Is Excessive Fee Litigation Headed For Its Dudenhoeffer?

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Harry Truman once wished for a one-handed adviser, because the other kind just said on the one hand something and on the other hand something else. Salty analogy aside, Truman was on to something, because an analysis that cancels itself out doesn't do you any good.

But the nationwide deluge of class actions challenging fees and services in large corporate 401(k) plans might create an exception. The signs that the cases are starting to even out are worth noting, a development warmly welcomed by plan sponsors and the financial industry. For the past decade, there's generally been one hand winning, and it wasn't theirs.

On the One Hand

The hand that has been winning belongs to a few plaintiffs class action firms that have filed more than 80 excessive fee lawsuits across every federal circuit. After a bit of trial and error in the early 2000s, they learned their way around the Employee Retirement Income Security Act and tailored their complaints accordingly to escape motions to dismiss. They also became more aggressive. On a single day, Sept. 11, 2006, 13 such suits were filed against large corporate plan sponsors including John Deere, Boeing, General Dynamics and Lockheed Martin.

The template for these cases has largely remained the same ever since: the named plaintiffs, typically participants in large 401(k) plans, claim that the fiduciaries breached ERISA duties of prudence and loyalty in selecting plan investment lineups and service providers. In most cases, plaintiffs allege that the fiduciaries failed to leverage the size of the plan to obtain the lowest-cost investment options, or failed to consider less-expensive alternatives like index funds or collective investment trusts. In some cases, the plaintiffs have claimed that the defendants received unreasonable "revenue sharing" payments from mutual fund managers that amounted to kickbacks for access to thousands of captive investors.

Because resolving the related legal questions involves relatively intense factual scrutiny — for example, whether the plans' investment fees were within a permissible range, or whether "revenue sharing" represented reasonable compensation under ERISA's prohibited transactions exemptions — most courts have declined to decide them at the motion to dismiss stage. After overcoming that relatively low obstacle, the plaintiffs held the advantage: extensive discovery, motions practice and the threat of unfavorable media have often convinced corporate plan sponsors that it would be wiser to settle rather than risk a protracted fight and a costlier defeat later. Although a handful of cases have made it to summary judgment or trial, the lion's share have settled.

Having established some success in a variety of industries, plaintiffs firms began to take on

banks and other financial institutions. The basic allegations were the same — the plans' mutual funds were expensive and bad, the services overpriced — but plaintiffs also greased the wheels with additional self-dealing claims, alleging that financial industry sponsors were stocking plan lineups with their own mutual funds and servicing them with their own record-keepers, all to benefit themselves at the expense of participants. There are dozens of such suits across the country, with the plaintiffs' general pattern of success so far intact.

Then, replicating their 2006 blitz strategy, plaintiffs sued 12 large private universities in about the same amount of days in August 2016. It was considered a bold move, ruining summer vacations and attracting the attention of The New York Times, National Public Radio and other national media, largely because it involved some of the most well-known universities in the world: Yale, Duke, MIT, NYU, Northwestern. For ERISA experts it was bold in a different way, because it meant plaintiffs saw gold in the unexplored terrain of 403(b) plans, to that point a no-man's-land for ERISA litigation. In fact, 403(b) plans, which are used by nonprofit entities such as private schools and hospitals, were in many cases not considered subject to ERISA, and not subject to much regulation by the IRS.

Undeterred, the plaintiffs essentially made the same claims they made in the 401(k) context but supplemented them by using the traditionally diffuse nature of university 403(b) plans against itself. For example, in contrast to most 401(k) plans, which typically include about 10 to 20 investment options, 403(b) plans can include hundreds, and the plaintiffs alleged that such a vast, confusing tangle led to "decision paralysis" for participants.

Now, about 18 months later, the result of the university cases so far is more of the same, with all but one surviving motions to dismiss. Likely encouraged by this early success, more plaintiffs firms have been drawn to these cases and, adopting the playbook of the original plaintiffs firms, have filed similar suits against a half-dozen private universities.

Using that well-traveled playbook, plaintiffs have won hundreds of millions of dollars in settlements over the last decade. Throwing out the highs and lows, the settlements have ranged from about $12 to $25 million. If that pattern continued, and even in the unlikely event no more such suits are filed, it's not far-fetched to imagine that years from now after the last gavel drops, these cases will have cost plan sponsors (and their insurers) close to $1 billion. Regardless of how it ends, the course of this litigation has already shaped practices for thousands of plan sponsors around the country.

On the Other Hand

Over the last half-year, however, six district courts in five federal circuits have provided 401(k) and 403(b) plan sponsors with some hope by turning the established trend upside-down and either dismissing excessive fee suits altogether or, in one case that went to trial, awarding the equivalent of a directed verdict to the plan sponsor defendants. Each of these cases could merit its own article, but here are some highlights:

- **Meiners v. Wells Fargo, District of Minnesota, May 26, 2017**[1]: In the first dismissal of an affiliated-funds excessive fee suit, the court rejected the plaintiffs' claim that the mutual funds used in the plan had underperformed compared to Vanguard passively

managed funds, among other claims. Such a comparison is “insufficient,” the court ruled, because those funds have entirely different investment strategies. That conclusion contrasted with the approach taken by many other courts that found similar allegations (including some drafted by the same law firm) properly stated a claim.

- **White v. Chevron, Northern District of California, May 31, 2017**[2]: The court had already dismissed the plaintiffs’ original complaint in 2016 (the first such dismissal in this line of litigation), and their amended complaint fared no better. Among other deficiencies, the court concluded that even on the second try, plaintiffs had not properly pled facts sufficient to show the fiduciaries failed to properly investigate funds they put in the plan. The plaintiffs have appealed to the Ninth Circuit.

- **Brotherston v. Putnam, District of Massachusetts, June 19, 2017**[3]: Possibly delivering the most significant of the recent defendants’ victories, the court entered judgment for Putnam after a seven-day bench trial, the first affiliated-funds case to go that distance. The court issued a number of insightful conclusions of law, including rejecting the plaintiff’s duty of loyalty claims. The plaintiff had failed, the court wrote, “to point to specific circumstances in which the defendants have actually put their own interests ahead of the interests of plan participants” — even though the Putnam plan included only Putnam funds as investment options.

  Further, pretrial, the court had granted summary judgment on a number of other important issues[4]; it concluded, for example, that the expense ratios of the mutual funds in the plan, which ranged from 0 percent to 1.65 percent, were reasonable as a matter of law, following precedent in the Seventh Circuit[5] (and previewing the conclusion of another district court discussed next). The case will likely gain even greater significance once the First Circuit rules after briefing is complete later this year.

- **Sweda v. University of Pennsylvania, Eastern District of Pennsylvania, Sept. 21, 2017**[6]: In the only university excessive fee case to be dismissed so far, the court relied on the 2011 Third Circuit Renfro case[7] to hold that the range of fees for the plan’s investment options — 0.04 percent to 0.87 percent — was reasonable (and “markedly lower than 0.10 percent to 1.21 percent at issue in Renfro”). Although it was the one maverick win for the universities, the case still revealed the larger theme of the litigation regardless of the ultimate outcome: It’s now settled, as the Sweda court put it, that “ERISA’s fiduciary duty standard does not differentiate between § 403(b) and 401(k) plans.” That makes it unlikely these matters will end soon, especially with more plaintiffs firms entering the coliseum.

- **Johnson v. Delta Air Lines, Northern District of Georgia, Dec. 12, 2017**[8]: The court granted Delta’s motion to dismiss largely because the plaintiffs had not alleged that they were invested in the funds or paid the fees they were complaining about, and thus had no standing.

- **Patterson v. Capital Group, Central District of California, Jan. 23, 2018**[9]: In another Ninth Circuit win for defendants, the court followed other recent rulings in finding that because the plaintiff clearly knew for years that Capital Group was using its own mutual funds in the plan (and collecting fees from them), she had “actual knowledge” of the alleged breach for longer than the three years ERISA affords for

pursuing such a claim. The case is likely to return, however, since the dismissal was without prejudice.

The Duedenhoffer Precedent

Besides coming in relatively rapid succession, the six cases address almost all the significant aspects of the excessive fee litigation that have been battled out over the years: the appropriateness of offering affiliated products and services to participants; the receipt of payments for record-keeping services from managers of mutual funds in the plan; and the range and type of investment options appropriate for participants, among others.

Some of their holdings stand in direct contrast to earlier court rulings in other districts, particularly those granting motions to dismiss. Although they are a minority among the larger body of case law, they could make an effective string citation attempting to persuade courts that the boundaries of ERISA fiduciary duties have been adequately defined and the pleading standards therefore require revisiting.

They could also set up a clash between circuits, or settle a matter for circuits yet to address it. For example, the U.S. Supreme Court could affirm the judgments of the Third, Seventh[10] and Ninth Circuits[11] (and possibly the First Circuit and Eighth Circuits depending on the resolution of appeals there) that a certain range of fees among plan investment options — for example, 0.04 percent to 0.87 percent — is reasonable as a matter of law under ERISA, making it more difficult for plaintiffs to plead sufficiently.

The situation is somewhat similar to the one that led to the Supreme Court's 2014 decision in Fifth Third Bancorp v. Dudenhoeffer[12], which completely changed the landscape of the large number of employee stock ownership plan, or ESOP, stock-drop cases brought after the economic downturn in 2008. Because of a split among the circuits on the standard of prudence for ESOP fiduciaries, the court granted certiorari.

The opinion, written by Justice Stephen Breyer, seemed to acknowledge the need to "weed[] out meritless claims" among the many stock drop suits that had been filed since 2008, requiring "careful judicial consideration" of the complaint. He directed courts to apply the pleading standards of Twombly[13] and Iqbal[14] to the circumstances of an ESOP. The pleading standard Justice Breyer set out has left plaintiffs firms — largely successful to that point — essentially having to perform a triple-bank shot to keep their cases alive. In the excessive fee context, every win by defendants, like the six highlighted above, provides 401(k) and 403(b) plan sponsors some hope that the plaintiffs will be held to similar scrutiny.

While the only excessive fee case to rise to the Supreme Court has been Tibble v. Edison[15], significant in establishing that there is an ongoing fiduciary duty to monitor plan investments, the recent losses have forced plaintiffs to appeal, perhaps in turn forcing the court to reconsider the pleading standard in these matters. The result could be greeted with applause by plan sponsors, or they could return to the familiar sound of one hand clapping.

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[1] Meiners v. Wells Fargo & Co., No. 0:16-cv-003981, 2017 WL 2303968 (D. Minn. May 25, 2017).

[2] White v. Chevron Corp., No. 4:16-cv-00793, 2017 WL 2352137 (N.D. Cal. May 31, 2017).

[3] Brotherston v. Putnam Invs. LLC, No. 1:15-cv-13825, 2017 WL 2634361, (D. Mass. June 19, 2017).

[4] Brotherston v. Putnam Invs. LLC, No. 1:15-cv-13825, 2017 WL 1196648 (D. Mass March 30, 2017).

[5] Hecker v. Deere & Co., 556 F.3d 575, 586 (7th Cir. 2009); Loomis v. Excelon Corp., 658 F.3d 667 (7th Cir. 2011).

[6] Sweda v. University of Pennsylvania, No. 2:16-cv-04329, 2017 WL 4179752 (E.D. Penn. Sept. 21, 2017).

[7] Renfro v. Unisys Corp., 671 F.3d 314 (3d Cir. 2011).

[8] Johnson v. Delta Air Lines, No. 1:17-cv-02608 (N.D. Ga. Dec. 12, 2017).

[9] Patterson v. The Capital Group Companies Inc., No. 2:17-cv-04399, 2018 WL 748104 (C.D. Cal. Jan. 23, 2018).

[10] Hecker v. Deere & Co., 556 F.3d 575 (7th Cir. 2009).

[11] Tibble v. Edison Int'l, 729 F.3d 1110 (9th Cir. 2013).

[12] Fifth Third Bancorp v. Dudenhoeffer, 134 S. Ct. 2459 (2014).

[13] Bell Atlantic Corp. v. Twombly, 127 S. Ct. 1955 (2007).

[14] Ashcroft v. Iqbal, 129 S. Ct. 1937 (2009).

[15] Tibble v. Edison Int'l, 135 S. Ct. 1823 (2015).