UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF ILLINOIS

ANTHONY ABBOTT et al., Plaintiffs, v. **LOCKHEED MARTIN CORPORATION et al.,** Defendants.	Case No. 3:06-cv-701-MJR-DGW

DEFENDANTS' TRIAL BRIEF ON ADMINISTRATIVE FEES CLAIM

Lockheed Martin became the large company it is today through organic growth and a strategic and aggressive course of mergers and acquisitions. Its Salaried Savings Plan ("SSP") and Hourly Employee Savings Plan Plus ("HSP") are among the nation's largest and most complex retirement plans. Depending on when plan participants joined Lockheed Martin, which predecessor company brought them in, and whether they belong to a labor union, their retirement accounts are subject to widely differing rules and privileges. Keeping track of these permutations is no trivial endeavor.

Because plan participants rely on their retirement accounts—and an accurate accounting of their rights and benefits—Lockheed Martin dedicates substantial internal resources to the administration of its retirement plans. It also engages a sophisticated outside vendor to keep the records for participant accounts and to enforce the array of rules to which their accounts are subject.

Plaintiffs claim that Lockheed Martin overpaid for recordkeeping services. But the evidence at trial will show otherwise. A sophisticated team of professionals at Lockheed Martin monitored industry trends and identified the services required by the SSP and HSP and procured the necessary services from the right company at an appropriate price.

Plaintiffs raise two objections. *First*, based on the report of expert witness Al Otto, they say that Lockheed Martin exceeded an arbitrary benchmark for per-person recordkeeping fees. But one of their other experts, Paul Kampner, denied that such benchmarking "is even appropriate in recordkeeping, because recordkeeping is based on services delivered." As he explained: "When you start getting into averages and stuff like that, . . . you're never—almost never comparing apples to apples." And that is the problem here. Not only does Mr. Otto miscalculate the fees paid by plan participants, he compares that amount to an arbitrary benchmark that fails to account for the "services delivered" to Lockheed Martin in even a superficial sense. As such, his opinion is not entitled to weight here.

Second, Plaintiffs claim that Lockheed Martin waited too long to subject their recordkeeping agreement to a competitive bid process. During a stretch of years in which Lockheed Martin engaged in a series of corporate mergers—mergers that required close cooperation between Lockheed Martin and the plans' recordkeeper—plan fiduciaries took appropriate steps to identify market trends and competitor vendors. It hardly made sense to change horses midstream when the incumbent was providing excellent service at a competitive price. Lockheed Martin thus waited until this string of mergers ended to conduct a formal bid process. After initiating a lengthy bid process in 2008, plan fiduciaries confirmed that they were paying the right company an appropriate price for recordkeeping services. Tellingly, they elected to stay with their current vendor.

FACTUAL BACKGROUND

The SSP and HSP are separate plans, but their assets are pooled in the Lockheed Martin Defined Contribution Master Trust ("Master Trust"). The Master Trust also contains seven other retirement plans sponsored by Lockheed Martin, none of which is at issue in this lawsuit.

Master trust structures are common for large companies with sophisticated retirement systems. They achieve economies of scale and permit certain services to be performed at the trust level. At all relevant times, recordkeeping was one of the services handled at the trust level. In 1997, plan fiduciaries selected State Street Bank & Trust as recordkeeper for all plans in the Master Trust. State Street was one of only a handful of companies equipped to handle the recordkeeping for a complex plan like Lockheed Martin's. Unlike its competitors, State Street offered the flexibility to tailor its recordkeeping platform to Lockheed Martin's specifications.

As Lockheed Martin created new defined-contribution plans, the 1997 agreement was amended to incorporate those plans (twice in 1998, once in 1999, and again in September 2000). Although the recordkeeping contract remained with State Street at all times, in April 2000, State Street assigned its responsibilities under the contract to a joint venture it formed with Citigroup called CitiStreet. For Lockheed Martin's purposes, the transition from State Street to CitiStreet was seamless, as there was no change in services, fees or, importantly, the team of personnel who provided the recordkeeping services.

By the start of the class period in 2000, the recordkeeping contract had been amended four times to reflect the addition of a series of new plans. Lockheed Martin agreed to pay State Street an annual fee of $6,935,000 for recordkeeping services, plus an additional annual fee of $404,000 to process Lockheed Martin's payroll on a weekly (rather than biweekly) basis, and $4.00 per participant for internet account access, which was then a new feature. At the time, the Master Trust included approximately 150,000 accounts, so that the contract amounted to $46.20 per account per year for basic services, plus an additional $2.70 for weekly payroll processing and $4.00 for internet servicing. The plans separately paid fees and postage for one-time participant mailings and participants paid additional fees for certain individual services (like

personal loan processing). As mandated by the Master Trust, plan-wide fees were passed along to plan participants on an accrual basis—instead of a flat, annual fee, participants paid a specified percentage of their assets, approximately 0.048% over the course of a year. A participant with a $10,000 balance paid $4.80 per year, a participant with a $100,000 balance paid $48.00 per year, and a participant with a $1,000,000 balance paid $480.00 per year. As the Department of Labor has recognized, where, as here, "the method of allocating expenses is determined by the plan sponsor (i.e., set forth in the plan documents), fiduciaries, consistent with section 404(a)(1)(D) [29 U.S.C. § 1104(a)(1)(D)], will be required to follow the prescribed method of allocation." *See* U.S. Dep't of Labor, Field Assistance Bulletin 2003-3. Even when fiduciaries do have discretion to exercise, the Department of Labor generally favors pro rata allocation. *See id.*; *Loomis v. Exelon Corp.*, 658 F.3d 667, 672-73 (7th Cir. 2011) ("flat payments per participant may help some participants but hurt others, depending on the size of each participant's account").

The recordkeeping agreement was again amended in January 2003. The fee for weekly payroll processing was incorporated into the base rate, and the ongoing annual fee for the ERISA plans was set at $7,179,000, plus $4.00 per participant for internet access. In 2007, after this lawsuit was filed, the contract was again reconfigured, with ongoing annual fees set at $7,500,000 for the ERISA plans, including participant internet access. As of 2008, the Master Trust covered approximately 180,000 participants, so that the base annual fee was approximately $41.67 per participant.

During the class period, Lockheed Martin engaged in a series of mergers and acquisitions. As a result of these corporate transactions, more than a dozen different plans were merged into the SSP and HSP. Each merger required a months-long program of aligning and

mapping investment options, programming new plan rules, and integrating assets. The mergers kept Lockheed Martin personnel abreast of industry trends. Each merger offered an opportunity to work with the merged company's recordkeeper and offered insights as to trends and pricing. Some of the mergers involved smaller companies, but the vendors (like Fidelity and T. Rowe Price) were the same companies that made pitches to land Lockheed Martin's recordkeeping business.

Moreover, Lockheed Martin had a hand in administering several large retirement plans that were not merged into Lockheed Martin's plan. For example, Sandia National Laboratories is operated by Sandia Corporation, a wholly-owned subsidiary of Lockheed Martin. Its $2 billion 401(k) plan was administered by Lockheed Martin and LMIMCo using Fidelity as the recordkeeper. United Launch Alliance, a joint venture between Lockheed Martin and Boeing, has a half-billion dollar 401(k) plan that was administered by CitiStreet. And Lockheed Martin developed a detailed proposal for the administration of the 401(k) plan for Los Alamos National Laboratory. These separate plans provided Lockheed Martin additional competitive data on the market for recordkeeping services.

By all measures, Lockheed Martin had an excellent recordkeeping arrangement. CitiStreet was well regarded as an effective and responsible recordkeeper. Lockheed Martin determined that competitors of CitiStreet who solicited Lockheed Martin's business were not up to the task or would have required Lockheed Martin to redesign its custom plan to fit their template. And industry data suggested that Lockheed Martin's fee setup was within the appropriate range despite the size and complexity of the various Master Trust plans. Lockheed Martin compared favorably to its peer group in informal comparisons at industry conferences, as

well as in industry surveys. Objectively and subjectively, plan fiduciaries were entirely satisfied with their CitiStreet relationship.

In July 2008, CitiStreet was acquired by ING Groep NV. The acquisition coincided with the last of Lockheed Martin's planned mergers and with a technological milestone. Although participant internet access went live in 2001, participants (particularly those at a security conscious company like Lockheed Martin) did not become comfortable with managing their retirement plans online for another half-decade. By 2008, however, enough plan participants were transacting online that Lockheed Martin could consider forgoing a dedicated call center. Given all these changes, Lockheed Martin decided to solicit bids for a new recordkeeping contract.

Among the companies deemed qualified to provide recordkeeping services, the initial bids ranged from \$35-\$42.50 per person. Those base costs were not entirely comparable with one another or with the existing contract, because each included a different bundle of services. In any event, the fee proposals were all deemed reasonable, and Lockheed Martin made its selection on the basis of which applicant would provide the best service for plan participants. ING remained the chosen service provider and, with the closure of the dedicated call center, the final contract provided for a base fee of \$33 per participant per year. (Pursuant to the terms of the Master Trust, the total fee is still allocated pro rata to plan participants, some of whom will pay less and some of whom will pay more than \$33 per year.) The new contract became effective in December 2009. ING, which is now known as Voya Financial, remains the recordkeeper to the Master Trust.

ARGUMENT

I. The Recordkeeping Arrangement Was The Product Of Prudent Fiduciary Decisionmaking.

ERISA imposes upon fiduciaries the duty to act as would "a prudent man acting in a like capacity and familiar with such matters." 29 U.S.C. § 1104(a)(1)(B). That standard requires fiduciaries to exercise their professional judgment to provide a well-functioning retirement plan.

In selecting recordkeeping vendors, a fiduciary properly considers more than just fees. The recordkeeper communicates directly with plan participants, so a fiduciary must consider whether the recordkeeper can deliver plan statements that are clear and reliable, provide qualified customer service representatives, dedicate staff to ensure data integrity, and update the recordkeeping infrastructure to keep up with market trends. Thus, as with choosing investment managers, ERISA imposes "no duty to scour the market" to identify "the lowest imaginable fees." *Hecker v. Deere & Co.*, 569 F.3d 708, 710 (7th Cir. 2009). Cheaper options are often "plagued by other problems," *Hecker v. Deere & Co.*, 556 F.3d 575, 586 (7th Cir. 2009), that turn small savings into pyrrhic victories.

A court's role, then, is not to sit as a rate-setting body. After all, "[t]he Court is institutionally unsuited to gather the facts upon which economic predictions can be made, and professionally untrained to make them." *Gen. Motors Corp. v. Tracy*, 519 U.S. 278, 308 (1997); *see also Town of Concord v. Boston Edison Co.*, 915 F.2d 17, 25 (1st Cir. 1990) (Breyer, C.J.) ("[H]ow is a judge or jury to determine a 'fair price'?"). Rather than engage in the hair-splitting exercise of retroactive price-setting, courts look more broadly to assess whether fiduciaries accepted "'a fee that is so disproportionately large that it bears no reasonable relationship to the services rendered and could not have been the product of arm's-length bargaining.'" *Young v. Gen. Motors Inv. Mgmt. Corp.*, 325 F. App'x 31, 33 (2d Cir. 2009) (quoting *Gartenberg v.*

Merrill Lynch Asset Mgmt., 694 F.2d 923, 928 (2d Cir. 1982)); *cf. Jones v. Harris Assocs. L.P.*, 559 U.S. 335, 352-53 (2010) (applying the same standard to assess claims of breach of fiduciary duty under the Investment Company Act of 1940, 15 U.S.C. § 80a-35(b)). That approach to fee claims is consistent with the Seventh Circuit's decision in *Hecker*. *See* 556 F.3d at 586 (rejecting plaintiffs' claim that certain fund-level fees were excessive because "[t]he fact that it is possible that some other funds might have had even lower [expense] ratios is beside the point").

Regardless of the precise contours of the standard of review, the evidence at trial will show that Lockheed Martin fiduciaries acted reasonably to obtain an appropriate recordkeeping arrangement with their vendors. Plan fiduciaries were mindful of the appropriate considerations in selecting State Street before the class period and in monitoring CitiStreet's performance and renegotiating their relationship during the class period. Few recordkeepers had the technical know-how to develop and update the custom technological platform required to satisfy the needs of the SSP and the HSP. Some of the remaining recordkeepers would have obligated the plans to include particular investment options (namely, funds that were managed by the recordkeeper), or would have made plan design changes prohibitively expensive. In sum, State Street and CitiStreet were a good match for the SSP and HSP and offered a competitive cost structure.

To ensure that CitiStreet's pricing remained competitive, Lockheed Martin fiduciaries interviewed competitors, spoke to peers, and reviewed industry data. So when CitiStreet sought nearly annual fee increases as new mergers and the attendant integration of additional plans made the plans ever more complex, Lockheed Martin used its market intelligence to keep fee levels constant. And when it made sense to consider introducing a new recordkeeper, plan fiduciaries undertook the appropriate investigation, which ultimately confirmed that Lockheed

Martin's prior arrangement was prudent. Indeed, every objective measure confirms that Lockheed Martin was getting high-quality services at a good price.

II. This Court Has Ruled Revenue Sharing Out Of The Case.

During summary judgment proceedings, this Court ruled out revenue sharing as a basis for liability. Doc. 226 at 7; *see also id.* at 16 (noting that Al Otto's "opinion is flawed for purposes of this analysis because he considered revenue sharing").

By way of background, revenue sharing is a common practice in 401(k) plans. Although some recordkeepers are paid explicit fees set by contract, others are compensated primarily or exclusively by other service providers—typically, mutual fund managers, which share portions of their investment management fees with the recordkeeper in exchange for services rendered. Those fees are typically computed as a percentage of assets under management, which means that as plan assets grow, the recordkeeper's compensation grows, too. *See, e.g.*, *Tussey v. ABB, Inc.*, 746 F.3d 327, 331 (8th Cir. 2014) (discussing a plan in which the recordkeeper was paid primarily through revenue sharing).

Lockheed Martin's arrangement with CitiStreet was based on an explicit fee, and CitiStreet was not paid through revenue sharing. To the contrary, every agreement between Lockheed Martin and State Street provided that all compensation from third parties would be rebated to plan participants. Nevertheless, Plaintiffs' primary fee-related argument is that CitiStreet was overcompensated because of "internal" revenue sharing with its parent company, State Street Bank & Trust. As part of its responsibilities to the joint venture, State Street remitted much of its revenue to CitiStreet. But State Street's internal funding of its joint venture has no bearing on the reasonableness of Lockheed Martin's fee arrangements. The remittals to CitiStreet began in 2000 (when CitiStreet was created), but Lockheed Martin's recordkeeping and investment management contracts did not change. Thus, State Street's mechanism for

funding its joint venture cannot possibly mean that Lockheed Martin was overpaying for recordkeeping services. It only means that CitiStreet needed an infusion of capital to get off the ground. That is why, as this Court has recognized, how a company chooses to allocate its income internally is not a commentary on the economic value to plan participants. What matters to plan participants is whether the bottom-line cost bears an appropriate relationship to the total services rendered. Lockheed Martin plan fiduciaries discharged that duty according to ERISA's standards.

Since this Court's ruling on summary judgment, Plaintiffs have tried at every turn to make their fees claim about revenue sharing. *E.g.*, Docs. 265, 294, 357. This Court has consistently rejected those requests for reconsideration. *E.g.*, Docs. 278, 296, 367. No further entreaty should be considered at trial. Any claim based on revenue sharing is foreclosed by the law of this case and precedent, *see Hecker*, 556 F.3d 575, and lacks any economic significance. Moreover, as this Court has recognized, any claim based on revenue sharing—a fund-by-fund phenomenon—would be inconsistent with the plan-wide class sought by Plaintiffs and certified by this Court. Doc. 367 at 7 ("Since Plaintiffs' challenge is to the sum of plan-wide fees, it does not include revenue sharing.").

As explained by this Court at summary judgment, to prevail at trial Plaintiffs must prove that the total fees charged to plan participants were excessive. Because that is an insurmountable burden, Defendants are entitled to judgment.

III. The Recordkeeping Contract Should Be Evaluated At The Trust Level.

Lockheed Martin negotiated contracts for the provision of recordkeeping services for every account in the Master Trust, including but not limited to the plans at issue in this lawsuit (the SSP and HSP). Any evaluation of that contract should look at whether it was a reasonable agreement for trust-level services.

A mathematical misstep in Plaintiffs' recordkeeping fees challenge arises from the method for allocating expenses among plan participants. Lockheed Martin allocated trust-level expenses on a pro rata basis, which means that participants paid a small percentage of their assets rather than a fixed annual fee. That allocation method was mandated by the trust agreement, which is a part of the plans' design. The Department of Labor has issued guidance that "ERISA contains no provisions specifically addressing how plan expenses may be allocated among participants and beneficiaries," but that, when the plan design specifies a particular allocation method, fiduciaries are "required to follow the prescribed method of allocation." U.S. Dep't of Labor, Field Assistance Bulletin 2003-3. The Department of Labor has further recognized that, even when a fiduciary is empowered to decide how to allocate expenses, "a pro rata method of allocating expenses among individual accounts . . . would appear in most cases to be an equitable method of allocation of expenses among participants." *Id.*; *see also* U.S. Dep't of Labor, *A Look at 401(k) Plan Fees*, http://www.dol.gov/ebsa/publications/401k_employee.html ("administrative fees are either allocated among participants' individual accounts in proportion to each account balance (i.e., participants with larger account balances pay more of the allocated expenses) or passed through as a flat fee against each participant's account").

The difference between pro rata and fixed-fee allocation can be sizable. Suppose, for example, that a plan contained just two participants—Participant A with a $20,000 balance and Participant B with an $80,000 balance. $100 in annual recordkeeping expenses, if allocated as a fixed fee, would be $50 each; on a pro rata basis, it would be $20 for Participant A and $80 for Participant B. If $100 is a reasonable annual recordkeeping expense for two participants and the employer opts for pro rata allocation as recommended by the Department of Labor, it is irrelevant to consider whether $80 is a reasonable expense for Participant B.

But that is Plaintiffs' approach. They do not (and cannot) challenge the trust agreement's requirement that trust-level fees be allocated on a pro rata basis. But instead of evaluating the trust-wide recordkeeping agreement at the trust level to which the recordkeeping contract corresponds and where the per-participant fee could easily be calculated), Plaintiffs would evaluate the agreement based on how much was allocated to each plan under the pro rata allocation. Because the SSP had the highest average account balance among the plans in the Master Trust, it is a matter of simple arithmetic that the average recordkeeping expense for the SSP is higher than the average recordkeeping expense for the Master Trust. But that says nothing about whether the recordkeeping agreement for the Master Trust was appropriate; that speaks only to the mode of allocation.

The disparity between the SSP and the HSP in the analysis of Mr. Otto highlights Plaintiffs' error. The SSP had substantially higher average balances. So although the SSP and the HSP were serviced by the same recordkeeping agreement, there are years in which Mr. Otto deems the HSP agreement reasonable and the SSP agreement unreasonable. But there is only one agreement for the entire Master Trust, so that this sort of cherry-picking is inappropriate. The contracted fee amount was either reasonable or unreasonable—it cannot be both. In other words, the appropriateness of the fee arrangement should be assessed based on the contract as a whole. On those terms, plan participants received good value for the appropriate level of services provided by CitiStreet to the Master Trust throughout the class period.

CONCLUSION

At the close of the evidence, this Court should enter judgment for Defendants on Plaintiffs' fees claim.

Dated: December 3, 2014

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CERTIFICATE OF SERVICE

The undersigned, one of the attorneys for Defendants Lockheed Martin Corporation and Lockheed Martin Investment Management Company, hereby certifies that on the 3rd day of December 2014, a true and correct copy of the foregoing was electronically filed with the Clerk of the Court using the CM/ECF system, which will send notification of such filing to the following:

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