Benefits Practitioners' Strategy Guide, Employee Benefits Litigation, ERISA Fee Litigation: Developing Best Practices to Limit Exposures

Benefits Practitioners' Strategy Guide
Employee Benefits Litigation

ERISA Fee Litigation: Developing Best Practices to Limit Exposures

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Overview —

As originally envisioned, 401(k) and like plans offered tax deferred savings vehicles to supplement the retirement benefits (typically annuities) provided by traditional defined benefit pension plans.[1] However, since the addition of § 401(k) to the Internal Revenue Code in 1978, 401(k) plans have moved from a supplemental to central role in providing retirement benefits–indeed, it is now quite common for employees to have access only to a 401(k) plan (or 403(b) plan for certain nonprofit organizations) to fund their retirement.[2] But employees, not employers, bear the risk of investment performance in these plans, and employees also typically pay the cost of investment and administrative fees for the plans. This enhanced role for 401(k) and 403(b) plans has thus put increased pressure on plan performance, and has led to steadily increasing ERISA litigation challenging the fees and expenses, and the prudence of the selection of the mutual fund and other investments offered in the plans.[3] There is also general civil litigation challenging fees derivatively, on behalf of mutual funds, on whether the fees charged the fund are excessive under Section 36(b) of the Investment Company Act of 1940.[4]

[1] *See, e.g.,* Teresa Ghilarducci, Guaranteed Retirement Accounts: Toward Retirement Income Security, Economic Policy Institute, Agenda for Shared Prosperity (Nov. 2007).

[2] *See, e.g.,* U.S. Dep't of Labor, Emp. Benefits Sec. Admin., Private Pension Plan Bulletin: Abstract of 2016 Form 5500 Annual Reports, at 2 ((Dec. 2018) (noting 656,240 of the total 703, 000 pension plans are defined-contribution plans, and that 560,000 of those defined-contribution plans are 401(k) plans)).

[3] There has also been substantial litigation challenging 401(k) plan investments in employer stock. For a discussion of the claims and issues, *see* Robert Rachal, Howard Shapiro, & Nicole Eichberger, *Fiduciary Duties Regarding 401(k) and ESOP Investments in Employer Stock*, in BNA ERISA Litigation 1259, 1259 (6th Ed. 2017).

[4] "[T]o face liability under § 36(b), an investment adviser must charge 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." *Jones v. Harris Assocs. L.P.*, 559 U.S. 335, 346, 2010 BL 69004, (2010). The plaintiff is a shareholder of the fund at issue, and sues derivatively on behalf of the mutual fund; the defendant is the investment adviser that receives the fees. For a discussion of the cases and issues in Section 36(b) litigation, *see* Sean M. Murphy *et al.,* Developments in Litigation Under Section 36(b) of the 1940 Act, Investment Company Institute (Nov. 2013).

Settlements and Judgments in ERISA Fee Cases —

In the ERISA area, there have been substantial settlements and judgments. Some examples include:

Example: A $140 million settlement was approved in *Haddock v. Nationwide* that included attorney's fees and expenses of more than $50 million.[5]

[5] *See* $140M Settlement Between Nationwide, Retirement Plans Receives Final Approval, BNA Pension & Benefits Daily, Apr. 10, 2015.

Example: On the eve of trial, *Abbott v. Lockheed Martin* settled for a $62 million payment that included $22.3 million in attorney's fees and $160,000 in incentive awards for named plaintiffs.[6]

[6] *See* Matthew Loughran Firm Awarded $22M in Fees for Lockheed 401(k) Case, BNA Pension & Benefits Daily, July 20, 2015.

There has also been an uptick in litigation against colleges and universities alleging they charged participants in their 403(b) plans excessive fee cases. Many of these have resulted in large settlements including by:

Massachusetts Institute of Technology ($18.1 million);[7]

[7] Tracey et al v. Massachusetts Institute of Technology et al.

Emory University ($16.75 million);[8]

[8] Henderson et al v. Emory University et al, **Docket No. 1:16-cv-02920 (N.D. Ga. Aug 11, 2016),**

Vanderbilt University ($14.5 million);[9]

[9] Cassell et al v. Vanderbilt University et al, **Docket No. 3:16-cv-02086 (M.D. Tenn. Aug 10, 2016)**

Johns Hopkins University ($14 million);[10]

[10] Kelly et al v. The Johns Hopkins University, **Docket No. 1:16-cv-02835 (D. Md. Aug 11, 2016).**

Duke University ($10.65 million);[11]

[11] Clark et at v. Duke University et al, **Docket No. 1:16-cv-01044 (M.D.N.C. Aug 10, 2016)**

the University of Chicago ($6.5 million);[12]

[12] Daugherty et al v. The University of Chicago, **Docket No. 1:17-cv-03736 (N.D. Ill. May 18, 2017), Court Docket**

Princeton University ($5.8 million);[13] and

[13] Nicolas v. The Trustees of Princeton University, **Docket No. 3:17-cv-03695 (D.N.J. May 23, 2017), Court Docket**

Brown University ($3.5 million).[14]

[14] Short et al v. Brown University, **Docket No. 1:17-cv-00318 (D.R.I. Jul 06, 2017), Court Docket [not available]**

In addition, employees of the University of Pennsylvania successfully petitioned the U.S. Court of Appeals for the Third Circuit to allow them to proceed with their proposed class action alleging breach of fiduciary duties in choosing investment options with high fees that performed no better than less costly alternatives.[15]

[15] Sweda v. Univ. of Penn., **923 F.3d 320, 2019 EBC 158780** 3d Cir. 2019). Plaintiffs agreed to settle the case following the Third Circuit's decision. See *Sweda v. Univ. of Penn.*, Docket No.

2:16-cv-04329 **(E.D. Pa., Dec 1, 2020), ECF No. 96.**

Practice Tip: Experience in the cases has shown that ERISA fee litigation operates like hydraulic pressure, probing for liability from any weak aspect of plan management and administration, even if the 401(k) or 403(b) plan is overall collectively sound and well managed. It is thus not surprising that plaintiffs continue to file ERISA fee cases, including ones asserting new theories of liability.

Example: In another lawsuit, the plaintiffs claimed hundreds of millions of dollars in losses from a plan fiduciary's decision to include hedge funds and private equity investments in target date and diversified funds.[16] Universities and other non-profits have been subject to lawsuits claiming their 403(b) plans included too many funds or more than one recordkeeper, and thus allegedly are not minimizing fees and expenses by using economies of scale.[17]

[16] *See* Complaint, at 59-70, Sulyma v. Intel Corp. Inv. Policy Comm., No. 5:15-cv-04977 (N.D. Cal. Oct. 29, 2015), ECF No. 1.

[17] *See* David Powell and Mark Bieter, View From Groom: The University Fee Cases–Product of the Past, Possible Wave of the Future, BNA Pension & Benefits Daily, Sept. 28, 2016.

Deference Owed to ERISA Fiduciaries —

Several rulings make it clear that strict standards apply to ERISA fiduciaries. In this context, ERISA fiduciaries are *not* treated like corporate fiduciaries, who typically are protected by the business judgment rule.[18] And although the U.S. Supreme Court has elsewhere noted that deference to ERISA fiduciaries is an important part of plan administration in interpreting plans,[19] there still remains some uncertainty whether deference is due ERISA fiduciaries regarding their decisionmaking in plan management and investment, with the majority of courts granting some level of deference.[20] Most importantly, deference typically requires that there must first be a prudent fiduciary process and decision on which to defer. Absent this process, courts often second-guess ERISA fiduciary decisions. *Tatum v. RJR Pension Inv. Comm.*, illustrates this dynamic and the “would have” standard that may apply when there is no procedural prudence–that is, the fiduciary may be in the unenviable position of having to show that the decision made was not merely permissible, but was clearly prudent.[21] The need for a prudent process and decision can extend to monitoring and retaining existing investments options. In *Tibble v. Edison Int'l*, the U.S. Supreme Court held that ERISA imposes some duty to periodically monitor plan investments, even if the fiduciary selected the investment outside the fiduciary six-year statute of limitations period.[22]

[18] *See Howard v. Shay*, 100 F.3d 1484, 1489 (9th Cir. 1996) (noting “[t]he business judgment rule is a creature of corporate, not trust, law”); *Donovan v. Mazzola*, 716 F.2d 1226, 1231-32 (9th Cir. 1983) (prudent person test, not business judgment rule, is used to evaluate ERISA fiduciary decisions); compare *Armstrong v. LaSalle Bank Nat. Ass'n*, 446 F.3d 728, 733, 37 EBC 2256 (7th Cir. 2006) (Posner, J.) (analogizing the ERISA's prudent-person standard to the business judgment rule, but noting that “[a] trustee is not an entrepreneur” and “[h]e is supposed to be careful rather than bold”).

[19] *See Conkright v. Frommert*, 559 U.S. 506, 512, (2010) (noting deference in plan interpretation “preserves the ‘careful balancing’ on which ERISA is based” and ensures the plan system “is [not] so complex that administrative costs, or litigation expenses, unduly discourage employers from offering [ERISA] plans in the first place” (alterations in original)).

[20] *See Tussey v. ABB, Inc.*, 746 F.3d 327, 335 & n.6, (8th Cir. 2014) (holding trustee due discretion in fee litigation claim and collecting cases); *see also Firestone Tire & Rubber Co. v. Bruch*, 489 U.S. 101, 111 (1989)

[21] 761 F.3d 346, 365-66, (4th Cir. 2014). Defendants appear to have finally won on their substantive prudence defense in *Tatum v. RJR Pension Inv. Comm.*, 855 F.3d 553, (4th Cir. April

28, 2017).

[22] 135 S. Ct 1823, 1828-29, (2015). After rejecting numerous claims, the district court found the fiduciaries breached their fiduciary duties by including more expensive retail class instead of institutional class mutual funds. However, the district court found that claims challenging funds that were added more than six years before the complaint was filed were untimely 135 S. Ct 1823 , at 1826. *Id.* The Supreme Court reversed and remanded, reasoning that under trust law a fiduciary is required periodically to monitor plan investments, and thus the fiduciary may have breached a duty to remove these retail funds within the six years preceding the lawsuit. 135 S. Ct 1823, 1828-29.

Fiduciaries may also be allowed to receive compensation for providing investment advice, provided they comply with DOL and SEC regulations. For more information, see Investment Advice.

Types of Investment Fee and Investment Prudence Cases —

The lawsuits challenging the fees and the prudence of investments in 401(k) and 403(b) plans can generally be broken down into three types:

- general 401(k) and 403(b) plan cases;
- proprietary fund cases; and
- gatekeeper cases.

This chapter focuses on the first category of cases, including the key issues affecting plan sponsors and plan fiduciaries, and potential best practices they may consider adopting.

General Characteristics of the Claims

General 401(k) and 403(b) Plan Cases —

These cases have generally targeted larger (billion-dollar plus) 401(k) and 403(b) plans, though a few cases have been filed against smaller plans with as little as $9 million in plan assets.[23] Participants claim that the fiduciaries caused the plans to pay unreasonable or prohibited fees by:

[23] *See, e.g.,* Jacklyn Wille, *Uptick in Fee Litigation Reshaping 401(k) Industry* , BNA Pension & Benefits Daily, June 9, 2016; *Tibble v. Edison Int'l*, 2010 BL 170372 (C.D. Cal. July 8, 2010), *aff'd*, 711 F.3d 1061 (9th Cir. 2013).

- failing to take into account revenue-sharing fees paid by mutual fund managers to recordkeepers and other vendors;[24]
- offering mutual funds as investment options instead of lower cost separate accounts or collective trusts;[25]
- offering more expensive actively managed funds as investment options instead of index funds;[26] and
- offering more expensive retail class mutual funds as investment options instead of institutional class funds.[27]

[24] *Tibble v. Edison Int'l*, 2010 BL 170372 (C.D. Cal. July 8, 2010), *aff'd*, 711 F.3d 1061 (9th Cir. 2013).

[25] *See, e.g., Mehling v. New York Life Ins. Co.*, 2007 BL 147078 (E.D. Pa. 2007).

[26] *See, e.g., Taylor v. United Techs. Corp.*, 2009 BL 42047 (D. Conn. Mar. 3, 2009), *aff'd*, 354 F. Appx. 525, (2d Cir. 2009).

[27] *See, e.g., Tussey v. ABB, Inc.*, 746 F.3d 327 (8th Cir. 2014); *Tibble v. Edison Int'l*, 711 F.3d 1061 (9th Cir. 2013).

In other cases, participants have asserted expanded and new theories challenging fees and expenses, including that:

- the fiduciaries failed to properly monitor recordkeeping fees;[28]
- offering low-cost index funds such as those offered by Vanguard was imprudent for large plans that could have qualified for cheaper share classes;[29]
- universities and other non-profits' 403(b) plans included too many funds or more than one recordkeeper, and thus did not minimize fees and expenses by using economies of scale;[30] and
- the plan's recordkeepers are receiving excessive compensation based on fees paid for “robo-advisors” that advise plan participants.[31]

[28] *E.g., Tussey*, 746 F.3d at 337 (8th Cir. 2014).

[29] *E.g.,* Complaints in Bell v. Pension Committee of ATH Holding Co., No. 1:15-cv-02062, (S.D. Ind. Dec. 29, 2015), ECF No. 1, amended March 16, 2016, ECF No. 23

[30] David Powell and Mark Bieter, View From Groom: The University Fee Cases–Product of the Past, Possible Wave of the Future, BNA Pension & Benefits Daily, Sept. 28, 2016.

[31] *See, e.g.*, Robo-Advisers Steer 401(k) Plan Litigation Trend, BNA Pension & Benefits Daily, Feb. 7, 2017. Robo-advisors provide algorithm-based digital investment advice.

Participants also have challenged the prudence of offering certain investments in the plans, including claims that:

- actively managed funds underperformed against relevant benchmarks;[32]
- hedge funds and private equity investments should not have been included in target date and diversified funds;[33]
- stable value funds were too conservative and underperformed against benchmarks;[34]
- stable value funds should have been offered instead of money market funds as an investment option;[35] and
- guaranteed benefit contracts allegedly do not meet the requirements to be considered exempt from ERISA's fiduciary requirements.[36]

[32] Robert Rachal, Disney and Chevron 401(k) Fee Litigation: Court Skepticism Can Provide Some Important Limits to Fee Litigation, BNA Pension & Benefits Daily, Nov. 30, 2016.

[33] *See* Complaint, Sulyma v. Intel Corp. Inv. Policy Comm., No. 5:15-cv-04977, at 59-70 (N.D. Cal. Oct. 29, 2015), ECF No. 1.

[34] Ellis v. Fidelity Management Trust Co., No. 1:15-cv-14128, at 1, 12, 20 (D. Mass. Dec. 11, 2015), ECF No. 1.

[35] *E.g., White v. Chevron*, 2016 BL 281396 (N.D. Cal. Aug. 29, 2016) (rejecting claim).

[36] *See Teets v. Great-West Life & Annuity Ins. Co.*, No. 1:14-cv-02330, 315 F.R.D. 362, ,

ECF No. 118 at *22-23 (D. Colo. June 22, 2016) (granting class certification of a class of more than 270,000 retirement plan investors challenging the ERISA-exempt status of a guaranteed benefit contract).

Finally, participants have filed failure-to-disclose claims, including asserting that fiduciaries have a duty to disclose to participants how the fees are distributed between the service providers and mutual funds through revenue sharing or other payments. DOL regulations that went into effect in 2011 and 2012 have effectively mooted many of these claims.[37]

[37] 29 C.F.R. § 2550.408b-2(c). For more, see Service Provider Fee Disclosure Rules: The Basics.

Proprietary Fund Cases —

The origins of "proprietary fund" litigation can be traced to *Dupree v. Prudential Ins. Co. of America*,[38] Franklin v. First Union Corp.,[39] and *Mehling v. New York Life Ins. Co.*[40] In each suit, plaintiffs claimed the plan fiduciaries breached their fiduciary duties and engaged in prohibited transactions by selecting "proprietary" mutual funds (*i.e.*, funds affiliated with the plan sponsor) as the plan's investment options.[41]

[38] 2007 BL 261609 (S.D. Fla. Aug. 7, 2007). After a bench trial, the court in *Dupree* found in favor of the defendants.

[39] 84 F. Supp. 2d 720 (E.D. Va. 2000). The *Franklin* case settled for $26 million and an agreement that an independent fiduciary would be retained to advise the fiduciary committee.

[40] 248 F.R.D. 455 (E.D. Pa. March 4, 2008). The *Mehling* case settled for $14 million (70% for the 401(k) plan and 30% for two defined benefit plans).

[41] In *Mehling,* for example, the plaintiffs claimed that the Board, which managed the plans, was induced by New York Life employees to invest assets of the plans in mutual funds offered by plan sponsor New York Life, which they claimed resulted in excessive service fees and lowered rates of return on investment. *See Mehling v. New York Life Ins. Co.*, 246 F.R.D. 467, 472 (E.D. Pa. Oct. 24, 2007).

Plaintiffs claim that financial industry fiduciaries, by choosing proprietary funds, selected expensive or poorly performing proprietary funds in order to benefit the employer or its affiliates, and thus violated their fiduciary duties of loyalty to the plan and the plan participants.[42] Plaintiffs also claim these investments were prohibited transactions under ERISA Sections 406(a) and ERISA Sections 406(b). Similar claims have also been brought when the employer has provided administrative services to the plan.[43] Allegations of economic self-dealing have generally defeated motions to dismiss in these proprietary fund cases.[44]

[42] *See, e.g., Gipson v. Wells Fargo & Co.*, 563 F. Supp. 2d 149 (D.D.C. 2008) (alleging that plan fiduciaries put Wells Fargo's interests ahead of the plan's interests by choosing investment products and services offered and managed by Wells Fargo and affiliates).

[43] *See Perez v. City Nat'l Corp.*, 176 F. Supp. 3d 945 (C.D. Cal. 2016) (granting DOL summary judgment when employer charged more than its direct expenses for administering the plan).

[44] *See, e.g.,* Jacklyn Willie & Madi Alexander, Why (Almost) Every Mutual Fund Company Can Expect to Be Sued, BNA Pension & Benefits Daily, Mar. 3, 2017 (discussing cases); Jacklyn Willie, *American Century Can't Escape 401(k) Lawsuit* , BNA Pension & Benefits Daily, Feb. 28, 2017 (discussing cases).

Gatekeeper Cases —

Plaintiffs bring gatekeeper lawsuits against financial service providers and their affiliates based on the theory that the financial providers or their affiliates are fiduciaries because they act as "gatekeepers" in screening the funds offered to the plan. Plaintiffs challenge various types of revenue-sharing payments by mutual funds, mutual fund advisers, and other investment providers to other service providers of the plan, on the grounds the providers received excessive fees in relation to the services provided to the plans.[45] Gatekeeper cases have arisen in both the large and small-plan context. In cases involving large plans, although the 401(k) plan participants include the service provider as a defendant, the focus of the claims typically is on whether the plan fiduciaries violated their fiduciary duties.[46] In the small-plan context, often the plan fiduciaries sue service providers as part of a "class of plans."[47] Similar to the gatekeeper cases, several cases also have been filed against insurers offering investments to the plan, challenging whether the investment at issue was an ERISA-exempt guaranteed benefit contract, or is instead subject to ERISA fiduciary rules.[48]

[45] *See, e.g.*, *Columbia Air Servs., Inc. v. Fidelity Mgmt. Trust Co.*, 2008 BL 305859 (D. Mass. Sept. 30, 2008); *Ruppert v. Principal Life Ins. Co.*, 2008 BL 194733 (S.D. Iowa Aug. 27, 2008); *Phones Plus, Inc. v. Hartford Fin. Servs., Inc.*, 2007 BL 131902 (D. Conn. Oct. 23, 2007); *Charters v. John Hancock Life Ins. Co.*, 534 F. Supp. 2d 168 (D. Mass. 2007).

[46] *See, e.g.*, *Hecker v. Deere & Co.*, 556 F.3d 575 (7th Cir. 2009).

[47] For example, in *Haddock v. Nationwide Financial Servs. Inc.*, 419 F. Supp. 2d 156 (D. Conn. 2006), *vacated*, 460 F. Appx. 26 (2d Cir. 2012), trustees of a 401(k) plan sued Nationwide Financial Services, which provided mutual fund investment options to participants through variable annuity contracts, claiming that Nationwide's contractual arrangements with mutual funds and receipt of revenue-sharing payments amounted to a breach of Nationwide's fiduciary duties. The plaintiffs also contended that retention of the revenue-sharing funds by Nationwide amounted to a prohibited transaction in violation of ERISA § 406.

[48] Two U.S. Courts of Appeals came to opposite conclusions on the issue of whether insurers that set interest rates on guaranteed investment products are ERISA fiduciaries. Compare *Teets v. Great-West Life & Annuity Ins. Co.*, 919 F.3d 1232 (10th Cir. 2019) (Great-West Life & Annuity Insurance Co. didn't act as an ERISA fiduciary when it set the rate of return on its guaranteed investment product, because investors were free to reject the rate and take their money elsewhere) with *Rozo v. Principal Life Ins. Co,* 949 F.3d 1071 (8th Cir. 2020) (Principal acts as a fiduciary under the Employee Retirement Income Security Act when it unilaterally sets the interest rate paid to investors who hold its Principal Fixed Income Option. Principal imposed a 12-month waiting period on any plan that tried to reject the new rate of return while the insurer in *Teets* had the option to impose a waiting period but chose not to).

Case Teachings on Plaintiffs' Claims and Best Practices to Limit Exposures

Implement and Document a Prudent Fiduciary Process —

ERISA Section 404(a)(1)(B) requires a fiduciary to act "with the care, skill, prudence, and diligence" that a prudent person "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."[49] Courts have held that "the test of prudence.is one of conduct"; procedural prudence is not determined by "whether [the] investments succeeded or failed."[50] "Prudence is evaluated at the time of the investment without the benefit of hindsight."[51] Thus, as long as the prudent person standard is satisfied, ERISA imposes no further duty to take any specific course of action.[52] Still, a plan fiduciary must always act in the beneficiaries' best interest, including researching decisions that may affect the benefit plan.[53] A decision that could otherwise be prudent thus can constitute a breach of fiduciary duties if the fiduciary's decision was motivated by a desire to benefit the employer.[54]

[49] ERISA Section 404(a)(1)(B). See Smart Code® for the latest cases.

[50] *Kirschbaum v. Reliant Energy, Inc.*, 526 F.3d 243 (5th Cir. 2008).

[51] *DeBruyne v. Equitable Life Assurance Soc'y*, 920 F.2d 457, 465 (7th Cir. 1990) ("ERISA's fiduciary duty of care "requires prudence; not prescience").

[52] *Taylor v. United Techs. Corp.*, 2009 BL 42047, at *7-9 (D. Conn. Mar. 3, 2009) ("ERISA does not require a fiduciary to take 'any particular course' so long as the fiduciary's decision meets the prudent person standard.") (citing *Chao v. Merino*, 452 F.3d 174 (2d Cir. 2006) (a fiduciary's "actions are not to be judged from the vantage point of hindsight")), *aff'd*, 354 F. Appx. 525 (2d Cir. 2009).

[53] *Chao v. Moore*, 2001 BL 1680, *4 (D. Md. June 15, 2001) (quoting *Schaefer v. Arkansas Med. Soc'y*, 853 F.2d 1487, 1491 (8th Cir. 1988)).

[54] *See Tussey v. ABB Inc.*, 850 F.3d 951, 955 (8th Cir. 2017).

Where fees are at the center of a dispute, the "ultimate measure" of the fiduciary's performance is the reasonableness of the fees approved.[55] Prudence does not require fiduciaries to select the lowest cost "blue plate special" in choosing the administrative service provider or investment options for a 401(k) plan.[56] Rather, fees and expenses are only one component of a fiduciary's evaluation of an administrative service provider or an investment.[57] As the DOL has recognized, it can be a breach of fiduciary duty to select the low-cost provider if it is unqualified or provides an inferior quality or level of services.[58]

[55] *Brock v. Robbins*, 830 F.2d 640, 644–46 (7th Cir. 1987).

[56] *See* Dep't of Labor, 401(k) Plan Fee Disclosure Form 2010, July 6, 1999 (noting that fees and expenses are one of several factors fiduciaries should consider; other factors of "equal or greater importance to consider include the quality and type of services provided, the anticipated performance of competing providers and their investment products and other factors specific to your plan's needs. *The service provider offering the lowest cost services is not necessarily the best choice for your plan*.") (emphasis in original); EBSA Info. Letter (Feb. 19, 1998) ("[T]he responsible plan fiduciary must engage in an objective process designed to elicit information necessary to assess the qualifications of the provider, the quality of services offered, and the reasonableness of the fee in light of the services provided…;[T]he fiduciary need not select the lowest bidder when soliciting bids, although the fiduciary must ensure that the compensation paid to a service provider is reasonable in light of the services provided to the plan.").

[57] *See, e.g., Hecker v. Deere & Co.*, 556 F.3d 575 (7th Cir. 2009) (recognizing that because ERISA does not require fiduciaries to choose the fund offering the lowest fee, the fact that funds exist with fees lower than the selected fund is of little significance).

[58] *See, e.g.*, EBSA Info. Letter (Feb. 19, 1998)

Practice Tip: Prudent process often is the key defense in these fee litigation cases, and can protect fiduciaries from being judged with hindsight.

Example: In *Taylor v. United Techs. Corp.*,[59] plaintiffs claimed that the defendants breached their fiduciary duties by offering actively managed mutual funds with unreasonable fees. The court held that the plaintiffs had not shown any imprudence in the selection of actively managed funds based on the record detailing the "evaluation and analytical process or 'appropriate consideration'" by which the defendants selected the mutual funds.[60] In particular, the court found that the defendants' "selection process included appropriate consideration of the fees charged on the mutual fund options, and of the returns of each mutual fund net of its management expenses."[61]

[59] 2009 BL 42047, at *7-9 (D. Conn. Mar. 3, 2009), *aff'd*, 354 F. Appx. 525 (2d Cir. 2009).

[60] *Taylor*, 2009 BL 42047, at *8-11.

[61] *Taylor*, 2009 BL 42047, at *8-11.

> ***Practice Tip:*** In contrast, in *Tibble v. Edison Int'l*,[62] the court found that the fiduciaries failed to exercise procedural prudence when they invested in retail share classes rather than the institutional share classes offered by six mutual funds. The only difference between the share classes was that the retail share classes charged higher fees to the plan participants, which in turn were the source of revenue-sharing amounts paid to the plan sponsor. The court found that the defendants never considered or evaluated the different share classes available for the three funds, and thus breached their fiduciary duty of prudence.[63] For more on Tibble and its implications, see **Monitoring and Selecting Lowest Cost Share Classes**

[62] 2010 BL 170372 (C.D. Cal. July 8, 2010), *aff'd*, 711 F.3d 1061 (9th Cir. 2013).

[63] *Tibble*, 2010 BL 170372, at *26-33.

A fiduciary who failed to follow procedural prudence, in some instances, may be insulated from fiduciary liability if a "hypothetical prudent fiduciary" would have made the same decision– what is often called substantive prudence.[64] Substantive prudence, however, can be difficult to establish. *Tatum v. RJR Pension Inv. Comm.* illustrates this dynamic and the "would have" standard that may apply when there is no procedural prudence—that is, the fiduciary may be in the unenviable position of having to show that the decision or course of action taken was not merely permissible, but was clearly prudent.[65] Thus in *Tatum*, a decision that otherwise would have been prudent with a prudent process (the closing of a spun-off, undiversified single stock fund in a 401(k) plan), has created substantial litigation and the risk of liability.[66]

[64] *Roth v. Sawyer-Cleator Lumber Co.*, 16 F.3d 915, 919 (8th Cir. 1994) ("Even if a trustee failed to conduct an investigation before making a decision, he is insulated from liability if a hypothetical prudent fiduciary would have made the same decision anyway.").

[65] *Tatum v. RJR Pension Inv. Comm.*, 761 F.3d 346, 365–366 (4th Cir. 2014).

[66] *See Tatum v. RJR Pension Inv. Comm.*, 761 F.3d 346, 368 (4th Cir. 2014). Defendant RJR Nabisco was, for years, a merged company consisting of RJR Reynolds, a tobacco company, and Nabisco, a food company. Defendant decided to spin off its food business from its tobacco business to lessen what is known as the "tobacco taint" arising from the tobacco litigation. 761 F.3d 346, at 351–352. For tobacco employees, this meant there was now a frozen "orphan" fund in their 401(k) plan, the non-employer single stock fund consisting of Nabisco stock. 761 F.3d 346, at 351–352. Defendants appear to have finally won on their substantive prudence defense in *Tatum v. RJR Pension Inv. Comm.*, 855 F.3d 553 (4th Cir. 2017).

Provide a Diversified Mix of Styles and Costs in Investment Options —

Offering a diversified mix of investment options, including on categories, styles and costs, coupled with fulsome disclosures (see the next section) can provide a powerful defense to claims that fund fees were too high, or to hindsight-based claims that certain fund investment options were too risky or underperformed. In *Hecker v. Deere & Co.*,[67] the U.S Court of Appeals for the Seventh Circuit thus found implausible the claim of excessive fees, noting there were 20 Fidelity funds and 2,500 other funds offered with fees varying between .07 to 1%, which reflected market competition. The Seventh Circuit also noted that nothing in ERISA requires offering the cheapest fund, which may be plagued by other problems.[68] Dismissal of fiduciary breach claims were likewise affirmed in the seminal case of *Loomis v. Exelon*, where the court found that the defendant “offered participants a menu that includes high-expense, high-risk, and potentially high-return funds, together with low-expense index funds that track the market, and low-expense, low-risk, modest-return bond funds.”[69] The Seventh Circuit upheld this ruling, finding that the defendant “left choice to the people who have the most interest in the outcome, and it cannot be faulted for doing this.”[70]

[67] 556 F.3d 575 (7th Cir. 2009). See Smart Code® for the latest cases.

[68] 556 F.3d 575, 586 (7th Cir. 2009).

[69] *Loomis v. Exelon Corp.*, 658 F.3d 667, 674 (7th Cir. 2011).

[70] *Loomis v. Exelon Corp.*, 658 F.3d 667, 673-675 (7th Cir. 2011).

In contrast, in *Braden v. Wal-Mart Stores, Inc.* [71] the Eighth Circuit concluded that plaintiff pled a viable claim. In *Braden*, plaintiff claimed defendants breached their fiduciary duties by imprudently choosing investment fund options with excessive fees, continuing to offer investment options that were unreasonably expensive compared with alternatives, and permitting the plan's mutual fund investments to pay revenue sharing that was actually a kickback to the plan's trustee.[72]

[71] 588 F.3d 585, 596 (8th Cir. 2009), *aff'g* 590 F. Supp. 2d 1159 (W.D. Mo. 2008).

[72] *Braden*, 590 F. Supp. 2d at 1166–67.

The Eighth Circuit held that the plaintiff had stated cognizable claims that the selection process was flawed, and that the fiduciaries selected overpriced funds despite the availability of better options.[73] The court reasoned that although there may be lawful reasons why these funds were selected, the plaintiff did not need to plead facts to rebut possible lawful explanations, at least when the lawful explanations were not the obvious or more likely explanations.[74] The court distinguished *Hecker* on the grounds that the plan in that case offered access to more than 2,500 mutual funds, whereas in *Braden* the plan offered a “far narrower range of investment options,” which made it more plausible that this plan was imprudently managed.[75]

[73] *Braden*, 588 F.3d at 598-600.

[74] *Braden*, 588 F.3d at 598-600.

[75] *Braden*, 588 F.3d at 596, fn. 6.

Braden indicates that plaintiffs' claims are more likely to survive motions to dismiss when they include plausible allegations of economic self-dealing, or that fees are high in relation to reasonable benchmarks.[76] As noted, allegations of economic self-dealing have generally defeated motions to dismiss in the proprietary fund cases.[77]

[76] For example, in *Krueger v. Ameriprise Fin., Inc.*, 2012 BL 313619 (D. Minn. Nov. 20, 2012), plaintiff stated a plausible claim by alleging that defendants chose more expensive funds of affiliates with no track record. *See also Johnson v. Fujitsu Tech. & Bus. of America, Inc.*, 250 F. Supp. 3d 460 (N.D. Cal. 2017) (concluding plaintiffs pled a plausible claim where they alleged that the plan was the most expensive “mega plan” (more than $1 billion in assets) in the United States with expenses three times higher than average).

[77] *See, e.g.,* Jacklyn Wille, *American Century Can't Escape 401(k) Lawsuit* , BNA Pension & Benefits Daily, Mar. 1, 2017.

It should also be noted that the Third Circuit in *Sweda v. Univ. of Penn.*, 923 F.3d 320 (3d. Cir. 2019) rejected defendants’ argument that it was insulated from claims of imprudence by offering a mix and range of investment options because this would allow a fiduciary to avoid liability by stocking a plan with hundreds of options, even if the majority were overpriced or underperforming. Adopting such an approach would hinder courts from evaluating fiduciaries' performance against contemporary industry practices because practices change over time and ERISA fiduciaries have a duty to act prudently according to current practices.[78]

[78] *Sweda v. Univ. of Penn.*, 923 F.3d 320, 326 (3d. Cir. 2019).

By contrast, the Seventh Circuit in *Divane v. Northwestern Univ.*, 953 F.3d 980 (7th Cir. 2020) upheld dismissal of imprudence claims and briefly commented on plaintiffs' reliance on the Third Circuit's decision in *Sweda*, and, in particular, plaintiffs' argument that the Third Circuit held that plan fiduciaries cannot satisfy their obligations by simply offering a wide range of investment options.[79] The Seventh Circuit observed that the Third Circuit's ruling merely held that offering a wide range of investment options in and of itself did not insulate fiduciaries from misconduct and that, in addition to evaluating the plan as a whole, courts must also consider the prudence of the challenged actions.[80] The Seventh Circuit also held that "the ultimate outcome of an investment is not proof of imprudence" and plan fiduciaries "may generally offer a wide range of investment options and fees without breaching any fiduciary duty."[81]

[79] *Divane v. Northwestern Univ.*, 953 F.3d 980, 992 (7th Cir. 2020), cert gr. *Hughes v. Northwestern Univ.*, No. 19-1401, July 2, 2021.

[80] *Divane v. Northwestern Univ.*, 953 F.3d 980, 992 (7th Cir. 2020), cert gr. *Hughes v. Northwestern Univ.*, No. 19-1401, July 2, 2021.

[81] *Divane v. Northwestern Univ.*, 953 F.3d 980, 992 (7th Cir. 2020), cert gr., No. 19-1401, July 2, 2021.

Provide Fulsome Plan and Fund Disclosures —

Plan and fund disclosures can provide significant defenses to claims that fiduciaries acted imprudently regarding plan investments, including by providing a defense to hindsight-based claims challenging those investments.

> ***Practice Tip:*** Courts are far more skeptical of participants' claims when the plan fiduciaries have provided participants fair notice on what they elected to invest in, including the investment's risks and fee costs. Rather, if a fiduciary offers an overall prudent mix of investments, the fact that some of those investments are high-cost or high-risk does not render them imprudent.

Example: In *In Re Disney ERISA Litigation,* plaintiffs challenged Disney's inclusion of the Sequoia Fund as an investment option in Disney's 401(k) plan, principally because this mutual fund had concentrated investments in a pharmaceutical company's stock, which suffered substantial losses in late 2015.[82] In rejecting this claim, the *Disney* court noted, among other things, that the Sequoia Fund's concentrated investment strategy was disclosed to the plan investors, and that in the plan's mix of investments, this concentrated fund was offered as one with higher growth potential and commensurate risk.[83] In rejecting plaintiffs' second attempt to plead a claim, the district court again focused on what the plan told participants about the Sequoia Fund, finding that nothing in those communications told participants that the fund would limit itself to "value" investments.[84]

[82] 16-cv-2251 PA (JCx), 2017 BL 132189, ECF No. 50 (C.D. Ca. Nov. 14, 2016).

[83] 16-cv-2251 PA (JCx), 2017 BL 132189, ECF No. 50 (C.D. Ca. Nov. 14, 2016). See also, e.g., *Barchock v. CVS Health Corp.*, 2017 BL 127046 at *5-*7 (D.R.I. April 18, 2017) (dismissing claim stable value fund was invested imprudently since fund was invested in conformity with its stated investment objectives).

[84] 2017 BL 132189 at *7-*9 (C.D. Ca. April 21, 2017).

However, in *Sulyma v. Intel Corp. Inv. Policy Comm.*,[85] a participant sued over the inclusion of hedge funds and private equity investments in target date and diversified funds and the Supreme Court ultimately held that his claims were not time-barred under ERISA's three year statute of limitations merely because he was given access to disclosures on his plan benefit's website.[86] By way of background, the participant filed his lawsuit more than three years after he elected these investments, claiming, with the benefit of hindsight, that they performed unsatisfactorily because of an alleged over-allocation of funds to these alternative investments. The court dismissed all claims as time-barred because the participant had ready access to detailed information on the allocation of funds to these investments.[87] The Ninth Circuit reversed, holding that there was a dispute of material fact as to whether plaintiff had "actual knowledge" of the underlying facts because he testified that he had not read the materials containing the information that would have alerted him to these facts.[88] The Supreme Court affirmed, holding that for a person to have "actual knowledge" of something, they must "in fact be aware of it" and cannot merely possess constructive knowledge.[89] Therefore, since plaintiff testified that they had not read the disclosure materials, he did not possess actual knowledge three years prior to bringing suit.[90]

[85] 2017 BL 106910 (N.D. Ca. Mar. 31, 2017).

[86] *Intel Corp. Investment Policy Committee v. Sulyma*, 140 S. Ct. 768 (2020).

[87] 2017 BL 106910 (N.D. Ca. Mar. 31, 2017). at *2-*4 (setting forth information provided in the SPDs and fund fact sheets). This ruling was in keeping with other courts finding similarly: *see e.g, Creamer v. Starwood Hotel & Resorts Worldwide, Inc.*, Case No. CV 16-9321 DSF (MRWx) (C.D. Ca. May 1, 2017) (finding fee claims on BlackRock Index fund time-barred because those fees had been disclosed more than three years before the suit was filed); *Brotherston v. Putnam Invs., LLC*, No. 15-cv-13825-WGY, 2017 WL 1196648, at *11, 2017 BL 103953 (D. Mass. Mar. 30, 2017) (finding prohibited transaction claims on investment funds time-barred because the plan's enrollment kit disclosed that Putnam entities acted as record-keeper and investment manager for the plan more than three years before the suit was filed).

[88] *Sulyma v. Intel Corp. Inv. Policy Comm.*, 909 F.3d 1069 (9th Cir. 2018).

[89] *Intel Corp. Investment Policy Committee v. Sulyma*, 140 S. Ct. 768, 777 (2020).

[90] *Intel Corp. Investment Policy Committee v. Sulyma*, 140 S. Ct. 768, 778 (2020).

The *Intel* decision does offer some potential opportunities to plan fiduciaries because the Court stated that "[n]othing in this opinion forecloses any of the 'usual ways' to prove actual knowledge at any stage in the litigation." [91] Specifically, the Court explained that: (1) plaintiffs who recall reading particular disclosures "will of course be bound by oath" to say so in their depositions; (2) actual knowledge may be proved through inference from circumstantial evidence; (3) a court should not adopt plaintiff's version of the facts if their denial of knowledge is "blatantly contradicted by the record;" and (4) defendants are not precluded from contending that evidence of "willful blindness" supports a finding of "actual knowledge."[92]

[91] *Intel Corp. Investment Policy Committee v. Sulyma*, 140 S. Ct. 768, 779 (2020

[92] *Intel Corp. Investment Policy Committee v. Sulyma*, 140 S. Ct. 768, 779 (2020 .

> ***Practice Tip:*** Therefore, if a fiduciary is able to submit evidence in support of any of (1)-(4) above, ERISA's three-year statute of limitations may still provide a valid defense. The often fact-specific nature of this dispositive defense can also provide strong grounds to attack class claims that seek to recover for fiduciary breaches more than three years before suit was filed.

Claims Focused on Fees and Expenses —

Much of the litigation on 401(k) and 403(b) plans has focused on challenging the plan's investment fees and recordkeeping expenses. Several benchmarking services exist that allow participants and plaintiffs' counsel to compare a plan's fees and expenses against various benchmarks and averages.[93] Although plan fiduciaries are not obligated to go with the lowest-cost provider,[94] they should consider monitoring their plan's fees and expenses against appropriate benchmarks, and documenting their prudent process evaluating the fees and expenses of the plan's recordkeeper and funds. Monitoring and selecting the lowest cost share classes is among the discussion “hot topic” issues driving excessive fee litigation.

[93] *See, e.g.,* BrightScope.

[94] *See, e.g.,* EBSA Info. Letter (Feb. 19, 1998).

Monitoring and Selecting Lowest Cost Share Classes —

Many mutual funds offer different share classes, with fees varying based on the size of the investment, or whether the mutual fund shares revenue with the recordkeeper. Plaintiffs have targeted this issue, claiming that plan fiduciaries left money on the table by not selecting the lowest-cost share class for the fund at issue. As the *Tibble* case discussed below illustrates, this can be a fraught area for plan fiduciaries, where unpublished practices (such as funds offering large plans lower-cost share classes even though they have not met investment minimums[95] can create liability.

[95] *See Tibble v. Edison Int'l*, 2010 BL 170372 (C.D. Cal. July 8, 2010).

White v. Chevron Corp.[96] illustrates how periodically monitoring share classes can avoid liability. In *Chevron,* plaintiffs targeted Chevron's 401(k) plan, a very large plan with assets of over $19 billion. The plan offered participants a diversified array of investment options with an overall low-cost fee structure, including 12 Vanguard mutual funds, 12 Vanguard collective trust target date funds, a Vanguard money market fund, and at least six other non-Vanguard investment options.[97] Of import here, plaintiffs alleged that participants lost over $20 million through unnecessary expenses because Chevron included 10 Vanguard funds--including some with fees as low *as 5bp*--for which there were allegedly identical Vanguard funds with lower-cost share classes available.[98]

[96] 2016 BL 281396 (N.D. Cal. Aug. 29, 2016).

[97] *White*, 2016 BL 281396.

[98] *White*, 2016 BL 281396.

The court rejected these claims, noting that price is not the only investment feature that a fiduciary is required to consider when compiling investment options.[99] The court also noted that plaintiffs' own allegations suggested that the plan fiduciaries *were* in fact periodically monitoring fund costs, including by periodically removing or changing investment options, and by offering a diverse mix of investment options, including low-cost funds.[100] Plaintiffs, with leave from the court, amended their complaint, but the court again granted Chevron's motion to dismiss all claims.[101] In rejecting plaintiffs' claims of excessive management fees the court reiterated that the test of prudence is whether the fiduciaries employed the appropriate methods to investigate the merits of the investment, and that it was insufficient to merely provide comparisons between funds that were in the plan lineup and funds that plaintiffs claim were less expensive.[102] The court also stated that Chevron had provided a valid rationale for being in the retail class shares, specifically noting that the revenue sharing fees associated with those higher-cost share classes paid the plan's recordkeeping expenses.[103]

[99] *White*, 2016 BL 281396.

[100] *White*, 2016 BL 281396.

[101] *White v. Chevron Corp.*, 2017 BL 183229 (N.D. Cal. Mar. 31, 2017).

[102] *White v. Chevron Corp.*, 2017 BL 183229 at *44-45.

[103] *White v. Chevron Corp.*, 2017 BL 183229 at *43.

In contrast, in *Tibble v. Edison Int'l*,[104] the court found that the fiduciaries failed to exercise procedural prudence. Plaintiffs claimed the defendants breached their duty of prudence when they invested in the retail share classes rather than the institutional share classes offered by six of the mutual funds. The only difference between the share classes was that the retail share classes charged higher fees to the plan participants, which in turn were the source of revenue-sharing amounts paid to the plan sponsor. The court concluded that the evidence established that the defendants never considered or evaluated the different share classes for the three funds, and rejected the defense that the plan did not qualify for these institutional share classes because the evidence showed that mutual funds had unwritten practices of granting large plans waivers even when they have not met investment minimums.[105] Therefore, the *Tibble* court held that the defendants breached their fiduciary duty of prudence.[106] In later rulings, the courts held the fiduciaries had duties periodically to monitor these investments, even if the fiduciaries had selected the investments with higher share class fees outside the limitations period.[107]

[104] 2010 BL 170372 (C.D. Cal. July 8, 2010), *aff'd*, 711 F.3d 1061 (9th Cir. 2013).

[105] *See Tibble v. Edison Int'l,* 2010 BL 170372 (C.D. Ca. July 8, 2010).

[106] *Tibble*, 2010 BL 170372, 2010 WL 2757153.

[107] *See Tibble v. Edison,* 135 S. Ct. 1823, 1828-29 (2015); 834 F.3d 1187 (9th Cir. 2016) (en banc).

To determine damages, the *Tibble* court ordered the plaintiffs to identify and measure the difference in investment fees for the retail share classes included in the plan and the less expensive institutional share classes that were available but not selected. The court also held that if the plan fiduciaries had not invested in the more expensive retail share classes, plan participants would have had more money invested and therefore would have earned more money over the course of time (“lost investment opportunity”). The court required the plaintiffs, in calculating their damages from lost investment opportunity, to use the returns of other funds in which participants invested their assets. The Ninth Circuit affirmed but did not specifically address the methodology used to determine damages.[108]

[108] *Tibble v. Edison Int'l,* 711 F.3d 1061 (9th Cir. 2013).

Monitoring Recordkeeping Fees —

Because recordkeeping is a major expense of plans, plaintiffs often include claims targeting the fees paid to the recordkeepers. For example, in *White v. Chevron Corp.*,[109] plaintiffs alleged Chevron imprudently paid excessive administrative fees to Vanguard as recordkeeper because Vanguard was compensated for a period through an asset-based arrangement, where its fees increased as the plan's assets (which were very large) increased.[110] The court rejected this argument. The court noted that when the plan's assets grew, the plan fiduciaries renegotiated the arrangement to specify a per-participant fee structure.[111] The court stated that these actions suggested that the fiduciaries were monitoring recordkeeping fees and taking steps to ensure that these fees were reasonable.[112]

[109] 2016 BL 281396 (N.D. Cal. Aug. 29, 2016).See Smart Code® for the latest cases.

[110] *White*, 2016 BL 281396

[111] *White*, 2016 BL 281396

[112] *White*, 2016 BL 281396 , at *38.; In dismissing the amended complaint the court also found the administrative fee claims were time barred because plan participants were provided disclosures that provided actual knowledge of the revenue sharing arrangement more than three years prior to the complaint being filed. *White v. Chevron Corp.*, 2017 BL

183229, 2017 WL 2352137 (N.D. Cal. May 31, 2017).

In plaintiffs amended complaint in *Chevron*, they further alleged that hiring Vanguard as the plan's recordkeeper also constituted a breach of the fiduciary duty of loyalty because of purported conflicts of interest between Vanguard and Chevron based on Vanguards' proxy voting practices regarding Chevron's stock.[113] The court found this conflict claim failed on the merits because it was speculative and contradicted by the pled facts that Chevron was repeatedly taking actions to lower Vanguard's fees, while Vanguard took the same proxy positions with Chevron that it had taken with all companies across the S&P 500. Plaintiffs also brought a prohibited transaction clam regarding the payment of recordkeeping fees to Vanguard. The court noted that plaintiffs had not responded to defendants' argument that ERISA permits service providers to earn reasonable compensation, but found this claim time barred because the decision to hire Vanguard as the recordkeeper took place six years before the filing of the complaint.[114] The court rejected plaintiffs' argument that following *Tibble* the plan has a duty to monitor "a past occurrence" and noted that that there is no "such thing as a continuing prohibited transaction – as the plain meaning of transaction is that it is a point-in-time event."[115]

[113] *White*, 2017 BL 183229, 2017 WL 2352137 (plaintiffs alleged that Chevron's investment and administrative decisions were "infected by conflicts of interest" it had with Vanguard based on the fact that Vanguard holds over $13 billion of Chevron stock and when voting its proxies, Vanguard overwhelmingly supported management proposals).

[114] *White*, 2017 BL 183229, 2017 WL 2352137.

[115] *White*, 2017 BL 183229, 2017 WL 2352137.

In contrast, in *Tussey v. ABB, Inc.*,[116] the Eighth Circuit affirmed a $13.4 million judgment rendered after trial against the plan fiduciaries. Fidelity was the recordkeeper for the ABB 401(k) plan, and was paid by revenue sharing from the investment companies whose funds were offered in the plan. These fees are a percentage of the funds invested, and rise as more money is invested in the funds offering revenue-sharing payments. The district court found that "ABB never calculated the dollar amount of the recordkeeping fees the Plan paid to Fidelity Trust via revenue-sharing arrangements," even after an outside consulting firm told ABB that it was overpaying for recordkeeping fees, which the court concluded appeared to be subsidizing the costs of services Fidelity provided to ABB in other plans.[117] The court further found that monitoring the expense ratio of the retail funds offered in the plan was not an effective substitute because it failed to factor in the size of the plan's investments in these funds, and how fiduciaries can use that fund size to negotiate lower fees for the plan.[118] In determining that the plan overpaid $13.4 million for recordkeeping costs, the district court credited plaintiffs' expert witness, who used fees paid by a similarly sized retirement plan for Texas employees as the comparator, and found this was consistent with trend lines as to what were reasonable revenue-sharing earnings for other plans.[119]

[116] 746 F.3d 327 (8th Cir. 2014).

[117] *Tussey*, 2012 WL 1113291, *10, 2012 BL 84927

[118] *Tussey*, 2012 WL 1113291, *10, 2012 BL 84927.

[119] *Tussey*, 2012 WL 1113291, *12, 2012 BL 84927.

Practice Tip: In the 403(b) context, the Seventh Circuit concluded that ERISA does not require a plan to (i) negotiate a record-keeping agreement that charges a fixed per-participant fee (as opposed to the asset-based agreement negotiated by Northwestern), or (ii) have one record-keeper or mandate a specific record-keeping arrangement.[120]

[120] *Divane v. Northwestern Univ.*, 953 F.3d 980, 990 (7th Cir. 2020), cert gr. *Hughes v.*

Northwestern Univ., No. 19-1401, July 2, 2021.

Monitoring and Managing Unitized Employer Stock Funds and Preventing Excessive Trading in Funds —

Employer stock funds (and sometimes other non-mutual fund investments) can be structured as unitized funds, which consist of investments in the underlying investment plus a cash cushion to facilitate trading. Unitized funds can save trading costs by netting out buys and sales between participants, and they allow participants to reinvest the same day instead of waiting for the trade in the underlying stock to clear. Some participants, however, may seek to game this system by engaging in excessive trading in the unitized funds, and plaintiffs have brought claims challenging the management of such funds.

In *George v. Kraft Foods Global, Inc.*,[121] plaintiffs claimed that the defendants breached their fiduciary duty for the unitized employer stock fund because they had permitted excessive investment and transactional drag in that fund–which are costs that can be associated with use of a unitized fund structure.[122] The Seventh Circuit noted that there was ample evidence in the record of the defendants' discussion of investment and transactional drag, its consequences, and potential solutions. The court concluded, however, that there was no evidence whether the defendants made an affirmative choice to maintain or remedy the issues associated with investment and transactional drag. As a result, the Seventh Circuit reversed the district court's grant of summary judgment in favor of the defendants, finding that "no Plan fiduciary ever made a decision regarding the solutions to investment and transactional drag that were proposed between 2002 and 2004."[123] The Seventh Circuit remanded to the district court, suggesting that if a prudent fiduciary would have made a decision in these circumstances, then the "plaintiffs would likely be entitled to an injunction requiring the fiduciaries to consider the proposed solutions to these issues and come to a decision."[124] In addition, the court noted that if plaintiffs can show a breach, then they could seek an order compelling the fiduciaries to make good to the plan the losses caused by their breaches.[125]

[121] 641 F.3d 786, 796 (7th Cir. 2011).

[122] As noted, in a unitized fund the fund holds stock and some amount of cash to facilitate trading in the fund. When the stock price is rising the cash buffer will cause what plaintiffs call investment drag. Transactional drag can be caused by the fact that the fund as a whole bears trading costs, not the participants who initiate the trades.

[123] 641 F.3d 786, 796 (7th Cir. 2011).

[124] *George*, 641 F.3d 786 at 797.

[125] *George*, 641 F.3d 786 at 797.

Claims Focused on the Prudence of the Investment

Investment Prudence Basics —

In their 401(k) and 403(b) litigation, plaintiffs have challenged not just the fees and expenses paid by the plan, but also the prudence of the investments selected for the plan. In *Bell Atl. Corp. v. Twombly*,[126] the Supreme Court held that "a complaint must contain sufficient factual matter, accepted as true, to 'state a claim to relief that is plausible on its face.'"[127] In complex cases, this means the facts pled must "show"—as required by Rule 8 of the Federal Rules of Civil Procedure—that the legal violation occurred, not merely that the alleged facts are consistent with a possible violation.[128] And in *Fifth Third Bancorp v. Dudenhoeffer*, the Supreme Court observed that motions to dismiss can be important mechanisms to investigate and weed out meritless claims that an ERISA fiduciary acted imprudently.[129]

[126] 550 U.S. 544 (2007).

[127] *Twombly*, 550 U.S. at 570; *see also Ashcroft v. Iqbal*, 556 U.S. 662, at 677–78 (2009).

[128] *Iqbal*, 556 U.S. 662 at 677–78.

[129] 134 S. Ct. 2459, 2471-73 (2014).

It should be noted that in *Sweda v. Univ. of Penn.*, 923 F.3d 320 (3d. Cir. 2019) the Third Circuit rejected the district court's reliance on the pleading standard articulated by the Supreme Court in *Bell Atl. Corp. v. Twombly*, instead holding that an ERISA plan participant is not required to rule out possible lawful explanations for the plan fiduciary's conduct to state a plausible claim for relief.[130] The Third Circuit joined the Eighth Circuit in holding that requiring a plaintiff to rule out every possible lawful explanation for the challenged conduct would "invert the principle that the complaint is construed most favorably to the nonmoving party."[131] According to the Third Circuit, that pleading requirement, established in *Twombly*, is limited to antitrust cases because in such cases "a conclusory allegation of agreement at some unidentified point does not supply facts adequate to show illegality."[132]

[130] *Sweda v. Univ. of Penn.*, 923 F.3d 320 (3d. Cir. 2019).

[131] *Sweda v. Univ. of Penn.*, 923 F.3d 320, at 326 (3d. Cir. 2019).

[132] *Sweda v. Univ. of Penn.*, 923 F.3d 320, at 326 (3d. Cir. 2019).

Aside from this, in prudent investment claims, plaintiffs often appear to use the benefit of hindsight to challenge the prudence of the investments offered.[133] And, as noted above, the Seventh Circuit in *Divane v. Northwestern Univ.*, 953 F.3d 980 (7th Cir. 2020) held that "the ultimate outcome of an investment is not proof of imprudence" and plan fiduciaries "may generally offer a wide range of investment options and fees without breaching any fiduciary duty."[134] Also, as noted previously, fulsome disclosures that accurately disclose the nature of the challenged investment can be a powerful defense to such claims–and can make courts rightly wary of allowing 401(k) and 403(b) litigation as vehicles for participants to get "do overs" for their investment choices.

[133] See Smart Code® for the latest cases.

[134] *Divane v. Northwestern Univ.*, 953 F.3d 980, 991 (7th Cir. 2020), cert gr. *Hughes v. Northwestern Univ.*, No. 19-1401, July 2, 2021.

The three and six-year fiduciary statute of limitations defense can also provide defenses to claims brought over extended periods, or for investments selected before the limitations period begin. Claims pursued under failure-to-monitor theories, however, may avoid these defenses after *Tibble v. Edison International*.[135] *Tibble* also may effectively limit the defense of release if the participant remains in the plan after the release.[136] As detailed above, in *Tibble*, the claim was that the fiduciaries breached their duties by failing to investigate the use of cheaper institutional share classes for certain fund investments. The lower courts found that this failure to investigate was a breach of fiduciary duty, but held that the claims were time-barred for funds selected more than six years before plaintiffs filed suit. The Supreme Court reversed, reasoning that under trust law and ERISA, a fiduciary has some duty to periodically monitor plan investments, even if the fiduciary originally selected the investment outside the fiduciary six-year limitations period.[137]

[135] 135 S. Ct 1823 (2015).

[136] A fiduciary cannot seek to release future fiduciary breaches, and *Tibble* makes clear that fiduciaries have duties to periodically monitor plan investments and fees. Thus, participants who signed releases may still be able to bring claims even where the fiduciary had originally selected the funds or recordkeepers prior to the release. *See Wildman v. Am. Century Servs., LLC*, No. 4:16-CV-00737-DGK, 2017 U.S. Dist. LEXIS 31699, 2017 BL 69989 (W.D. Mo. Feb. 27, 2017) (applying same).

[137] 135 S. Ct. at 1827-29.

Inclusion of Non-Traditional or Concentrated Investments in Funds —

Plaintiffs have targeted non-traditional and concentrated investment options in plans when, in hindsight, they performed poorly. Thus, in *In Re Disney ERISA Litigation,* plaintiffs challenged Disney's inclusion of the Sequoia Fund as an investment option in Disney's 401(k) plan, principally because this mutual fund had concentrated investments in a pharmaceutical company's stock, which suffered substantial losses in late 2015.[138] Plaintiffs claimed the Disney plan should have removed this fund at some unspecified time before then, asserting that there were serious concerns and questions about the pharmaceutical company's business model and accounting methods in the public domain *before* its stock began its precipitous decline in October 2015.

[138] 16-cv-2251 PA (JCx), 2017 BL 132189 (C.D. Ca. Nov. 14, 2016), ECF No. 50.

The *Disney* court identified the major flaw in this theory, *i.e.*, that because the stock price had stayed up after these disclosures, other market investors had rejected these concerns, instead seeing positive prospects in the company. Relying on the U.S. Supreme Court's decision in *Fifth Third Bancorp v. Dudenhoeffer*,[139] the *Disney* court noted (i) procedurally, that motions to dismiss are an important mechanism to weed out meritless claims challenging the prudence of plan investments,[140] and (ii) substantively, allegations that a fiduciary should have discerned that the market was over or undervaluing stock are, as a general rule, implausible absent special circumstances suggesting flaws in the market's ability to price securities. The court found no facts suggesting this.[141]

[139] 134 S. Ct. 2459 (2014).

[140] *See also Barchock v. CVS Health Corp.*, 2017 BL 127046 (D.R.I. April 18, 2017) (applying Dudenhoeffer to dismiss claim stable value fund was invested imprudently). Some courts, however, continue to apply very lenient standards to motions to dismiss in this context, treating the complaint as an opportunity to engage in discovery to see if a plaintiff can find facts to support his claim. *See Troudt v. Oracle Corp.*, 2017 WL 663060, at *7, 2017 BL 47916 (D. Colo. Feb. 16, 2017).

[141] *In re Disney ERISA Litigation,* 16-cv-2251 PA (JCx), 2016 BL 390959, 62 EBC 2956 (C.D. Cal. Nov. 14, 2016), ECF No. 50, at 5. The Disney court also noted that the Sequoia Fund's concentrated investment strategy was disclosed to the plan investors, and that in the plan's mix of investments, this concentrated fund was offered as one with higher growth potential and commensurate risk. Finally, the court was skeptical, at least absent special circumstances, of imposing duties on plan fiduciaries actively to monitor not just mutual funds, but also their underlying investments in the market.

Inclusion or Composition of Stable Value Funds —

The inclusion or composition of stable value funds is another growth area in excessive fee litigation. Among the claims made related to stable value funds are that fiduciaries breached their duties by not offering such funds, and others making “Goldilocks” style claims alleging that (after waiting with hindsight to see how the fund performed) the particular fund at issue was invested either too conservatively, or too aggressively, when compared against averages.

> ***Practice Tip:*** Fulsome disclosures of fund characteristics and searching inquiries by the courts have led, so far, to the dismissal of these claims.

Example: In *White v. Chevron Corp*.[142] plaintiffs alleged that Chevron's fiduciaries breached their duties of loyalty and prudence by including the Vanguard money market fund instead of a stable value fund. Using hindsight, plaintiffs argued that stable value funds outperformed money market funds during the class period, and that the decision to maintain money market funds caused plan participants to lose over $130 million in retirement savings.

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[142] 2016 BL 281396 (N.D. Cal. Aug. 29, 2016).

[143] *See* Complaint, White v. Chevron Corp., No. 4:16-cv-00793, at 38 (N.D. Cal. Feb. 17, 2016), ECF No. 1.

The district court found plaintiffs' attempt to infer an imprudent process because of the inclusion of a money market fund instead of a stable value fund “implausible.”[144] The court further noted that plaintiffs' focus on the performance of the stable value funds and the money market funds over a period of six years was “an improper hindsight-based challenge to the Plan fiduciaries' investment decision making.”[145]

[144] 2016 BL 281396.

[145] 2016 BL 281396.

In *Bell v. Anthem*, plaintiffs alleged that defendants breached their fiduciary duty by including a money market fund as an investment option while failing to prudently consider a stable value fund.[146] The court first noted that there is no duty that requires a fiduciary to “absolutely” offer a stable value fund over a money market fund.[147] The court then rejected plaintiffs' argument that had defendants considered a stable value fund and weighed the benefits, defendants would have favored the stable value fund over the money market fund as conclusory and not enough to state a claim.[148]

[146] *Bell v. Pension Comm. of ATH Holding Co.*, No. 1:15-cv-02062-TWP-MPB, 2017 BL 92116, 2017 WL 1091248 (S.D. Ind. 2017))

[147] *Bell v. Pension Comm. of ATH Holding Co.*, No. 1:15-cv-02062-TWP-MPB, 2017 BL 92116, 2017 WL 1091248 (S.D. Ind. 2017). at *15-16.

[148] *Bell v. Pension Comm. of ATH Holding Co.*, No. 1:15-cv-02062-TWP-MPB, 2017 BL 92116, 2017 WL 1091248 (S.D. Ind. 2017). at *15-16.

In *Barchock v. CVS Health Corp.*,[149] plaintiffs challenged the composition of a stable value fund, claiming the investment manager for the fund overly invested it in short-term investments that impaired returns. In granting the motion to dismiss, the district court cited *Dudenhoeffer* for the proposition that, in the ERISA context, a motion to dismiss “is an ‘important mechanism for weeding out meritless claims.'"[150] The court viewed plaintiffs' challenge as based on hindsight when the stable value fund was invested in conformity with its stated investment objectives to preserve capital while generating a steady return at a higher rate than that provided by a money market fund.[151]

[149] 2017 BL 127046 (D.R.I. April 18, 2017).

[150] 2017 BL 127046 (D.R.I. April 18, 2017). 4 (quoting *Fifth Third Bancorp v. Dudenhoeffer*, 134 S. Ct. 2459, 2471, 2014 BL 175777, ***11 (2014)).

[151] *2017 WL 1382517* at *4-*5, 2017 BL 127046 (D.R.I. April 18, 2017

Funds that Performed Poorly in Hindsight —

Plaintiffs often challenge investment funds that, in hindsight, performed poorly in relation to peers or benchmarks. Of course, benchmarks are averages, based on that some funds will perform above the benchmark while others will perform below. Unless a plan were to offer only passive, index-based investments, there *always* will be a substantial risk that at least some actively managed funds may underperform benchmarks for periods of time.

> ***Practice Tip:*** In light of the foregoing, courts are skeptical of hindsight-based attacks on fund performance, and will dismiss claims if fiduciaries can show that they engaged in a prudent process in selecting and

periodically monitoring funds. As noted above, courts have held that "the test of prudence ... is one of conduct"; procedural prudence is not determined by "whether [the] investment succeeded or failed."[153] "Prudence is evaluated at the time of the investment without the benefit of hindsight."[154]

[153] Donovan v. Cunningham, 716 F.2d 1455, 4 EBC 2329 (5th Cir. 1983)

[154] *DeBruyne v. Equitable Life Assurance Soc'y*, 920 F.2d 457, 465 (7th Cir. 1990) (ERISA's fiduciary duty of care "requires prudence; not prescience").

White v Chevron Corp. [155] illustrates this dynamic. In *Chevron* plaintiffs challenged the continued offering of an actively managed small-cap stock fund, arguing it should have been removed sometime earlier than it was.[156] The court rejected this claim, noting that plaintiffs' allegations showed that defendants were actively monitoring this fund and eventually removed it, and that there was no plausible claim of imprudence based on not removing the fund immediately because of short-term underperformance.[157]

[155] 2016 BL 281396 2016 WL 4502808 (N.D. Cal. August 29, 2016).

[156] 2016 BL 281396 *2016 WL 4502808* (N.D. Cal. August 29, 2016)

[157] 2016 BL 281396 *2016 WL 4502808* (N.D. Cal. Aug 29, 2016).

In contrast, if there is no prudent process, fiduciaries risk exposure to litigation and hindsight-based claims that they should have made a different decision. *Tatum v. RJR Pension Inv. Comm.* illustrates this dynamic and the "would have" standard that may apply when there is no procedural prudence—that is, the fiduciary may be in the unenviable position of having to show that the decision or course of action taken was not merely permissible, but one that clearly was prudent.[158] Thus in *Tatum*, a decision that otherwise would have been prudent with a prudent process (the closing of a spun-off, undiversified single stock fund in a 401(k) plan), has created substantial litigation and the risk of liability.[159] Although it appears that the fiduciaries will be absolved of liability, this absolution is occurring *after* fifteen years of litigation.[160]

[158] *Tatum v. RJR Pension Inv. Comm.*, 761 F.3d 346, 365–366 (4th Cir. 2014).

[159] *Tatum v. RJR Pension Inv. Comm.*, 761 F.3d 346, 368 (4th Cir. 2014).

[160] *Tatum v. RJR Pension Inv. Comm.*, 855 F.3d 553 (4th Cir. 2017).

Monitoring Guaranteed Benefit Policies —

Plan fiduciaries may want to evaluate and monitor whether any guaranteed benefit policies offered in their plans are in fact exempt from ERISA. For example, plaintiffs have challenged the ERISA-exempt status[161] of stable value funds offered by insurers, including New York Life, Prudential and Great-West Life; the funds are ERISA-exempt to the extent that they are guaranteed benefit policies.[162] Plaintiffs principally argue that because the insurers can unilaterally set the rate of return on the investments, the investments are not truly guaranteed benefit policies.[163] If the court concludes that the investments do not offer guaranteed benefits then, according to plaintiffs' theories, the insurers that manage the funds are subject to ERISA fiduciary standards.

[161] Under ERISA a "guaranteed benefit policy" is exempt to the extent that such "policy or contract provides for benefits the amount of which is guaranteed by the insurer." 29 U.S.C. § 1101(b)(2)(B).

[162] *See* Complaints, Wittman v. New York Life Ins. Co., No. 1:15-cv-09596 (S.D.N.Y. Dec. 8, 2015), ECF No. 1; Wood v. Prudential Ret. Ins. & Annuity Co., No. 1:15-cv- 01785 (D. Conn. Dec. 3, 2015), ECF No. 1.

[163] *See Teets v. Great-West Life & Annuity Ins. Co.*, 106 F. Supp. 3d 1198 (D. Colo. 2015));

Rozo v. Principal Life Ins. Co., No. 14-cv-000463, 2015 BL 309423, at *2-4 (S.D. Iowa Sept. 21, 2015).

As mentioned above in *supra n. 43,* two U.S. Courts of Appeals came to opposite conclusions on this issue. The Tenth Circuit in *Teets v. Great-West Life & Annuity Ins. Co.*, 919 F.3d 1232, 2019 EBC 106328 (10th Cir. 2019) held that Great-West Life & Annuity Insurance Co. didn't act as an ERISA fiduciary when it set the rate of return on its guaranteed investment product because investors were free to reject the rate and take their money elsewhere. By contrast, in *Rozo v. Principal Life Ins. Co.*,949 F.3d 1071, 1074 (8th Cir. 2020), the Eighth Circuit held that Principal acted as a fiduciary when it unilaterally set the interest rate paid to investors who held its fixed income option because Principal imposed a 12-month waiting period on any plan that tried to reject the new rate of return, which in the Eighth Circuit's view meant that Principal impeded rejection of the interest rate and effectively exercised control and authority over the interest rate.

Conclusion —

Although the recent fee litigation rulings and case filings give cause for concern, they also illustrate ways to lessen fiduciary exposure. One of the old rules of ERISA applies with added force in this area, which is otherwise fraught with hindsight risk: a documented, prudent fiduciary process is the best, first line of defense to claims challenging 401(k) plan investments and the selection and retention of the plans' service providers. Coupling this prudent process with the offering of a diversified mix of investment options and fulsome disclosures of fees, expenses and risks, will defeat claims challenging fiduciary prudence, and should help discourage sophisticated plaintiffs' counsel from targeting the plan.