Plan Sponsor Fee Litigation Cases on the Rise

A summary of recent fee lawsuits and implications for your plan.

By Dilroop Sidhu, Diana Hodges, Justin Holmes, David Levine, Brigen Winters

Over the past year an ever-increasing number of lawsuits have been filed against plan sponsors alleging claims of "excessive fees" with regards to defined contribution retirement plans. In particular, the lawsuits allege excessive or hidden fees, improper selection or monitoring of investment options, and revenue sharing and other alleged self-dealing transactions with respect to defined contribution plans. These lawsuits are almost always structured as class action suits so the potential liabilities are enormous. This year has been an active year for excessive fee cases as more than 30 cases have been filed across almost every circuit in the country. In comparison, over the past decade, there were only about 80 ERISA excessive-fee cases filed across the country.

There are three main types of excessive fee litigation. The first involves lawsuits against large corporate plan sponsors challenging fees and expenses associated with employee plans. These lawsuits against corporate plan sponsors allege breaches of ERISA fiduciary duties based on the plan sponsor's selection of specific investment vehicles and receipt of "revenue sharing" payments. The cases typically allege that the investment options selected by plan sponsors are overly expensive, underperforming, and imprudent compared to alternative investment vehicles available in the marketplace.

The second type involves lawsuits against financial institutions who also happen to be plan sponsors. In these cases, the plaintiffs make similar claims as in general excessive fee cases, but also allege that these plan sponsors used affiliated investment products and service providers to increase the financial institution's revenue. Such self-interested actions, the plaintiffs claim, are breaches of fiduciary duty and ERISA prohibited transactions.

The most recent iteration of excessive fee cases involves university-sponsored 403(b) plans. The allegations in these actions are similar to those made in the general excessive fee cases — that the university plan fiduciaries breached their ERISA duties by, among other actions, offering large, complex investment lineups with options that were expensive, duplicative, and poorly performing.

This article examines each of these three types of excessive fee lawsuits.

Plan Sponsor Fee Litigation

Plan sponsor fee litigation cases involve corporate plan sponsors' selection of specific investment vehicles. These cases allege that the investment options selected by plan sponsors are overly expensive and underperforming compared to alternative investment vehicles available in the marketplace. Many of these cases have been settled out of court for large sums. Currently, in the large plan market, the range of money obtained in these settlements is between $3 million and $62 million: N.Y. Life Ins. Co. ($3M); Teachers Insurance and Annuity Insurance Association of America ($5M); Northrop Grumman ($16.8M); American Airlines ($22 M); Merrill Lynch ($25M); Lockheed Martin Corporation ($62M); Boeing Company ($57 M); Massachusetts Mutual Life Insurance Company ($30.9M).

In the early stages of plan sponsor fee litigation, defendants often prevailed at the motion to dismiss stage. But as the plaintiff's bar has become more knowledgeable about ERISA and changed tactics, it has become less common, although not impossible, for defendants to win at the motion to dismiss stage, leading to large settlements. As plaintiffs began to achieve larger settlements, the plaintiff's bar became more aggressive in filing more lawsuits. In essence, each settlement leads to many more lawsuits. The plaintiff's bar generally allege that plan sponsors breached their duties under ERISA by: (1) selecting investment options that carry high fees; (2) selecting inferior investment options; (3) selecting retail versus institutional class funds; (4) selecting actively managed versus passively managed funds, such as lower cost index funds (often comparing to Vanguard funds); (5) selecting mutual funds versus collective investment trusts or separately managed accounts; and (6) selecting money market funds versus stable value funds.

An example of one of these large fee settlement cases involves American Airlines. *Main v. Am. Airlines, Inc.*, No. 4:16-cv-00473 (N.D. Tex., motion for settlement approval filed Jul. 7, 2017). In this class action lawsuit, participants alleged that American Airlines (AA) (1) breached its fiduciary duty of loyalty and prudence and (2) failed to monitor plan fiduciaries. In particular, participants argued that AA promoted its business interest at the expense of the Plan because AA had an affiliated mutual fund company (called American Beacon Funds) that it sold to Lighthouse Holdings, Inc., while obtaining an ownership stake in Lighthouse Holdings, Inc. After the sale, American Beacon continued to provide investment management services for AA's pension, 401(k) and other plans.

Plaintiffs alleged that approximately half of the Plan's investment alternatives were American Beacon Funds which they alleged were imprudent holdings. Plaintiffs also alleged that the investment management fees for the some of the funds were six to eight times higher than a comparable index fund from Vanguard. In addition, participants stated that identical funds were available from Fidelity that charged less than a third in investment management fees from what American Beacon was charging. Participants also alleged that it was imprudent to hold onto actively-managed American Beacon funds that had significantly underperformed the benchmark index. Lastly, the participants alleged that AA failed to investigate the use of separate accounts and collective trusts as alternatives to mutual funds, even though they are typically less expensive and offer the same type of investments. On July 11, 2017, American Airlines Inc. agreed to settle the lawsuit for $22 million dollars.

Another notable case is *Tibble v. Edison Int'l*, No. 2:07-cv-05359 (C.D. Cal., decided Aug. 16, 2017). In this case, Plaintiffs filed a class action against the Southern California Edison Company (Edison) for alleged financial losses suffered by the plan due to breach of fiduciary duty. The case involved 17 mutual funds where Edison initially selected the retail share class instead of the institutional shares class, or failed to switch to the institutional share class once they became available. The court found that Edison's decision to invest in the retail shares instead of institutional shares violated its duty of prudence. In addition, the court held that Edison breached its duty to monitor because Edison knew, or should have known that institutional share classes existed, and a prudent fiduciary would have known the institutional share classes are otherwise identical to retail share classes, but with lower fees. Edison agreed to pay $7.52 million in damages for the time period from 2001 to 2011, when the 17 mutual funds were in the plan.

Financial Institutions as Plan Sponsors

There has also been a rise in lawsuits against financial institutions who also happen to be plan sponsors. In the past couple years, a number of financial institutions such as Charles Schwab Corp., JPMorgan, Jackson National Life Insurance Co., T. Rowe Price, and Morgan Stanley have faced class action suits for holding in-house investment products in their defined contribution plans.

A recent example is *Schapker v. Waddell & Reed Financial, Inc.*, No. 2:17-cv-02365 (D. Kan., complaint filed Jun. 23, 2017) where participants brought a class action lawsuit against Waddell & Reed Financial, Inc. (WR), the employer sponsor of a 401(k) plan, for failing to act in the exclusive benefit of the plan and its participants. The participants alleged that WR breached its fiduciary duty and engaged in prohibited transactions because 97% of the investment opportunities made available through the plan were established and managed by WR or its affiliates. In particular the complaint alleged that the options offered in the plan cost more than comparable investment options, performed worse than comparable investment options, and in a number of cases were duplicative in content but not in cost with other options. The compliant also alleged that WR selected as the default option for participants investment products operated and managed by WR, and failed to concentrate assets so as to qualify for investment funds that had lower fees to drive down fees.

University Fee Cases

University-sponsored 403(b) defined contribution plan lawsuits are the newest version of the excessive fee cases. These university cases are novel because 403(b) plans, until recently, were not subject to ERISA. Therefore, university plans developed differently over the past 60 years. Plaintiffs have targeted the fact that universities hired multiple managers and service providers to work directly with professors and staff, resulting in some plans offering hundreds of investment options and multiple record-keepers. As a result, some participants have alleged that the fiduciaries breached their duties by offering too many options, leading to "decision paralysis." These complaints generally state that the university plan fiduciaries breached their ERISA duties by, offering large, complex investment lineups with options that were expensive, duplicative and poorly performing.

The private universities that have been targeted in these lawsuits include New York University, Yale, Duke, Vanderbilt, Northwestern, University of Southern California, MIT, Brown, Columbia, Cornell, Pennsylvania, Princeton, Duke, Johns Hopkins, University of Chicago, Washington University, and Emory. The main question that is posed is will courts apply the same fiduciary standards that have developed in the 401(k) context to these University plans?

One of the most recent university fee cases was filed in July against Brown University. *Short v. Brown Univ.,* No. 1:17-cv-00318 (D.R.I., complaint filed July 6, 2017). This class action lawsuit alleged breach of duties of loyalty and prudence. In particular, Plaintiffs alleged that because the plans have more than a billion dollars in assets, the plans have tremendous bargaining power to demand low-cost administrative and investment management services and well-performing funds. Plaintiffs allege in their complaint that instead defendants caused the plans to pay unreasonable and excessive fees for investment and administrative services. Further, they allege that defendants selected and retained investment options for the plans that historically and consistently underperformed their benchmarks and charged excessive investment management fees. The complaint also alleged that defendants' decision-making process was flawed, citing a "bewildering array of 175 investment options," duplicative fund choices, and lack of diversification.

New York University is another private university facing a class action suit regarding the fees and investment lineups of its retirement plans. *Sacerdote v. N.Y. Univ.,* No. 1:16-cv-06284 (S.D.N.Y., complaint filed Aug. 9, 2016). Plaintiffs filed suit against the New York University (NYU) 403(b) pension plans. Plaintiffs' allegations against NYU included that it breached its fiduciary duty of loyalty and prudence by failing to use the plan's bargaining power to reduce expenses, for having conflicted third party service providers (TIAA-CREF and Vanguard) dictate the plans' investment lineup, contain too many funds, and breached its duty to monitor. On August 25, 2017, the Southern District Court of New York granted in part and denied in part NYU's motion to dismiss. The Court ruled that plaintiffs failed to plead sufficient facts to support the loyalty-based claims because they failed to distinguish these claims from duty of prudence allegations. The Court stated that plaintiffs "must do more than simply recast purported breaches of the duty of prudence as disloyal act." The Court also added that an act that has the effect of furthering interests of a party is fundamentally different from an act taken with that as the goal.

The court also dismissed many of the plaintiffs' duty of prudence allegations. The court stated that NYU's contractual agreement to include certain investment options was not by itself enough to result in imprudence. In addition, the court found that the plaintiffs' allegations regarding NYU's "dizzying array" of investments did not support a prudence claim because plaintiffs failed to allege facts suggesting the plans' beneficiaries were harmed or allege that participants were in fact confused or overwhelmed. The court allowed the plaintiffs to continue on two duty of prudence allegations, that (1) NYU failed to solicit competitive bids from other record-keepers and (2) NYU failed to prudently select and evaluate plan investment options because it failed to employ appropriate methods in making its investment decisions.

In contrast, in the class action filed against Duke University, the District Court stated that plaintiff's claims that the plan contained too many funds could continue. *(Clark, et al. v. Duke University et al.,* No 1:16-cv-1044 (M.D.N.C., Aug. 10, 2016). In particular, the plaintiffs claimed that rather than consolidating the plan's more than 400 investment options into a core investment lineup, defendants retained multiple investment options in each asset class and investment style. Plaintiffs alleged that this deprived the plan of its ability to qualify for lower cost share classes of certain investments, while violating the well-known principle for fiduciaries that such a high number of investment options causes participant confusion. The court also denied a motion to dismiss the claim that the plan fiduciaries failed to engage in a prudent and loyal process for selecting a record-keeper. The plaintiff claimed that the University using four record-keepers instead of one subjected participants to an unnecessarily high cost for recordkeeping services and that the plan fiduciaries failed to solicit competitive bids from vendors on a flat per-participant fee.

Hope for Plan Sponsors

However, several cases suggest the tide of litigation against plan sponsors could be turning. One such case is *White v. Chevron,* No.4:16-cv-00793 (N.D. Cal., decided May 31, 2017). This case is a class action suit by participants in the Chevron Employee Savings Investment plan against Chevron Corporation (Chevron). In 2016, the court dismissed plaintiffs' complaint for failure to state a claim but gave plaintiffs leave to amend. In 2017, the court dismissed plaintiffs' complaint once again. In sum, the plaintiffs contended that the value of their 401(k) retirement accounts would have been significantly higher had Chevron acted more prudently and chosen funds with higher returns or lower administrative and management fees. Plaintiffs alleged that the plan fiduciaries breached their fiduciary duties by offering these high management fee funds and paying excessive fees to the record-keeper. In the complaint plaintiffs alleged that the plan included mutual fund share classes, when there were "identical," lower priced share classes available.

The question for the court was whether the mere allegation that there is a cheaper, "identical," or in some cases, very similar, investment available enough to get plaintiffs past a motion to dismiss? The court found it was not enough. In particular, the court stated that the plaintiffs' complaint needed to plead facts relating to the failure of the plan sponsor to investigate the appropriateness of the various funds and facts regarding the lack of process for choosing funds. The court therefore indicated that the test of prudence is whether the fiduciaries employed the appropriate methods to investigate the merits of the investment and to structure the investment. Courts must ask whether the fiduciary engaged in a reasoned decision-making process, consistent with that of a prudent person acting in like capacity. The court held that plaintiffs' statement of facts did not allege any facts sufficient to create a plausible inference that Chevron failed to investigate the merits of the funds included in the plan lineup, or failed to engage in a reasoned decision-making process in selecting the funds.

Cases against financial institutions are also proving increasingly difficult for plaintiffs to win. For example, Putnam Investments, LLC (Putnam) faced allegations of charging excessive plan fees. *Brotherston v. Putnam Invs., LLC,* No. 1:15-cv-13825 (D. Mass., decided Jun. 19, 2017). The class action alleged breach of fiduciary duties of loyalty and prudence, failure to monitor and other equitable relief based on ill-gotten proceeds. Plaintiffs argued that Putnam stuffed the plan's investment lineup with all of Putnam's funds.

In contrast, Putnam contended that it did not exploit the plan but rather took actions that cost it considerable money and dwarfed any revenue it received form the plan. Putnam pointed out that it made discretionary contributions to the plan totaling more than $40 million dollars for the time period in question. The court stated that although this money did not eliminate Putnam's ability to breach the duty of loyalty, plaintiffs failed to point to specific circumstances in which Putnam put its own interest ahead of the plan. The court added that pointing to self-dealing alone is insufficient for plaintiffs to meet their burden of persuasion to show a breach of duty. Plaintiffs also alleged the defendants failed to monitor the investments in terms of costs and performance and therefore breached its duty of prudence. Putnam countered that it fulfilled this obligation since Putnam's Investment Division monitored the performance of all of its mutual funds, including those in which the plan was invested. The court stated that the fact that some of the investments the Division monitored aligned with those in the plan was not a sufficient process to review the plan investments.

Ultimately, the case was decided in favor of Putnam based on the Court's opinion that plaintiffs failed to articulate how the alleged breaches by Putnam resulted in losses to the plan. The court stated that ERISA requires plaintiffs to prove losses to the plan for any breach of fiduciary duty claim. Currently the Circuits are split on whether the burden to show losses shifts upon a plaintiff's prima facie showing of breach of duty. The Second, Sixth, Ninth, Tenth, and Eleventh Circuits have all have all held that plaintiffs bringing ERISA breach of fiduciary claims have to prove damages stemming from the breach. Here, the Court found Plaintiffs' claim for $37.3 million in ill-gotten proceeds was legally insufficient because Plaintiffs failed to prove loss causation.

Another example of plan sponsor success in fee litigation is from this summer when a U.S. District Court dismissed a lawsuit against a Wells Fargo 401(k) plan. *Meiners v. Wells Fargo & Co.,* No. 0:16-cv-03981 (D. Minn., decided May 26, 2017). The Judge granted a motion to dismiss order in favor of the defendants. Participants had claimed that Wells Fargo included expensive and poorly performing company-affiliated target-date funds in its 401(k) plan. However, the court held that the plaintiffs failed to demonstrate that plan executives had breached their fiduciary duties under ERISA because the plaintiffs did not provide a meaningful benchmark for fee comparison. The Court rejected the plaintiff's comparison to lower-fee funds offered by Vanguard, finding those funds worked in a different manner. In short, the court found that Wells Fargo could not be held liable for "failing to choose the cheapest fund."

There is also hope for university plan sponsors. On September 21, 2017, the University of Pennsylvania was able to successfully dismiss a class action lawsuit regarding its retirement plan. *Sweda v. Univ. of Penn.,* No. 2:16-cv-04329 (E.D. Pa., decided Sept. 21, 2017.) The University of Pennsylvania is the first school to defeat such a lawsuit challenging its plan investment lineup and associated fees. It urged dismissal of the complaint, arguing that the court should rely on the Third Circuit Court of Appeals' decision in *Renfro v. Unisys Corp.,* 671 F. 3d 314 (3rd Cir. 2011). In *Renfro,* plan participants filed a class action lawsuit challenging the selection of their plan's investment options. The Third Circuit Court of Appeals held that courts must evaluate the plausibility of claims against the backdrop of the reasonableness of the mix and range of investment options. The District Court agreed and found that the plaintiffs' excessive fee argument was invalid because there was a reasonable mix and range of fee options in the plan, including fees as low as 0 .04%. The District Court held that plan fiduciaries are not required to focus on the singular goal of lower fees. It also rejected the claim that a fiduciary can breach its duty by offering too many investment options, finding that the plaintiffs had not identified any participants confused by the plan's investment lineup.

Dilroop Sidhu is an Associate at Groom Law Group, Chartered.

Diana Hodges is a Senior Policy Advisor at Groom Law Group, Chartered.

Justin Holmes is an Associate at Groom Law Group, Chartered.

David Levine is a Principal at Groom Law Group, Chartered.

Brigen Winters is a Principal at Groom Law Group, Chartered.