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Defendants Secure Another Win on Discretionary Use of 401(k) Plan Forfeitures

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On September 19, 2024, the Southern District of California dismissed claims brought by a 401(k) plan participant against Thermo Fisher Scientific Inc. regarding the use of forfeitures to offset future employer contributions. As summarized below, the decision largely tracks a decision in favor of Hewlett Packard (“HP”) earlier this year, furthering a split in rulings on the issue by federal courts in California.

The Opinion

The central theme of plaintiff’s claims against Thermo Fisher was that, in choosing to use forfeitures to reduce employer contributions instead of reducing administrative expenses charged to participants, the plan participants were harmed. The plan document provided the plan with *discretionary* authority over how forfeitures were allocated, allowing all or part to be used to “pay reasonable expenses of the Plan” or “reduce . . . Discretionary Contributions...”

Following the prior court ruling in favor of HP, the Court initially concluded that plaintiff’s claims focused on actions that were fiduciary, not settlor, in nature, because the defendants were implementing the settlor’s decision when choosing among the permissible uses for forfeitures described in the plan document. Although the Court found that defendants had acted as fiduciaries, it concluded that ERISA “does not require a fiduciary to maximize pecuniary benefits,” and, as such, a fiduciary does not breach ERISA’s fiduciary duties by not using forfeitures to pay administrative expenses “especially when the plan document does not create an entitlement to such benefits.” The Court reasoned that, to find otherwise, would improperly extend ERISA beyond its bounds and contradict existing regulatory authority that allows forfeitures to be used to reduce future employer contributions. According to the Court, because ERISA’s fiduciary provisions “neither created a benefit nor abrogated Treasury regulations,” Plaintiff’s claims for breach of fiduciary duty were “too broad to be plausible.”

Plaintiff’s forfeiture-based anti-inurement claim also failed to gain traction with the Court. As in other cases, Plaintiff relied on a “debt theory”: *i.e.*, the obligation to make matching contributions was a preexisting debt of the company and the company benefited from using forfeitures to reduce that debt. The Court swiftly disposed of the

claim, concluding that, because the forfeitures remained in the plan's trust and were used to benefit plan participants, there was no reversion of plan assets to the employer and, therefore, no inurement.

Plaintiff's prohibited transaction claim similarly failed as it "dovetail[ed]" with Plaintiff's unsuccessful debt theory. Plaintiff contended that a prohibited transaction occurred because the employer purportedly exchanged forfeitures for a "diminution of [the Company's] funding obligation." The Court clarified that Section 401(a)(1)(D) of ERISA's prohibited transaction rules was written with transactions analogous to "a sale or leasing of property to a third-party" in mind. According to the Court, an intra-plan allocation of assets, such as reallocation of forfeitures, to provide benefits to other plan participants is characteristically dissimilar to transactions covered under ERISA's prohibited transaction rules.

Key Takeaways

Lawsuits targeting 401(k) plans' use of forfeitures are rapidly being filed by the plaintiffs' bar. Approximately two dozen lawsuits are now pending nationwide challenging the use of forfeitures. A [recent decision](#) in favor of a Groom client indicates that including plan terms that eliminate discretion by directing how forfeitures are to be used can mitigate litigation risk. The *Thermo Fisher* decision rationally describes why, for plans that allow forfeitures to be used for multiple purposes, employers should not be penalized in litigation for following the preexisting regulatory authority and commonly accepted, longstanding practices of 401(k) plan sponsors and fiduciaries.