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ERISA class actions: Ninth Circuit rules that a third-party administrator is NOT an ERISA fiduciary with respect to the terms of its own compensation

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Common sense often makes good law—William O. Douglas

The Employee Retirement Income Security Act of 1974 ("ERISA") imposes fiduciary duties on certain parties that deal with retirement and health care plans. In a recent class action, *Santomenno v. Transamerica Life Ins. Co*., 883 F.3d 833 (9th Cir. 2018), the Ninth Circuit reversed a district court order ruling that a third-party plan administrator was an ERISA fiduciary, and vacated another order certifying three separate "breach of fiduciary duty" classes. In doing so, the Ninth Circuit provided important clarification and guidance regarding a third-party administrator's status as a fiduciary when negotiating and then collecting contractually-specified fees from plan revenue. In short, the Ninth Circuit emphasized that a third-party plan administrator deals at arm's length with an employer when negotiating compensatory fees, and the resulting services and annuity contracts should be enforced as written.

The plaintiffs were members of 401(k) plans governed by ERISA. The defendant, Transamerica, was the third-party administrator of those plans. As typically happens, the plaintiffs' employers entered into contracts with Transamerica to operate the plans. In connection with that contracting process, the employers selected a list of potential investment options, which were then offered to their employees. Several of the plans were advised and managed by Transamerica affiliates. Transamerica structured each selected investment option (typically a mutual fund) as a separate account. The contributions of all plan members choosing any individual mutual fund or other option were pooled in the separate account, leading to substantial savings in administrative expenses. The agreements required Transamerica to track the investments of individual employees, among other administrative tasks.

Transamerica's compensation was established by its contracts with the employers as a fixed percentage of the assets in each separate account, disclosed in a specific schedule of fees for each separate account. Transamerica then collected its fees every day by withdrawing them from the separate accounts. The managers of the investment vehicles also charged fees (these managers included affiliates of Transamerica), and Transamerica received fees from these managers. Transamerica fully disclosed all of these arrangements in advance.

The class action complaint alleged that Transamerica violated ERISA by (1) charging fees as a percentage of the assets managed on the separate accounts, in addition to those charged by the managers of the underlying investments; (2) charging an additional "Investment Management Charge" on the separate accounts; (3) receiving additional revenue sharing payments from managers of the underlying investments; (4) "failing to invest in the lowest priced share class of the mutual funds that underlie the separate account investment options that invest in mutual funds"; and (5) "negotiating the traditional lower fees that are associated with these investment options but retaining them rather than passing the savings along to Plaintiffs." *Id*. at 836.

Transamerica moved to dismiss, asserting it did not violate ERISA because it was "not a fiduciary with respect to the terms of its own compensation." *Id*. An employer that forms an ERISA plan is a named or statutory fiduciary. *See* 29 U.S.C. § 1102(a). A party not named in a plan can also become a fiduciary if (i) it exercises any discretionary authority or control respecting management of the plan or disposition of its assets, (ii) it renders investment advice for compensation with respect to property of the plan, or (iii) it has any discretionary authority or responsibility in the administration of the plan. 29 U.S.C. § 1002(21)(A). These non-named fiduciaries are sometimes called "functional" fiduciaries, and a third-party administrator like Transamerica can become a functional fiduciary under the right circumstances. A functional fiduciary under ERISA must behave as a fiduciary; that is, the functional fiduciary cannot "deal with the assets of the plan in his own interest or for his own account" or "receive any consideration for his own personal account from any party dealing with such plan in connection with a transaction involving the assets of the plan." 29 U.S.C. § 1106(b)(1), (3).

The district court denied Transamerica's motion to dismiss and subsequently certified three ERISA classes corresponding to plaintiffs' breach of fiduciary duty claims. The district court, however, certified its orders for immediate appeal. The Ninth Circuit accepted the appeal and reversed the district court.

Agreeing with decisions by the Third, Seventh, and Eighth Circuits, the Ninth Circuit first held that "[a] service provider is plainly not involved in plan management when negotiating its prospective fees or compiling a list of proposed investment options." *Id*. at 838. This is because the service provider negotiates its fees at arm's length with the employer, another sophisticated entity and ERISA fiduciary. Nothing prevented the employers from rejecting the offering and selecting another service provider; in the words of the Third Circuit, "the choice was theirs." *Id*. at 838 (quoting *Santomenno ex rel. John Hancock Tr. v. John Hancock Life Ins. Co. (U.S.A.)*, 768 F.3d 284, 295 (3d Cir. 2014)). Moreover, any plan sponsor that agreed to unreasonable terms for its own employees would itself be liable for breaching its fiduciary duties.

With respect to Transamerica's paying itself fees *after* it became the plan administrator, the plaintiffs argued that Transamerica engaged in prohibited self-dealing by (1) receiving revenue sharing payments from investment managers and (2) withdrawing its fees from the separate accounts. The Ninth Circuit dismissed the first argument out of hand, because the revenue sharing arrangements were fully disclosed. As for the "withdrawing fees" claim, that claim was meritless because "at least with respect to withdrawing its formula-driven fee from the pooled accounts," Transamerica's actions "were purely ministerial." *Id*. at 840. The plaintiffs did not allege that Transamerica did anything other than collect contractually owed fees.

But the Ninth Circuit concluded: “Our holding today is narrow. We simply conclude that when a service provider's definitively calculable and nondiscretionary compensation is clearly set forth in a contract with the fiduciary-employer, collection of fees out of plan funds in strict adherence to that contractual term is not a breach of the provider's fiduciary duty.” *Id*. at 841. If plaintiffs alleged that Transamerica took more in fees than authorized by contract, for example, “this might well be a different case.” *Id*.