The Importance of "a Deliberative Process": Missouri Federal Court Finds Plan Fiduciaries Liable for Breach of Fiduciary Duty in *Tussey v. ABB Inc.*

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Following a four-week bench trial in the case of *Tussey v. ABB Inc.* (W.D. Mo. Mar. 31, 2012), Judge Nanette K. Laughrey found that ABB's 401(k) plan fiduciaries breached their duties to plan participants by failing to monitor recordkeeping costs, negotiate rebates and prudently select and retain investment options. Throughout the Court's discussion of revenue sharing, recordkeeping fees, target date funds, share classes and floats, its predominant theme was the importance of implementing and adhering to processes and focusing on the merits of the investments above all other considerations. The Court in *ABB* explained that while the methods the fiduciaries used were not *per se* breaches of any fiduciary duty, the fiduciaries' failure to conduct basic research and follow the plan's own Investment Policy Statement—coupled with their failure to make decisions based solely on the merits of the investments—resulted in a breach of fiduciary duty. As a result, the Court awarded the plaintiff class a damages award of $13.4 million against ABB for failure to monitor recordkeeping costs and to negotiate rebates and $21.8 million for imprudent mapping of funds; it also required Fidelity to pay $1.7 million for improperly administering an investment float associated with interest and income derived from the holding of Plan assets.

Revenue Sharing and Recordkeeping Fees

The first breach of fiduciary duty addressed by the Court dealt with ABB's use of revenue sharing from Fidelity to pay for recordkeeping and other administrative expenses incurred by the trustee, Fidelity Trust. Although the Court acknowledged that fiduciaries may use revenue sharing to pay for administrative fees (rather than paying with a "hard dollar," per participant fee), it found the ABB plan fiduciaries' use of revenue sharing in this instance breached their duties.

The Court identified a number of problems with the fiduciaries' use of revenue sharing. Most critically, the Court found that ABB had decided to use revenue sharing to pay for plan costs and fees because it had separately agreed that plan costs and fees would (at least in part) be paid for by ABB itself. Thus, ABB's decision to use revenue sharing to minimize plan fees was driven by a desire to decrease ABB's fee obligations – a motivation that plainly (the Court believed) was not in the best interests of participants. Further, the Court noted that the fiduciaries never determined whether the fees paid through revenue sharing were more than the actual costs of the fees, never considered how the Plan might use its size or "purchasing power" to leverage reduced costs, ignored a third party's advice that it was overpaying, did not investigate the market price for comparable fees, and never even asked Fidelity Trust for a rebate or cost reduction. Comparing the ABB plan to other plans, the Court found that ABB overpaid for its recordkeeping services.

While ABB noted that it did monitor the reasonableness of the overall expense ratio, the Court concluded that this was not enough. This was insufficient because it does not show how much revenue is flowing, does not show the competitive market for comparable funds, and fails to take into account the size of the plan. The Court explained that these analyses were particularly critical because the Plan's Investment Policy Statement ("IPS") required that revenue sharing "be used to offset or reduce the cost of providing administrative services to plan participants." Without calculating the dollar amount of the recordkeeping fees, ABB could not know whether revenue sharing was offsetting or reducing the cost. By failing to comply with the IPS provision, ABB breached its fiduciary duties.

ABB also argued that the revenue sharing reasonably permitted risk sharing between Fidelity and the Plan, because when the assets of the Plan decline, Fidelity shares the loss in revenue sharing, whereas when the assets of the Plan increase, Fidelity realizes an increase in revenue sharing. The Court explained that the problem with this argument is that Fidelity kept track of decreases in its revenue sharing and requested hard-dollar fees when revenue sharing declined, whereas, in contrast, ABB did not track reciprocal increases in revenue sharing and request from Fidelity rebates when revenue sharing increased. This conduct, the Court found, showed that ABB did not protect the plan participants.

In concluding that the revenue sharing practices at issue resulted in breaches of fiduciary duties, the Court was careful to note that "the Court is not stating that revenue sharing is an imprudent method for compensating a plan's recordkeeper." Rather, the Court explained, if a fiduciary opts for revenue sharing, "it also must have gone through **a deliberative process** for determining why such a choice is in the Plan's and participants' best interest." (Emphasis added.)

Selection and De-Selection of Investments

In addition to finding breaches of fiduciary duties as a result of revenue sharing practices, the Court found that ABB violated its fiduciary duties to the Plan in its selection and de-selection of investments. Specifically, the Court found that ABB violated its fiduciary duties when it (1) removed the Vanguard Wellington Fund and replaced it with Fidelity's Freedom Funds; and (2) selected more expensive share classes for the Plan's investment platform when less expensive share classes were available.

The Court found that the decision to remove the Vanguard Wellington Fund and replace it with Fidelity's Freedom Funds did not comply with the IPS, which included the method of de-selecting funds and a winnowing process for fund selection. In terms of the de-selection process, the IPS required the Committee to examine whether the fund had underperformed over a three to five-year period, and, if it had, place the fund on a watch list and remove the fund within six months. The Court found that the Committee did not follow any of these procedures in removing the Vanguard Wellington Fund but instead acted upon an uninformed recommendation from a member of the Pension Committee.

In terms of the selection process, the Court found that the Committee did not follow the IPS process in selecting the Fidelity Freedom Funds, but instead conducted only scant and superficial research, considering only three funds and immediately eliminating one fund from consideration. To make matters worse, the Court found that the recommendation was motivated by ABB's desire to decrease its out-of-pocket costs for recordkeeping fees. Pursuant to a collective bargaining agreement with the employee union, ABB paid the difference between the hard-dollar fee paid to the Union Plan and the Main Plan. Accordingly, it was in ABB's interest to maintain low hard-dollar costs for the Union Plan, as any difference in fees was paid for by ABB. This allowed ABB to maintain the appearance that its employees were not paying for the administration of the Plan by using revenue sharing instead of hard dollar fees. Because ABB based its decision-making upon factors other than the merits of the investments, ABB breached its fiduciary duties.

The Court also criticized ABB's decision to map the Wellington Fund onto the Freedom Funds because doing so was inconsistent with the stated purpose for removing the Wellington Fund. The Court noted that the Wellington Fund had competitive expense ratios and provided only 15 basis points in revenue sharing as compared to the 35 basis points provided by Freedom Funds. Because ABB failed to compare differences in expense ratios or revenue sharing percentages between the Wellington Funds and the Freedom Funds or other balanced funds on the Plan platform, the Court found that ABB failed to make a prudent determination as to which investment would have been most appropriate for mapping the Wellington Fund's assets. Moreover, the Court found that the cursory analysis once again indicated that ABB was motivated in part by its desire to decrease the fees that ABB paid.

The Court also criticized ABB's selection of more expensive share classes for the Plan's investment platform when less expensive share classes were available. Specifically, the Court found that ABB selected share classes based upon their effect on ABB's revenue sharing proceeds method of compensation to Fidelity Trust – rather than the best interests of the participants. This was particularly critical in view of the Court's finding that the IPS required use of a share class that has the least expenses. By choosing a fund based upon something other than the merits of the investment or its value to the participants, ABB breached its fiduciary duty to the Plan.

Subsidization of ABB Corporate Administrative Services with Excessive Revenue Sharing Generated by PRISM Plan Assets

In addition to the violations discussed above, the Court found that ABB, and the Employee Benefits Committee violated their fiduciary duties to the Plan when they agreed to pay to Fidelity an amount that exceeded market costs for Plan services in order to subsidize the corporate services provided to ABB by Fidelity, such as ABB's payroll and recordkeeping for ABB's health and welfare plan and its defined benefit plan. The Court explained that ABB had received (1) information from Fidelity Trust regarding the revenue and cost information as to all of its services to ABB and (2) a report from a third party that indicated that ABB overpaid for Plan recordkeeping services and that the Plan's recordkeeping payments via revenue sharing appeared to be subsidizing services for ABB corporate plans. The Court found that key individuals turned a purposeful blind eye to the subsidization so that ABB could continue to receive discounted services for its welfare plans This conduct was in stark contrast to the conduct the Court would have expected under the circumstances: immediate action to investigate.

Breaches of Fiduciary Duties by Fidelity Trust and Fidelity Research

Further, the Court found that Fidelity Trust and Fidelity Research also breached their fiduciary duties to the Plan by improperly using a "float" on plan investments. "Float income" or "float" is the income and interest earned when contributions and disbursements are held temporarily in overnight secured vehicles during the transfer process. Fidelity Research managed the Plan assets when in the temporary overnight accounts, and transferred the assets into an account registered to Fidelity Operations. Fidelity Trust in turn distributed the float pro rata among individual investment options. By distributing the float *pro rata* among individual investment options, all shareholders of the investment option—not just participants in the ABB 401(k) Plan—received the benefit. Since the float income constitutes Plan assets, distributing these assets to non-plan participants was a breach of ERISA's fiduciary responsibilities.

Key Takeaway

The *ABB* case provides useful guidance in the context of ERISA fee litigation because it highlights the importance of both following established processes and also acting for the exclusive benefit of the plan participants and beneficiaries. As is often true in ERISA fiduciary litigation, the decision is less about the propriety of any particular action in the abstract (e.g., the use of revenue sharing to pay for plan fees and costs), and more about the importance of using careful process and investigation, with an eye towards the best interests of the plan and its participants.