Plan Expense Litigation
Are We Done?

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I. Background

In the Fall of 2006 John Deere, United Technologies, Unisys, Lockheed Martin, International Paper, Boeing, General Dynamics, A.G. Edwards, Kraft Foods, Caterpillar, Exelon, ABB (formerly known as Westinghouse), Bechtel, and Northrop Grumman were all sued by plaintiffs alleging that plan fiduciaries breached their duties of loyalty and prudence by permitting excessive 401(k) recordkeeping and investment management fees. Many of the cases were brought by a previously unheralded personal injury and plaintiffs' firm in St. Louis, Schlichter Bogard & Denton. Many more "401(k) fee" cases were filed over the next couple of years.

Although the cases received a lot of attention, by 2010 (the last time I gave this talk) they had not been particularly successful. Many of the cases and claims had been dismissed at the pleadings stage (e.g., the cases against John Deere, Unisys[1], General Motors, and Honda of America) or upon summary judgement, where defenses based on section 404(c) of ERISA and limitations periods were successful (e.g., the cases against Lockheed Martin, United Technologies, Edison International, and Bechtel). The only case that had settled or been decided in the plaintiffs' favor at that time was the case against Caterpillar, and the settlement appeared to be based on the unusual circumstances of the case.[2]

II. What are the Principal Claims in the Expense Lawsuits?

A. Revenue Sharing. Plaintiffs in the 401(k) fee cases bring several claims relating to "revenue sharing," the practice of mutual fund investment options paying a portion of 12b-1, sub-transfer, and similar fees to 401(k) plan recordkeepers and trustees.

1. Excessive Fees. The plaintiffs claim that the revenue sharing payments do not benefit plan participants and result in excessive fees paid to plan recordkeepers and trustees, violating the fiduciary duties of loyalty and prudence. See, e.g., *Taylor v. United Technologies Corp.*, 2009 WL 535779 (D.C. Conn. 2009), *affirmed*, 2009 WL 4255159 (2nd Cir. 2009). In particular, plaintiffs claim the asset-based revenue sharing payments increase fees over time with asset growth without any increase in services or recordkeeping costs. *Troudt v. Oracle*, No. 1:16-cv-00175 (D.Co. Jan. 22, 2016), ECF No. 1.

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[1] In the Unisys case, the district court granted Unisys' and Fidelity's motions to dismiss, and in the alternative, approved Unisys' motion for summary judgment based on an ERISA section 404(c) defense. 2010 WL 1688540 (E.D. Penn. 2010).

[2] Caterpillar established a for profit mutual fund company that was seeded with assets from its retirement plans. The company was subsequently sold to T. Rowe Price. In 2008 Caterpillar paid $16.5 million to settle the case. *Nolte v. Cigna Corp.*, *Kanawi v. Bechtel Corp.*, *Main v. American Airlines Inc.,* and *Pledger v. Reliance Trust Co.* discussed below, involve similar facts and claims of self dealing with respect to in-house investment fund and plan administration operations.

2. Prohibited Transactions. The plaintiffs claim that revenue sharing payments violate section 406 of ERISA. Several theories have been offered by the plaintiffs.

a. The payments to Plan trustees and recordkeepers violate sections 406(b)(1) (self-dealing) and 406(b)(3) (kickbacks) and section 408(b)(2) does not apply to section 406(b). See *Kanawi v. Bechtel Corp.*, 590 F.Supp.2d 1213 (N.D. Cal. 2008); but see *Dupree v. The Prudential Ins. Co. of America*, 2007 WL 2263892 (S.D.Fla. 2007) (holding that ERISA section 408(b)(2) applies to exempt the alleged ERISA section 406(b) transactions relating to excessive fees paid to the plan sponsor/service provider).

b. To the extent the plan sponsor otherwise pays plan administration fees but the fees are reduced by revenue sharing credits (consistent with DOL Op. Ltr. 97-15A), the revenue sharing payments result in indirect "kickbacks" to the plan sponsor in violation of sections 406(b)(1) and/or 406(b)(3). See, *Tibble v. Edison Int'l*, 2009 WL 2382340 (C.D. Cal. 2009).

c. To the extent the fee payments were excessive and unreasonable, the prohibited transaction exemption under section 408(b)(2) does not apply. See *Braden v. Wal-Mart Stores, Inc*. 588 F.3d 585 (8th Cir. 2009).

3. Failure to Disclose. In addition to the substantive claims regarding revenue sharing the plaintiffs allege that plan fiduciaries breach their duties of loyalty when they fail to disclose revenue sharing and other aspects of allegedly excessive fees. The plaintiffs' argument is that the failure to make such disclosures constitutes a "material omission" that is misleading to participants. See, e.g., *Braden v. Wal-Mart Stores, Inc.*, 588 F.3d 585 (8th Cir. 2009). In recent lawsuits, generalized disclosure claims have been replaced with claims of failure to comply with the DOL fee disclosure regulations described below. See *Jacobs v. Verizon Communications Inc.*, No. 1:16-cv-01082 (S.D.N.Y. Feb. 11, 2016), ECF No. 1 (claiming that Fidelity breached its fiduciary duties by designing and distributing a participant fee disclosure that failed to disclose indirect compensation and by not reporting a dollar amount of eligible indirect compensation on the plan's annual return (Form 5500)); *Troudt v. Oracle Corp.* (claiming failures to disclose complete information regarding indirect compensation on annual returns (Form 5500) resulting in concealment of information that justifies a six-year limitations period).

B. Excessive Direct Expenses. More recent cases have not focused on revenue sharing per se because of the widespread understanding that such sharing is merely one way in which to allocate plan administrative (recordkeeping) fees. Instead, the claims have emphasized the imprudence of asset-based recordkeeping fees in relation to actual costs based on participant counts or, when fees are already allocated on a per capita basis, on fees that exceed a claimed appropriate amount per participant. See *Bell v. Anthem Inc.* and *Troudt v. Oracle Corp.* (below). The cases have also challenged particular fund investment management expenses as exceeding the investment costs of alternatives. See *Bell v. Anthem Inc.* and *White v. Chevron Corp.* (below).

C. Self-Dealing with In-House Funds, Advisors, and Recordkeepers. Several cases have involved claims of self-dealing with respect to the use of plan assets to "seed" in-house plan administration and investment fund operations. See *Martin v. Caterpillar*, *Nolte v. Cigna Corp.*, *Kanawi v. Bechtel Corp., Main v. American Airlines Inc.* No. 3:16-cv-01033-C (N.D.Tex. April 15, 2016) ECF No. 1*,* and *Pledger v. Reliance Trust Co.* (the Insperity case described below). Be very careful when selling or spinning off an in-house plan administration or investment fund division.

D. Failure to Capture or Account for Other Revenue. In addition to the classic revenue sharing claims based on 12b-1 and/or sub-transfer fees, plaintiffs have alleged breaches of fiduciary duty due to a failure to capture or take into account float, securities lending fees, finders' fees, and other fees in setting service provider compensation. See, e.g., *Tibble* and *Taylor* (float); *Martin v. Caterpillar*, Civ. Action 1:07-CV-01009 (C.D. Ill. 2008) (securities lending and finders' fees).

E. Retail Mutual Funds vs Institutional Funds or Separate Accounts. The plaintiffs assert that the payment of higher fees for retail mutual funds is imprudent when lower institutional fees are available for the same fund or when the plans have the leverage to instead negotiate for separate accounts. See, e.g., *Braden* (claiming that an investment in retail shares of the PIMCO Total Return Fund with an expense ratio of 0.68% was imprudent compared to the lower expense ratio of 0.43% for institutional shares of the same fund); *Tibble v. Edison Int'l* (claiming that retail mutual funds were imprudent compared to the lower cost and better performing separate accounts they replaced). The plaintiffs also claim that the payment of 12b-1 fees charged by many retail funds is imprudent because the fees are mainly used for advertising to attract new customers, and that activity does not benefit plan participants. See, e.g., *Braden* and *Bell v. Anthem Inc.* (below).

F. Use of Actively Managed Funds vs Index Funds. Plaintiffs have claimed that index funds are cheaper and perform better than similar actively managed funds. See, e.g., *Braden* (claiming that over the period in question, a basket of similar Vanguard index funds outperformed the actively managed funds in the Wal-Mart plan by $140 million); *Taylor v. United Technologies* (rejecting the same claim on summary judgment because the relevant issue is procedural prudence with respect to the funds actually selected, not generic comparison to index funds).

G. Unitized Employer Stock Funds. Plaintiffs have claimed that the cash component of unitized employer stock funds causes fund performance to lag compared to direct investments in employer stock. See, e.g., *Taylor* (holding that the plan administrator's evaluation of the merits of retaining cash to provide transaction liquidity satisfied its obligation of procedural prudence); *Tibble v. Edison Int'l* (finding in favor of defendants on summary judgment because the fiduciaries prudently managed the cash in the fund and because, given the uncertainty regarding future performance, the cash component of a fund can decrease volatility); *Abbott v Lockheed Martin Corp.*, 2009 WL 839099 (S.D. Ill. 2009) (declining to rule on summary judgment due to a genuine issue of material fact as to whether a breach of fiduciary duty occurred when cash investments exceeded the 10% ceiling described in the plan's prospectus).

H. Stable Value Funds vs Money Market Funds. Plaintiffs claim that money market funds are not appropriate capital preservation investment options compared to stable value funds due to higher fees and lower returns. See, e.g., *White v. Chevron Corp.* (below). Plaintiffs have also raised claims that funds labeled as stable value funds are "closet" money market funds due to holding very short duration investments (including large percentages of assets invested in other money market funds). See *Abbott v Lockheed Martin Corp.*, 725 F.3d 803 (7th Cir. 2013); *Ellis v. Fidelity Management Trust Co.*, No. 1:15-cv-14128, at 1, 12, 20 (D. Mass. Dec. 11, 2015), ECF No. 1.

I. Employer Financial Institutions. Plaintiffs who participate in plans maintained by financial institutions (banks and insurance companies) have filed special expense and fiduciary claims given that the plans typically utilize investment funds managed by the sponsor or its affiliate (e.g., claims that the sponsors used plan assets as "seed money" to start new investment funds). *See, e.g., Mehling v. New York Life Ins. Co.*, 2007 WL 3145344 (E.D. Pa. 2007); *see also*, *Leber v. Citigroup Inc.* 2010 WL 935442 (S.D.N.Y. 2010) (discussing the prohibited transaction class exemptions that apply in connection with such claims).

J. Other Issues. The 401(k) fee litigation cases also involve procedural issues (such as class certification and standing) that are beyond the scope of this presentation.

III. What Has Happened Over the Last Six Years?

A. Fee Disclosure Regulations Finalized.

1. <u>408(b)(2) Service Provider Fee Disclosure</u>. The DOL issued interim regulations in July of 2010 and final regulations in February of 2012 (effective July 1, 2012) under section 408 of ERISA requiring covered service providers to disclose compensation to responsible plan fiduciaries as a condition for the prohibited transaction exemption for reasonable compensation paid to plan service providers.

2. <u>404(a) Participant Disclosure Regulations</u>. The DOL issued final regulations in October of 2010 (effective for plan years beginning on or after November 1, 2011) requiring plans to disclose plan expenses and investment information to participants using a "comparative chart" format and to provide additional statement information on a quarterly basis. The effective date for initial disclosures was subsequently postponed until 60 days after the effective date of the section 408(b)(2) regulations (i.e., for calendar year plans, August 30, 2012 for the initial disclosure and November 14, 2012 for quarterly statement disclosures).

3. <u>Revised 404(c) Regulations</u>. In connection with the 404(a) regulations described above, the DOL also updated regulations under section 404(c) of ERISA. Most of the updates reflect that the disclosure rules formerly contained in the section 404(c) regulations are now included in the 404(a) regulations. But in response to the decision in *Hecker v. Deere & Co.* (holding that the ERISA section 404(c) defense applies to claims of improper fund selection – see 556 F.3d 575 (7th Cir. 2009), *rehearing denied*, 569 F.3d 708), the regulations have also been revised to include a provision that was previously contained only in the preamble to the prior regulations. The 2010 final regulations now specify that the applicable plan

fiduciary has an obligation to prudently select and monitor plan service providers and investment options and that section 404(c) does not relieve the fiduciary of that obligation. Even prior to this change other courts had upheld the DOL's reading of section 404(c) as not providing a defense to claims of imprudent fund selection by the plan fiduciaries. See *Tibble v. Edison International*, 729 F3d 1110 (9th Cir. 2013) *vacated on other grounds* 135 S.Ct. 1823 (2015)[3]; *Howell v. Motorola, Inc.*, 633 F3d 552 (7th Cir. 2011) (reading *Hecker* as not having reached the 404(c) issue because the plaintiffs' claims had been dismissed, obviating the need for the defense, and holding that ERISA section 404(c) does not apply to company stock fund selection claims); *Pfeil v. State St. Bank & Trust Co.*, 671 F.3d 585,599-600 (6th Cir. 2012) (following *Howell* in holding that ERISA section 404(c) "does not relieve fiduciaries of the responsibility to screen investments"); *In re Tyco International. Ltd. Multidistrict Litigation,* 2009 WL 921147 (D.N.H. 2009) (holding that ERISA section 404(c) is not available as a defense to claims of fiduciary breach in the selection of a company stock fund as an available investment option under the plan).

B. Supreme Court Decides Tibble v. Edison International. *Tibble* involved claims that fiduciaries of the Edison 401(k) plan imprudently included as plan investment options higher cost retail mutual funds instead of materially identical lower priced institutional-class mutual funds. The 9th Circuit ruled in favor of the defendant fiduciaries on statute of limitations grounds because selection of the retail mutual funds occurred more than six years before plaintiffs filed the lawsuit. The Supreme Court reversed and held that plan fiduciaries have a continuing duty to monitor and remove imprudent investment options and therefore that a claim is timely as long as the alleged breach of the continuing duty occurred within six years of the suit.[4] 135 S.Ct. 1823 (2015). Prior to the Court's decision, many other excessive fee cases had been decided in defendants' favor on statute of limitations grounds. See, e.g., *David v. Alphin*, 704 F.3d 327 (4th Cir. 2013); *Kanawi v. Bechtel Corp.*, 590 F.Supp.2d 1213 (N.D. Cal. 2008)*; Young v. General Motors Investment Management Corp.*, 2008 WL 1971544 (S.D.N.Y. 2008); *Leber v. Citigroup,* 2010 WL 935442 (S.D.N.Y. 2010); *Shirk v. Fifth Third Bancorp*, 2009 WL 3150303 (S.D. Ohio 2009); see also, *Krueger v. Ameriprise Fin., Inc.,* 2014 WL 1117018 (D. Minn. 2014). While the Court's decision has reduced the scope of the statute of limitations defense, it continues to provide important protection against claims based on conduct that occurred more than six years ago. Moreover, enhanced fee disclosure makes it more likely that the "actual knowledge" limitations period of three years under ERISA section 413(2) will apply to future 401(k) fee claims.

[3] In *Tibble*, the 9th Circuit held that the DOL's reading of section 404(c) as specified in the preamble to the prior regulations was entitled to *Chevron* deference and was correct. The court had earlier ruled that the new final regulations did not apply because the conduct in question in the case had occurred prior to the effective date of the final regulations.

[4] Although the plaintiffs prevailed on the legal claim with the Supreme Court, on remand the 9th Circuit affirmed the district court decision in favor of the defendants, ruling that plaintiffs forfeited the continuing duty claim because they had not made the claim in the lower court or on appeal.

C. Plaintiff Victories and Settlements

1. Tussey v. ABB. One of the original Schlichter cases, and one of the few cases to result in a decision on the merits rather than a settlement. The 8th Circuit agreed that plan fiduciaries had failed to monitor or understand excess fees paid to Fidelity and had breached fiduciary duties in transferring plan assets from a lower cost Vanguard balanced fund to Fidelity target date funds, but vacated most ($22 out of $35 million) of the lower court's damage award because it was speculative and because the award relating to float ($1.7 million) was improper. 746 F.3d 327 (8th Cir. 2014). On remand, the lower court ruled that plaintiffs had failed to prove damages with respect to the transfer of funds, but did award plaintiffs $11.7 million in attorneys' fees and expenses.[5] 2015 WL 8485265 (W.D. Mo. 2015).

2. Will v. General Dynamics Corp. Another one of the original Schlichter cases. The case was settled in late 2010, with General Dynamics and its fiduciary advisor agreeing to pay $15.5 million into a settlement fund, with plaintiffs' attorneys requesting a $5.7 million in fees and costs from the fund. No. 3:06-cv-00698-GP M-CJP (S.D. Ill. filed 9/11/2006).

3. Beesley v. International Paper Co. Another one of the original Schlichter cases. The claims included excessive recordkeeping expenses (per capita fees were reduced from $112 to $52 per participant after the case was filed), imprudent investments in company stock, and unreasonably high investment expenses. The case settled in 2013 after extensive disputes regarding class certification and discovery. International Paper agreed to pay $30 million into a settlement fund, and the court awarded $11.5 million from the fund to pay plaintiffs' attorneys' fees and costs. 2014 WL 375432 (S.D. Ill. 2014)

4. Abbot v. Lockheed Martin. Another one of the original Schlichter cases. Many of the claims (including those based on revenue sharing and float and all claims relating to actions that initially occurred prior to the six-year limitations period) were dismissed on a motion for summary judgment, but claims relating to excessive fees, the plan's stable value fund operating as a closet money market fund, and excessive cash in the company stock fund survived. 2009 WL 839099 (S.D. Ill. 2009). Just before the beginning of trial, the parties settled, and Lockheed Martin agreed to pay $62 million into a settlement fund, with plaintiffs' attorneys requesting $22.4 million in fees and costs from the fund.

5. Kanawi v. Bechtel Corp. Another one of the original Schlichter cases. Although many of the claims were dismissed on statute of limitations grounds, one self-dealing claim (relating to a four-month period in which the plan paid fees to an investment advisor which was previously an in-house advisor owned by Bechtel) survived. The parties settled in 2011, with Bechtel agreeing to pay $18.5 million into a settlement fund, with plaintiffs' attorneys requesting $4.8 million in fees and costs from the fund. 2011 WL 782244 (N.D. Cal. 2011)

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[5] Court filings indicate that attorneys for ABB and Fidelity were paid about $42 million!!! Given those figures, many of the other settlements described below basically amount to nuisance value.

6. Nolte v. Cigna Corp. Another Schlichter case involving claims by participants in Cigna's 401(k) plan, which was the largest client of Cigna's retirement plan recordkeeping and fund business that was sold to Prudential in 2004. The case settled in 2013 with Cigna and Prudential agreeing to pay $35 million into a settlement fund, with plaintiffs' attorneys requesting a $12.9 million in fees and costs from the fund. 2013 WL 3586645 (C.D. Ill. 2013).

7. Kruger v. Novant Health. Another Schlichter case. Plaintiffs brought claims relating to excessive asset-based recordkeeping and brokerage fees paid to Great West Life & Annuity and D.L. Davis & Company, Inc. and excessive investment fees paid with respect to retail class mutual funds. After plaintiffs' claims survived a motion to dismiss, the parties settled, and Novant Health agreed to pay $10.8 million for plaintiffs' attorneys' fees and costs and another $21 million in restorative contributions to the plan and direct payments to former participants.

8. Spano v. Boeing Co. Another Schlichter case. Just before trial the parties settled, and the court approved a settlement of $57 million for claims relating to excessive administrative fees paid to plan recordkeeper Citistreet, the inclusion of mutual funds rather than lower cost collective trusts and separate accounts, excessive investment fees for the cash component of the Boeing stock fund, and the inclusion of an imprudent and undiversified technology sector fund. Plaintiffs' attorneys' fees of up to $19 million were to be paid from the settlement fund.

9. George v. Kraft Foods Global, Inc. Another Schlichter case involving allegations of mismanagement of company stock funds (failure to timely address transaction costs resulting from unitized stock funds), the payment of excessive fees paid to Hewitt (the recordkeeper), and the improper retention of float by State Street (the trustee). The lower court dismissed all claims on motion for summary judgment. The Seventh Circuit reversed the decisions regarding the unitized stock funds and recordkeeping fees, but affirmed the decision regarding float (because the fiduciaries had received annual reports regarding the amount of float income retained by State Street). 641 F.3d 786 (7th Cir. 2011). To avoid going to trial on the two remaining claims, the plan fiduciaries settled for $9.5 million payable to a settlement fund plus $3.1 million for plaintiffs' attorneys' fees. *George v. Kraft Foods Global, Inc.*, Nos. 08-3799 & 07-1713, Final Order and Judgment (N.D. Ill. 2012) (ECF No. 349); *see also* Settlement Agreement, docketed as an Exhibit (ECF No. 328) to the parties' Joint Motion for Preliminary Approval of Settlement and Order Regarding Plaintiffs' Application for Attorneys' Fees and Reimbursement of Expenses (ECF No. 350).

10. Braden v. Wal-Mart Stores, Inc. The parties settled in 2012 after discovery and after the 8th Circuit vacated the lower court's decision to dismiss all claims. 588 F.3d 585 (8th Cir. 2009). The court approved settlement included a payment of $13.5 million from Wal-Mart ($3.5 million) and Merrill Lynch ($10 million) to offset future plan expenses that otherwise would have been paid by participants, and a $4 million payment for plaintiffs' attorneys' fees and costs. *Braden v. Wal-Mart Stores Inc.*, No.08-3109, Final Order and Judgment (W.D. Mo.

2012) (ECF No. 258); *Braden v. Wal-Mart Stores Inc.*, No.08-3109, Order (W.D. Mo. 2012) (ECF No. 261).

11. Financial Service Company Settlements. These cases are distinct from the standard ERISA fee litigation claims, because they usually involve claims of self-dealing by companies providing financial services to plans, and the plaintiffs are frequently the plans themselves rather than individual participants.

a. Haddock v. Nationwide Financial Services, Inc. Plaintiffs were employee benefit plans which claimed that Nationwide had charged excessive fees and violated fiduciary duties in receiving undisclosed revenue sharing payments from third party mutual funds. *Haddock v. Nationwide Fin. Servs., Inc.*, 419 F.Supp. 2d 156 (D.C. Conn. 2006). In 2015 the court approved a settlement of $140 million that included attorneys' fees and expenses of more than $50 million. *Haddock v. Nationwide Fin. Servs., Inc.*, No. 3:01-cv-1552, slip op. at 1-2, ECF No. 526 (D. Conn. 2015). The settlement class included all ERISA retirement plans that had group or individual annuity contracts with Nationwide between 1996 and 2014 or custodial account arrangements with Nationwide between 2009 and 2014.

b. Healthcare Strategies v. ING Life Insurance and Annuity Co. Plaintiffs were the administrators of employee benefit plans that had purchased group annuity contracts from ING. They claimed that ING had included mutual funds in the contracts based on revenue sharing payments to ING rather than suitability as plan investment options. The court rejected defendants' summary judgement motion (961 F.Supp.2d 393 (D. Conn. 2013)), and the case went to trial but was settled before the court made its decision. ING agreed to pay $15 million into a settlement fund for ING retirement plan customers since 2005. Plaintiffs attorneys' fees of $6.8 million were to be paid from the fund. Plaintiffs' attorneys asserted that required changes in ING's business practices would provide over $400 million in value to future ING retirement plan customers.

c. Goldenstar, Inc. v. MassMutual Life Insurance Co. The case involves typical claims that MassMutual was a fiduciary by virtue of its selection of available investment options for its retirement plan clients and breached its fiduciary duties and engaged in prohibited transactions by selecting funds based on revenue sharing payments to MassMutual. MassMutual's motion for summary judgment had previously failed, and the court ruled that MassMutual was a functional fiduciary to its benefit plan clients. 2014 WL 2117511 (D. Mass. 2014). The case settled for $9.5 million payable to a settlement fund, of which one-third was to be available for plaintiffs' attorneys' fees.

d. Krueger v. Ameriprise Fin., Inc. Another Schlichter case. The court approved a settlement providing for payment of $27.5 million to a

settlement fund plus approximately $10 million of plaintiffs' attorneys' fees[6] and expenses. 2015 WL 7596926 (D. Minn. 2015); 2015 WL 4246879 (D. Minn. 2015). The case involved claims that fiduciaries of the Ameriprise plan had improperly invested plan assets in Ameriprise funds ("seeded" the funds) to make them more marketable to third parties and had used Ameriprise's in-house recordkeeping business to increase the value of that business prior to a sale to Wachovia. While some of the claims were dismissed on summary judgement on statute of limitations grounds, several claims had survived (most claims had also survived on an earlier decision on defendants' motion to dismiss). 2012 WL 5873825 (D. Minn. 2012); 2014 WL 1117018 (D. Minn. 2014).

In addition to the monetary awards described above, all of the settlements and decisions have included injunctive relief, generally involving additional disclosures to participants, the retention of independent consultants to review recordkeeping agreements and fees, prohibitions on retail mutual funds, the termination of prior record keepers, putting recordkeeping services out for competitive bid, and, in the case of the financial services settlements, changing fee practices and disclosures to clients.

D. But the Path to Defendant Victory is Clear

1. Renfro v. Unisys Corp. The 3rd Circuit upheld the lower court's decision to dismiss claims against Fidelity because it was a directed trustee and therefore did not control fund selection or have any liability as a co-fiduciary absent actual knowledge of a breach of fiduciary duty by another fiduciary. 2011 WL 3630121 (3rd Cir. 2011). The court also upheld the dismissal of all claims against the plan administrator because, based on the allegations in the complaint, it could not infer that the fiduciaries engaged in a flawed process in selecting and monitoring plan investment options. The court stated that:

> … the range of investment options and the characteristics of those included options - including the risk profiles, investment strategies, and associated fees- are highly relevant and readily ascertainable facts against which the plausibility of claims challenging the overall composition of a plan's mix and range of investment options should be measured.

Applying this standard, the court concluded that:

> The Unisys plan contains a variety of investment options including company stock, commingled funds, and mutual funds. … the plan contained seventy-three distinct investment options. Among the retail mutual funds specifically targeted in the complaint were funds with a variety of risk and fee profiles, including low-risk and low-fee options. This range of selections is much closer to the characteristics of the

[6] For those wondering, that is $111.9 million in attorneys' fees and costs paid to Schlichter to date in connection with their 401(k) fee cases, with several cases still pending.

> plan evaluated by the *Hecker* court than to the scanty mix and range of selections[7] in the plan reviewed by the *Braden* court. Evaluating plaintiffs' complaint in light of an ERISA defined contribution 401(k) plan having a reasonable range of investment options with a variety of risk profiles and fee rates, we believe plaintiffs have provided nothing more than conclusory assertions that Unisys breached its duty to prudently and loyally select and maintain the plan's mix and range of investment options. Accordingly, … we do not believe plaintiffs have plausibly alleged a breach of fiduciary duty.

2. Loomis v. Exelon Corp. Following its decision in *Hecker v. Deere*, the 7th Circuit upheld the lower court's dismissal of all claims because, similar to the *Unisys* case above, the plan offered a sufficient mix of investment options with varying expense ratios.[8] 2011 WL 3890453 (7th Cir. 2011). The court also noted that institutional class investment options are not always better than retail class shares due to valuation and liquidity issues of the institutional class shares.

3. White v. Chevron Corp. This case decided last month is a good example of the path to victory under the heightened pleading standards of *Ashcroft v. Iqbal* and *Bell Atlantic Corp. v. Twombly*. The court dismissed all of plaintiffs' fiduciary breach claims (although with leave to amend the original complaint). 2016 BL 281396, (N.D. Cal. 2016). The plaintiffs claimed that the plan fiduciaries breached their duties of loyalty and prudence by

a. providing participants with a money market fund as a capital preservation option, instead of offering them a stable value fund;

b. providing "retail" investment options that charged higher management fees than lower-cost "institutional" versions of the same investments;

c. providing mutual funds that charged higher management fees rather than other lower-cost investment options such as collective trusts and separate accounts;

d. failing to obtain competitive bids for plan administrative services on a regular basis, and instead paying excessive administrative fees to Vanguard as recordkeeper through revenue sharing from plan investment options;

e. retaining the Artisan Small Cap Value Fund (ARTVX) as an investment option despite its underperformance compared to its benchmark, peer group and lower-cost investment alternatives.

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[7] The Wal-Mart plan had ten mutual fund investment options (most retail class and seven charging 12b-1 fees), a stable value fund, an unspecified common/collective trust, and a company stock fund.

[8] The Exelon plan offered 32 investment options, 24 of which were mutual funds. The funds had expense ratios ranging from 3 to 96 basis points.

f. failing to monitor the investment committee's performance and fiduciary process;

g. failing to ensure that the investment committee had a fiduciary process in place; and

h. failing to remove investment committee members whose performance was inadequate.

The court rejected the claims of breach of the duty of loyalty because the complaint did not plead facts sufficient to raise a plausible inference that plan fiduciaries took actions for purposes of benefitting themselves or third parties with connections to Chevron.

The court rejected the claim of fiduciary breach based on the selection of a money market fund rather than a stable value fund because the complaint did not include any facts showing that the fiduciaries failed to use a reasoned process in selecting a money market option rather than a stable value fund. That is, the complaint did not allege any failures of procedural prudence in considering an appropriate capital preservation option, and the mere fact that a money market fund was selected does not raise an inference of a breach because neither ERISA nor the plan's investment policy statement required the plan to include a stable value fund option.

The court rejected the claims of fiduciary breach based on the use of higher cost retail rather than institutional class mutual funds and higher cost mutual funds rather than collective trusts and separate accounts because the complaint did not plead facts sufficient to show an imprudent process in selecting the investment options. To the contrary, the complaint indicated that the plan fiduciaries changed the plan investment options from time to time, creating an inference that the fiduciaries were actively monitoring the plan's investment options. The mere fact that retail funds were selected does not give rise to an inference of breach because fiduciaries may value investment features other than price (citing *Unisys* and *Exelon*). Following *Hecker*, the court also ruled that the broad range of options and fees (ranging from 5 to 124 basis points) made conclusory claims of imprudence implausible.

The court rejected the claims of fiduciary breach based on asset-based (rather than per capita) recordkeeping fees and failure to engage in competitive bidding because the complaint did not please facts indicating that fees were unreasonable, and nothing in ERISA requires competitive bidding. Note that the plan did switch to a per capita (rather than asset-based) recordkeeping fee during year three of the six-year period involved in the complaint.

The court rejected the claims relating to the Artisan Small Cap Value Fund because the complaint did not plead facts showing a failure to engage in a prudent process in evaluating the fund or facts that would have allowed the fiduciaries to predict such underperformance, but instead included only conclusory "hindsight" allegations that the fund's performance lagged its benchmark during a four-year period prior to its removal as a plan investment option. The court explained that

> Poor performance, standing alone, is not sufficient to create a reasonable inference that plan administrators failed to conduct an adequate investigation — either when the investment was selected or as its underperformance emerged — as ERISA requires a plaintiff to plead some other objective indicia of imprudence.

Finally, the court rejected all of the failure to monitor claims because the complaint did not include specific facts supporting the allegation and because the claims were derivative of the above claims, none of which survived. The court rejected plaintiffs' request for discovery to ascertain such facts, explaining that

> Plaintiffs … argue that they should be permitted to conduct discovery in order to acquire such facts. This is insufficient to state a plausible claim. While an ERISA plaintiff may lack direct evidence of the fiduciaries' process, the plaintiff must at a minimum plead facts that give rise to a "reasonable inference" that the defendant committed the alleged violation.

4. <u>In re Fidelity Erisa Float Litigation</u>. Following a number of earlier decisions (including *Tussey v. ABB* and *George v. Kraft Foods* described above) the First Circuit upheld the lower courts' decision to dismiss the complaint on the pleadings. 2016 WL 3748685 (1st Cir. 2016). The court ruled that float income was not a plan asset based on plan and service agreement/trust terms and ordinary notions of property rights. Because the complaint did not raise the claim, the court refused to consider the argument made by the DOL as amici that Fidelity's use of float violated fiduciary duties because Fidelity failed to seek and obtain the plans' permission to such use. Trustees and custodians now commonly disclose their use of float and condition services on approval of such use.

IV. Recent Cases and Trends for the Future

A. Recent Cases. After an initial burst of lawsuits in 2006, 2007, and 2008, the pace of litigation slowed dramatically until the end of 2015. Then, over a three-month period, plaintiffs filed more than a dozen new 401(k) fee cases, including *White v. Chevron Corp.* described above. Below are summaries key cases with a focus on changes in the basic claims.

1. <u>Jacobs v. Verizon Communications Inc.</u> Like several other cases below, the focus of this case is less on fees and more on the performance of specific plan investment options. No. 1:16-cv-01082 (S.D.N.Y. Feb. 11, 2016), ECF No. 1. The only complaint relating to fees is a claim against the plan recordkeeper, Fidelity, for failure to disclose certain indirect compensation. The other claims in the complaint relate to the performance of one specified investment option and the inclusion of alternative investments (commodities, global infrastructure, global high yield bonds, global equities) in the plan's target date funds.

2. <u>Troudt v. Oracle Corp</u>. Another Schlichter case, but with a change of focus. No. 1:16-cv-00175 (D.Co. Jan. 22, 2016), ECF No. 1. Plaintiffs do not make any claims regarding self-dealing, but instead simply allege that asset-based

recordkeeping fees (calculated by plaintiffs at $68 to $140 per participant per year) were excessive compared to the alleged reasonable amount of $25 per participant per year. Presumably as a hook to survive the motion to dismiss, plaintiffs claim that the unreasonably high fees result from Fidelity's retention for 26 years without competitive bidding. Plaintiffs also claim that three specific investment options[9] performed poorly and that the plan fiduciaries failed to exercise procedural prudence by adding two of the funds shortly after they were created without an adequate history of performance to evaluate. Unlike earlier cases, no allegations were made regarding fund expenses. Finally, plaintiffs allege in the complaint that Fidelity and the plan failed to disclose Fidelity's indirect compensation on the plan's annual returns (Form 5500s) and that the concealment justifies a six-year limitations period (i.e., the plaintiffs were precluded from obtaining earlier actual knowledge of the fiduciary breaches).

3. Bell v. Anthem Inc. Another Schlichter case. No. 1:15-cv-02062 (S.D. Ind. Dec. 29, 2015), ECF No. 1, amended March 16, 2016, ECF No. 23. The most unusual aspect of this case is that the fee allegations relate to Vanguard as recordkeeper and to several Vanguard funds, which had previously been held up by plaintiffs in other case as superior, lower cost options. See, e.g., *Troudt v. Oracle* (comparing the Artisan Small Cap Value Fund to the Vanguard Small-Cap Value Index Fund). However, on closer examination the allegations are typical and mainly relate to the use of higher cost retail classes of mutual funds rather than institutional classes of the same funds (with cost differences ranging from 2 to 98 basis points) and higher cost mutual funds rather than separate accounts and collective trusts. Plaintiffs also allege that asset-based recordkeeping fees were excessive prior to a change to per capita fees in 2013 and that per capita fees of $42 per participant per year after the change are 40% greater than a reasonable fee ($30 per participant per year) for such services. Finally, the plaintiffs claim that fiduciaries imprudently included a money market fund rather than a stable value fund as the capital preservation investment option.

4. Pledger v. Reliance Trust Co. An unusual aspect of this case is that it involves claims against the "section 3(38) investment manager" (Reliance Trust) to whom the plan administrator had delegated responsibility for selecting plan investment options (the delegation occurred in 2003). No. 1:15-cv-04444 (N.D. Ga. Dec. 22, 2015), ECF No. 1, amended Apr. 15, 2016, ECF No. 37. Despite this delegation, the plaintiffs sued both the investment manager (Reliance Trust) and the plan sponsor and its separate retirement plan committee. Plaintiffs claim that the latter approved excessive fees to the investment manager and received excessive recordkeeping fees paid by the plan for services from Insperity's in-house recordkeeping business (another "seeding" claim).[10] Otherwise, the complaint contains fairly typical allegations of excessive investment expenses involving retail

[9] The Artisan Small Cap Value Fund, PIMCO Inflation Response Multi-Asset Fund, and the TCM Small-Mid Cap Growth Fund.

[10] See Part II.C. above for other cases involving claims involving in-house investment fund and recordkeeping businesses.

mutual fund options instead of lower cost institutional class mutual funds or separate accounts/collective trusts and for the use of money market rather than stable value funds. In addition, the plaintiffs claim that Reliance Trust improperly selected its "new and untested" proprietary target date funds for inclusion as plan investment options.

5. Johnson v. Fujitsu Tech. & Bus. of Am. Like the *Jacobs* case above, plaintiffs claim that the plan's custom target date funds included inappropriate asset classes including natural resources and real estate limited partnerships. Otherwise the complaint includes typical claims of excessive fees relating to mutual fund retail share classes, excessively high recordkeeping fees, and the selection of new mutual funds without track records for prudent evaluation, No. 5:16-cv-03698-NC, at 11, 120-134 (N.D. Cal. June 30, 2016), ECF No. 1.

6. Ellis v. Fidelity Management Trust Co. This case involves claims against Fidelity by participants in the Barnes & Noble 401(k) plan with a purported class of all plans that invested in a particular Fidelity stable value fund, the Fidelity Group Employee Benefit Plan Managed Income Portfolio Commingled Pool, a collective investment trust. No. 1:15-cv-14128, at 1, 12, 20 (D. Mass. Dec. 11, 2015), ECF No. 1. Plaintiffs claim that Fidelity imprudently invested fund assets primarily in asset-backed securities that declined in value after the 2008 financial crisis, and then overcorrected that failure at the demand of "wrapper" insurers by overinvesting in short duration government securities, resulting in low returns.

B. What Does the Future Hold? As a result of the original 401(k) fee cases and the DOL's fee disclosure regulations, defined contribution plan administrators are now relentlessly focused on plan expenses. Consequently, the likelihood of successful future claims against large employer has been significantly reduced. But some risks remain.

1. Claims Against Smaller Plans. In May of 2016 a relatively small plan with only $9 million of assets was sued for having excessive fees. See *Damberg v. LaMettry's Collission [sic] Inc.*, No. 0:16-cv-01335-JNE-SNR (D. Minn. May 18, 2016) ECF No. 1. The case may be a harbinger of future claims against smaller plans that typically use higher cost recordkeepers (such as ING/Voya, the recordkeeper involved in the *Damberg* case) and that do not have the sophistication to actively manage 401(k) plan vendors. While I do not expect additional lawsuits against plans having less than $10 million in assets, plaintiffs' firms may find that cookie cutter claims and quick settlements against plans with $25 to $100 million in assets are profitable due to the high cost of defending such claims.

2. Focus on Individual Fund Performance and Fees. As indicated above, recent cases such as those against Verizon, Oracle, and Fidelity have focused on the performance and fees of specific funds rather than overall plan expenses.

3. Disclosure Claims Based on ERISA Section 404(a)/408(b)(2) Regulations. Recent cases have also included claims that plan administrators and vendors failed to comply with the final DOL fee disclosure regulations. While successful claims based on 5500 disclosures are unlikely (courts have long held that only the DOL, and not participants, can recover penalties associated with 5500 filing

failures), future complaints will include allegations of notice failures (such as those in the cases against Oracle and Anthem) to avoid the three-year limitations period that would otherwise apply if participants received notice of "excessive" fees through the annual fee disclosures.

4. Brokerage Option Expenses. After the court in *Hecker v. Deere* referred favorably to the plan's brokerage account option as providing access to large numbers of lower cost investment options, many vendors have claimed that such options provide a hedge against a successful fee lawsuit. However, such options typically result in much higher participant investment fees including fees from retail funds that may duplicate other institutional class investment options already available under the plan. I expect that future fee litigation will also include claims regarding brokerage account options.