Proskauer

ERISA Litigation

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Editor's Overview

In 2016, we saw a considerable uptick in the number and variety of excessive fee lawsuits commenced against plan fiduciaries of defined contribution plans. We begin the year by taking a look at these filings, many of which have advanced novel theories of imprudence that are not dependent on allegations of self-dealing. The article also identifies affirmative steps that plan fiduciaries may take to prevent these types of claims from succeeding. In the Rulings, Filings, and Settlements of Interest section, we review court decisions on retiree benefits and the EEOC final rules on employee wellness programs.

Fee Litigation Update: Moving Beyond Allegations of Self-Dealing*

By Neil V. Shah

Over the past year, there has been a noticeable increase in the number and variety of excessive fee lawsuits commenced against plan fiduciaries of defined contribution plans. In addition to lawsuits challenging the use of affiliated investment funds, plan participants have advanced several novel theories of imprudence that are not dependent on allegations of self-dealing. First, several lawsuits challenge the prudence of actively managemd funds as investment options and argue that the fees charged by such funds are not justified by performance that is comparable to lower cost passively managed funds. Second, plan participants, in over one dozen lawsuits, filed against colleges and universities, argue that: (i) the availability of too many investment options prevented them from investing in lower-cost funds and share classes; and (ii) plan fiduciaries failed to negotiate waivers of minimum investment requirements with fund providers that would have allowed participants to invest in the same funds for lower fees. Third, several lawsuits challenge the failure of plan fiduciaries to monitor revenue sharing payments by mutual fund providers to plan recordkeepers as a form of excessive compensation.

In this article, we review the alleged bases for these lawsuits and, in particular, the theories by which plan participants seek to satisfy the standards for pleading a viable fiduciary breach claim without the benefit of allegations of self-dealing. We conclude with affirmative steps that plan fiduciaries may take to prevent these types of claims from succeeding.

Background

Since 2009, most courts have used the twin guideposts of *Hecker v. Deere & Co.*, 556 F.3d 575 (7th Cir. 2009) and *Braden v. Wal-Mart Stores*, 588 F.3d 585 (8th Cir. 2009), to distinguish between claims that are sufficient to infer that plan fiduciaries engaged in an imprudent process in selecting plan investments, and that may therefore proceed to discovery, and those that are not. Several courts have acknowledged that one of the determinative factors is some allegation of self-dealing by plan fiduciaries, such as the use of a fund managed by an affiliated company.

Absent meritorious allegations of self-dealing, existing case law suggests a tough road ahead for claims that allege nothing more than a failure to charge the lowest available fees. In recent years, courts have reiterated that "nothing in ERISA requires [a] fiduciary to scour the market to find and offer the cheapest possible fund (which might, of course, be plagued by other problems." *Hecker v. Deere & Co.*, 556 F.3d 575, 586 (7th Cir. 2009). They have emphasized the importance of "offer[ing] participants meaningful choices about how to invest their retirement savings," which includes evaluating "the range of investment options and the characteristics of those included options – including the risk profiles, investment strategies, and associated fees." *Renfro v. Unisys Corp.*, 671 F.3d 314, 327 (3d Cir. 2011).

By contrast, excessive fee claims coupled with allegations of self-dealing have tended to be more successful. For instance, in *Cryer v. Franklin Templeton Resources, Inc.*, No. C-16-4265, slip op. (N.D. Cal. Jan. 17, 2017), the court denied defendants' motion to dismiss and concluded that plaintiffs plausibly alleged that the proprietary index funds offered by the plan, which paid management fees to the plan sponsor's affiliates, charged excessive fees relative to comparable lower-cost alternatives.

Recently filed complaints reflect efforts on the part of the plaintiff's bar to pursue claims for relief even absent allegations of self-dealing.

Challenges To The Use Of Actively Managed Investments

An actively managed fund selects investments based on analytical research, investment forecasts, and the manager's own judgment and experience. By contrast, a passively managed fund is one whose investments mirror a market index. By virtue of their different management styles, actively managed funds generally charge higher expense ratios than passively managed funds. For purposes of comparison, the passively managed Vanguard S&P 500 Index fund charges between 1-15 basis points in fees, while actively managed funds typically charge considerably higher amounts.

Relying on recent literature opining that active, retail, and institutional traders rarely beat the performance of indices like the S&P 500, plan participants have commenced a number of lawsuits challenging the inclusion of actively managed funds in 401(k) plan investment lineups. In these actions, participants compare the performance of actively managed funds in the lineup – irrespective of each fund's investment objective or style – to Vanguard's S&P 500 Index fund. If these lawsuits survive motions to dismiss, 401(k) plan fiduciaries will likely be discouraged from offering actively managed funds, or alternatively, encouraged to couple them with comparable passively managed funds.

Challenges To Revenue Sharing Payments

Another line of lawsuits alleges that plan fiduciaries failed to prudently monitor the revenue sharing payments made to plan recordkeepers, thereby causing participants to pay unreasonable expenses for plan administration. Plan recordkeepers typically receive two forms of compensation: from the plan, the recordkeepers receive a per-participant or asset-based administrative fee; and from each mutual fund or investment vehicle, the recordkeepers receive a portion of their expense ratio for providing recordkeeping and administrative services relating to that investment. The latter payments, known as "revenue sharing," are commonplace within the industry, and have been credited with making plans affordable for participants; revenue sharing payments are often credited to the plan and used to pay plan administration expenses or paid back to plan participants.

In the past, successful challenges to revenue sharing arrangements have focused on alleged self-dealing by plan sponsors. For instance, in *Tussey v. ABB, Inc.*, 746 F.3d 327 (2014), plaintiffs established that revenue sharing was used to subsidize other corporate, non-plan related services provided by the recordkeeper to the plan sponsor.

Recent challenges to revenue sharing arrangements are notable in that, in place of allegations of self-dealing, they allege that plan fiduciaries failed to ensure that the total amount of compensation being paid to the plan's recordkeeper did not exceed what a reasonable recordkeeper would have been paid on a per-participant basis. Thus far, courts have not been particularly receptive to this theory. In *White*, the court rejected "plaintiffs' conclusory assertion that fees under a revenue-sharing arrangement are necessarily excessive and unreasonable," noting that "'[r]evenue sharing is a 'common' and 'acceptable' investment industry practice that 'frequently inure[s] to the benefit of ERISA plans.'" Similarly, in *Rosen v. Prudential Ret. Ins. & Annuity Co.*, No. 3:15-CV-1839 (VAB), 2016 WL 7494320 (D. Conn. Dec. 30, 2016), the court held that allegations that a plan engaged in "revenue sharing, without more, do not state a claim for a violation of ERISA."In so ruling, the court observed that plaintiffs had not alleged that other recordkeepers offered more favorable revenue sharing terms, or identified an alternate compensation model that was available.

Challenges To Plans That Offer Too Many Investment Options

Over one dozen lawsuits were filed last year against colleges and universities that sponsor 403(b) plans for their employees, alleging that plan fiduciaries had breached their fiduciary duties by providing investment options that charged excessively high fees, and failing to replace them with lower cost options. The complaints generally assert four principal claims.

First, the complaints allege that plan fiduciaries diluted their ability to negotiate lower fees by offering participants too many investment options. In one case, plaintiffs argue that if the plan instead offered only one lower-cost option, participants could have avoided paying several million dollars in fees while achieving the same performance. In other cases, participants complain that the plans offer several hundred investment options and several investment styles and objectives that are alleged to be overlapping and duplicative, thereby diluting the plan's ability to make lower-fee investment options available. The large number of offerings is likely the result of the historical evolution of these plans, and courts will be tasked with evaluating whether the decision to permit participants to continue to invest in their preferred investment choices amounts to a fiduciary breach.

Second, participants argue that the plan fiduciaries failed to offer the lowest-cost share class for each investment option. Mutual fund managers often create multiple share classes for their funds with different minimum investment thresholds. While each share class invests in the same underlying portfolio, larger investments are eligible for lower-fee share classes. To date, cases alleging a failure to offer the lowest-cost share have met with mixed results. In *White v. Chevron Corp.*, No. 16-CV-0793-PJH, 2016 WL 4502808 (N.D. Cal. Aug. 29, 2016), the court rejected the plaintiffs' argument that "the mere inclusion of a fund with an expense ratio that is higher than that of the lowest share class violates the duty of prudence." In so ruling, the court pointed to allegations in plaintiffs' own complaint that plan fiduciaries had selected lower-cost share classes for some funds, and distinguished cases like *Braden* as involving plausible claims of self-dealing. By contrast, in *Kruger v. Novant Health, Inc.*, 131 F. Supp. 3d 470 (M.D.N.C. 2015), the court held that plaintiff had stated a plausible claim that plan fiduciaries breached their fiduciary duties based on the relevant plan's large asset pool and the plan's inclusion of only retail class shares when lower-fee institutional class shares were available. In so ruling, the court rejected the defendants' attempt to distinguish *Braden* as involving plausible claims of "kickbacks."

Third, participants allege that plan fiduciaries should have negotiated with the providers of these funds to waive their minimum investment thresholds. According to the plaintiffs, investment providers routinely waive these thresholds for ERISA plans, taking into consideration the total amount invested in the provider's funds, as opposed to the amount invested in any particular fund. Courts do not appear to have previously addressed this argument.

Finally, participants challenge the inclusion of actively managed funds over those that are passively managed and charge lower fees, as well as revenue sharing payments made by mutual fund providers to plan recordkeepers. As noted, these types of claims have been asserted elsewhere.

Proskauer's Perspective

At one point, courts had observed that "self-interest is the lynchpin for nearly every claim charging breach of fiduciary duty in the ERISA context." *Laboy v. Bd. of Trustees of Bldg. Serv. 32 BJ SRSP*, No. 11 CIV. 5127 HB, 2012 WL 3191961, at *4 (S.D.N.Y. Aug. 7, 2012), *aff'd*, 513 F. App'x 78 (2d Cir. 2013). The claims discussed in this update are notable in that they do not rely on allegations of self-dealing in order to create an inference that the process by which plan fiduciaries managed the plan was imprudent.

Time will tell whether courts will allow them to proceed beyond the pleading stage. In the meantime, plan fiduciaries can take a number of proactive steps to lessen the risk that such claims will succeed.

First, plan fiduciaries should periodically review available alternatives to each of the funds in their investment lineups, and document any factors that support maintaining a fund over lower-costing alternatives. Case law is clear that plan fiduciaries may consider factors other than cost in selecting funds, but this case law is of little use if the plan's consideration of these other factors is not adequately documented.

Second, plan fiduciaries should periodically evaluate whether there are any steps they can take to offer lower-cost share classes of existing investment options. As suggested in the university fee cases, plan fiduciaries should explore the prospects of negotiating waivers of minimum investment thresholds where their plan offers a variety of funds from the same investment provider (or at least document their attempts to do so). They also should consider whether they can lower their fee structure by removing duplicative funds having the same investment style and thereby concentrating more assets in the remaining alternatives.

Finally, plan fiduciaries should periodically monitor the revenue-sharing arrangement with the plan's recordkeeper and consider whether a more advantageous revenue-sharing arrangement is available from other recordkeepers. It also is important that plan fiduciaries fully understand the extent to which (if at all) revenue sharing payments are being recaptured by the plan and how the recaptured payments are being used.

Rulings, Filings, and Settlements of Interest

UPDATE: District Court Denies Preliminary Injunction in AARP Suit to Block Final Rules on Employee Wellness Programs

By Seth Safra and Laura Fant

- The U.S. District Court for the District of Columbia (Judge Bates) has denied AARP's request to block the implementation of the EEOC's final wellness regulations pending a decision on the merits. As we have discussed previously, the regulations address the extent to which an employer may offer incentives to participate in a wellness program without violating the Americans with Disabilities Act (ADA) or the Genetic Information Nondiscrimination Act (GINA). The final rules have taken effect as of January 1, 2017.

As we previously reported, AARP filed suit in October of this year, seeking to block the EEOC's final rules, which were issued in May 2016. Among other provisions, the final rules permit employers to offer workers up to 30 percent of the cost of self-only health insurance for participation in wellness programs that include tests or assessments that can reveal confidential medical information or genetic data. In its complaint, AARP asserted that the incentives permitted by the final rules "enable employers to pressure employees to divulge their own confidential health information and the confidential genetic information of their spouses as part of an employee 'wellness' program." AARP asserted that the final rules "depart starkly from the EEOC's longstanding position" that "employee wellness programs implicating confidential medical information are voluntary only if employers neither require participation nor penalize employees who choose to keep their medical and genetic information private."

The district court denied AARP's request for a preliminary injunction, finding that AARP failed to demonstrate that its members would suffer irreparable harm if the rules became effective as scheduled. The court further found that the evidence presently in the record did not support a finding that AARP is likely to succeed on the merits of its arguments. Although the court provided detailed analysis that supports deferring to the EEOC, the court reserved final judgment on the merits until after the parties produce an administrative record and provide further briefing.

The suit will now proceed to development of the administrative record and arguments on the merits. In the meantime, the regulations will remain in effect.

We will continue to monitor this case and report on further developments.

District Court Rejects Retirees' Claim for Lifetime Healthcare Benefits

By Madeline Chimento Rea

- A federal district court in Michigan dismissed retirees' claims for lifetime, unalterable healthcare benefits from BorgWarner. BorgWarner provided healthcare benefits to Plaintiffs through a series of collective bargaining agreements and health insurance agreements. After BorgWarner unilaterally modified the available retiree healthcare benefits, Plaintiffs filed suit. Applying the principles set forth in *M&G Polymers USA, LLC v. Tackett*, 135 S. Ct. 926 (2015) and the Sixth Circuit's subsequent decision in *Gallo v. Moen, Inc.*, 813 F.3d 265 (6th Cir. 2016), the district court granted BorgWarner's motion for summary judgment and held that Plaintiffs' healthcare benefits did not vest under ordinary principles of contract interpretation. In so holding, the court first observed that the agreements were for three-year terms and did not expressly state that the healthcare benefits vested, whereas the pension plan documents stated that Plaintiffs' pension benefits were lifetime benefits. Next, the court observed that several of the agreements restated and sometimes redefined the healthcare benefits available going forward, which would be unnecessary if the benefits had vested. Lastly, the court observed that the agreements contained: (i) a reservation of rights provision granting BorgWarner the right to modify, amend, suspend, or terminate the plan, and (ii) a termination of coverage provision that limited the healthcare benefits to the term of the governing agreement. The case is *Sloan v. BorgWarner, Inc.*, No. 09-cv-10918, 2016 WL 7107228 (E.D. Mich. Dec. 5, 2016).

Honeywell Defeats Retirees' Class Action Suit for Lifetime Health Benefits

By Madeline Chimento Rea

- A federal district court in Ohio dismissed retirees' claims for lifetime healthcare benefits from Honeywell. Honeywell provided healthcare benefits to plaintiffs through a series of collective bargaining agreements and, although it continued to do so for several years after the final CBA expired, Honeywell eventually notified plaintiffs that it would terminate contributions toward their healthcare benefits. Applying the principles set forth in *M&G Polymers USA, LLC v. Tackett*, 135 S. Ct. 926 (2015) and the Sixth Circuit's subsequent decision in *Gallo v. Moen, Inc.*, 813 F.3d 265 (6th Cir. 2016), the district court held that plaintiffs' healthcare benefits did not vest because the CBAs were for three-year terms and did not expressly state that the healthcare benefits vested, whereas the CBAs did expressly vest pension benefits for life. Although, unlike in *Gallo*, there was no reservation-of-rights clause, the court held that such a clause was not required to find that the CBAs unambiguously did not provide lifetime health benefits to plaintiffs. The case is *Watkins v. Honeywell Int'l, Inc.*, No. 16-1925, 2016 WL 7325161 (N.D. Ohio Dec. 16, 2016).

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403(b) plans are offered by public schools and non-profit institutions (e.g., hospitals and universities), and many, but not all (e.g., governmental and church plans), are subject to ERISA. Like 401(k) plans, 403(b) plans allow participants to self-direct their investments, but the available investment options are more limited.

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