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Employee Benefit Plan Review

The New Wave of 401(k) Excessive Fee Lawsuits

By Ron M. Pierce

401(k) plan participants absolutely should be protected from bad behavior by those entrusted with their retirement funds. Many of the recent 401(k) fee lawsuits serve that purpose well. However, observers argue, that the majority of these suits are not brought out of those altruistic motives but, rather, as a vehicle to generate large payouts for the plaintiffs' lawyers.

The core arguments are that plan fiduciaries breached their ERISA duties by:

- Selecting investment options that charged participants excessive fees (when compared to other available options);
- Using administrators who charged too much for their services; or
- Relying on proprietary funds instead of more competitive alternatives.

These suits are brought as class actions on behalf of all plan participants.

Filed documents argue, for example, that fees were up to "*six times*"[1] more than were prudent under ERISA standards. Plaintiffs' lawyers use words like "polluted self-interest," "blind preference," "favoritism," "disloyal" and "imprudent." Courts generally like those words. Cases are allowed to proceed at far faster rate than they are dismissed. And the recent U.S. Supreme Court decision in *Hughes v. Northwestern*,[2] instead of narrowing access to these claims, effectively left the door open.

Much (we are talking a lot) has been written about these cases. However, since it is more likely now than ever your plan (or your client's plan) will be sued, this column aims to take a fresh look by:

- Reviewing a recent case and its key arguments; and
- Advising plan sponsors how they can be less attractive targets.

The Excessive Fee Suit Landscape

Benefits experts agree that frequency of these lawsuits is going to skyrocket.

Although some large targets remain, (a class action suit against a $7.3 billion 401(k) plan recently was allowed to continue) the pool for these massive targets is dwindling. Plaintiffs' attorneys have instead turned to smaller employers and smaller plans. While relying on time tested arguments, they continue to craft creative angles to attack plan fiduciaries.

Approximately 200 such suits have been filed in federal courts since 2020 alone resulting in at least $68 million in combined settlements. However, representative settlements between $1.2 million and $4 million are more prevalent recently. This clearly reflects the trend of targeting smaller plans.[3]

It is not all bad news for plan fiduciaries. Cases ruling in a plan's favor have relied on

the prudent decision-making process employed by the fiduciaries (discussed in detail below). The case is evaluated at the time the decision was made, not with hindsight. Some courts also have had little patience with plaintiffs' conclusory arguments. For example, it is not enough simply to allege that the fiduciaries always should pick the lowest fee share class. Those wins are very rare relative to the number of lawsuits.

The Life of a Typical 401(k) Excessive Fee Lawsuit[4]

The Complaint

On November 23, 2020, an excessive fee lawsuit was initiated against a plan having approximately 34,000 participants and $1.6 billion in assets. Specifically, the complaint alleged that fiduciaries "severely" breached their duties when they: "(1) allowed unreasonable recordkeeping/administrative expenses to be charged to the Plan; and (2) selected, retained, and/or otherwise ratified high-cost investments, instead of offering more prudent alternative investments when such prudent investments were readily available."

One "obvious indicator" of wrongdoing was that the plan assessed each participant a $56 annual administrative fee, when, according to the complaint, the appropriate fee for the plan was $35. This constituted a "shocking" breach of fiduciary duties. Plan fiduciaries, allegedly, failed to use even a "modestly prudent approach" and may have been "complicit in paying grossly excessive fees."

Next the complaint turned to the "exceedingly expensive" investment options. The fiduciaries committed a "profound" breach. Finally, the failure to use the least expensive share class for one of the funds offered resulted in plaintiffs paying "needless extra fees."

Specifically, the lawsuit claimed that:

- Fiduciaries breached their duty;
- The plan sponsor failed to monitor the fiduciaries; and
- At the very least, the plan sponsor participated in a breach of duty.

As a result, the plan sponsor was liable to restore the "millions" participants could have been earning in additional benefits to the plan.

The Motions to Dismiss

On February 12, 2021, the plan filed motions to dismiss claiming:

- The $56 fee is not objectively unreasonable;
- The prudent standard does not mean fiduciaries must choose the cheapest alternative;
- The range of investment offerings and fees reflect that lowest cost options were considered; and
- Use of a more expensive share class does not create an inference of imprudence.

The court was having none of it. On September 16, 2021, the court agreed that the "Plan's preternatural skew toward expensive funds . . . corroborate[d] all the other circumstantial facts in the Complaint." It examined each of the plaintiffs' claims, upheld them all with similar logic, and summarily rejected the plan's motion to dismiss.

The Settlement

The plaintiffs claimed that the plan had lost millions of dollars, including specifically $17.3 million in excessive investment fees. With the help of a mediator, the case settled for $2.75 million.

On August 11, 2022, parties filed a settlement agreement and release with the court. The plan continued to "vigorously" deny any wrongdoing and admits to no wrongdoing. The settlement cuts off the possibility of related future lawsuits against the plan related to allegations for the period covered by the suit.

Strategies For Plan Sponsors

The threat of these suits is now a reality of sponsoring a 401(k) plan. Plans can take steps to avoid being a target, and if they are a target, provide the best defenses.

The Real Cost

The ultimate monetary outlay of $2.75 million, relative to the potential liability of tens of millions, is a great result for the plan. However, that considers only a small portion of the real costs.

Reflect for a minute on the costs, in both effort and money, incurred in addition to the settlement payout. Those costs are well described in the case. "The Parties engaged in meaningful discovery, briefed several motions, participated in other pretrial proceedings, and were able to fully evaluate the merits of the claims and defenses and alleged losses to the Plan." It is truly impossible to quantify the nonmonetary costs in anguish and distraction that were incurred.

These "real" costs should serve as motivation to take appropriate defensive steps immediately.

Action Items

Reviewing the Plan's Decision-Making Processes

As the court summarized well, when evaluating fiduciary behavior, "the key is whether [the plan sponsor's] process in making its investment decisions was imprudent." In other words, even if the plan's decision ultimately did not work out as intended, following a prudent decision-making process is the best defense.

A prudent process includes:

- Ensuring that the delegation of any fiduciary duties to, for example, an investment committee,

is properly documented (with a unanimous consent of the Board of Directors);

- Adopting committee bylaws describing duties and operations;
- Establishing an Investment Policy Statement which stakes out the parameters of acceptable and unacceptable fund choices;
- Keeping detailed, written, and contemporaneous records of committee meetings.
- Having regular committee meetings (ideally quarterly) which are attended by all committee members.
- Appointing committee members with the appropriate level of sophistication to make informed decisions.

Engaging Assistance

Part of being prudent is knowing when help is needed. Examples include:

- Retaining independent experts to assist with, or take on, fiduciary duties relating to investments
- Securing appropriate fiduciary liability insurance.

Monitoring Investments

Ideally with the help of a qualified investment manager, regularly and carefully:

- Ensure plans include a reasonable number of diversified investment options;
- Monitor each investment alternative for return and costs;
- Evaluate where the plan stands against peer plans of like sizes in terms of cost to participants.

Evaluating Plan Providers

A key component of the settlement in the above case was that the plan would be required to conduct a request for proposal for record keeping services within three years of the settlement's effective date.

Third party administrators' and investment managers' performance should be reviewed and reflected in the minutes at least annually. Formal requests for proposals ("RFPs") should be conducted often (at least every few years). Both the costs and scope of these services constantly change. These RFPs will review available marketplace options and demonstrate that a deliberate process was followed to protect participants' best interests.

Conclusion

Discharging ERISA's fiduciary duties is not an easy task and fiduciaries who take those responsibilities lightly put the plan and the company at significant risk. The Supreme Court noted: "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."

Regardless of the size of your plan, now is the time to review your practices for selecting and monitoring plan service providers and investments.

Notes

1. Emphasis in original.
2. No. 19-1401 (U.S. Jan. 24, 2022).
3. *https://www.bloomberglaw.com/bloomberglawnews/ - Victoria's Secret Parent Settles 401(k) Suit for $2.75 Million.*
4. *Allison v. L Brands, Inc.*, S.D. Ohio, No. 2:20-cv-06018.

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