7th Circuit: Benefit Plan Administrators May Have Violated ERISA

4/22/2011 By W. Kevin Smith

The alleged failure of plan fiduciaries of the Kraft Foods Global Inc. 401(k) plan to change plan structure and recordkeeping fees to reduce participants' costs may have been a breach of their fiduciary duties.

The Kraft 401(k) plan had between 37,000 and 55,000 participants during the period relevant to the lawsuit, 2000 to 2006. In that time, the plan held between $2.7 billion and $5.4 billion in assets. Participants had several options regarding the funds in which their contribution was directed. The primary funds at issue in this case were those invested principally in Kraft and Altria Group Inc. (the parent of Kraft) stock, known as company stock funds (CSFs).

The plaintiffs were certified as a class of current and former Kraft employees who directed their contributions to CSFs. The funds are "unitized," meaning that participants purchase units of a CSF rather than shares of company stock.

Unitization may result in "investment drag," which is caused by cash held in a CSF. Because cash reserves in a fund would not appreciate at the same rate as appreciating company stock, the return on investment for unitized funds lags the return on investment in the appreciating stock alone.

Also, although unitization results in avoidance of many transaction costs (i.e., requests to buy and sell units), some costs are inevitable. Those costs are taken from the total value of the fund, meaning that each participant pays equally for trading, regardless of the number of transactions they initiate. This is known as "transactional drag."

The plaintiffs allege that by failing to eliminate investment drag and transactional drag, the fiduciaries did not act reasonably. The fiduciaries of the plan discussed several options to address these issues between 2002 and 2004. In particular, the fiduciaries discussed moving to "real-time trading," whereby participants would own shares of stock rather than units of a CSF. Ultimately, the fiduciaries made no changes to the plan structure.

The plaintiffs also claimed that in failing to solicit bids for recordkeeping services after securing the services of Hewitt Associates, the fiduciaries drastically overpaid for recordkeeping with plan funds. The fiduciaries periodically engaged consultants to examine the fees paid to companies servicing the fund, including Hewitt.

The lower court held that the fiduciaries had met their duties with regard to eliminating or reducing drag. Additionally, choosing to ignore contrary evidence presented by the participants, the lower court found that the fiduciaries properly relied on the advice of their consultants that the fees paid to Hewitt were reasonable. The lower court granted summary judgment on these and other charges brought by the participants.

On appeal, a majority of the 7th U.S. Circuit Court of Appeals held that the decision of the lower court should be overruled. According to the court, the fiduciaries were required to prove that they had acted reasonably under the circumstances.

The court found that the fiduciaries failed to act to address the transactional and investment drag, and so may have acted unreasonably. Further, the court determined that the lower court improperly discounted the evidence offered by the participants regarding recordkeeping fees. As a result, summary judgment on those claims was inappropriate. Therefore, the court reversed the lower court and returned the case to the lower court for trial on those issues.

The dissent found that the practices employed by the Kraft plan fiduciaries were the standard practice for the industry. As such, according to the dissenting judge, the fiduciaries did not breach any duty owed to the participants.

George v. Kraft Foods Global Inc., 7th Cir., No. 10-1469 (April 11, 2011).

Professional Pointer: If you are involved in the management of an employee retirement or profit-sharing plan, do not limit the scope of your review to performance of the fund assets; also consider the fees and costs involved in managing those assets.

*W. Kevin Smith is an attorney with the firm of **Smith & Smith Attorneys**, the **Worklaw® Network** member firm in Louisville, Ky.*

Editor's Note: This article should not be construed as legal advice.

Society for Human Resource Management

1800 Duke Street Alexandria, Virginia 22314 USA	Phone US Only: (800) 283-SHRM Phone International: +1 (703) 548-3440	TTY/TDD (703) 548-6999 Fax (703) 535-6490	Questions? Contact SHRM Careers Careers @ SHRM