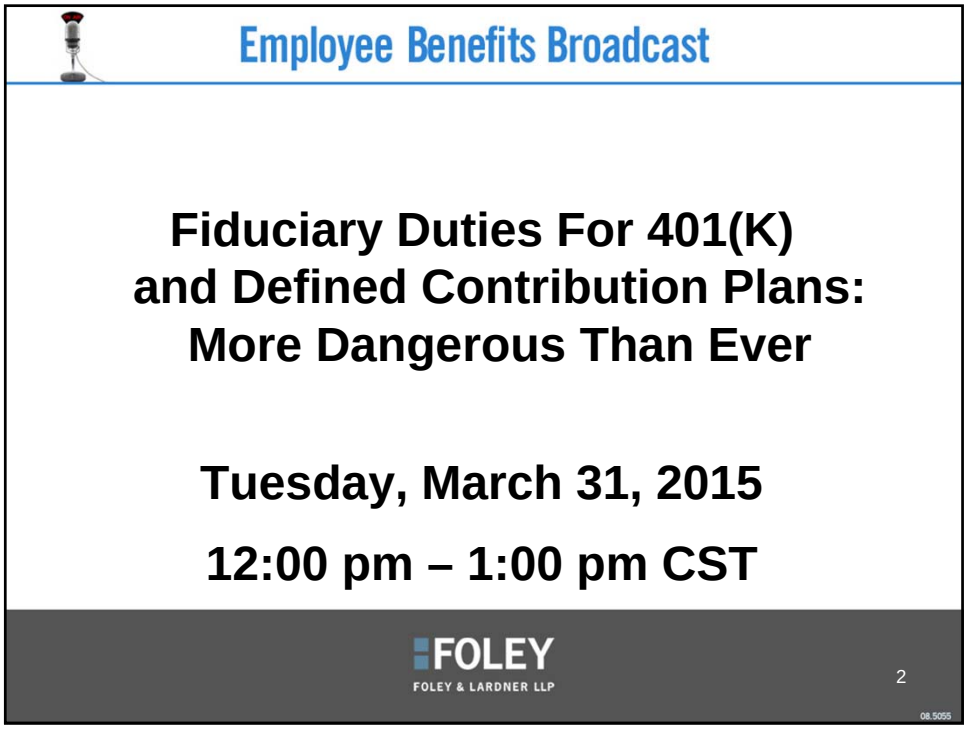

Employee Benefits Broadcast

Today's Speakers

Gregg H. Dooge

Isaac J. Morris

FOLEY
FOLEY & LARDNER LLP

3

08.5055

Employee Benefits Broadcast

Housekeeping Issues

- Questions can be entered via the **Q&A widget** open on the left-hand side of your screen. We will address questions at the end of the program, time permitting.
- If you experience technical difficulties during the presentation, please visit the Webcast Help Guide by clicking on the **Help button** below the presentation window, which is designated with a question mark icon
- The PowerPoint presentation will be available on our website at Foley.com in the next few days or you can get a copy of the slides in the **Resource List** widget
- Foley has applied for HRCI credit and will apply for CLE credit after the program. To be eligible for CLE, you will need to log into the On24 session and answer a polling question during the program. If you did not supply your CLE information upon registration, please e-mail it to ekemmeter@foley.com.
- **NOTE:** Those seeking **Kansas, New York & New Jersey CLE** credit are required to complete the Attorney Affirmation Form in addition to answering the polling question that will appear during the program. A 4-digit code will be announced during the presentation. Email the code and the form to ekemmeter@foley.com immediately following the program.

FOLEY
FOLEY & LARDNER LLP

4

08.5055

Employee Benefits Broadcast

A Brief History

- At one time, retirement plans primarily defined benefit
  - Plan sponsor bears the risk of investment gain or loss
  - ERISA litigation generally limited to
    - Individual benefit claims (limited exposure because a single participant is involved)
    - Egregious violations, e.g., substantially all plan assets loaned back to the plan sponsor
  - Not many "teachable moments"

FOLEY
FOLEY & LARDNER LLP

5

08.5055

Employee Benefits Broadcast

The Sea Change

- Plan sponsors shifted from defined benefit to defined contribution designs
  - Shifted investment risk from plan sponsor to plan participants
  - More predictable accounting treatment
    - No balance sheet liability (or other financial disclosures) that fluctuate with changes in interest rates
    - "Risk" associated with benefits accrued during a year generally limited to employer funding of contribution for that year

FOLEY
FOLEY & LARDNER LLP

6

08.5055

Employee Benefits Broadcast

Unintended Consequences

- For the most part, the move from defined benefit to defined contribution has done exactly what plan sponsors intended
- However, in one area – ERISA's fiduciary duty rules – the shift from defined benefit to defined contribution has produced a large increase in ERISA litigation
  - Defined benefit: little incentive to "fight"
  - Defined contribution: more incentive to "fight"

FOLEY
FOLEY & LARDNER LLP

7

08.5055

Employee Benefits Broadcast

Current State of Affairs

- Magnified volume of ERISA fiduciary litigation (defined contribution fiduciary litigation)
- Class action litigation
  - Large groups of participants may have requisite commonality
- Surprisingly large judgments or settlements
  - Plaintiffs are increasingly successful
- Courts stress importance of process and documentation
  - Not a new concept, but more important than ever

FOLEY
FOLEY & LARDNER LLP

8

08.5055

Employee Benefits Broadcast

ERISA's Fiduciary Duties

- Fiduciary duties are not a new concept – they have been part of ERISA since the beginning
- ERISA Section 404(a)(1)(B) requires that a fiduciary discharge his or her duties 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 (prudent expert standard)

FOLEY
FOLEY & LARDNER LLP

9

08.5055

Employee Benefits Broadcast

The Prudence Requirement

- Section 404 doesn't provide specific action steps for the 401(k) universe
- Generally, the prudence requirement is defined in terms of the decision-making process followed by the fiduciary
- For example:
  - Section 2550.404a-1 refers to a fiduciary with investment duties satisfying the prudence requirement if the fiduciary "has given *appropriate consideration* to those facts and circumstances that, given the scope of such fiduciary's investment duties, the fiduciary knows or should know are relevant to the particular investment or investment course of action involved . . . ."

FOLEY
FOLEY & LARDNER LLP

10

08.5055

Employee Benefits Broadcast

Defined Contribution Challenges

- In 401(k)/defined contribution universe, fiduciary challenges generally allege one of two things:
  - Imprudent selection (or monitoring) of investment options
  - Imprudent fee arrangements, failure to monitor fees, or similar challenges to direct or indirect fees.
- Plaintiffs don't always prevail
  - Hecker v. Deere, 556 F. 3d 575 (7th Cir. 2009)
  - Loomis v. Exelon Corp., 658 F. 3d 667 (7th Cir. 2011)
- But, the past year was a good year for plaintiffs

FOLEY
FOLEY & LARDNER LLP

08.5055

Employee Benefits Broadcast

Recent Trends

- Plaintiffs have made "head-way"
  - Large verdicts in decided cases, e.g., ABB
  - Large settlements (in cases settled before trial)
    - December, 2014 -- $140 million settlement proposed in one case.
  - Additional cases going to trial
    - Defendants previously more successful in obtaining dismissal prior to trial
    - Plaintiffs now having more success getting cases to trial, e.g., Boeing

FOLEY
FOLEY & LARDNER LLP

08.5055

Tussey v. ABB, Inc. (1 of 3)

- Tussey v. ABB, Inc.
  - Originally decided in 2012
  - Appeal decided in 2014
- District Court Decision (History from 2012)
  - Failure to monitor and control recordkeeping fees -- $13.4 million award.
  - Imprudent action to replace one mutual fund investment option with another and "map" non-electing participants to the new fund -- $21.8 million award.

Tussey v. ABB, Inc. (2 of 3)

  - District court decision based on concepts of procedural prudence (particularly with respect to the $13.4 million award for failure to monitor fees)
    - ABB lacked a **deliberative process** for reviewing the total fees and/or compensation received by the trustee, and for comparing the trustee's fees/compensation to market rate of compensation
- Court of Appeals Decision
  - Affirmed the $13.4 million recordkeeping award
  - Reversed the $21.8 million investment option award

Tussey v. ABB, Inc. (3 of 3)

- Tussey v. ABB, Inc. is instructive
  - Not because of the particular fee arrangement at issue (market trends now favor a negotiated fixed fee)
  - But, rather, because the court focused on lack of process (procedural prudence)
    - "However, if a plan sponsor opts for revenue sharing as its method of payment for recordkeeping services, it must not only comply with its governing plan documents, it must also have gone through a deliberative process for determining why such a choice is in the Plan's and participants' best interest."
- Lack of process (and/or lack of documentation of the process) carried a $13.4 million cost

George v. Kraft Foods Global (1 of 3)

- Claim of imprudent operation of employer stock fund
  - District court grants summary judgment to Kraft
  - Appeals court reverses (sends case back to lower court for trial)
  - $9.5 million settlement

Employee Benefits Broadcast

George v. Kraft Foods Global (2 of 3)

- Plan fiduciaries had explored whether to change from one method to another.
- However, according to the Court of Appeals, the record did not reveal whether the fiduciaries made a decision (the status quo simply continued)
- Court of Appeals viewed failure to make a decision as a possible fiduciary breach (the court completed the incomplete narrative)

FOLEY
FOLEY & LARDNER LLP

17

08.5055

Employee Benefits Broadcast

George v. Kraft Foods Global (3 of 3)

- The Court of Appeals wrote:
  - "Under ERISA, a fiduciary's failure to exercise his or her discretion – i.e., to balance the relevant factors and make a reasoned decision as to the preferred course of action – under circumstances in which a prudent fiduciary would have done so, is a breach…"
- Did a documentation failure cost $9.5 million?
  - Isn't it likely that plan fiduciaries (when exploring options) made a decision to continue with the option historically used, but neglected to document the decision? As opposed to never making a decision.

FOLEY
FOLEY & LARDNER LLP

18

08.5055

Employee Benefits Broadcast

Recent Developments

- Spano v. Boeing (December 30, 2014)
  - Excessive fee case to proceed to trial (Boeing unable to obtain dismissal at pre-trial stage)
  - Somewhat of a surprising result in the 7th Circuit (Wisconsin, Illinois and Indiana)
    - 7th Circuit had decided Hecker v. Deere in 2009.
    - In Hecker, the 7th Circuit easily rejected an excessive fee case.

FOLEY
FOLEY & LARDNER LLP

19

08.5055

Employee Benefits Broadcast

Spano v. Boeing (1 of 2)

- *"Having been in the trenches in 2009 after the [Hecker v. Deere] decision, betting a dollar that a decision such as this [Boeing] would be likely someday would have been a waste of a perfectly good dollar."*
  - *Thomas E. Clark, Jr.*
- Boeing might still win at trial (although in many cases a defendant who can't obtain a pre-trial dismissal of the case will settle instead of fighting on)

FOLEY
FOLEY & LARDNER LLP

20

08.5055

Employee Benefits Broadcast

Spano v. Boeing (2 of 2)

- Why did the court allow the case to continue?
  - Failure to solicit competitive bids for the plan's administrative (record-keeping) services
  - Plaintiff conflict of interest arguments resonated with court (at least at this stage)
  - Defendants failed to cite to any evidence of procedural prudence in support of its selection and monitoring of certain investments

FOLEY
FOLEY & LARDNER LLP

08.5055

Employee Benefits Broadcast

Lessons Learned: Take the Steps and Document Them!

- In ABB, Kraft and Boeing, the court focused on procedural prudence
  - What steps did the fiduciaries take to study and evaluate?
  - Was there a thoughtful decision-making process (and once a decision had been made, was there evidence of an on-going review process)?
  - Was the process documented (so that it is obvious even at the pre-trial stages)?
- There must be evidence of a thoughtful process (and documentation of that process)

FOLEY
FOLEY & LARDNER LLP

08.5055

Employee Benefits Broadcast

Who Controls the Narrative?

- Plaintiff cases are built by creating a narrative along one of several lines:
  - #1 The fiduciary didn't pay attention, i.e., the fiduciary didn't have a process, or didn't complete the process
  - #2 The fiduciary has an ulterior motive (self-dealing)
  - #3 A prudent fiduciary could not have made the decision that the plan fiduciary made, e.g., a prudent plan fiduciary would not have continued with that investment option, would not have paid that fee, etc.

FOLEY
FOLEY & LARDNER LLP

23

08.5055

Employee Benefits Broadcast

Controlling the Narrative

- Destroy the plaintiff's possible narrative (claim) by using a thoughtful process and by documenting why the fiduciary reached its decision or continued the status quo
  - Minutes of the fiduciary committee are the most effective defense.
  - Minutes don't need to be a transcript of the discussion, but they should document the decision reached and reason for it
  - Document reasons for not changing the status quo (fiduciary inactivity might be the easiest to attack)
  - Make certain that the quarterly investment report doesn't become a plaintiff's best friend.

FOLEY
FOLEY & LARDNER LLP

24

08.5055

Employee Benefits Broadcast

The Quarterly Investment Report

- Many defined contribution plans have retained an investment consultant
  - Each quarter, consultant produces a book that reviews investment performance
    - Existence of third party consultant and report should offer fiduciary protection (evidence of review process)
    - The report could become a plaintiff's weapon if it shows issues that have not been addressed, e.g., if report shows under-performance but record does not indicate decision and basis (see ABB case)
- Might this be the next area of challenge?

FOLEY
FOLEY & LARDNER LLP

25

08.5055

Employee Benefits Broadcast

Controlling the Narrative – Ex. 1

- The Quarterly Investment Report
  - A plan investment option trails its index benchmark over the trailing one, three, and five year periods ending September 30, 2014, but has favorable comparisons over the trailing seven year period. No action is taken to change the investment option.
  - Plaintiff's argument: Continuation of investment option with five year under-performance relative to benchmark was imprudent
    - Although reversed on appeal, District Court decision in ABB indicates that courts may have an appetite for such an argument
    - Unless defendant can prevail on summary judgment, transaction costs can be significant

FOLEY
FOLEY & LARDNER LLP

26

08.5055

Employee Benefits Broadcast

Controlling the Narrative – Ex. 1

- The Quarterly Investment Report
  - Retaining the option could be reasonable under multiple scenarios
    - Seven year performance reflects a full-market cycle and committee gives significant weight to full-cycle performance
    - (Equity Manager) The manager has a conservative bias and is expected to "underperform" during strong bull market periods. Only the seven year return reflects both "up" (2009-present) and "down" (2008) markets
    - (Fixed Income Manager) The manager was selected because it tends to invest in higher quality issues (and thus has less risk) than the benchmark itself, which contains more lower quality issues. For periods during which the market rewards risk, the selected fund will underperform, but the manager is doing exactly what is was hired to do.

FOLEY
FOLEY & LARDNER LLP

08.5055

Employee Benefits Broadcast

Controlling the Narrative – Ex. 1

- The Quarterly Investment Report
  - (Go Anywhere Fund) The benchmark assumes a particular style and/or market universe, and while the benchmark is used for comparison, it may be an "apples to oranges" comparison given fund's "go anywhere" mandate.
  - (Fund with International Exposure Using S&P 500 Benchmark) In recent years U.S. equity has out-performed international equity, so a globally diversified fund will have under-performed the S&P 500.
- If appropriate reason is documented in committee minutes, then defendant might win case on summary judgment
  - Arbitrary & capricious standard of review can apply to investment decisions

FOLEY
FOLEY & LARDNER LLP

08.5055

Employee Benefits Broadcast

Controlling the Narrative – Ex. 2

- Recordkeeping Fees
  - We are happy with our current record keeper, but haven't done a full-blown RFP for many years. How do we protect against an excessive fee claim?
  - Plaintiff's argument: Recordkeeping services are fungible, so issue is purely based on price

FOLEY
FOLEY & LARDNER LLP

29

08.5055

Employee Benefits Broadcast

Controlling the Narrative – Ex. 2

- Recordkeeping Fees
  - Consider fee bench-marking service even if you don't do an RFP
    - Fee must not be excessive in light of services received, although current vendor doesn't have to be the lowest cost provider
  - Document evaluation of non-monetary consideration
    - The fee, in relationship to services received and disruption that change would cause, is reasonable

FOLEY
FOLEY & LARDNER LLP

30

08.5055

Employee Benefits Broadcast

QUESTIONS & ANSWERS

FOLEY
FOLEY & LARDNER LLP

08.5055

Employee Benefits Broadcast

Contact Information

Gregg H. Dooge
Partner
414.297.5805
gdooge@foley.com

Isaac J. Morris
Senior Counsel
414.297.4973
imorris@foley.com

FOLEY
FOLEY & LARDNER LLP

08.5055

Employee Benefits Broadcast

Thank You!

- A copy of the PowerPoint presentation and a multimedia recording will be available on the event Website early next week: **http://www.foley.com/employee-benefits-broadcast-spring-2015/**
- HRCI or CLE questions? Contact Ellie Kemmeter at **ekemmeter@foley.com**
- We welcome your feedback. Please take a few moments before you leave the Web conference today to provide us with your feedback

FOLEY
FOLEY & LARDNER LLP

33

08.5055