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Plan Fee Litigation: The Tide May Be Turning in Favor of Plan Fiduciaries

By Mark E. Bokert and Alan Hahn

For many years, plan sponsors and other fiduciaries have been caught in a whirlwind of litigation primarily related to 401(k) and 403(b) plan fees. Many of these cases have settled resulting in plan fiduciaries having to pay many millions of dollars. Other cases have resulted in adverse decisions against plan fiduciaries.

In Hughes v. Northwestern, the U.S. Supreme Court had the opportunity to stem these lawsuits but declined to do so, remanding the case to the U.S. Court of Appeals for the Seventh Circuit for further deliberation. As a result, plan sponsors and other fiduciaries were left with little hope that the proliferation of 401(k) and 403(b) fee cases would ever abate.

Recent federal court decisions suggest, however, that courts are becoming more skeptical of claims against plan fiduciaries. These new cases apply a more common sense analysis of plaintiff claims and offer hope that the tide of cases resulting in fiduciary liability may be receding. These cases also offer important lessons for plan fiduciaries which should be discussed with ERISA counsel.

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ERISA FIDUCIARY DUTIES

ERISA imposes twin duties of prudence and loyalty on fiduciaries of retirement plans. The duty of loyalty requires fiduciaries to act "solely in the interest of the participants and beneficiaries," and "for the exclusive purpose of providing benefits to participants and their beneficiaries; and defraying reasonable expenses of administering the plan."[1] The duty of prudence requires a fiduciary to act "with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims."[2]

To evaluate whether the "prudent person" standard is satisfied, a court must ask whether "the individual trustees, at the time they engaged in the challenged transactions, employed the appropriate methods to investigate the merits of the investment and to structure the investment."[3] The prudence of a fiduciary is measured against an objective standard, and their own "lack of familiarity with investments is no excuse" for failing to act with the care, skill, prudence and diligence required under the circumstances then prevailing.[4]

A fiduciary breaches its duty of prudence when it fails to employ "the appropriate methods" in making investment decisions.[5] Pursuant to ERISA regulations, a fiduciary's compliance with the prudent-man standard requires that the fiduciary give "appropriate consideration" to whether an investment "is reasonably designed, as part of the portfolio . . . to further the purposes of the plan, taking into consideration the risk of loss and the opportunity for gain (or other return) associated with the investment."[6] Fiduciaries should consider the prudence of each investment as it relates to the portfolio as a whole, rather than in isolation. Accordingly, courts must look "not only to [a fiduciary's] investigation procedures, but also to the methods used to carry out those procedures as well as the thoroughness of their analysis of the data collected in that investigation."[7]

Moreover, fiduciaries have a continuing duty to monitor investments and remove imprudent ones. This means that a fiduciary "cannot assume" that investments that were prudent at one time "will remain so indefinitely."[8] Rather, the fiduciary "must 'systematic[ally] conside[r] all the investments of the trust at regular intervals' to ensure that they are appropriate."[9] In short, a fiduciary who ignores changed circumstances that increase the risk of loss is imprudent.'"[10]

A fiduciary also has the responsibility of ensuring that fees paid to recordkeepers are not excessive relative to services rendered.[11] A prudence claim based on excessive fees must be supported by facts that take the particular circumstances into account.[12] ERISA does not dictate "any particular course of action" with regards to fees, but it does require a "fiduciary . . . to exercise care prudently and with diligence under the circumstances then prevailing."[13]

HUGHES V. NORTHWESTERN

On January 24, 2022, the U.S. Supreme Court decided Hughes v. Northwestern University.[14] In this class action case, lead plaintiff Abigail Hughes sued Northwestern University for allegedly violating ERISA's duty of prudence. Among other things, Hughes alleged that Northwestern offered mutual funds that carried higher fees than otherwise identical mutual funds.

The district court had dismissed the claim and the Seventh Circuit affirmed, reasoning that Hughes' allegations failed because Northwestern's plans contained numerous investment alternatives that Hughes agreed were prudent. Thus, Hughes was barred from complaining about the deficiencies of other investment alternatives.

The Supreme Court reversed the Seventh Circuit. In a unanimous opinion, the Court held that offering some prudent investment funds does not bar a plaintiff from alleging that other investment options are imprudent. Instead, the Court held that ERISA's duty of prudence requires plan fiduciaries to monitor all the investment alternatives offered under a plan and to remove those which fail to be prudent. The Court remanded the case to the Seventh Circuit to reconsider Hughes' complaint.

Some observers view the Supreme Court's decision in Hughes as a missed opportunity to stem the tide of 401(k) and 403(b) plan fee litigation. Had the Court upheld the Seventh Circuit's decision, it surely would have made it more difficult for plaintiffs to successfully sue plan fiduciaries for offering allegedly imprudent investments. From a plan fiduciary perspective, about the only thing positive to come from the Hughes decision was a recognition by the Court that at "times, the circumstances facing an ERISA fiduciary will implicate difficult tradeoffs, and courts must give due regard to the range of reasonable judgments a fiduciary may make based on her experience and expertise."[15]

Despite the Supreme Court's ruling in Hughes, there is a developing trend among circuit courts expressing skepticism about some of the most common allegations in these fee-related lawsuits.

MATOUSEK V. MIDAMERICAN ENERGY CO.

In Matousek, et al., v. MidAmerican Energy Co., et al.,[16] participants in the MidAmerica 401(k) plan filed a class action lawsuit against the plan's fiduciaries alleging they had breached their ERISA fiduciary duties by causing the plan to pay excessive recordkeeping costs and selecting plan investments that either underperformed or were too costly. To buttress these claims, the plaintiffs offered other recordkeeping arrangements

and investment alternatives as comparators to show that cheaper and better-performing options were available.

The district court dismissed the plaintiffs' claims and the U.S. Court of Appeals for the Eighth Circuit affirmed, holding that the plaintiffs failed to provide "meaningful benchmarks" to support a breach of fiduciary duty claim.

With respect to the plan's recordkeeping expenses, the Eighth Circuit found that the comparators provided by the plaintiffs were ill-suited for evaluating the MidAmerica 401(k) plan. The MidAmerica 401(k) plan received basic recordkeeping services, but also negotiated for plan participants to receive individualized investment advice and other services. In contrast, the comparator plans generally offered only basic recordkeeping services or it was unclear what services they provided.

With respect to the plan's investment funds that were allegedly too expensive, the plaintiffs offered "peer groups" of funds with lower expense ratios, but failed to explain the content of the peer groups and whether they consisted of funds which had securities, strategies or risk profiles that were similar to the plan's funds.

Regarding the plan funds that were allegedly underperforming, the plaintiffs offered benchmarks that were markedly different than the plan's funds. For example, in one instance, a "value" fund was compared by the plaintiffs with a "growth" fund.

Due to the plaintiffs' numerous failures to provide meaningful comparators, the Eighth Circuit held that the complaint failed to create a plausible inference that the plan fiduciaries breached their fiduciary duties.

ALBERT V. OSHKOSH

In Albert v. Oshkosh Corp.,[17] plaintiffs who were participants in the Oshkosh 401(k) plan filed a class action lawsuit against the plan's fiduciaries alleging they had breached their ERISA fiduciary duties by allowing excessive recordkeeping fees, overpriced investment options and imprudent investment consulting fees.

In affirming the district court's dismissal, the Seventh Circuit held that the plaintiffs failed to state a claim relating to excess recordkeeping fees because they did not establish that the fees were excessive relative to the recordkeeping services rendered to the plan. While the plaintiff was able to point to several plans with less expensive recordkeeping arrangements, they provided no information or context about these comparator plans or arrangements, which the court called a "potentially random assortment."[18]

The court also held that the plaintiffs failed to state a claim for breach due to the high cost of certain investment options. Although the plan offered actively managed investment funds that were higher in price than similar passive investment funds, the court determined that ERISA does not require plan fiduciaries to simply offer the lowest price fund. Rather,

in order to state a claim, plaintiffs needed to provide a thoughtful comparison of the lower priced funds and the higher priced funds, which the plaintiffs failed to do.

Finally, the court held that the plaintiffs failed to state a claim of breach of duty for imprudent investment consulting fees. While the plaintiffs alleged that the plan fiduciaries failed to conduct a prudent search for the investment consultant, the court found that their claim was deficient because they failed to demonstrate that the investment consulting fees were unreasonable.

PIZARRO V. THE HOME DEPOT

In Pizarro, et al., v. The Home Depot, Inc., et al.,[19] plaintiffs brought a class action lawsuit against The Home Depot alleging that plan fiduciaries breached their duties by failing to monitor the plan's managed account services resulting in excessive managed account fees and failing to monitor and remove several plan investment options that allegedly underperformed for certain periods of time.

The court noted that plan fiduciaries spent little time monitoring the plan's investment options, did not benchmark plan fees or engage in a competitive bidding process of plan services, and did not evaluate the fees assessed by their managed account provider in their committee meetings. However, the court ruled that even though Home Depot did not closely monitor its investment funds, the funds themselves were not imprudent investments. The court stated that "[r]egardless of any imprudent process, if a plan fiduciary selects an objectively prudent service or investment option, the plan has not suffered a loss. . . ." The court further indicated that even though some funds briefly underperformed comparators, retaining underperforming funds as part of an overall long-term strategy is not imprudent. The court also noted that underperformance in hindsight is not the basis for a claim under ERISA.

Regarding the plaintiffs' allegations that managed account services were too expensive, the court found that, although the defendant fiduciaries did not act with prudence in selecting or monitoring the managed account provider, plaintiffs failed to provide sufficient evidence that the plan paid excessive fees due to the fact that plan participants actually paid lower fees for services than most of the other plans serviced by the managed account provider.

KEY TAKEAWAYS

Defendants can breathe a small sigh of relief based on the foregoing cases which are favorable to plan fiduciaries. Nevertheless, plan fiduciaries must continue to abide by their fiduciary duties and these cases offer several lessons relating to fiduciary compliance.

Of critical importance is for plan fiduciaries to ensure that their recordkeeping fees are reasonable. This should be done by comparing their plan's recordkeeping fees to the fees charged to similarly-sized plans who receive similar services (i.e., not just similarly sized plans).

Plan fiduciaries should ask their consultants to provide benchmarking studies at least annually. Any benchmarking studies should also include an evaluation of revenue sharing payments, if any, net investment management fees, and any indirect compensation received by the recordkeeper and other service providers. Plan fiduciaries need to be aware of any revenue generated from their plan and have documentation bolstering that the revenue is reasonable for the services rendered.

It is also best practice to engage in a competitive bidding process from time to time to confirm the reasonableness of the recordkeeping fees. Although not required by ERISA, a search for a new recordkeeper should be conducted every five through seven years (or more frequently if there are any intervening material changes to the plan or plan population such as the result of a merger or acquisition or divestiture). By directing their consultant to perform benchmarking studies and vendor searches, plan fiduciaries can protect themselves against claims alleging excess recordkeeping fees. It is, of course, also best practice for plan fiduciaries to periodically review and evaluate plan investments relative to appropriate benchmark and peer group data – and to have ERISA counsel document those reviews.

CONCLUSION

Courts have begun taking a more common sense approach to analyzing 401(k) and 403(b) fee litigation cases. As a result, there have been several rulings favorable to defendants which may suggest that the flood of litigation against plan fiduciaries is slowing. However, plan fiduciaries need to continue to be vigilant and engage in fiduciary best practices to avoid, or be in the best position to defend, an ERISA lawsuit.

Notes

1. ERISA § 404(a)(1)(A).

2. ERISA § 404(a)(1)(B).

3. Katsaros v. Cody, 744 F.2d 270, 279 (2d Cir. 1984) (quoting Donovan v. Mazzola, 716 F.2d 1226, 1232 (9th Cir. 1983), cert. denied, 464 U.S. 1040 (1984).

4. Katsaros, 744 F.2d at 279.

5. Katsaros, 744 F.2d at 279 (quoting Mazzola, 716 F.2d at 1232).

6. 29 C.F.R. § 2550.404a-1(b)(2)(i)).

7. Chao v. Tr. Fund Advisors, No. Civ. A. 02-559, 2004 WL 444029, at *3 (D.D.C. Jan. 20, 2004).

8. A. Hess, G. Bogert & G. Bogert, Law of Trusts and Trustees (Bogert 3d) § 684, pp. 145-146 (3d ed. 2009)).

9. Bogert 3d § 684.

10. Armstrong v. LaSalle Bank Nat'l Ass'n, 446 F.3d 728, 734 (7th Cir. 2006).

11. Young v. Gen. Motors Inv. Mgmt. Corp., 325 Fed. App'x 31 (2d Cir. 2009).

12. Id.

13. Chao v. Merino, 452 F.3d 174, 182 (2d Cir. 2006) (internal quotation omitted).

14. April Hughes, et al., v. Northwestern University, et al., 142 S.Ct. 737 (2022).

15. Hughes, 142 S.Ct. at 742.

16. Matousek, et al., v. MidAmerican Energy Co., et al., 2022 WL 6880771, __ F.4th __ (8th Cir. 2022).

17. Albert v. Oshkosh Corp., No. 21 2789 (7th Cir. Aug. 29, 2022).

18. Id.

19. Pizarro, et al., v. The Home Depot, Inc., et al., No. 3:20-MC-157-FDW-DCK (W.D. North Carolina, Nov. 4, 2020).

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