

Client Alert

Seventh Circuit Clarifies Standard for Establishing Fiduciary Status for Plan Service Providers

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In *Leimkuehler v. American United Life Insurance Co.*, Nos. 12-1081, 12-1213 & 12-2536 (7th Cir. Apr. 16, 2013), the Seventh Circuit expanded on its prior ruling in *Hecker v. Deere*, 556 F.3d 575 (7th Cir. 2009) and held that a service provider that offers a menu of investment options to a 401(k) plan and retains the right to overrule the options chosen by the plan from that menu is a functional fiduciary only to the extent that it actually exercises authority or control over plan assets. In this advisory, attorneys from our ERISA Litigation and Employee Benefits and Executive Compensation Practices summarize the case and identify important ramifications of the Court's decision, which will be of particular interest to plan service providers.

Background

In this case, the trustee of the Leimkuehler, Inc. Profit Sharing Plan filed suit against American United Life Insurance Company (AULIC). AULIC provides the plan with the use of a group variable annuity contract that allows plan participants to indirectly invest in mutual funds. Participants' investments are placed in a separate account controlled by AULIC, which then uses that money to invest in the mutual funds selected by the participants. AULIC credits the proceeds back to the participants, and the performance of participants' investments mirrors the performance

of the selected mutual funds. AULIC receives revenue sharing payments from the selected mutual funds, which are payments for administrative services AULIC performs that otherwise would have been performed by the mutual fund providers had participants directly invested in those mutual fund.

AULIC also selected a menu of mutual fund investment options, determining which share classes would be part of the menu, and then presented the menu to the plan's trustee. The trustee then selected from the menu the options that were made available to plan participants. The trustee retained the discretion to change his selections, and AULIC retained the right to substitute or delete from the trustee's choices (which it did on two occasions).

On behalf of the plan, the trustee sued AULIC alleging that AULIC's revenue-sharing practices constituted an ERISA breach of fiduciary duty. The district court granted summary judgment to AULIC. It ruled that AULIC had no fiduciary obligations with respect to its revenue sharing practices and therefore was not a functional fiduciary under ERISA.

Opinion

The Court first examined the trustee's "product-design theory," which argued that by designing a

menu of investment options, AULIC decided which funds and share classes will be offered, and thereby influenced how much it will receive in revenue sharing fees. According to the trustee, “These product-design decisions shape the disposition of Plan assets: they limit the universe of funds, as well as the share classes within those funds, in which Plan assets are invested.” The trustee argued that this made AULIC a functional fiduciary with regard to the management or disposition of plan assets.

The Court looked to its prior ruling in *Hecker* that “the act of selecting which funds will be included in a particular 401(k) investment product, without more, does not give rise to a fiduciary responsibility.” The Court stated in *Hecker* that there is no authority holding that the act of limiting a menu of investment options automatically creates discretionary control under ERISA. Furthermore, the applicable trust agreement in *Hecker* gave the plan sponsor the final say on which investment options would be offered to participants.

The Court found that the fact that AULIC reserved the right to make substitutions to the funds chosen by the trustee (a fact that was not present in *Hecker*), did not mean that AULIC exercised this right in a way giving rise to a claim.^[1] Furthermore, the concept of share classes did not lead to a different conclusion because AULIC disclosed the bottom-line cost of the funds it offered and the trustee was free to seek a better deal with a different service provider.^[2]

The Court then dismissed the trustee’s argument that AULIC exercised control over the plan’s assets because it maintained and controlled the separate account. According to the trustee, AULIC’s actions with regard to the separate account, such as keeping track of participants’ contributions and directions, investing participants’ money in accordance with their directions, and crediting returns back to the participants’ accounts, amounted to control over plan assets because ERISA 3(21)(A) only requires that AULIC exercised “any” authority or control over the assets.

The Court acknowledged that the *Hecker* decision caused confusion as to whether a finding of discretionary control is necessary to hold someone a functional fiduciary of plan assets and made clear that “insofar as ‘management or disposition of assets’ is concerned, there is no separate requirement of discretionary authority or control.”^[3] However, this reasoning did not persuade the Court that AULIC was a functional fiduciary because the trustee did not argue that AULIC mismanaged the separate account. The trustee’s arguments centered around revenue sharing and the selection of share classes, but those actions had nothing to do with AULIC’s maintenance of the separate account. Decisions regarding revenue sharing and share classes were made as part of the investment menu that had already been selected before participants invested their contributions.

The Court then addressed the argument made by the Department of Labor (DOL) in its amicus brief that AULIC is a fiduciary because it retained the right to delete or substitute the funds selected by the trustee for the plan and thereby exercised fiduciary authority every time it invested participants’ contributions in one of the chosen mutual fund class shares instead of a cheaper share class. The DOL argued that AULIC’s failure to substitute with less expensive share classes amounted to a fiduciary breach. The Court dismissed this argument, holding that AULIC’s decision not to exercise its right to substitute funds did not amount to an exercise of authority. The DOL’s theory would impermissibly expand the definition of functional fiduciary to include entities that take no action with respect to a plan.

Ramifications

The primary take-away from this decision is that merely being authorized to choose plan investment options is not enough to make a plan service provider a fiduciary. The Court’s reasoning supports arguments by service provider defendants that fiduciary breach claims against them should be

dismissed where the plaintiff pleads only that the service provider had a theoretical control of plan assets. Plaintiffs must plead more than that a service provider got to choose the composition of a menu of investment options and that it was authorized to make decisions as to which investments that plan would offer participants in order to adequately plead fiduciary status. Instead, the plaintiffs will need to allege that the defendants actually exercised that authority or control over plan assets.

Furthermore, this decision reconciles *Hecker* with decisions in other circuits regarding who is and is not a functional fiduciary over plan assets. This case makes clear that *Hecker* does not add a discretionary control requirement into the analysis.

For plan fiduciaries, the *Leimkuehler* decision highlights that they, not vendors providing their plans with a platform of investment options, will in most cases be responsible for selecting available investment options.

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- [1] The Court noted that one instance where AULIC exercised this right fell out of the statute of limitations period and the other instance involved a substitution of funds offered by the same mutual fund provider (none of which made revenue sharing payments to AULIC).
- [2] The Court also noted that the cheapest share class might not always be the best option, and there was nothing to suggest that AULIC would not have sought to make up lost revenue from offering cheaper share classes by charging higher direct fees to the plan.
- [3] This reasoning is in accord with decisions from the 2nd, 3rd, 6th, 9th, 10th, 11th and D.C. Circuits.

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