISA. A fiduciary under ERISA is obliged to discharge his, her or its duties with respect to the Plan solely in the interest of the participants and beneficiaries: (a) for the exclusive purpose of providing benefits to participants and their beneficiaries and defraying reasonable expenses of administering the plan; (b) with the care, skill, prudence and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims; (c) by diversifying the investments of the plan to minimize the risk of large losses, unless under the circumstances, it is clearly prudent not to do so; and (d) in accordance with the documents and instruments governing the plan insofar as such documents and instruments are consistent with the provisions of ERISA. In addition, a plan fiduciary must avoid engaging in prohibited transactions that involve assets of the plan.

A. Litigation Has Become Common. In recent years, as financial markets have grown more volatile and the investment climate more challenging, litigation over alleged mismanagement of plans unfortunately has become common. In this environment, a number of class actions were instituted in the last few years against well-known companies, and interest groups brought pressure on Congress and the United States Department of Labor to focus greater attention on third-party administrative and investment service providers for employer-sponsored retirement plans and the fees those providers charge retirement plans, particularly where the fees are paid by offsetting or deducting them from participant investment returns. Indeed, we have seen the results of some of this litigation and increased regulatory scrutiny very recently.

B. Recent Caterpillar Inc. Settlement. In August 2010, Caterpillar Inc. reached a $16,500,000.00 settlement in a class action brought by its employees, who accused it of breaching its fiduciary duty under ERISA. The case dates back to September 2006 and was one of the first ERISA breach of fiduciary duty class actions brought against a number of Fortune 100 companies. In the case, a group of Caterpillar workers sued the company in the United States District Court for the Central District of Illinois alleging that Caterpillar's retirement plan administrators breached their fiduciary duty by (1) selecting investment options with excessive and unreasonable fees, (2) selecting investment funds managed by a subsidiary of Caterpillar Inc. for Caterpillar Inc.'s benefit rather than for the benefit of participants of the plan, and (3) failing to make disclosures to plan participants regarding fees deducted from participant investment returns.

C. Final Department of Labor (DOL) Regulations Imposing Fee – Disclosure Requirements. Another development with broader impact was the Department of Labor's adoption and release of long-awaited regulations on July 15, 2010 imposing fee-disclosure requirements on third-party administrative and investment service providers to employer-sponsored retirement plans. A summary of the new regulations are attached under Tab 2. These regulations are intended to make it easier for plan fiduciaries to assess the reasonableness of the compensation paid for administrative and investment services that plan fiduciaries purchase in order to properly manage their plans and to highlight potential conflicts of interest that may affect a provider's performance. (The regulations place the principal burden of disclosure upon third-party service providers, but, of course, plan fiduciaries are still obliged to become familiar with these new requirements to discharge their fiduciary duties.) The Department of Labor recently extended the effective date for compliance with these regulations. Under the extension, all contracts or arrangements that fall within the scope of the rule must be in compliance by April 1, 2012.

1. DOL Regulations Requiring Reporting of Plan Fees. It should be noted that these regulations were only the second installment of a three-part initiative of the United States Department of Labor related to the disclosure of plan fees. The first part, which was published in 2009, dealt with reporting of plan fees on Schedule C to the Form 5500 Annual Report/Return.

2. Final DOL Regulations Requiring Disclosure of Fees at the Participant Level. The third and final part of the initiative was the Department of Labor's adoption and release of another set of long-awaited final regulations on October 15, 2010, which require the disclosure of fees at the participant level. A summary of the new regulations is attached under Tab 3. The final regulations apply to all participant-directed individual account plans subject to ERISA, not just those that have elected to comply with ERISA Section 404(c). Individual account plans that do not permit participant investment direction are not covered by the regulations. Due to a recent extension of the effective date for compliance by the Department of Labor, the initial disclosures that are required at or before the time a participant or beneficiary can first direct his or her investments must be furnished no later than April 1, 2012.

D. DOL Regulation Defining "Fiduciary" to be Re-Proposed. In recent months, the Department of Labor issued a proposed regulation that would substantially expand the circumstances in which a person who renders investment advice to a plan or to an individual retirement account (IRA) will be considered to be a fiduciary under ERISA and the Internal Revenue Code.

1. The proposed regulation is intended to replace final DOL regulations defining the circumstances in which a person is considered an investment-advisor fiduciary, which is not been updated since 1975. The preamble to the proposed regulation stated that DOL issued the new

proposed regulation largely because it does not believe "the current framework represents the most effective means of distinguishing persons who should be accountable as fiduciaries from those who should not."

2. The initially proposed regulation was met with expressions of concern from both the private sector and Congress. Numerous lawmakers strongly urged the regulatory agencies to withdraw and re-propose the regulations after a comprehensive economic impact study could be performed. In September, the Department of Labor announced that it will re-propose the regulation revising the definition of the term "fiduciary" in early 2012. It is expected that the new rule will: (i) clarify the scope of the rule regarding individualized advice directed to specific parties (ii) address concerns regarding routine appraisals of the value of securities or other property; (iii) clarify the scope of the rule with respect to arms' length transactions; (iv) provide an exemption for current fee practices of brokers and advisors; and (v) maintain current exemptions allowing brokers to receive commissions in connection with mutual funds, stocks and insurance products.

IV. <u>Litigation Update</u>

A. <u>LaRue v. DeWolff, Boberg & Associates, Inc., 552 U.S. 248 (2008)</u>. In this case, the United States Supreme Court held that a participant in a defined contribution plan could bring a claim under ERISA for individualized relief for a fiduciary breach. The claim was based on losses that resulted when the plan administrator allegedly failed to make changes to investments in the participant's plan account that the participant had directed. The court held that a claim may be made under Section 502(a)(2) of ERISA, which requires a fiduciary to make good any losses to a plan caused by a breach of fiduciary duty. *This case is viewed as an expansion of the rights of participants to seek remedies on an individualized basis. Previously, it was widely believed that the only possible relief available was relief to protect the plan as a whole*.

1. <u>Claim Made</u>. The participant claimed that he directed the plan administrator to make changes to the investments in his plan account but that these directions were never carried out. The participant sued the employer and the plan, claiming that the plan administrator's failure "depleted" his interest in the plan by approximately $150,000.00 and amounted to a breach of fiduciary duty under ERISA.

2. <u>Lower Courts' Decisions</u>. The case was dismissed on the pleadings by the District Court, finding that the participant's request for remedy was not available under ERISA, and the Court of Appeals affirmed the finding that the participant could not qualify for relief under ERISA Section 502(a)(2). The Court of Appeals based its decision on a 1985 Supreme Court decision called *Massachusetts Mutual Life Insurance Company v. Russell* in which the Supreme

Court stated that suits under Section 502(a)(2) are aimed at protecting "the entire plan, rather than the rights of an individual beneficiary." LaRue then petitioned the Supreme Court, which reversed and remanded.

3. Decision and Holding. The Supreme Court acknowledged that the language in the prior decision appeared to support the result reached by the Court of Appeals, but it ruled that, because of the different type of plan involved in the case under consideration, the result is different. It noted that in the earlier case the plan provided a fixed monthly benefit (*i.e.*, a defined benefit) and that the claim in that case was not for reduced benefits but for damages from a delay in payment of the promised benefits. In contrast, in the case under consideration, the plan was an individual account plan, and the participant's claim was that he did not receive the proper amount of benefits due to the alleged failure of the plan administrator. The court specifically held that ERISA Section 502(a)(2) authorizes recovery for fiduciary breaches that impair the value of plan assets in a participant's individual account.

B. Hecker v. Deere & Co., 556 F.3d 575 (7th Cir. 2009). In this case, the United States Court of Appeals for the Seventh Circuit held that participants in a defined contribution plan failed to state a claim for breach of fiduciary duty: (1) against the plan administrator in alleging that the plan administrator failed to disclose to participants of the plan that expenses paid to managers of investment funds were shared with the trustee and recordkeeper of the plan as compensation for its trust and administrative services (instead of the trustee being paid directly by the plan sponsor for such services); (2) against the plan administrator, trustee and investment advisor in alleging that the plan administrator, the trustee and investment advisor only made available to participants selected investment options for the plan with unreasonably high fees.

1. Increasing Number of Claims of Mismanagement of Defined Contribution Plans. At the beginning of its opinion, the court noted that, even before the stock market began its precipitous fall in early October 2008, litigation over alleged mismanagement of defined contribution plans was becoming common and that this type of litigation received a boost when the Supreme Court decided *LaRue v. DeWolff, Boberg & Associates, Inc.* (see Part II above), which held that a participant in a defined contribution pension plan may sue a fiduciary whose alleged misconduct impaired the value of plan assets and the participant's individual account.

2. Issues Broadly Stated. The court further stated that the case before it required it to look into two questions: first, how broad is the sweep of actionable misconduct; and second, does someone who serves as the manager and investment advisor for a 401(k) plan or for some of the plan's investment options owe fiduciary duties to

the plan sponsor's employees.

3. Claims Asserted. Plaintiffs sued both individually and for a class of participants, asserting that Deere, as plan sponsor and plan administrator, violated its fiduciary duty under ERISA by failing adequately to disclose the fee structure to plan participants and by selecting investment options that required the payment of excessive fees and costs. Plaintiffs also sued Fidelity Management Trust Company (Fidelity Trust), the directed trustee and recordkeeper for the plan, and Fidelity Management and Research Company (Fidelity Research), the investment advisor for the mutual funds offered as investment options under the plan, on the theory that they were functional fiduciaries of the plan with respect to the selection of investment options, the structure of the fees or the provision of information regarding the fee structure.

4. Facts. The plan was sponsored by Deere, which in turn engaged Fidelity Trust to serve as trustee. Fidelity Trust was required to advise Deere on what investments to include in the plan, to administer the participant's accounts and to keep records for the plan. The plan offered a generous choice of investment options for plan participants; the menu included 23 different Fidelity mutual funds, 2 investment funds managed by Fidelity Trust, a fund devoted to the stock of Deere, and a Fidelity-operated facility called BrokerageLink, which gave participants access to 2,500 additional funds managed by different companies. Fidelity Research advised Fidelity mutual funds offered by the plan. Each plan participant decided where to invest the money credited to his or her account, the only limitation being that the investment vehicle had to be one offered by the plan. Each investment fund available charged a fee calculated as a percentage of assets the investor placed with it. Fidelity Research shared its revenue, which it earned from the mutual funds fee, with Fidelity Trust, which in turn compensated itself through those shared fees rather than through a direct charge to Deere for its services as trustee.

5. Lower Court's Decision. The District Court disposed of the case on the pleadings, ruling that the complaint failed to allege facts sufficient to state a claim.

    a. Failure to Disclose Revenue-Sharing Arrangement. With respect to the plaintiff's claims against Deere, the District Court found nothing in the statute or regulations that required Deere to disclose the fact that Fidelity Research was sharing part of the fees it received with its corporate affiliate, Fidelity Trust, and held that materials that were furnished to plan participants, which disclosed the expenses actually paid to fund managers, were sufficient. The court noted that there were proposals by the United States Department of Labor to amend its regulations so that revenue sharing arrangements would be disclosed (see Part IV, below), but the fact that they had not yet been adopted made it clear to the court that the present rules imposed no such disclosure obligation. The District Court rejected the argument that disclosure of the revenue-sharing arrangement was required as a general matter of ERISA law.

b. <u>Alleged Imprudent Selection of Investment Options</u>. With respect to the assertion that Deere and the Fidelity companies breached their fiduciary obligations by selecting investment options with unreasonably high fees, the court found that ERISA Section 404(c), which provides what the court characterized as a "safe harbor" for fiduciaries when the qualified plan permits the participants to exercise control over their assets, provided the defendants with an affirmative defense and concluded that the facts alleged in the pleadings were sufficient to apply that defense.

c. <u>Fidelity Trust and Fidelity Research</u>. Finally, the District Court held that because plaintiffs had failed to state a claim against Deere for breach of fiduciary duty for failure to disclose or for the selection of investment options, the Fidelity companies could not be held liable either. The District Court added that neither Fidelity defendant had fiduciary responsibilities with respect to either of the tasks plaintiffs targeted.

6. <u>Decision regarding Fidelity Trust and Fidelity Research</u>. On appeal, the court, construing the complaint in the light most favorable to the plaintiffs and accepting as true all well-pleaded facts alleged, and drawing all possible inferences in plaintiffs' favor, held that neither Fidelity Trust nor Fidelity Research were functional fiduciaries of the plan because there were no allegations that either exercised discretionary authority or control over the management of the plan, disposition of its assets or the administration of the plan. The court stated that this left it with the claim against Deere, which could be reduced to two assertions: (1) that Deere breached its fiduciary duty by not informing the participants that Fidelity Trust received money from the fees collected by Fidelity Research; and (2) that Deere imprudently agreed to limit the investment options to Fidelity Research funds and therefore only offered investment options with excessively high fees.

7. Decision regarding Revenue-Sharing Arrangement. The *Hecker* court characterized as critical to the plaintiffs' case their assertion that Deere and Fidelity had a duty to disclose the revenue-sharing arrangement that existed between Fidelity Trust and Fidelity Research. The Court of Appeals agreed with the finding of the District Court that the revenue-sharing arrangement violated no statute or regulation, noting that the participants were told about the total fees imposed by the various investment funds and that they were free to direct their dollars to lower-cost investment options if that was what they wished to do. The court held that plaintiffs failed to state a claim against Deere based on the revenue-sharing arrangement and the lack of disclosure about it and further held that the omission of information about the revenue-sharing arrangement was not material because Deere disclosed to the participants the total fees for the funds and directed the participants to the fund prospectuses for information about fund-level expenses.

8. Decision regarding Alleged Imprudent Selection of Investment Options. Turning next to the contention that Deere violated its fiduciary duty by selecting investment options with excessive fees, the court noted that there was a wide range of expense ratios respecting the mutual funds, running from the .07% at the low end to just over 1% at the high end. The court stated it was significant that all of these funds were also offered to investors in the general public and that the expense ratios were therefore necessarily "set against the backdrop of market competition." In these circumstances, the court held that, taking the allegations in the complaint in the light most favorable to the plaintiffs, there was no breach of a fiduciary duty on Deere's part.

C. Howell v. Motorola, Inc. and Lingis v. Dorazil (7th Cir. 2011). In these cases, the United States Court of Appeals for the Seventh Circuit held that the "safe harbor" in ERISA Section 404(c) shielded the fiduciaries of the Motorola 401(k) Plan from claims by the plaintiffs that the defendants failed to disclose sufficient information about an allegedly bad business transaction and that certain defendants failed to monitor the conduct of fiduciaries who they had appointed.

1. Claims Made. The principal claim made by the plaintiffs in these cases was that the defendants, alleged fiduciaries of the Motorola 401(k) Plan, breached their fiduciary duty by continuing to offer as one of the investment options to plan participants the Motorola Stock Fund, a fund that exclusively held Motorola common stock, in spite of their knowledge that Motorola had engaged in a bad business transaction that was not known by the general public. The plaintiffs also alleged that the defendants misrepresented material information about the bad business transaction and failed to monitor plan committee members who were

responsible for administering the Motorola 401(k) Plan.

2. Court's Decision and Holding. The trial court granted the defendants' motion for summary judgment. On appeal, the Court of Appeals ruled that one plaintiff's release agreement, which was signed as part of a reduction in force, barred his breach of fiduciary duty claims despite a carve-out for claims for "benefits" under the company's plans. The court also held that the safe harbor in ERISA Section 404(c) shielded fiduciaries of the plan from claims by the plaintiffs that the defendants failed to disclose sufficient information about an allegedly bad business transaction and that certain defendants failed to monitor the conduct of the fiduciaries that they had appointed. The court also determined that the fiduciaries did not violate ERISA's duty of prudence by continuing to include the Motorola Stock Fund as an investment option in the 401(k) plan despite the fact that the value of the stock dropped substantially during the relevant period, because Motorola stock never performed so poorly as to make it an imprudent investment option.

3. Significance of the Decision and Holding. The court's opinion in this so-called "stock-drop case" reaffirms the importance of compliance with ERISA Section 404(c). This safe harbor provision can provide 401(k) plan sponsors with protection if decisions regarding the prudence of the selection of investments for plan assets are later challenged, *although the Court correctly declined to apply the safe harbor to the initial decision to include particular investment options in a plan*. The Court's ruling on the applicability of the release agreement is also significant because, it enhances the value of a well-drafted severance agreement. Moreover, the ultimate holding on the imprudent investment claim sets a high bar for plaintiffs. Essentially, the Court of Appeals for the Seventh Circuit has said that to recover on an imprudence theory, a plaintiff in a stock-drop case must show that the employer has to be on the verge of collapse and that only worthless or extremely risky stocks will be deemed to be imprudent investment options. Clearly, this is a significant limitation on stock-drop cases, as well as other cases challenging the prudence of particular investment options in 401(k) plans.

D. Spano v. The Boeing Co. and Beesley v. International Paper Co. (7th Cir. 2011). In these cases, the Court of Appeals for the Seventh Circuit vacated nearly identical orders which certified classes of virtually all plan participants who were asserting claims that challenged the appropriateness of certain 401(k) plan fees and the prudence of plan investment options.

1. Decision. The Court of Appeals found that the certified classes failed to meet the "adequacy" requirement and the "typicality" requirement of Rule 23(a) of the Federal Rules of Civil Procedure, which governs the procedural requisites of a class action in the federal courts.

2. Holding and Its Significance. With respect to the failure to

meet the typicality requirement, the court noted that many of the members in the class that had been erroneously certified by the lower court had never had stock in the particular stock funds at issue in the complaint. The court further held that the plaintiffs failed to demonstrate adequacy of representation where the scope of class members was too broad, because the relief sought by the named plaintiffs could have harmed other class members. Thus, the opinion in these cases strongly suggests that a class that encompasses all participants in a 401(k) plan often may well be too broad given the wide variety of investment practices and dates of participants' entry and exit from a plan.

E. Peabody v. Davis (7th Cir. 2011). In this case, the plaintiff brought an action against the fiduciaries of the company retirement plan into which the plaintiff had rolled over funds from an individual retirement account (IRA) when he became employed by the company and elected to invest 98% of his account in the common stock of the company.

1. Facts. The company was a closely held corporation, the plan trustees were responsible for determining the value of the company stock from time to time, and participant-directed investing of the plan assets was not authorized. When the plaintiff first became a participant in the plan and invested most of his IRA account in company stock in 1999, a share of stock was valued at $2,000.00 per share. Over time, however, the stock severely depreciated in value as the company's profit margins declined by 70% to 80% due to regulatory changes that undermined the company's business model. The participant left the company and sought a distribution in 2004. The company never made the distribution and went out of business in 2005.

2. Lower Court's Decision. Although the trial court found that the defendants had no express duty to diversify the investment of plan assets, it held that the defendants violated their fiduciary duty of prudence by maintaining the investment in the stock of the closely held corporation throughout its decline, because a prudent investor would not have remained 98% invested in company stock in view of the knowledge that the core business model of the company was seriously undermined throughout the relevant time period. In addition, the trial court found that the defendants breached their fiduciary duty by failing to distribute the plaintiff's benefit.

3. Decision and Holding. On appeal, the Court of Appeals for the Seventh Circuit held that the record contained sufficient evidence to support the trial court's judgment in favor of the plaintiff based on the claim that the plaintiff incurred losses due to the trustee's breach of their fiduciary duty in managing the assets of the plan by continuing to hold company stock as an investment. Although the court upheld the judgment in favor of the plaintiff, it remanded the matter to the trial court for a different calculation of damages in order to account for a gradual

withdrawal of company stock as an investment rather than calculating damages based on a one-time sale of all of the stock at a specific point in time, as the trial court had calculated damages in its first effort.

4. Significance of the Decision and Holding. It is significant to note that the court found that the plan was not designed to take advantage of the protection under ERISA Section 404(c), which renders plan fiduciaries not liable for plan losses attributable to a participant's own investment decisions when the plan is properly designed to afford participant-directed investing. *This case highlights the point that where ERISA Section 404(c) does not apply, it may well be imprudent for a plan sponsor to even provide the option of investing in employer stock.*

F. George v. Kraft Foods Global, Inc. (7^{th} Cir. 2011). In this case, a class action lawsuit for breach of fiduciary duty involving allegations of insufficient investment returns and excessive plan expenses was sent back to the district court for further consideration after the Court of Appeals for the Seventh Circuit, by a 2-1 vote, reversed portions of the district court's grant of summary judgment favoring the plan fiduciaries of the 401(k) plan. A strong dissent was filed, arguing that the district court's grant of summary judgment in favor of the defendants should be affirmed.

1. Facts. Kraft Foods Global, Inc. ("Kraft") maintained a 401(k) plan, which allowed participants to direct their plan contributions into one or more mutual funds. Two of the funds were company stock funds, one of which invested almost exclusively in the common stock of Kraft, and the other of which invested almost exclusively in the common stock of Kraft's then parent company, Altria Group, Inc. (formerly Phillip Morris). The plan administrators for the plan hired various service providers, including a recordkeeper, Hewitt Associates ("Hewitt"), and a trustee, State Street Bank & Trust Company ("State Street"). The fees of both Hewitt and State Street were paid out of plan assets.

2. Claims Asserted. A group of plan participants brought a class action lawsuit against Kraft and various individual and entities associated with the plan (collectively referred to below as the "fiduciaries") claiming that the fiduciaries: (1) mismanaged the company stock fund by having a "unitized" fund instead of "real time trading;" (2) caused the plan to overpay Hewitt by not having periodic, full blown competitive bidding for those services; and (3) paid excessive trustee fees to State Street by allowing it to keep the float on the cash account of the plan without knowing the amount of the float.

3. Lower Court's Decision. The federal district court granted summary judgment in favor of the fiduciaries, and the plaintiffs appealed.

4. Decision and Holding

a. Mismanagement of Common Stock Funds. For the Kraft plan, the two common stock funds were operated on a "unitized" basis, meaning that participants owned units of the fund rather than shares of the underlying common stock. A unified fund invests almost exclusively in company stock, but it invests a small amount of cash (in this case, up to 5%) as a liquidity buffer. In a unitized fund, participant transactions may be immediately implemented without the need to wait three days for a market trade to settle, and daily transactions may be "netted" so that the plan need not go into the market and pay a brokerage commission and fees on each transaction. The plaintiffs complained that, because of the cash buffer in the stock funds, the common stock funds underperformed as compared to a direct investment in the common stock of the company by almost $84,000,000.00 over the course of an eight-year period. (This alleged underperformance was referred to in the opinion as "investment drag.") In addition, the plaintiffs argued that transaction costs of market trades are charged against the entire company stock fund and, thus, participants who seldom trade in company stock end up subsidizing the costs of participants who trade frequently (this alleged built-in disparity was referred to in the opinion as the "transactional drag"). The plaintiffs argued that the fiduciaries of the plan failed to minimize or eliminate the investment drag and transactional drag and breached their fiduciary duties to act prudently. Specifically, plaintiffs claimed that the fiduciaries failed to exercise their discretion under circumstances in which a prudent fiduciary would have done so. The court found that their was a genuine issue of material fact as to whether the fiduciaries had breached the prudent man standard of care by failing to make a reasoned decision under circumstances in which a prudent fiduciary would have made a decision and reversed the district court's grant of summary judgment on the mismanagement claim, remanding the claim to the district court for further consideration.

b. Claim of Excessive Recordkeeping Fees. The plaintiffs' next claim was that the plan fiduciaries had acted imprudently in connection with the fees paid to the plan's recordkeeper, Hewitt Associates, by failing to solicit competitive bids for recordkeeping services on a periodic basis, resulting in Hewitt receiving an excessive fee after its initial contract term had expired. In particular, Kraft had hired Hewitt in 1995 under a five-year contract and had subsequently hired Buck Consultants to evaluate the proposed renewal terms with Hewitt, but did not obtain actual fee quotes for comparison. Buck Consultants noted that Hewitt's fees did not appear to pass on savings gained from Hewitt's familiarity with the plan or economies of scale as the number of participants grew, and Buck recommended a tiered pricing structure where per-participant fees decline as the number of participants increased. Nevertheless, Buck stated that the fees charged by Hewitt seemed to be fair if Kraft, as the plan sponsor and plan administrator, was satisfied with the level of service. In the absence of competitive bids, the Court of Appeals held that a trier of fact could reasonably conclude that the plan fiduciaries had not satisfied their duty to ensure that the recordkeeping fees were reasonable and therefore reversed the lower court's grant of summary judgment on that issue, remanding that issue for further proceedings in the trial court.

c. Claim of Excessive Trustee Fees. The final claim by the plaintiffs involved the compensation paid to State Street for its trustee services. In addition to paying State Street a fee, the plan allowed State Street to retain interest income from funds that remained on deposit at State Street pending clearance of checks written on plan assets (referred to as "float"). Until a check cleared, those funds could be used on a short-term basis to generate income. Under the agreement with State Street for trust services, State Street was allowed to retain the income earned from float. Absent such an agreement, the float income would have been property of the plan. Plaintiffs argued that the fiduciaries failed to determine how much float income State Street was actually earning and that, unless the fiduciaries knew that amount, they could not satisfy their fiduciary duty to ensure that the total compensation paid for trust services was reasonable. The court affirmed the district court's grant of summary judgment because there was no evidence that the plan fiduciaries did not know the amount of the float.

G. CIGNA Corp. v. Amara (U.S. Supreme Court, May 16, 2011). On Monday, the United States Supreme Court issued its long-awaited opinion in this case, the primary issue of which was whether participants who are members of a class action lawsuit must prove detrimental reliance on an inaccurate summary plan description (SPD) in order to receive a remedy under ERISA or whether mere proof of "likely harm" is enough to justify relief.

1. Facts. CIGNA Corp. converted its defined benefit pension plan, which provided a retiring employee with a defined benefit in the form of an annuity calculated on the basis of his preretirement salary and length of service, into a cash balance plan in 1998. Each participant's defined benefit was frozen, and new "opening balances" were established under the new cash balance plan. Opening balances for some of the participants of the plan were less than their frozen accrued benefits under the defined benefit pension plan, creating a "wear-away" aspect in the way future benefits under the new cash balance plan were earned or accrued. The SPD failed to disclose the wear-away aspect of benefit accrual, so it

was not evident to participants that all future benefit accruals were not in addition to their frozen accrued benefits under the defined benefit plan until later. Upon learning of the difference between the opening balance of benefits provided in the new plan document, which, as noted, in some cases were less than the frozen accrued benefit under the defined benefit pension plan, plaintiffs brought a class action suit challenging the benefits provided under the new plan, claiming in part that CIGNA had failed to give them proper notice of changes to their benefits, particularly because the new plan in certain respects provided them with less generous benefits.

2. Lower Court Decision. The district court held that the cash balance conversion was unlawful because of the failure of the SPD to disclose the wear-away feature. The court stated that the actual disclosures created a "reasonable expectation" that the frozen defined benefit pension benefits would remain and that additional benefits earned under the converted plan going forward would begin to accrue immediately and would be in addition to the frozen accrued benefits under the defined benefit pension plan, without any need for wear-away. Because the SPD was misleading, the district court held that it was incorporated into the terms of the plan itself, and the participants could therefore sue to recover benefits due under the terms of the plan if the defective SPD caused "likely harm." In so ruling, the district court held that the participants action was based upon ERISA Section 502(a)(1)(B), which provides that a participant or beneficiary of a plan may sue "to recover benefits due under the terms of [the] plan." The lower court held that "likely harm" is a proper standard and that, in this case, class members were likely harmed. The court stated that when likely harm is shown, the burden shifts to the defendant to prove no harm in individual cases. The court ordered CIGNA to reform its records to reflect benefit accruals calculated by adding to the amounts of frozen accrued benefit under the defined benefit plan benefits earned after the conversion to a cash balance plan (i.e., no wear-away) and that CIGNA give each participant a new benefit statement and issue a new SPD. On appeal to the Court of Appeals for the Second Circuit, that court affirmed the decision and holding of the lower court.

3. Supreme Court Decision. The Supreme Court granted certiorari, framing the issue as follows: "Must participants show actual detrimental reliance on the SPD, or is the showing of "likely harm" sufficient, switching the burden of proof to CIGNA to show the deficiency in the SPD was harmless?"

a. Plaintiffs' Arguments. The plaintiffs argued that every court that has ruled on the issue has held that the SPD trumps the plan document and that, as the drafter of the SPD, the plan sponsor must bear the burden of inconsistency. The plaintiffs further argued that the SPD is not an amendment to the plan but rather is one of the plan's governing instruments, and it controls. The plaintiffs therefore asserted that they were entitled to recover under ERISA Section 502(a)(1)(B), authorizing suits for benefits due under the terms of the plan. From a policy standpoint, the plaintiffs argued that companies should not be allowed to deliberately mislead plan participants, that CIGNA could have corrected the SPD immediately, which in this case would have excused the inconsistency, and that individual demonstrations of detrimental reliance are completely unworkable in a class action involving thousands of participants.

b. CIGNA's Arguments. On the other hand, CIGNA argued that the SPD is not the plan, that it is a summary of the plan and that participants may only sue under ERISA Section 502(a)(1)(B) under the *plan*, not under the *summary*. CIGNA pointed out that ERISA repeatedly treats the SPD, which is provided by the plan administrator, differently from the "written instrument" under which the plan is maintained and which is written by the plan sponsor. CIGNA further stated that the plan sponsor can only amend the plan by following the amendment procedure and not by issuing an SPD inconsistent with the plan. CIGNA further noted that the SPD explicitly states that, in the event of a conflict, the plan document controls. CIGNA therefore asserted that relief should only be available under ERISA Section 502(a)(3), which only authorizes equitable relief, not money damages. The policy reasons CIGNA stated in support of its arguments were that giving participants the better of what the plan document provides or what the SPD provides is inconsistent with ERISA's principles of fairness, that each participant should be required to show detrimental reliance, as in a common law action for economic tort based on misrepresentation, and that if participants were permitted to recover based on an inconsistency between the SPD and the plan document, regardless of detrimental reliance, the actuarial soundness of defined benefit pension plans would be threatened, and the effect would potentially jeopardize the pension rights of others legitimately entitled to receive them.

c. Decision and Holding. The Supreme Court vacated the federal district court's ruling that had ordered CIGNA to reform its pension plan as a remedy for the plan administrator's violations of ERISA. The Court held that ERISA Section 502(a)(1)(B), which allows participants and beneficiaries to bring lawsuits to enforce the "terms of the plan," does not authorize relief in this case. The notice or disclosure violations occurred in the SPD issued to plan participants. The Court found that an SPD is not itself a "plan" that can be enforced under Section 502(a)(1)(B) of ERISA. The majority opinion went on to say that ERISA Section 502(a)(3), which authorizes equitable remedies, could possibly provide remedies to the plan participants of CIGNA in this case but that the district court would have to determine that upon remand.

H. <u>In Re Citigroup ERISA Litigation (Gray v. Citigroup, Inc. and Gearren v. McGraw-Hill Cos. (2nd Cir. 2011)</u>. The United States Court of Appeals for the Second Circuit recently adopted the "presumption of prudence" that had been previously applied in other federal circuits.

1. <u>Facts</u>. In both cases, the sponsoring businesses offered employer stock as an investment option in their defined contribution plans. In the Citigroup case, the company had invested extensively in subprime mortgages and securities related to subprime mortgages in the mid-2000s. When the subprime mortgage market collapsed, Citigroup lost tens of billions of dollars in subprime mortgage-related investments resulting in a loss of 52% of its value during the period in question. The employees alleged that Citigroup and the investment and administration committees for the plans involved knew the company would sustain heavy losses but failed to tell employees and investors about the company's vast subprime loan loss exposure. Similarly, in the McGraw-Hill class action, the plaintiffs alleged that McGraw-Hill Cos. and its leadership knew or should have known that the company's stock was likely to decline sharply in value when it was revealed that the company's financial services division, Standard & Poors (S&P), had given improperly high credit ratings to complex financial instruments like residential mortgage-backed securities and collateralized debt obligations. From December 2006 through early December 2008, the McGraw-Hill stock declined approximately 64%. In both cases, the district court granted the defendants' motions to dismiss all claims, relying on the presumption of prudence in cases where businesses offer employer stock in their defined contribution plans.

2. <u>Holding</u>. <u>The Court of Appeals holding</u>. The Court of Appeals for the Second Circuit affirmed the dismissal of both cases, ruling that the presumption of prudence can only be overcome where there is a "dire situation" objectively foreseeable. The court further held that the presumption can be applied at the pleading stage. In both cases, the court held that the plaintiffs did not plead sufficient facts to overcome the presumption, noting that a fiduciary's actions must be judged at the time of the investment decision and that the "bad" business decisions cited were not sufficient to show that the companies were in a dire situation. The court also noted that fiduciaries have no duty to provide plan participants with nonpublic information that could pertain to the expected performance of plan investment options.