ERISA CASE SERIES

Fiduciary Breach Results in Multi-Million Dollar Damages Award

Executive Summary
In 2012, the U.S. District for the Western District of Missouri Central Division handed down a ruling in the class action suit ***Tussey et al. v. ABB, Inc. et al*****,** No.2:06-CV-04305 (W.D. Mo. March 31, 2012) that has caused plan sponsors as well as plan service providers to scrutinize their plan service arrangements more closely for potential fiduciary violations. The court ruled Defendant ABB, as well as the plan's record keeper, Fidelity Trust, committed several fiduciary breaches and, as a result, were liable to the plan for nearly $37 million in damages.

<u>Defendant ABB's fiduciary liability</u> resulted from breaches associated with the

- Failure to monitor recordkeeping costs and negotiate rebates from Fidelity Trust;
- Mapping of certain funds;
- Selection of more costly classes of investments that had higher expenses when other share classes were available that had lower expense ratios;
- Subsidization of ABB corporate services through the payment of excessive plan fees.

<u>Fidelity's fiduciary liability</u> resulted from breaches associated with failing to distribute float income solely for the interest of the plan.

In 2014, on appeal, the Eighth Circuit Court of Appeals upheld the district court's judgment for the $13.4 million award against ABB fiduciaries for failing to monitor recordkeeping fees and negotiate plan pricing rebates. However, it reversed the District Court's $1.7 million judgment against Fidelity regarding the treatment of float income, ruling that float income is not a plan asset. The court also vacated and remanded the judgment and award (for $21.8 million) on the participants' investment selection and mapping claims to the district court for further consideration.

The Supreme Court of the United States denied a review of the case in November 2014.

On remand in July 2015, despite the finding that Defendant ABB abused its discretion, the district court ruled Plaintiffs Tussey had failed to prove damages consistent with the method of damage calculation suggested by the Eighth Circuit. Therefore, judgment was entered in favor of the Defendant ABB on this remaining claim. Consequently, Defendant ABB was not liable for the $21.8 loss resulting from the investment mapping claims.

At this point, of the initial $37 million judgment, ABB is liable for $13.4 million.

Background of *Tussey v. ABB, Inc.*

- ☐ Defendant ABB sponsors two participant-directed 401(k) plans, referred to as the PRISM Plans. The available investment options are determined by the ABB Pension Review Committee (at the recommendation of the Pension Thrift Management Group of ABB).

- ☐ In 1995, through a competitive bid process, ABB selected Fidelity Trust to provide recordkeeping services for both 401(k) plans. Initially, Fidelity Trust was compensated through a per-participant hard dollar fee, but was eventually transitioned into a primarily revenue-sharing compensation model by April 2001.

- ☐ After choosing the new method of compensating Fidelity, ABB did not calculate the actual cost of Fidelity's services, nor did ABB consider leveraging the plan's size to reduce recordkeeping costs – even after it had been alerted by an outside consulting firm that it was overpaying for recordkeeping services. (A direct violation of the plan's investment policy statement that would ultimately have severe monetary consequences for ABB.)

- ☐ In 2001, ABB's Pension Review Committee, acting on the recommendation of the Pension Thrift Management Group of ABB, removed the Vanguard Wellington Fund (a fund with a consistent and strong-performing track record) and replaced it with the Fidelity Freedom Funds (a balanced fund). ABB's investment replacement process did not follow the plan's investment policy statement, which constituted a fiduciary breach and led to additional monetary consequences for ABB.)

- ☐ Fidelity's investment process involved temporarily depositing plan contributions into secure overnight investment vehicles. The following day, the principal amount would then be moved into the investment options selected by the participants. The temporary accounts used in this process earned interest called "float income." This float income, as a plan asset, should have been allocated to the plan, but was instead used to pay Fidelity Trust's operating expenses for recordkeeping and administering the plan. After that, any remaining float income was distributed among the plan's individual investment options that choose to receive it. The use of float income in this manner was a fiduciary violation.

- ☐ In 2006, Plaintiff and plan participant, Ronald Tussey filed suit against the ABB defendants (including Fidelity) alleging ABB breached their fiduciary responsibilities by paying excessive recordkeeping fees to Fidelity and for failing to disclose the revenue sharing agreements to plan participants. In addition, Plaintiff alleged Fidelity Trust steered the plan toward expensive funds managed by Fidelity Management in exchange for compensation (an arrangement ABB was aware of or should have been).

- ☐ In December 2007, the district court certified the lawsuit as a class action representing over 12,000 employees (the number of participants in the two 401(k) plans at the end of 2005).

- ☐ In 2008, defendants ABB along with Fidelity filed a motion to dismiss the case due to the failure of the Plaintiff's ability to show a fiduciary violation. The district court denied the motion to dismiss the case.

- In March 2012, the district court found ABB along with Fidelity liable of breaching some of their fiduciary duties with respect to the PRISM plans.

    - ABB defendants are jointly liable for

        - $13.4 million lost by the plan for ABB's failure to monitor recordkeeping fees and negotiate for rebates, and
        - $21.8 million lost by the plan due to mapping the Vanguard Wellington Fund to the Fidelity Freedom Funds – a change that did not follow the plan's investment policy statement.

    - Fidelity is liable for compensating the plan for $1.7 million for lost float income as a result of using the float as additional recordkeeping income (the trust agreement specifies payment through revenue sharing only), and failing to distribute income generated by the plan assets solely to plan participants and beneficiaries.

- In March 2014, the Eighth Circuit Court of Appeals issued an opinion in the case upholding and vacating some of the district court's rulings from 2012.

    - The Eighth Circuit Court of Appeals upheld the district court's judgment and $13.4 million award against ABB fiduciaries for failing to monitor recordkeeping fees and negotiate plan pricing rebates. The judgment and award ($21.8 million) on the participants' investment selection and mapping claims was vacated and remanded to the district court for further consideration. The Eighth Circuit directed the district court to reevaluate its method of calculating the damage award.
    - The District Court's $1.7 million judgment against Fidelity was reversed.

- In 2015, upon remand, the Eighth Circuit instructed the district court to reevaluate its method of calculating the damage award, if any, for the participants' investment selection and mapping claims. It suggested that, in light of the IPS requirement to add a managed allocation fund, damages would be more accurately measured by comparing the difference between the performance of the Freedom Funds and the minimum return of the subset of managed allocation funds the ABB fiduciaries could have chosen without breaching their fiduciary obligations. Plaintiffs Tussey argued this method for calculating damages was wrong. The district court ruled that given that the Eighth Circuit had suggested a measure of damages, the court finds that measure persuasive and the Plaintiffs Tussey had failed to satisfy their burden of proof on the issue of damages. Judgment was entered in favor of the Defendant ABB on the remaining claim.

Additional Details

- ☐ ABB created an IPS which provided a process for selecting, deselecting and monitoring investments offered within the plan. Specifically, the process specified within the IPS for deselecting a fund required

  - > The fund be examined during a period of 3-5 years,
  - > Determining whether the fund has five years of underperformance (at which time the fund is placed on a watch list), and
  - > Removal of any fund on the watch list within six months.

The recommendation to deselect the Vanguard Wellington Fund was made without following the process noted above, which as the court states, is a "blatant violation of the IPS and illustrates a careless, imprudent decision-making process."

- ☐ According to the district court order, ABB is

- > Ordered to conduct a competitive bidding process within 18 months of the order to select a new record keeper (Fidelity Trust can take part in this process),
- > Ordered to monitor the recordkeeping costs associated with the plan as well as negotiate price for services provided to the plan by the record keeper, and
- > Prohibited from using the same record keeper to service the PRISM plans as well as other corporate services.

What Actions Should Fiduciaries Consider

Much can be learned from this case. Not only does the order convey the importance of monitoring fees associated with servicing a retirement plan, it also attests to the importance of following an established process for making changes to the plan's investment line-up. As a fiduciary liability reduction strategy with respect to plan fees, plan fiduciaries should:

- ☐ Carefully monitor plan fees and expenses on an ongoing basis to ensure they remain reasonable

- ☐ Meticulously evaluate revenue sharing arrangements, including amounts generated and payments made

- ☐ Retain documentation used to select and monitor service providers

- ☐ Comply with expanded participant fee disclosure requirements under ERISA §404(a)(5).

In addition, plan fiduciaries should implement a strategy to help minimize added risk associated with the investments offered under the plan. To help in this effort, plan fiduciaries should:

- ☐ Regularly review, update and follow the plan's IPS with respect to investment selection and replacement
- ☐ Schedule an annual ERISA Sec. 404(c) review to ensure compliance with all requirements (applicable for plans that intend to comply with ERISA 404(c))
- ☐ Conduct an annual review of the qualified default investment alternative (QDIA) selected for the plan