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ERISA Excessive Fee and Imprudent Investment Fiduciary Breach Cases: How to Avoid Being a Target

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There has been a proliferation of lawsuits alleging breach of fiduciary duty in 401(k) and 403(b) plans. The claims include, but are not limited to, fiduciary failures associated with: excessive fees; use of expensive share classes; failure to follow an investment policy statement; and investment imprudence both in the selection and monitoring the plan investments. Although the cases of note involve larger employers and the corresponding larger 401(k) or 403(b) plans, fiduciaries of plans of all sizes should heed the warnings and lessons from the cases that populate the retirement plan news on a regular basis.

This discussion focuses on the employer and its responsibility as the sponsor of the 401(k) or 403(b) plan. It then discusses the Supreme Court's analysis and current fiduciary standards regarding excessive fees and investment selection and monitoring. Finally, it offers some practical advice to avoid becoming the target of a fiduciary breach claim.

ERISA's Fiduciary Rules

A primary purpose of the Employment Retirement Income Security Act (ERISA) is to protect participants and beneficiaries. The conduct of those who have authority over a plan's management or assets are fiduciaries.

The Department of Labor (DOL) indicates that: "Plan sponsors and other fiduciaries have a solemn responsibility to protect the interests of the workers and retirees in their benefit plans."

Each plan is required to identify one or more named fiduciaries who have the authority to control the plan's operation and administration. This authority includes, by way of example, interpreting the terms of the plan document, selecting a trustee, appointing investment managers, approving investment recommendations and retaining investment options. Although the officers of an employer may be the individuals who carry out the fiduciary duties, it is the employer, as the plan sponsor, and as the plan administrator who is ultimately responsible. Because the employees holding various official capacities may change over time, the employer is designated as the named fiduciary. Consequently, although employees may perform the duties as part of their day-to-day job functions, the employer retains the ultimate responsibility to insure prudent fiduciary performance.

ERISA Section 404 sets forth specific duties that fiduciaries are duty bound to perform with respect to ERISA plans. These duties are: to act solely in the interests of participants and for the exclusive purpose of providing benefits and defraying reasonable expenses of plan administration; to act with the care, skill, prudence and diligence that a prudent person acting in a like capacity and familiar with the matters would use; to diversify plan investments to minimize the risk of large losses; and to act in accordance with the plan documents. One court has described the duties charged to an ERISA fiduciary as "the highest known to the law." *Chao v. Hall Holding Co., Inc.,* 285 F.3d 415 (6th Cir. 2002).

Seminal Case: Hughes v. Northwestern University

Hughes v. Northwestern University 142 S.Ct.737 (2022): Current and former employees brought a court action against the university as the administrator and sponsor of its retirement plans.

The plans are ERISA plans under which each participant chooses an individual investment mix from a menu of options selected by the plan administrators. The plaintiffs claimed the university violated ERISA's duty of prudence by:

1. Failing to monitor and control recordkeeping fees, resulting in unreasonably high costs to plan participants;
2. Offering mutual funds and annuities in the form of “retail” share classes that carried higher fees than those charged by otherwise identical share classes of the same investments; and
3. Offering options that were likely to confuse investors (by offering too broad a selection of investment options).

The District Court granted the university’s motion to dismiss, and the Seventh Circuit affirmed the dismissal.

On appeal, the Supreme Court, held *that the* Seventh Circuit erred in relying on the participants' ultimate choice over their investments to excuse allegedly imprudent decisions by the plan administrator. Justice Sotomayor’s opinion held that the mere fact that the plans offered some mutual funds and annuities with lower fees did not preclude claims for breach of the duty of prudence.

The Court states at 738:

Determining whether petitioners state plausible claims against plan fiduciaries for violations of ERISA's duty of prudence requires a context-specific inquiry of the fiduciaries' continuing duty to monitor investments and to remove imprudent ones as articulated in Tibble v. Edison Int'l, 575 U.S. 523, 135 S.Ct. 1823, 191 L.Ed.2d 795. Tibble concerned allegations that plan fiduciaries had offered “higher priced retail-class mutual funds as Plan investments when materially identical lower priced institutional-class mutual funds were available.” Id., at 525–526, 135 S.Ct. 1823. The Tibble Court concluded that the plaintiffs had identified a potential violation with respect to certain funds because “a fiduciary is required to conduct a regular review of its investment.” Id., at 528, 135 S.Ct. 1823. Tibble's discussion of the continuing duty to monitor plan investments applies here. Petitioners allege that respondents' failure to monitor investments prudently by retaining recordkeepers that charged excessive fees, offering options likely to confuse investors, and neglecting to provide cheaper and otherwise-identical alternative investments—resulted in respondents failing to remove imprudent investments from the menu of investment offerings. In rejecting petitioners' allegations, the Seventh Circuit did not apply Tibble's guidance but instead erroneously focused on another component of the duty of prudence: a fiduciary's obligation to assemble a diverse menu of options. But respondents' provision of an adequate array of investment choices, including the lower cost investments plaintiffs wanted, does not excuse their allegedly imprudent decisions. Even in a defined-contribution plan where participants choose their investments, Tibble instructs that plan fiduciaries must conduct their own independent evaluation to determine which investments may be prudently included in the plan's menu of options. See id., at 529–530, 135 S.Ct. 1823. If the fiduciaries fail to remove an imprudent investment from the plan within a reasonable time, they breach their duty. The Seventh Circuit's exclusive focus on investor choice elided this aspect of the duty of prudence. The court maintained the same mistaken focus in rejecting petitioners' claims with respect to recordkeeping fees on the grounds that plan participants could have chosen investment options with lower expenses.

Costs and Consequences

Large employer plans have generated large settlements: Lockheed Martin Corporation - $62 million settlement for excessive fees; Boeing Corporation - $57 million. See: *Abbott v. Lockheed Martin Corporation,* 725 F3d 803 (7th Cir. 2013); *Spano v. The Boeing Co*., 633 F3d 574 (7th Cir. 2011).

In addition to the actual settlement or damage award, add the potential for paying the plaintiffs’ legal fees and costs on top of the sponsor’s own defense costs. Although, it may be difficult to monetize, there is a cost

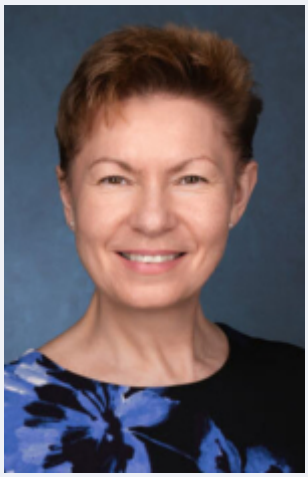
associated with the disruption to the employer sponsor's operations. Key personnel, who likely serve on a plan advisory committee, will be involved in litigation related activities rather than productive endeavors. The *Hughes* case began in 2018 and the Supreme Court opinion remanding the case to the lower courts for further hearings, was rendered in 2022. On remand to the District Court and second appeal to the Court of Appeals, on March 23, 2023, 2 of the 3 plaintiffs' claims survived the motion to dismiss. See *Hughes v. Northwestern* 2023 WL 2607921. The matter has not yet gone to trial, but has required attention and costs for no less than five years.

Best Practices

Although you can never prevent a participant or beneficiary from making a claim, the plan sponsor can take actions to minimize the risk of being a target and if a claim is made, demonstrate that it acted prudently and satisfied the other fiduciary duties of ERISA Section 404. These actions include:

- Know the plan's recordkeeping expenses and how they are calculated. If you do not understand how much the plan is paying or how the fees are being calculated it is impossible for the employer, as the plan administrator, to make an informed decision as to whether the fees are reasonable or excessive. Compare the plan's fees against those of similar sized plans with comparable investment offerings and participant features. Seek competitive bids. The bid process will help the employer better understand its own plan and the participant benefits and features, but it will also provide the best market determination of competitive pricing.
- Most likely the plan has an investment policy statement (ISP). One of the fiduciary duties is to act in accordance with the plan documents. Review the ISP and make sure that it provides a workable framework in which to select, monitor and take action regarding plan investments. If the ISP is so rigid that it requires jettisoning an investment after 2 consecutive quarters in the bottom 50% of its style peers, the plan administrator is duty bound to follow the ISP. Such inflexibility could cause unintended and untimely disruption of the plan's investments.
- Know what you don't know. Hire an investment advisor. Whether this is an ERISA Section 3(38) money manager who selects the plan's investment options or a Section 3(21) investment advisor who recommends the investments for approval by the plan administrator, hire a professional financial advisor. The professional advisor will keep the plan inside the ISP guardrails, steer the plan away from retail class investments, help minimize exposure to high cost investment options and insure diversification without a confusing array of competing investment options.
- Don't be lulled into thinking that target date funds will cure all problems. With the increased popularity of target date funds, the DOL has published: Target Date Retirement Funds – Tips for ERISA Plan Fiduciaries. See: target-date-retirement-funds.pdf (dol.gov).
- Have a process. Follow your process. Document your actions. These steps apply to the selection, monitoring and actions taken with respect to investments and plan administration. In addition to investment selection and monitoring, include rotating topics for plan administration. These may include: data security; technology features such as mobile device applications; participant education; a more detailed review of the target date funds. If your process involves an annual review, the circumstances in the economy may dictate that the plan's advisory committee meet more frequently. It is imperative that the actions of the advisory committee be documented. Look at the timeline in the *Hughes* decision. The litigation commenced in 2018 and relates to investment options from 2016 and prior. The litigation on the merits may begin in 2023. Only adequate written records of the plan advisory committee actions and decisions regarding the investment decisions in 2016 will support the employer as plan administrator. The plan administrator will not always be correct, but it must always act in accordance with the duties set forth in ERISA Section 404. Having a process designed to insure compliance with ERISA Section 404 and demonstrating conduct in accordance with that process is the plan administrator's best defense.
- Perhaps most importantly, proceed on the basis that every action or inaction is governed [and may ultimately be judged] by the highest fiduciary duty known to the law.

If you have questions about this topic, or other retirement or benefit questions, please contact Nadia Havard.



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