ERISA Case Alert - May 2011: George v. Kraft Foods Global, Inc.

05.06.2011
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George v. Kraft Foods Global, Inc., No. 10-1469 (7th Cir. April 11, 2011)

George, et al. v. Kraft Foods Global, Inc., et al., No. 10-1469 (7th Cir. Apr. 11, 2011), a recent Seventh Circuit decision, is a significant ERISA fiduciary duties case that calls for careful review by administrators of ERISA plans. *George* illustrates the importance of documenting a careful, reasoned decision process, especially for the design of retirement benefit plans and the investment decisions for those plans.

Unitization of the CSFs

George was filed in 2006 by current and former employee-participants in the 401(k) plan ("the Plan") sponsored by Kraft Foods Global, Inc. ("Kraft"). The Plan established individual accounts for participants and allowed directed contributions to one or more funds. Two of the funds were company stock funds ("CSFs"). The Plaintiffs alleged that Plan fiduciaries mismanaged the CSFs, resulting in a loss to the participants.

The Plaintiffs alleged a fiduciary breach based on unitization of the CSFs. Participants owned units of each fund rather than purchasing actual shares of company stock. Each CSF invested almost exclusively in the relevant company stock, but also held a small amount of liquid assets such as cash (roughly 5% of fund value). The liquid assets allowed the CSFs to distribute funds to participants more quickly when shares were sold. The unitizing approach also had the benefit of "netting" the cost of participant transactions. The Plan could offset one participant's request to sell with another participant's request to purchase, and thus pay a brokerage commission and related fees only to the extent needed to meet a net inflow or outflow of fund investment. Without this approach, the Plan would have had to pay the brokerage commission and fees each time a participant initiated either a purchase or sale of the stock.

The Plaintiffs alleged that unitizing the funds created "investment drag" and "transactional drag." They claimed that the CSFs' returns were lower than they could have been because the return on investment for the cash portion (inherently less risky than stock) was lower than returns on stock in the period from

2000 to 2007. Thus, they alleged that holding liquid assets caused lower returns for the Plan than would have been the case if the participants' funds had only been used to buy shares of company stock. The alleged "transactional drag" related to the "netting" of the brokerage costs to all participants. Plaintiffs alleged that frequent participant-traders did not bear the full cost of their trades, while participants who traded infrequently paid more than their share of such costs.

The Plaintiffs alleged that investment and transaction "drag" altogether caused the CSFs to underperform direct investments in Kraft and Altria common stock by $83.7 million in the period from 2000 to 2007. The district court granted summary judgment for the Plan defendants, and the Plaintiffs appealed to the Seventh Circuit.

Seventh Circuit's decision

The evidentiary record in the case showed that, between 2002 and 2004, the plan fiduciaries had discussed the two forms of "drag," and that discussions of possible solutions to the transactional "drag" continued to the end of 2004. However, the record did not reveal whether the Plan fiduciaries made a decision regarding any change to Plan administration. The status quo simply continued. The court declared,

> 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 of the prudent man standard of care.

The Seventh Circuit therefore reversed the summary judgment for the defendants and remanded the case to the district court. The Seventh Circuit did not determine whether the fiduciaries should have made changes, or what those changes should have been. Rather, the Seventh Circuit held that the district court would need to determine whether the fiduciaries prudently made, or chose not to make, a decision regarding the "drag" issues.

George is one of many class action cases filed since 2006 in which plaintiffs allege that administrators of large retirement plans breached fiduciary duties in administering plans and making investment decisions. It remains to be seen whether the holding in *George* will breathe new life into this litigation trend, but at a minimum the case illustrates the importance of a prudent decision-making process, and of documentation by fiduciaries of their deliberations and decisions with respect to plan design and investments.

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