Recent ERISA Litigation Involving Financial Institutions – Risks Uncovered and Lessons Learned*

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Whenever significant losses are suffered by funds or accounts managed on behalf of ERISA plans, whether as a result of events adversely affecting specific securities or assets, or as a result of a general market decline, there often is a rise in ERISA fiduciary litigation against investment service providers to ERISA plans. The current market meltdown is no exception. Several factors contribute to this phenomenon:

(i) ERISA imposes duties on plan fiduciaries in selecting and monitoring service providers;

(ii) Named fiduciaries of plans may risk fiduciary liability for themselves if they do not take prudent steps (which may go as far as initiating litigation on behalf of the plan) to identify and remedy breaches by co-fiduciaries and other service providers;[1]

(iii) One of the principal remedies available under ERISA to redress fiduciary breaches is a make-whole obligation,[2] which may be a particular risk for investment fiduciaries whenever there are losses;

(iv) ERISA's heightened standards of care, strict conflict-of-interest prohibitions, complex prohibited transaction rules, and other technical requirements increase the risk that plaintiffs can allege breaches of ERISA to support the make-whole claim;

(v) Litigants also may allege that investments that are out of compliance (even in an immaterial way) with the governing investment agreement, fund agreement or investment guidelines are, for those reasons alone, sufficient to state a claim for a fiduciary breach under ERISA;[3] and

(vi) Due to ERISA's rules, a contractual provision that purports to exculpate or indemnify a fiduciary may not be enforceable if it is not properly drawn, and particularly so if that provision provides for indemnification out of plan assets for ERISA breaches. [4]

Dozens of ERISA fiduciary breach suits have been filed over the past year-and-a-half against investment fiduciaries that are attributable in some way to the market meltdown, seeking recovery for losses aris-

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ing out of investments in such assets as sub-prime mortgage-backed securities,[5] failed hedge funds,[6] securities lending collateral,[7] and funds and products that are affiliated with the investment fiduciary.[8] This article focuses on the significance of these cases to investment service providers in four areas: (1) fiduciary status under ERISA; (2) the prudence of investment decisions; (3) fee-related issues; and (4) circumstances giving rise to conflicts of interest.

I. Fiduciary Status under ERISA – Efforts to Stretch the Boundaries

A threshold question in many fiduciary breach suits under ERISA is which defendant, if any, was acting in an ERISA fiduciary capacity with respect to the investment of plan assets in the securities or other assets that gave rise to the loss?

Who is an ERISA Fiduciary?

Section 3(21)(A) of ERISA states that a person is a fiduciary of a plan to the extent that the person (i) exercises any discretionary authority or discretionary control with respect to management of such plan or exercises any authority or control with respect to management or disposition of its assets, (ii) renders investment advice for a fee or other compensation, direct or indirect, with respect to any money or other property of such plan or has any authority or responsibility to do so or (iii) has any discretionary authority or discretionary responsibility in the administration of such plan.

A regulation promulgated under ERISA[9] clarifies that a person shall be deemed to be rendering "investment advice" to an employee benefit plan only if (i) such person renders advice to such plan as to the value of securities or other property, or makes recommendations as to the advisability of investing in, purchasing, or selling securities or other property; and (ii) such person either directly or indirectly (e.g., through *or* together with an affiliate) has discretionary authority or control, whether or not pursuant to an agreement, arrangement or understanding, with respect to purchasing or selling securities or other property for the plan; or renders any advice (of the type described in clause (i) of this paragraph) on a regular basis to the plan pursuant to a mutual agreement, arrangement or understanding, written or otherwise, between such person and the plan or a fiduciary with respect to the plan, that such services will serve as a primary basis for investment decisions with respect to plan assets, and that such person will render individualized investment advice to the plan based on the particular needs of the plan regarding such matters as, among other things, investment policies or strategy, overall portfolio composition, or diversification of plan investments.[10]

The statutory definition and regulatory guidance make clear that a functional test is applied to determine fiduciary status under ERISA. In the very recent and significant opinion from the Seventh Circuit in *Hecker v. Deere & Co.*, 556 F.3d 575 (7th Cir. 2009) *reh'g en banc denied*, 2009 WL 1797441 (7th Cir. 2009), the court rejected the plaintiffs' argument that Fidelity Research and Fidelity Trust were "functional" fiduciaries merely because they had played a role in Deere's selection of investment options to be offered by its 401(k) plans. The court observed that Deere had exercised "final authority" over the selection of investment funds to be offered under the plans, and the allegation that the Fidelity entities "played a role" in the process was insufficient to establish that either entity served as a *de facto* fiduciary. In another recent case, *Dupree v. Prudential Ins. Co. of Am.*, 2007 WL 2263892 (S.D. Fla. 2007), the court entered judgment for Prudential after a bench trial on plaintiff's claims for breaches of fiduciary duty under ERISA with respect to investment decisions regarding the plan's assets because Prudential was not the party responsible for such decisions. An Investment Oversight Committee had authority to oversee and review the investment policy and practices of the plan, to select the types of investments and investment advisors, to select specific investment vehicles or strategies, and to negotiate fees and terms of investment strategies. The plaintiffs failed to name the Investment Oversight Committee or any of its members as defendants.

The Supreme Court's recent decision in *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544 (2007), requires a complaint to state its claims specifically and with specific support, and in ERISA litigation the courts increasingly are dismissing complaints on this basis.[11] However, if particular facts and circumstances of a defendant's actions,

position and role with respect to a plan must be considered to determine if the defendant is an ERISA fiduciary, courts may allow discovery to proceed. If the material facts are in dispute, summary judgment may not be available. For example, in *Atrix Int'l, Inc. v. Hartford Group Life Ins. Co.*, 2007 WL 2122163 (D. Minn. 2007), one of the defendants, Associated Financial Group, LLC ("AFG"), filed a motion to dismiss or, alternatively, for summary judgment based, in part, upon its contention that it was merely an insurance broker and not an ERISA fiduciary. The court denied the motion, stating that discovery would be needed to determine AFG's status as an ERISA fiduciary. *See also Haddock v. Nationwide Fin. Servs. Inc.*, 419 F.Supp.2d 156 (D. Conn. 2006) (Nationwide's motion for summary judgment was denied because the plaintiffs presented enough evidence to permit a reasonable fact-finder to conclude that Nationwide was an ERISA fiduciary in connection with Nationwide's control over the selection and removal of particular mutual funds as investment options for the 401(k) plans and participants); *Pipefitters Local 636 v. Blue Cross & Blue Shield of Mich.*, 213 Fed. Appx. 473 (6th Cir. 2007) (holding that the complaint contained sufficient allegations that Blue Cross acted as a fiduciary under ERISA in assessing and failing to disclose certain fees); *Charters v. John Hancock Life Ins. Co.*, No. 07 Civ. 11371 (D. Mass. filed July 26, 2007), (granting plaintiffs' motion for partial summary judgment, finding that Hancock was a fiduciary because it retained discretion to set and modify administrative fees and to substitute underlying investment options). In this regard, the *Charters* court concluded that the arrangement did not fall within the circumstances described in a 1997 advisory opinion issued by the Department of Labor to Aetna, in which the Department agreed that Aetna would not be a fiduciary by reason of its authority to change the fund lineup where a plan had a reasonable opportunity to withdraw, because the plan's only option in the *Charters* case was to transfer assets to another Hancock sub-account or terminate the contract entirely, which would subject the plans to termination fees. The court in *Phones Plus, Inc. v. Hartford Fin. Servs. Group, Inc.*, 2007 WL 3124733 (D. Conn. 2007) denied the defendants' motions to dismiss by concluding that the plaintiff's complaint alleged enough facts to support its claim that each defendant was an ERISA fiduciary due to its authority to add or remove investment options available to plaintiff's 401(k) plans.

However, if the court finds that the plaintiff did not allege facts sufficient to support the conclusion that the defendant was an ERISA fiduciary for the purposes central to the claims, the ERISA claims for fiduciary breach may be dismissed at an early stage of the litigation. In *Columbia Air Servs., Inc. v. Fidelity Mgmt. Trust Co.*, 2008 WL 4457861 (D. Mass. 2008), Fidelity's motion to dismiss was granted by the court because the plaintiff did not allege any facts supporting a conclusion that Fidelity acted as a fiduciary in negotiating the terms of Fidelity's engagement as directed trustee, including its compensation. Distinguishing this case from *Haddock*, the court noted that "Nationwide had significant authority over the mutual funds because it could unilaterally delete and substitute mutual funds from the list of available investment options whenever future investment appeared unwise [and] . . . had the power to remove all funds that refused to share revenue from the list of permissible investments and substitute only funds agreeing to share revenue. Here, [Fidelity] entirely lacks the kind of discretionary authority that Nationwide had and that made it a potential fiduciary." *See also Pipefitters Local 636*, which dismissed the plaintiff's claim that Blue Cross's refusal to release claims-related information was a decision made in Blue Cross's fiduciary capacity. Blue Cross cited statements in plaintiff's complaint to support its position that such decision was a business decision made while acting in its business capacity as opposed to its capacity as an ERISA fiduciary.

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Fiduciary Status Limited – "To the Extent"

Even if a person is determined to be an ERISA fiduciary with respect to a plan, it is important to remember that fiduciary status may be limited to certain matters. A person is a fiduciary only to the extent that such person has or exercises fiduciary functions. *See Pipefitters Local 636*. *See also Kanawi v. Bechtel Corp.*, 590 F. Supp. 2d 1213 (N.D. Cal. 2008), in which the court granted the plan sponsor's motion for summary judgment. Although the plan sponsor was a plan fiduciary by virtue of appointing members to, and monitoring, the committee that administers the plan, the plan sponsor did not retain any discretion or fiduciary responsibility for plan administration or investment management and, therefore, could not be held liable for any imprudent decisions in connection with the management of the plan. Courts have determined that a financial institution engaged as a directed trustee, for example, without discretionary authority over the investment of plan assets, would not be an ERISA fiduciary with respect to such investment decisions.[12] *See Columbia*, in which the court held that while Fidelity may have had some discretionary authority over plan assets, substantial limits were placed on its authority and discretion. The court looked to the agreement between the plaintiff and Fidelity which established that Fidelity, as trustee, had no discretion or authority with respect to the investment of plan assets but acted solely as a directed trustee of the funds contributed to the trust. As the plaintiff was the party who selected and removed the investment options for the plan, Fidelity was not an ERISA fiduciary with respect to such investment decisions. The plaintiff did not allege any facts to the contrary and, as such, the court dismissed the plaintiff's claim that Fidelity breached its fiduciary duty by receiving a share of the mutual fund fees from the funds in which the plan invested.

Definition of "Fiduciary" under Section 3(21)(B) of ERISA

Section 3(21)(B) of ERISA states that "[i]f any money or other property of an employee benefit plan is invested in securities issued by an investment company registered under the Investment Company Act of 1940, such investment shall not *by itself* cause such investment company or such investment company's investment adviser or principal underwriter to be deemed [an ERISA] fiduciary . . . except insofar as such investment company or its investment adviser or principal underwriter acts in connection with an employee benefit plan covering employees of the investment company, the investment adviser, or its principal underwriter." (emphasis added)

On March 3, 2009, Avatar Associates, LLC ("Avatar") requested an advisory opinion from the Department of Labor regarding, among other things, the application of ERISA to asset allocation arrangements involving mutual funds, which are typically structured as "fund of funds" in which the "top" mutual fund's assets are allocated among underlying mutual funds by the investment advisor to the top mutual fund. In its request, Avatar asserts, among other things, that the "by itself" limitation in Section 3(21)(B) of ERISA demonstrates that this exception to being a fiduciary is not absolute. As such, Avatar requests that the Department of Labor "address how to determine when the exception is not absolute and its application to asset allocation mutual funds."

"Dual Hats"

A person can wear both a fiduciary hat and a non-fiduciary hat, but not at the same time. *See Pipefitters Local 636*, in which the court acknowledged in one instance that Blue Cross was potentially acting as an ERISA fiduciary and in another that Blue Cross's refusal to release claims-related information was a business decision made by Blue Cross while acting in its business capacity as opposed to its capacity as an ERISA fiduciary.

Negotiating/Enforcing Contracts

A fiduciary generally does not act in a fiduciary capacity when negotiating or enforcing its contract. *See Columbia*, in which Fidelity's motion to dismiss was granted by the court because the plaintiff did not allege any facts that would support a conclusion that Fidelity was acting as a fiduciary in negotiating the terms of Fidelity's engagement as directed trustee. Potential exceptions include situations in which "the entity had a relationship to, authority over, or responsibility to the ERISA plan *before* the service agreement was signed . . . [or if] the service agreement gives it control over factors that determine the actual

amount of its compensation." *Columbia* at 4, citing other cases.

ERISA's functional definition of "fiduciary" frequently makes the determination of fiduciary status tricky, particularly in the financial services industry, where numerous affiliated and unaffiliated service providers play various roles in the delivery of an investment product. Clearly, one of the lessons to be learned by the financial services industry in the wake of the market turmoil is the importance of (i) clearly understanding where the line is drawn under ERISA between fiduciary and nonfiduciary services, (ii) clearly documenting the scope of fiduciary status of the various service providers playing a role in the delivery of an investment product, and (iii) adopting rules of conduct in dealing with ERISA clients that preserve the intended status. For example, a contract provision disclaiming fiduciary status (or emails disclaiming fiduciary status that are sent to plan fiduciaries) must be considered in light of the activities in which the putative fiduciary actually engaged. Proposed amendments to U.S. Department of Labor regulations interpreting the statutory exemption for service contracts would require the service provider to provide specific disclosures to a plan prior to entering into the contract, including whether the service provider (or an affiliate) will provide any of the services as a fiduciary within the meaning of ERISA or under the Investment Advisers Act of 1940.[13]

II. Prudence under ERISA – A Year of Alleged "Red Flags"

ERISA suits seeking to recover investment losses are almost always based fundamentally on the alleged imprudence of the decision to invest in the failed assets and/or failure to timely divest from the failed assets. Under ERISA the two key components of the prudence standard of care are (i) that the fiduciary had the requisite expertise to evaluate the investments involved (known as the "prudent expert standard of care"); and (ii) that the fiduciary engaged in the right level of initial and ongoing due diligence to make an informed investment decision and to monitor the investments on an informed basis (known as "procedural prudence"). Fiduciary breach claims against professional investment managers often focus on alleged lapses in the manager's procedural prudence.

For example, the complaint filed in a recent class action suit under ERISA against Austin Capital Management enumerated an array of "red flags" that plaintiffs alleged should have put the adviser on notice that the Madoff fund was a Ponzi scheme. *See Pension Fund for Hosp. & Health Care Employees-Philadelphia & Vicinity v. Austin Capital Mgmt., Ltd.,* No. 09 Civ. 00615 (E.D. Pa. filed Feb. 12, 2009). The red flags identified by the plaintiffs included:

- lack of transparency, including Madoff's refusal to disclose his investment strategy;
- abnormally smooth investment returns, with very little volatility, including only five months of negative returns in the past 12 years;
- use by other comparable funds of a "split-strike conversion" strategy (which Madoff asserted was his method) could not and did not generate returns in any way comparable to those allegedly earned by Madoff and Madoff Securities;
- Madoff Securities acted as the fund's own prime broker, while most hedge funds use large banks or broker-dealers as their prime brokers;
- the Madoff Fund generated revenue only through transaction-based commissions, while most hedge funds charge investment management fees based on fund performance;
- monthly investor account statements did not support reported returns;
- Madoff Securities and the Madoff Fund's independent auditor, Friehling & Horowitz, consisted of three employees, including a 78-year old living in Florida and a secretary;
- the Madoff Fund comptroller was based in Bermuda, not in-house; and
- a competitor, Harry Markopolos, wrote to the SEC twice between 1999 and 2005 explaining why the Madoff fund was a Ponzi scheme.

Another failed hedge fund suit was filed by the Department of Labor as an ERISA enforcement action against Zenith Capital, which acted as the adviser to ERISA plans invested in the hedge fund. After the hedge fund became insolvent and filed for bankruptcy, the receiver's report concluded that the insolvency was attributable to the hedge fund principals' diversion of assets, resulting in over $70 million of losses to investors in the hedge fund. The Department's complaint against Zenith alleged, among other things, that Zenith failed to use objective criteria to select the hedge fund as

an investment over other alternative investment options; failed to validate the hedge fund's books or performance reports; failed to conduct background checks on the principals of the hedge fund manager; and failed to obtain the names of other investors to use as references. *See Chao v. Zenith Capital LLC*, No. 08 Civ. 04854 (N.D. Cal. filed Oct. 23, 2008).

To be prepared to counter allegations of procedural imprudence, investment fiduciaries should maintain good records of investment decisions and the ongoing monitoring of investments, including the frequency of evaluations and the information considered in connection with the evaluation. The point of these records is not to enable a court to second-guess whether the investment or retention decision was, in fact, the best decision; but merely to demonstrate that there was active monitoring going on – that the fiduciary was not "asleep at the switch."

Even with good records demonstrating an investment fiduciary's active initial and ongoing due diligence, hedge funds have traditionally not afforded transparency to the investor with respect to specific portfolio holdings and strategies. In addition, investment mandates for hedge funds are typically broad, affording a significant amount of discretion to the manager, including even the authority to invest in commodities, speculative derivatives investments, real estate and other private equity interests. Investors have traditionally placed greater emphasis on scrutinizing the reputation, overall style and track record of the manager than on micromanaging the actual holdings of the hedge fund. Investors have also typically relied on the net asset value periodically reported by the hedge fund manager, validated by the annual financial statement audits performed by an independent accounting firm. The market meltdown has increasingly caused a focus on the risks of this investment model. ERISA litigation against investment fiduciaries seeking recovery for losses resulting from exposure to Madoff or similar Ponzi schemes could establish new precedent with respect to the extent to which prudence requires a fiduciary to have a direct knowledge and understanding of the underlying hedge fund investments and to verify valuations.

Even if a person is determined to be an ERISA fiduciary with respect to a plan, it is important to remember that fiduciary status may be limited to certain matters.

On February 5, 2009, the Labor Department released a statement on "Duties of Fiduciaries in Light of Recent Events Regarding Bernard L. Madoff Investment Securities LLC." The statement provides guidance to fiduciaries of plans that may have exposure to losses as a result of plan assets being invested with Madoff entities on what steps they should be taking to protect the interests of the plan. The Labor Department statement specifies that those steps may include:

(1) requesting disclosures from investment managers, fund managers, and other investment intermediaries regarding the plan's potential exposure to Madoff-related losses;
(2) seeking advice regarding the likelihood of losses due to investments that may be at risk;
(3) making appropriate disclosures to other plan fiduciaries and plan participants and beneficiaries; and
(4) considering whether the plan has claims that are reasonably likely to lead to recovery of Madoff-related losses that should be asserted against responsible fiduciaries or other intermediaries who placed plan assets with Madoff entities, as well as claims against the Madoff bankruptcy estate.

Another recent source of ERISA fiduciary breach litigation arising out of the market meltdown involves conservative, low-risk investment vehicles such as enhanced bond funds, stable value funds and securities lending collateral pools. These complaints often allege that the investment fiduciary failed to heed red flags. For example, in a complaint filed by the sponsor of a 401(k) plan that held an interest in the State Street Daily Bond Market Fund, the plaintiff alleged that State Street was imprudent when it expanded the fund's exposure to securities backed by subprime mortgages precisely at the time when defaults of subprime mortgages were sharply increasing and when numerous subprime lenders were facing insolvency. *See Apogee Enters., Inc. v. State Street*

Bank & Trust Co., No. 09 Civ. 00170 (D. Minn. filed Jan. 26, 2009).

Procedural imprudence claims bear a heavy burden to succeed, even in the wake of substantial investment losses, because the ERISA holdings are clear that the prudence of an investment is measured prospectively based on the information available to the fiduciary at the time the investment is made, and not retroactively with the benefit of hindsight. One court articulated this principle squarely when it ruled in favor of the investment fiduciary in a suit involving Black Monday losses by declaring that the "fiduciary duty of care requires prudence, not prescience." *De Bruyne v. Equitable Life Assurance Soc.*, 720 F. Supp. 1342, 1347-49 (N.D. Ill. 1989), *aff'd*, 920 F.2d 457 (7th Cir. 1990).

Another angle on the imprudence allegations is the argument made in some of the conservative fund cases that the failed investments were *per se* imprudent given the nature of the fund's investment guidelines. In the litigation involving securities-lending collateral pools, these allegations typically point to the fact that under a securities-lending arrangement, the lender of securities secures the loan with collateral. The collateral is then supposed to be invested in safe, short-term, liquid instruments so that the owner of the stock is able to receive some investment income from the collateral without risk of loss on collateral that must be returned to the borrower of the securities at the termination of the loan. For this reason, the plaintiffs argue, it would be *per se* imprudent to invest the collateral in anything other than secure investments, such as U.S. government bonds. *See, e.g.*, *Diebold v. Northern Trust Invs., N.A.*, 09 Civ. 01934 at p. 2 (S.D. Ill. filed March 30, 2009); see also, cases cited in note 8, *supra*. Imprudence allegations framed in this fashion place more emphasis on whether the failed investments were consistent with the applicable investment guidelines and disclosures made to investors. For example, in a suit filed against State Street Bank seeking recovery of $80 million in losses in two collective funds managed by State Street – a "Government Credit Fund" and an "Intermediate Bond Fund" – the complaint alleged that the failed investments, which included "undisclosed, highly leveraged positions in mortgaged-based financial derivatives" were in themselves inappropriate and imprudent given the nature of the funds. The complaint alleged further that the failed investments were imprudent because they were contrary to State Street's representations that the funds were "enhanced bond index" funds that sought "stable, predictable returns slightly above an index consisting of investment-grade U.S. Government and corporate bonds." *See In re State Street Bank & Trust Co. ERISA Litigation*.

ERISA complaints seeking recovery of investment losses often accompany their imprudence claims with allegations that the fiduciary was improperly motivated by some personal interest in breach of ERISA's duty of loyalty.[14] For example, in a suit filed against Wells Fargo by a participant in a Wells Fargo 401(k) plan, the plaintiff alleged that investment of the plan in mutual funds managed by its affiliates was imprudent and was motivated by the bank's desire to generate revenue. *See Gipson v. Wells Fargo,* No. 08 Civ. 04546 (D. Minn. filed Nov. 1, 2007). The complaints filed in connection with securities-lending collateral losses typically include allegations that the securities-lending agent's share of returns from the investment of collateral gave it an incentive to invest in riskier assets than were prudent. In one case, the complaint points to the fact that affiliates of the securities-lending collateral manager had other relationships, such as repurchase agreements, with Sigma, the issuer of failed MTN's held in the fund, which caused the manager to continue to hold the MTNs in the securities-lending collateral pool beyond the point of prudence. *See Bd. of Tr. of AFTRA Ret. Fund v. JPMorgan Chase Bank, N.A.*, 09 Civ. 00686 (S.D.N.Y. filed Jan. 21, 2009) (consolidated with *Bd. of Tr. of the Imperial County Employees' Ret. Sys. v. JPMorgan Chase Bank, N.A.*, No. 09 Civ. 3020 (S.D.N.Y. filed Mar. 27, 2009), consolidated Apr. 23, 2009).

The plaintiff in the *Dupree* case alleged that Prudential's investment of plan assets in affiliated funds was both imprudent and motivated by the desire to earn additional revenue. The court declined to find that the transactions violated ERISA's prudence or exclusive benefit rules merely because the transactions involved a measure of otherwise prohibited self-dealing that required exemptive relief. Indeed, the court found that Prudential's in-house fiduciaries satisfied ERISA's

prudence requirement in light of the "appropriate due diligence and procedural prudence in selecting proposed investments and monitoring the Plan's performance." The court noted with approval the fiduciaries' procedures for periodic reviews of the plan's investment performance and fees, including its consideration of unaffiliated products, as well as the retention by the investment committee of an independent advisor.

Given the broad range of services offered by large financial institutions and the complexity of investment products, investment fiduciaries who otherwise invested prudently and, at least prior to the market collapse, profitably for their investors may find their ability to zealously defend themselves compromised by conflict-of-interest allegations. Under ERISA, fiduciaries cannot cure certain types of potential conflicts of interest through disclosure or even consent. A variety of administrative and statutory exemptions are available for many investment arrangements that are typical in the financial services industry but that otherwise would involve potentially prohibited conflicts of interest for ERISA accounts. These exemptions provide the financial institution with a safe harbor from the prohibited transaction rules under ERISA, but do not afford any relief from the basic fiduciary duty of loyalty. Therefore, it is important for investment fiduciaries to not only implement compliance procedures to carefully document compliance with the applicable prohibited transaction exemptions under ERISA, but also to demonstrate that investment decisions are made in the best interests of the ERISA funds and accounts.

III. Focus on Fees

Over the last two years, there have been significant developments in case law addressing the direct and indirect payment of fees by ERISA investors. Courts have addressed a number of cases involving failure to disclose compensation received from third parties, payment of allegedly excessive fees, and payment of fees to a plan fiduciary or its affiliates in a manner creating an alleged prohibited conflict of interest. Many of these cases involve so-called "revenue sharing" arrangements, under which a portion of the investment management or other fees paid to investment funds in which plans invest may be directed to persons who provide other plan services, such as recordkeeping or trust services. Almost all of these recent cases involve 401(k) plans or other individual account plans.

Participant Claims against Plan Sponsors Involving Revenue-Sharing among Plan Service Providers

A series of class actions filed over the last two years charge that sponsors of participant-directed 401(k) plans caused the plans to pay excessive fees by imprudently selecting and monitoring the plan's underlying investment options. In particular, plaintiffs have alleged that inadequately disclosed revenue sharing arrangements result in the plan and its participants paying excessive fees for services rendered to the plan which, in turn, results in investment losses. These actions are alleged to involve breaches of ERISA's requirement that plan fiduciaries act prudently on behalf of the plan, as well as violations of ERISA's prohibited transaction rules.

Conduct allegedly violating ERISA's prudence requirement has included (1) plan sponsors' failure to investigate the existence of revenue-sharing arrangements, primarily between the mutual funds or other underlying investment options and other plan service providers such as plan recordkeepers and trustees; (2) the selection of actively managed funds rather than less-expensive passively managed index funds; (3) the selection of retail-class mutual fund shares rather than institutional shares; and (4) the decision to offer mutual funds rather than less-expensive collective investment funds. Many of the complaints filed in the series look quite similar, in part because many were filed by the same two plaintiffs' class-action law firms (Schlichter, Bogard & Denton and Keller Rohrback).

The most visible case as of this writing is *Hecker*, in which the Seventh Circuit recently upheld the dismissal of all claims against the Deere defendants. Deere engaged Fidelity Management Trust Co. to serve as the trustee of its two 401(k)-type plans, and retained Fidelity Management and Research Co. to advise it in selecting the investment funds to be offered under the plans. Deere ultimately selected 23 different Fidelity-affiliated mutual funds to serve as the designated investment options, and also offered a "BrokerageLink" open brokerage window offered by Fidelity,

under which participants could invest in any of approximately 2,500 additional mutual funds, including funds unaffiliated with Fidelity. Each of the mutual funds charged asset-based fees and shared a portion of the fee revenue generated by the Fidelity funds with other Fidelity entities providing trustee and administrative (e.g., record-keeping) services to the Deere plans.

Dennis Hecker, together with other named plaintiffs, filed suit against Deere through the Schlichter firm. The plaintiffs claimed that Deere violated its fiduciary duties under ERISA by limiting the designated investment funds to those affiliated with Fidelity, by providing investment options that were subject to excessive fees, and by failing to adequately disclose the fees, including the revenue-sharing arrangements, to plan participants. The district court dismissed all claims in 2007, and the plaintiffs appealed the dismissal to the Seventh Circuit.

On February 12, 2009, the Seventh Circuit upheld the district court's dismissal of all claims against the Deere defendants. The court concluded that under current law, there is no duty under ERISA to disclose the "revenue-sharing" arrangements challenged by defendants. Moreover, it found that there was no breach of fiduciary duty by the plan fiduciaries for selecting investment options with allegedly "excessive" fees where the plan offers a sufficient mix of investments options with a broad range of fees. The court also found that the plaintiffs' claims were barred by Section 404(c) of ERISA, which is a safe harbor for fiduciaries of participant-directed plans to the extent the participants exercise control over the investment of their own accounts. In reaching this determination, the court rejected plaintiffs' argument that the regulations under Section 404(c) required disclosure of the revenue-sharing arrangements, and also pointed to the broad range of investment options and fee levels available under the plan, including the designated Fidelity fund options and the funds available through the brokerage window. Although, the plaintiffs, supported by the Labor Department, certain consumer groups and other amici, petitioned the Seventh Circuit for a rehearing *en banc,* this petition was recently denied.

A number of other pending cases address similar issues.[15] Some of these cases have been stayed pending the resolution of *Hecker*. The participants in each case typically seek to certify a class of all similarly situated participants. In general, the participants seek to recover losses allegedly suffered by the plan through the payment of excessive fees to the plan's service providers resulting from the plan sponsor's failure to take into account undisclosed revenue-sharing arrangements. In addition, participants typically seek to recover the "investment losses" allegedly suffered by the plans through the payment of excessive fees embedded in the mutual funds or other investment options offered under the plan. In seeking to recover these alleged "investment losses," the complaints allege that the plans' fiduciaries cannot avail themselves of the "safe harbor" from fiduciary liability provided under Section 404(c) of ERISA because participants were not informed of all of the fees paid directly or indirectly by the plans to the extent required under the Labor Department's regulations under Section 404(c).

Although the primary target of revenue-sharing cases is the plan sponsor, these suits are likely to affect the investment industry in a number of ways, including the fee structures and disclosures required by plan sponsors. Investment providers are also at risk of being named as additional defendants in these suits, just as Fidelity was named in the *Hecker* suit against Deere. ERISA litigation is starting to more closely resemble securities litigation, with more challenges to the sufficiency of the disclosures provided by financial institutions and other plan service providers to the plan sponsor, as well as the disclosures provided by the plan sponsor to the participants. Areas of emphasis include disclosure of investment risks as well as fees and other sources of indirect compensation. Current cases track some of the regulatory developments still under consideration by the Department of Labor, but fee-related disclosure practices are being challenged even before final regulations are adopted.

Participant Claims against Financial Institution Plan Sponsors

Each of the revenue-sharing cases focus on the failure by plan sponsors to understand practices prevalent among investment funds in which 401(k) plan participants invest, but relatively few of the cases directly challenge the conduct of the financial insti-

tutions themselves. An obvious exception is where the plan sponsor is itself a financial institution.

As in the other revenue-sharing cases, the plaintiff participants in *Boeckman v. A.G. Edwards, Inc.* alleged that the A.G. Edwards savings plan was paying excessive fees because it utilized mutual funds rather than retaining the same professional money managers to manage single customer accounts on behalf of the plan at lower rates, and also because the plan invested in retail shares rather than less-expensive institutional shares. The plaintiffs further alleged that the mutual funds themselves were parties in interest, and that the plan's investment involved transfers of plan assets to a party-in-interest in violation of ERISA's prohibited transaction rules. The court dismissed the claims relating to prohibited transactions, finding that ERISA precludes any finding of a prohibited transaction where the plan, through its investment in the mutual fund, is merely paying ordinary shareholder service fees, transfer-agent fees, Rule 12b-1 fees, administrative fees, and similar fees that are the "normal incidents of investment in mutual fund shares." However, the court declined to dismiss the claim that the selection of these funds was imprudent.

In contrast, in *Nolte v. CIGNA Corp.*, CIGNA had selected separate accounts instead of mutual funds as the underlying investment options of the plan. Nevertheless, the plaintiffs alleged that the plan fiduciaries did not take steps to reduce plan expenses by capturing alleged revenue-sharing payments and other indirect sources of compensation (including compensation allegedly associated with the provision of cash-sweep services, securities-lending, and foreign exchange transactions) for the benefit of the plan, and also challenged the plan fiduciaries' decision to use actively managed investment options rather than less expensive passive strategies, thereby causing the CIGNA plan to pay excessive fees. The plaintiffs also alleged that CIGNA breached its fiduciary duties when it sold its retirement services business to another insurer, reaping the benefit of the inclusion of the plan's business (which the plaintiffs claim totaled more than 10% of the total revenues of that business unit) in the sale price that it obtained. A motion for summary judgment is pending; the district court stayed this case pending the outcome of *Hecker*.

Beane v. Bank of New York Mellon, 07 Civ. 09444 (SDNY filed Oct. 19, 2009) was filed by a participant on behalf of the Federal-Mogul Corp. Pension Plan and other similar plans against Callan Associates and Bank of New York Mellon. The complaint alleged that Callan served as an investment adviser and fiduciary to the plan, and that Callan breached its fiduciary duties to the plan by failing to disclose a commission-sharing arrangement it maintained with the BNY companies based on trades effected on behalf of Callan clients. On March 31, 2009, the court approved a settlement of this complaint involving the payment by the defendants of $2.2 million to the affected plans.

Actions Brought by Plan Sponsors against Plan Service Providers

In *Haddock*, one of the first cases challenging revenue-sharing arrangements relating to mutual funds offered as plan investment options, a group of 401(k) plan sponsors sued Nationwide Financial Services and Nationwide Life Insurance Company alleging that Nationwide's retention of revenue-sharing payments from the mutual funds offered under its group annuity contracts was in violation of its fiduciary duty of loyalty under ERISA and also constituted prohibited transactions under ERISA. Among other defenses, Nationwide denied that it was a fiduciary. However, in *Haddock*, the district court denied Nationwide's motion for summary judgment, holding, among other things, that the payments may constitute a form of prohibited "kickback" for purposes of ERISA.

Since *Haddock*, other plan sponsors have filed cases against insurance companies and other financial-service providers alleging that the defendants engaged in various forms of "revenue-sharing" arrangements that triggered prohibited transactions as well as violations of ERISA's general fiduciary responsibility rules. *See, e.g.*, *Phones Plus, Inc.*, which raises very similar issues, and is pending before the same court. *See also Ruppert v. Principal Life Ins. Co.*, No. 07 Civ. 00344 (S.D. Ia. filed Aug. 2, 2007); *Charters*; *Columbia Air Servs.*; *Zang v. Paychex, Inc.*, No. 08 Civ. 06046 (W.D.N.Y. filed Aug. 14, 2007).

Beary v. Nationwide Life Ins. Co., 2007 WL 4643323 (S.D. Ohio) and *Beary v. ING Life Ins. & Annuity Co.*, 520 F.Supp. 2d 356 (D. Conn. 2007) are distinctive in that they involve governmental plans maintained under Section 457(b) of the Internal Revenue Code of 1986, as amended,

that are not subject to ERISA. Accordingly, *Beary* (sheriff of Orange County, Florida) brought claims on behalf of the Section 457(b) plan in which he participated (as well as similarly situated plans) under state fiduciary law rather than ERISA. More specifically, the plaintiff claimed that Nationwide and ING breached their fiduciary duties under state fiduciary law by arranging for, receiving, and retaining revenue-sharing payments. Both of these cases were dismissed. In the *Nationwide* case, the district court concluded that Beary's claim was preempted under the Securities Litigation Uniform Standards Act of 1998 ("SLUSA"). In the *ING Life* case, the court agreed that Beary had succeeded in avoiding SLUSA preemption, but that in the course of so doing, he had failed to state a claim on which relief could be granted.

IV. Can Financial Institutions Ever Remain Conflict-Free?

Section 406(b) of ERISA prohibits a plan fiduciary from dealing with plan assets in his own interest or for his own account (the "self-dealing" prohibition); from acting in a transaction involving a plan on behalf of a party with interests adverse to the plan (the "adverse interests" prohibition) and from receiving any consideration for its own personal account (the "anti-kickback" prohibition). Certain types of otherwise-prohibited transactions are permitted if they satisfy the conditions of one of a variety of available statutory or administrative exemptions. As the economic crisis has deepened over recent months, financial institutions have faced increasing claims of self-dealing violations.

Investments in Affiliated Funds and Products

One area that has generated litigation activity, despite the availability of various potentially applicable exemptions, is the selection by 401(k) sponsors of affiliated funds as options on a limited menu from which plan participants may choose, or by defined benefit plan sponsors as plan investments. Receipt of fees by affiliates of the plan sponsor, the claims argue, indicate that the plan sponsor was acting in its own interest in selecting such options or investments, rather than in the interests of the plan. For example, *Leber v. Citigroup*, No. 07 Civ. 09329 (S.D.N.Y. filed Oct. 18, 2007) alleges that Citigroup's investment committee and administrative committee, as fiduciaries for Citigroup's 401(k) plan, put Citigroup's interests ahead of the plan's interests by choosing investment products and pension plan services offered and managed by Citigroup subsidiaries, generating substantial revenues for Citigroup, when lower cost options were available. Similarly, plaintiff plans sponsored by Bank of America, in *David v. Alphin*, No. 06 Civ. 04763 (N.D. Cal. filed Nov. 9, 2006), alleged that Bank of America engaged in self-dealing by selecting Bank of America funds as investments, generating substantial investment management and other fees for the bank, where lower-cost funds were available and where the bank could have used the plan's size to negotiate lower fees. The plaintiffs in *Gipson v. Wells Fargo* alleged that the benefit committee for the Wells Fargo 401(k) plan engaged in self-dealing by selecting investment products and pension plan services offered and managed by Wells Fargo subsidiaries and affiliates, generating substantial revenues for Wells Fargo and placing Wells Fargo's interests above those of the plan. In a subsequent motion by defendants to dismiss, Wells Fargo contended that a successful allegation of an ERISA conflict violation requires an allegation of failure to comply with Prohibited Transaction Exemption 77-3, a Department of Labor prohibited transaction exemption that exempts, in certain circumstances, investments in affiliated funds. The court did not directly address this contention, but held in denying the motion to dismiss that the plaintiffs' argument could be read to allege non-compliance with the exemption. We note that even if exemptive relief were found to be available for an alleged ERISA conflict violation, an exemption cannot

ERISA suits seeking to recover investment losses are almost always based fundamentally on the alleged imprudence of the decision to invest in the failed assets and/or failure to timely divest from the failed assets.

relieve a plan fiduciary from its basic fiduciary duty to act exclusively in the interest of the plan. Conflict allegations have also been raised in the market timing context, where a financial institution claimed to have engaged in market timing was alleged to have a conflict in selecting affiliated mutual funds as 401(k) investment options. *See Wangberger v. Janus*, No. 05 Civ. 02711 (D. Md. filed Sept. 30, 2005).

These cases also frequently claim that the sponsor institution used plan money to "seed" an affiliated investment fund. Each of the *David* and *Gipson* claims argued that the sponsor bank used plan assets as "seed money" to start up affiliated funds, which they argue was driven by the relevant bank's desire to attract other investors to such funds and to benefit its investment management business.

There have been substantial amounts paid to settle similar claims. *See*, *e.g. Franklin v. First Union Corp.*, 99 Civ. 344 (E.D. Va.) (settlement approved June 13, 2001 after partial summary judgment for defendants on certain counts); *Mehling v. N.Y. Life Ins. Co.*, 248 F.R.D. 455 (E.D. Pa. 2008) ($14 million settlement). In addition to paying damages, the defendants in *Mehling* agreed to utilize an independent advisor through 2010 to provide advice regarding appropriate investments for each of the plans.

In 2007, however, one court found no conflict of interest violations by Prudential in investing plan assets in affiliated funds, including funds in which the plan was the only investor and a "seeding" argument was made. In *Dupree*, the court dismissed claims brought by a retiree alleging that fees charged by Prudential under a group annuity contract it issued to its own defined benefit pension plan resulted in nonexempt prohibited transactions and that the arrangement violated ERISA's requirement that plan fiduciaries act for the "exclusive benefit" of plan participants. The plan's assets were held under a group annuity contract known as "PruPar," and the assets were invested in both pooled and separate accounts. Where the plan's assets were invested in pooled accounts, Prudential charged investment management fees at the same rate paid by other investors. In contrast, where the plan's assets were invested in single customer accounts, Prudential received no more than its "direct expenses" of providing investment management services, which resulted in a basis point charge that was less expensive than the assets invested in the pooled separate accounts. Thus, *Dupree* argued that Prudential had a fiduciary duty to ensure that all/more of the plan's assets were invested in single customer accounts.

The court found that Prudential's provision of investment management services with respect to the Prudential plan's investment in single customer accounts was eligible for exemptive relief under the statutory exemption for the provision of services by a party-in-interest. Interestingly, the court declined to follow the Department of Labor's long-standing position (which has been accepted by many courts) that the statutory exemption for services provides exemptive relief only from the "party-in-interest" prohibitions and not from the self-dealing prohibitions. However, the court noted that it was unnecessary to decide this issue, since Prudential had limited its compensation for providing investment management services to single-customer accounts maintained on behalf of its own plan to no more than its "direct expenses" of providing such services. The court found that the risk fees charged by Prudential under the PruPar group annuity contract and its provision of investment management services (at its usual rates) with respect to Prudential plan assets invested in pooled separate accounts were eligible for exemptive relief under statutory exemptions applicable to annuity contracts and insurance company pooled separate accounts. Notably, the court rejected the plaintiffs' argument that Prudential should have managed all of the plan's assets through single-customer accounts to which it charged no more than "direct expenses" (which were less expensive than the customary fees charged at the pooled separate account level), holding that Prudential had no obligation to make single-client accounts available for all investments or to subsidize its plan's investment fees. The *Dupree* case illustrates the importance of prohibited transaction compliance procedures. Many exemptions are complex and technical, and financial service providers are more likely to avert prohibited transaction allegations at an early stage in litigation if they have sound procedures and good records of compliance with such procedures.

Although, under ERISA, conflicts of interest cannot be cured by ensuring that the terms of an investment or service are favorable to the plan, documentation evidencing an investment fiduciary's diligence, prudence and independence can go a long way to convince a court that the investment fiduciary was not operating under a conflict. In the *Dupree* case, for example, the court found that Prudential's in-house fiduciaries satisfied ERISA's prudence requirement in light of the "appropriate due diligence and procedural prudence in selecting proposed investments and monitoring the Plan's performance." The court noted with approval the fiduciaries' procedures for periodic reviews of the Plan's investment performance and fees, including its consideration of unaffiliated products, as well as the retention by the investment committee of an independent advisor.

Dealings with Affiliates

Several cases also allege that plan fiduciaries violated ERISA's conflict-of-interest prohibitions by hiring affiliated entities to perform various services, or by engaging in transactions with affiliates. In *Bd. of Tr. of the AFTRA Ret. Fund v. JPMorgan Chase Bank, N.A.,* plans[16] alleged that JPMorgan engaged in self-dealing by investing in and retaining notes ("Sigma MTNs") issued by Sigma Finance Corporation in a securities-lending collateral pool containing plan assets, despite increasing indications of Sigma's likely failure. JPMorgan was conflicted, these claims allege, because JPMorgan simultaneously received fees and interest from short-term repurchase financing it provided to Sigma, and because it held Sigma MTNs in JPMorgan money-market funds. The plaintiff in *David v. Alphin* alleged that Bank of America engaged in self-dealing by paying fees to affiliated service providers for trustee, custodial, accounting, actuarial, recordkeeping and other services. In *Kanawi v. Bechtel*, the district court found a genuine issue of fact as to whether Bechtel's plan committee engaged in self-dealing in hiring an investment adviser affiliated with a plan sponsor (the court did note that for a period of time the plan sponsor paid the investment advisory fees, during which time it found no possibility of self-dealing). Transparency and disclosure of affiliate transactions are a common theme; this is consistent with the Department of Labor's proposed revisions (proposed on December 13, 2007 and currently under review by the new administration) to regulations interpreting the statutory exemption for services under which service providers to ERISA plans would be required to provide extensive disclosures of affiliate contracts.[17] Given their size and breadth, large financial institutions may find it virtually impossible to monitor all potentially conflicting dealings by affiliates. Financial institutions often separate lines of business within the financial institution by information "walls" to minimize the potential for conflicts. This practice was cited by the Department of Labor in its Field Assistance Bulletin 2004-03 (advising financial institutions that provide directed trustee services) as sufficient to avoid imputed knowledge of information by one part of an organization to the organization as a whole.

Target Date Funds

In another twist on alleged self-dealing relating to affiliated investments, a recent Department of Labor advisory letter request filed by Avatar on March 3, 2009 suggests that that "target date" mutual funds – typically structured as tiered arrangements in which one mutual fund allocates its assets among a variety of other affiliated mutual funds – are inherently engaged in self-dealing because they involve double layers of fees. Though mutual funds are statutorily exempt from ERISA, the letter suggests that tiered target date arrangements should not be covered by the statutory exemption, arguing that such arrangements were not contemplated at the time ERISA was enacted and are not subject to the same protections on which the exemption was based.

Securities Lending

A number of recent cases have claimed that collective fund managers engaged in self-dealing by accepting securities-lending fees, typically calculated as a percentage of investment gains on collateral pools, which allegedly created an incentive to take unreasonable risks. In *Fishman, et al. v. State Street*, 09 Civ. 10533 (D. Mass. filed Apr. 7, 2009), for example, a defined contribution plan administrator sued State Street, alleging securities-lending fees created an incentive for State Street to take unreasonable risks to benefit itself.[18]

Company "Stock-Drop" Cases

In "stock-drop" cases, which are typically filed after a drop in the price of public company employer stock offered as an investment option in a 401(k) plan (or in an ESOP), plaintiffs allege that plan fiduciaries – and directors and officers of the plan sponsor – knew or should have known about undisclosed facts which led to the drop in the price of the stock. Thus, according to these plaintiffs, the defendants failed to remove employer stock as an investment option before the price drop, and the participants should be made whole for the loss in the value of the stock. Though not unique to financial institutions, the dramatic decrease in bank stock prices has made financial institutions particularly vulnerable to this type of claim involving their own plans. In *Cannon v. MBNA*, 05 Civ. 00429 (D. Del. filed June 24, 2005), for example, plaintiff employees alleged that an MBNA plan committee and its members, in holding shares of MBNA stock in the plan, were incentivized to take actions (such as making false representations and failing to provide disclosures to plan participants) to artificially inflate the stock price even if doing so was not in the best interest of the plan. Similarly, in *Shirk v. Fifth Third Bancorp*, 2007 WL 1100429 (S.D. Ohio 2007)(motions to dismiss denied), plaintiff plan participants alleged that Fifth Third, as trustee of its 401(k) plan with discretionary authority over investment matters, breached its duty to avoid conflicts of interest by continuing to offer Fifth Third stock as an investment option after it should have known that such stock was no longer a prudent investment, and taking actions to artificially inflate the stock (such as making misrepresentations and concealing information). In particular, the plaintiffs alleged that Fifth Third was conflicted in its failure to engage independent fiduciaries, failing to notify federal agencies of certain allegedly questionable transactions, and its use of Fifth Third stock as a "currency" for acquisitions to meet growth targets that triggered bonus compensation for executives. As noted above, the use of independent advisors and consultants with respect to investments that involve the potential for self-dealing can be helpful in defusing such allegations. *See also In Re: The Bear Stearns Companies Inc. Securities, Derivative & Employee Ret. Income Security Act (ERISA) Litigation*, No. 08 M.D.L. 01963 (S.D.N.Y.)(consolidation of approximately twelve ERISA putative class actions. Amended Complaint filed Apr. 20, 2009).

V. Concluding Note – ERISA Fiduciary Litigation in Perspective

In the preceding pages of this article, we have provided an overview of the ERISA fiduciary compliance issues affecting financial institutions and financial services providers to ERISA plans, focusing primarily on the recent swell of cases in these areas. We conclude by offering some brief observations from our perspective in litigating these cases on behalf of fiduciaries.

Winning the motion to dismiss the complaint. There is a high value in winning an early motion to dismiss the complaint for failure to state a claim, if only to avoid the burden, costs, and disruptions of extensive discovery into the underlying merits. A motion to dismiss looks only at the allegations in the complaint. But since ERISA fiduciary breach complaints usually refer to the plan documents, there may be an opportunity to point to other plan documents (and plan-related documents that are available to participants upon request) that show a failure to state a claim.

Demonstrating procedural prudence. As we have discussed at several points in this article, procedural prudence is key. Were there established and well-considered procedures in place, were they documented, and were they followed? Demonstrating procedural prudence on threshold issues – who is or is not an ERISA fiduciary, or do the ERISA rules apply to a particular asset – often can be as important as documenting procedural prudence on the "substance" of investment decision-making.

Electronic discovery is not for rookies. If the case proceeds into merits discovery, there will usually be discovery requests to produce extensive documents and data, often in electronic form (such as transactional data, e-mails, and analyses). The requirements for document and data retention, preservation, and reviews for production are technically complex, and careful attention is required at the front-end of a case.

Fiduciary exception to the attorney-client privilege. Fiduciaries may not be aware that the attorney-client privilege is subject to a "fiduciary exception" under which otherwise privileged com-

munications about plan administration (including plan investments) may be subject to production in litigation. While the details about the fiduciary exception are beyond the scope of this article, the risks of potential disclosure of such communications should be considered in appropriate circumstances.

Using the section 404(c) defense under ERISA. Section 404(c) of ERISA provides a powerful defense in litigation alleging that investment options in a defined contribution plan were imprudent. This is an affirmative defense, which means that the defendants who offer this defense have the burden of showing that it applies. Many of the requirements under section 404(c), such as disclosures to participants, fall on plan administrators. But since service providers often are sued along with the "in-house" fiduciaries, service providers have an interest in ensuring that, in the course of providing services, they are providing the information required to make the section 404(c) defense available.

ENDNOTES

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Lennine Occhino is a partner in Mayer Brown's ERISA and Private Investment Fund practices. Since joining the firm in 1988, Lennine has concentrated exclusively in the pension investment area, advising on the structuring and offering of alternative investment vehicles of all types to ERISA and government plans and other institutional investors, including onshore and offshore hedge funds, private equity funds, real estate funds, infrastructure funds, group trusts, bank collective trusts, insurance company separate accounts, REMICs and REITs. Lennine also advises plan sponsors, trustees, investment managers, and other fiduciaries with respect to their fiduciary obligations and compliance procedures. She has extensive experience representing clients in connection with Department of Labor prohibited transaction exemption and advisory opinion requests, as well as audits and enforcement actions brought by the Department of Labor.

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1 Under ERISA, one fiduciary of a plan may incur liability as a result of the actions of a co-fiduciary if it is determined that the first fiduciary has enabled the breach by the co-fiduciary because of its imprudent retention or monitoring of the co-fiduciary, or if it is determined that the first fiduciary either participated in the breach or had knowledge of the breach by the co-fiduciary and failed to make reasonable efforts under the circumstances to remedy the breach. ERISA § 405(a), 29 U.S.C. § 1105(a) (2000).

2 A breach of an ERISA fiduciary duty could render a manager and other persons who are deemed, by virtue of their control over plan investments, to be fiduciaries, liable to (a) disgorge any profits made by such fiduciary as a result of the breach, and (b) restore any losses suffered by the ERISA investors as a result of the breach. ERISA § 409(a), 29 U.S.C. § 1109(a) (2000). In addition, if a breach involves a prohibited conflict of interest or a prohibited transaction, an excise tax of 15% per year of the amount involved in the transaction is imposed on the party in interest in the transaction. ERISA § 406, 29 U.S.C. § 1106 (2000).

3 Section 404(a)(1)(D), 29 U.S.C. § 1104(a)(1)(D), requires a fiduciary to discharge its duties with respect to a plan in accordance with the documents and instruments governing the plan.

4 ERISA § 410(a), 29 U.S.C. § 1110 (2000), 29 C.F.R. § 2509.75-4 (2006), 40 Fed. Reg. 31599 (July 28, 1975).

5 *See, e.g., In re State Street Bank & Trust Co. ERISA Litigation*, 579 F. Supp. 2d 512 (S.D.N.Y. 2008) (denying State Street's motion to dismiss complaint seeking recovery of $80 million in losses in two collective bond funds attributable to alleged overly risky and highly leveraged mortgage-based financial derivatives); *Apogee Enters., Inc. v. State Street Bank & Trust Co.,* S.D.N.Y., No. 09 Civ. 00170 (D. Minn. filed Jan. 26, 2009) (investments in securities backed by sub-prime mortgage loans and other "high-risk" assets inappropriate for a fund represented to be a stable, risk-controlled and well-diversified enhanced bond index fund).

6 *See, e.g., Pension Fund for Hosp. & Health Care Employees – Philadelphia & Vicinity v. Austin Capital Mgmt., Ltd.,* No. 09 Civ. 00615 (E.D. Pa. filed Feb. 12, 2009); *Chao v. Zenith Capital LLC,* No. 08 Civ. 04854 (N.D. Cal. filed Oct. 23, 2008); *Laborers Local 17 Pension Plan v. Tremont Group Holdings*, No. 09 Civ. 2505 (S.D.N.Y. filed Mar. 18, 2009); *Construction Ind. & Laborers Joint Pension Trust v. Austin Capital Mgmt., Ltd.*, No. 09 Civ. 3614 (S.D.N.Y. filed Apr. 8, 2009); *Morin v. J.P. Jeanneret Assocs., Inc.*, No. 09 Civ. 00305 (W.D.N.Y. filed Apr. 2, 2009); *Maritime Ass'n. – I.L.A. Pension, Ret., Welfare & Vacation Fund v. Meridian Capital Partners, Inc.*, No. 09 Civ. 01290 (S.D. Tex. filed Apr. 28, 2009); *Towsley v. Beacon Assocs. Mgmt. Corp.*, No. 09 Civ. 04453 (S.D.N.Y. filed May 8, 2009); *Bd. of Tr., Steamfitters Local 449 Ret. Sec. Fund v.*

Austin Capital Mgmt., Ltd., No. 09 Civ. 02634 (E.D. Pa. filed June 11, 2009); *Laborers' Dist. Council of W. Pa. Pension Fund v. Austin Capital Mgmt., Ltd.*, No. 09 Civ. 02848 (E.D. Pa. filed June 25, 2009).

[7] *See, e.g., FedEx Corp. v. The Northern Trust Co.*, No. 08 Civ. 02827 (W.D. Tenn. filed Dec. 1, 2008); *BP Corp. North Am. Inc. Savs. Plan Inv. Oversight Comm. v. The Northern Trust Invs., N.A.*, No. 08 Civ. 6029 (N.D. Ill. filed Oct. 21, 2008); *Bd. of Tr. of the AFTRA Ret. Fund v. JPMorgan Chase Bank, N.A.*, No. 09 Civ. 00686 (S.D.N.Y. filed Jan. 21, 2009) (consolidated with *Bd. of Tr. of the Imperial County Employees' Ret. Sys. v. JPMorgan Chase Bank, N.A.,* No. 09 Civ. 3020 (S.D.N.Y. filed Mar. 27, 2009); *Diebold v. Northern Trust Invs., N.A,* No. 09 Civ. 01934 (S.D. Ill. filed Mar. 30, 2009); *Fishman v. State Street Corp.,* No. 09 Civ. 10533 (D. Mass. filed Apr. 7, 2009); *Lockheed Martin Inv. Mgmt. Co. v. Northern Trust Co.*, No. 09 Civ. 01649 (D. Md. filed June 23, 2009).

[8] *See, e.g., Gipson v. Wells Fargo & Co.,* No. 08 Civ. 04546 (D. Minn. filed July 7, 2008).

[9] Reg. § 2510.3-21(c).

[10] *See, e.g., Ellis v. Rycenga Homes, Inc.*, 484 F. Supp. 2d 694 (W.D. Mich. 2007) (in which defendant Edward D. Jones & Co., L.P. was determined to be an ERISA fiduciary by virtue of the fact that it rendered investment advice to the plan's trustee for a fee or other compensation within the definition of a fiduciary under ERISA and the regulation promulgated thereunder); *Toledo Blade Newspaper Unions Blade Pension Plan v. Inv. Performance Servs., LLC*, 565 F. Supp. 2d 879 (N.D. Ohio 2008) (in which the court determined that not only was the corporate investment advisor defendant an ERISA fiduciary to the plaintiff, but so were two officers of the corporate investment advisor by virtue of playing "an active role in, and being contractually compensated for, the provision of investment advice and investment manager search services" to the plaintiff).

[11] In the "stock drop" cases alone, for example, recent decisions dismissing complaints (or affirming dismissal of the complaint) for failure to state a claim on the underlying merits include *Edgar v. Avaya, Inc.*, 503 F.3d 340, 349 & n.14 (3d Cir. 2007); *Wright v. Or. Metallurgical Corp.*, 360 F.3d 1090, 1098 (9th Cir. 2004); *In re Avon Prods., Inc. ERISA Litig.*, 2009 WL 884687, at *1 (S.D.N.Y. Mar. 30, 2009); *In re Bausch & Lomb Inc. ERISA Litig.*, 2008 WL 5234281, at *4-6 (W.D.N.Y. Dec. 12, 2008); *Graden v. Conexant Sys., Inc.*, 574 F. Supp. 2d 456, 463-64 (D.N.J. 2008); *In re Dell, Inc. ERISA Litig.*, 563 F. Supp. 2d 681, 693-94 (W.D. Tex. 2008); *Pedraza v. Coca-Cola Co.*, 456 F. Supp. 2d 1262, 1276 (N.D. Ga. 2006); *Smith v. Delta Air Lines, Inc.*, 422 F. Supp. 2d 1310, 1331 & n.21 (N.D. Ga. 2006); *In re Merck & Co., Inc., Sec. Derivative & ERISA Litig.*, 2006 WL 2050577 (D.N.J. 2006).

[12] ERISA § 403(a)(1), 29 U.S.C. § 1103(a)(1), imposes a residual duty on a directed trustee to determine that directions are "proper," "in accordance with the terms of the plan," and not contrary to ERISA.

[13] 72 Fed. Reg. 70988 (Dec. 13, 2007).

[14] ERISA § 404(a)(1), 29 U.S.C. § 1104(a)(1) (2000), requires a plan fiduciary to act "solely in the interest of the participants and beneficiaries" and "for the exclusive purpose of . . . providing benefits to participants and their beneficiaries [and] defraying reasonable expenses of administering the plan."

[15] *Montoya v. ING Life Ins. & Annuity Co.*, No. 07 Civ. 02574 (S.D.N.Y. filed Mar. 28, 2007); *Renfro v. Unisys Corp.*, No. 07 Civ. 2098 (E.D. Pa., filed Dec. 12, 2006 in C.D. Cal.); *Abbott v. Lockheed Martin Corp.*, No. 06 Civ. 00701 (S.D. Ill. filed Sept. 11, 2006); *Beesley v. Int'l Paper Co.*, No. 06 Civ. 00703 (S.D. Ill. filed Sept. 11, 2006); *Spano v. The Boeing Co.*, No. 06 Civ. 00743 (S.D. Ill. filed Sept. 25, 2006); *Boeckman v. A.G. Edwards, Inc.,* No. 05 Civ. 00658 (S.D. Ill. filed Sept. 15, 2005); *Will v. Gen. Dynamics Corp.*, No. 06 Civ. 00698 (S.D. Ill. filed Sept. 11, 2006); *George v. Kraft Foods Global, Inc.*, No. 07 Civ. 01713 (N.D. Ill. filed Oct. 16, 2006 in S.D. Ill.); *Loomis v. Exelon Corp.*, No. 06 Civ. 04900 (N.D. Ill. filed Sept. 11, 2006); *Martin v. Caterpillar, Inc.*, No. 07 Civ. 01009 (C.D. Ill. filed Jan. 11, 2007); *Nolte v. Cigna Corp.*, No. 07 Civ. 02046 (C.D. Ill. filed Feb. 26, 2007); *Tussey v. ABB, Inc.*, No. 06 Civ. 04305 (W.D. Mo. filed Dec. 29, 2006), *Kanawi v. Bechel Corp.*, 590 F.Supp.2d 1213 (N.D. Cal. 2008), *In re Northrop Grumman Corp. ERISA Litig.*, No. 06 Civ. 6213 (C.D. Cal. filed Sept. 28, 2006), *Tibble v. Edison Int'l*, No. 07 Civ. 05359 (C.D. Cal. filed Aug. 16, 2007).

[16] One claim was brought by a state plan not subject to ERISA but alleging breaches of duties applicable in the ERISA context; another was brought by the fiduciaries of an ERISA plan as a class action for plans who were participants in JP Morgan's securities-lending program through one or more collective investment vehicles managed by JPMorgan.

[17] 72 Fed. Reg. 70988 (Dec. 13, 2007).

[18] *See also* cases cited at n.8.