Employee Relations LAW JOURNAL
Electronically reprinted from Vol. 43, No. 2 Autumn 2017

Employee Benefits

Excessive Fee Litigation Is Getting Excessive

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Over the past several years, many lawsuits have been filed claiming that plan fiduciaries allowed their 401(k) plans to pay "excessive fees" in violation of the Employee Retirement Income Security Act of 1974, as amended (ERISA). While these lawsuits were directed initially at so-called "jumbo plans" (*i.e.*, plans with assets in excess of $1 billion), they have since been expanded to include smaller plans and plans maintained by not-for-profit organizations, particularly large, prestigious universities. The theories of liability espoused by plaintiff attorneys also have expanded. Now more than ever it is important for plan fiduciaries, along with their ERISA counsel, to establish prudent procedures and to document their adherence to those procedures in a meaningful way.

Small Plans Get Sued Too

Excessive fee claims typically were targeted toward plan fiduciaries of very large plans such as Verizon[1] ($30 billion in plan assets), Chevron[2] ($19 billion in plan assets), Intel[3] ($15 billion in plan assets), and Oracle[4] ($12 billion in plan assets). Understanding that the universe of very large plans is limited, plaintiff lawyers have gone down the food chain to attack some much smaller plans such as Checksmart[5] ($25 million in plan assets) and LaMettry's Collision[6] ($9 million in plan assets). It remains to be seen whether lawsuits against smaller plans is an emerging trend. Small plans can pay relatively high fees compared to their larger counterparts, because they are often unable to leverage their plan assets for a meaningful reduction in fees. In that sense, small plans may be "low hanging fruit" for hungry plaintiff lawyers. On the other hand, the recovery that a plaintiff's lawyer could expect

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from a small plan is smaller due to the small asset size. Whether these lawsuits against small plans represents a trend or not, fiduciaries of all plans are required by law to comply with their fiduciary responsibilities under ERISA, including making sure that the fees charged to their plan are reasonable.

Higher Education Is Targeted

In addition to plans in the for-profit sector, plans in the not-for-profit sector have also been sued, particularly large plans of prestigious universities such as Columbia,[7] Cornell,[8] Northwestern,[9] and USC.[10] Most of these universities maintain Section 403(b) plans, rather than 401(k) plans, but the claims are similar to the claims made against plan fiduciaries in the for-profit sector. For example, such claims include allegations that the plan fiduciaries breached their duties by failing to investigate lower fee share classes, offering expensive/underperforming investment funds, and failing to give adequate scrutiny to proprietary investment funds of their third-party plan administrator.

New Theories of Liability

To obtain a complete understanding of fiduciary compliance, it is important for plan fiduciaries, with their legal counsel, to monitor excessive fee cases and the allegations within them. New theories of liability are being espoused constantly and plan fiduciaries must determine how to react to them. For example, if it is alleged that a plan fiduciary breached its duties because it offered as a plan investment a money market fund instead of a higher performing stable value fund, the fiduciary may want to consider adding a stable value fund to their plan to help circumvent a potential claim by plaintiff lawyers. Several of the recent cases espousing less-than-traditional theories of liability against plan fiduciaries include the cases set forth below.

In *Bell v. Anthem,*[11] Anthem maintained a large 401(k) plan with over $5.1 billion in assets and nearly 60,000 participants. Participants in the plan filed a class action against Anthem on December 29, 2015, in the U.S. District Court for the Southern District of Indiana. The class action compliant made numerous allegations against the fiduciaries of the Anthem 401(k) Plan, some of which were new to excessive fee litigation. Among the claims made against plan fiduciaries:

- failing to offer the least expensive share classes for certain mutual funds;
- maintaining high-cost mutual funds when lower cost mutual funds were available;

- causing the plan to pay Vanguard excessive fees for administration ($80 to $94 per participant) when reasonable fees were alleged to have been $30 per participant;
- failing to offer less expensive separate accounts or commingled trusts instead of mutual funds;
- not sending their plan out to bid every three years;
- offering a money market fund instead of a stable value fund; and
- using revenue sharing to compensate Vanguard for administrative services instead of a per participant fee.

In *Troudt v. Oracle*,[12] Oracle maintained a large 401(k) plan with approximately $12 billion in assets and nearly 66,000 participants. Participants in the plan filed a class action against Oracle on January 22, 2016, in the U.S. District Court for the District of Colorado. As in the *Anthem* case, the class action complaint made numerous allegations against the fiduciaries of the Oracle 401(k) plan, including:

- causing the plan to pay Fidelity excessive fees for administration ($68 to $140 per participant) when reasonable fees were alleged to have been $25 per participant;
- retaining poorly performing investment funds;
- not sending their plan out to be every three years;
- adding mutual funds that did not have an adequate performance history; and
- using revenue sharing to compensate Fidelity for administrative services instead of a per participant fee.

Best Practices for Plan Fiduciaries

In sum, the class action lawsuits target fiduciaries for authorizing the payment of excessive fees for administrative and investment services provided to their plans. The lawsuits claim that these plan fiduciaries breached their ERISA fiduciary duties, which impose a duty to act prudently, in the best interest of participants, and to ensure that plan fees are reasonable.[13] To comply with the law and to stave off a lawsuit, plan fiduciaries should take very specific actions to evaluate the fees paid by their plans. Many of these actions are described below. In each case,

information should be gathered, experts consulted, and a well-reasoned decision should be made and documented with the assistance of ERISA counsel.

First, plan fiduciaries should evaluate the fees that their third-party administrator receives. All forms of compensation received by the administrator should be taken into account, including revenue sharing and hard-dollar fees. The aggregate fee that the third-party administrator receives should be benchmarked against the aggregate fees charged to similarly sized plans to ensure it is reasonable. The individual hard-dollar fees (*e.g.*, fees for QDRO processing and plan loans) also should be benchmarked to ensure they are reasonable.

Second, plan fiduciaries should evaluate the method of compensating their third-party administrator. Generally, there are three common methods: revenue sharing, flat dollar (*e.g.*, each participant account is charged $50 annually), and percentage of assets (each participant account is charged a certain percentage of assets annually). The pros and cons of each method should be evaluated and a well-reasoned choice should be made.

Third, plan fiduciaries should ask their administrator periodically whether there are any lower priced share classes available for the investment funds offered under their plan. Not switching into a lower price share class can be a breach of fiduciary duty, unless there is a good reason not to make the switch. Even if a lower price share class is not available to a plan because the plan does not have sufficient assets invested in the fund, plan fiduciaries may be able to ask the fund sponsor for an exception.

Fourth, although a fund's expense ratio is only one factor in determining whether to retain the fund as a plan investment, plan fiduciaries should regularly benchmark each fund's expense ratio to ensure that it is reasonable. While it is probably not a fiduciary breach to offer a few funds with higher-than-average expense ratios, offering more than a few funds could be problematic from a fiduciary perspective.

Fifth, plan fiduciaries should consider offering any available separate accounts or commingled trusts instead of mutual funds under their plans if they are less expensive than mutual funds. Some plan sponsors are precluded from participating in separate accounts and commingled trusts. In addition, mutual funds offer some comparative advantages over separate accounts and commingled trusts. For example, mutual funds are subject to greater regulatory scrutiny and government oversight. Thus, plan fiduciaries should consult with experts and act prudently in connection with the decision to offer separate accounts and commingled trusts.

Sixth, every three to five years plan fiduciaries should consider sending their plan "out to bid" to other third-party administrators. A competitive bidding process between third-party administrators should ensure that fiduciaries are obtaining the best price for plan administrative services.

Seventh, when selecting, monitoring, and replacing plan funds, plan fiduciaries should engage in a prudent process to evaluate the funds. Such process should include obtaining quantitative and qualitative investment information about the funds, consulting with an investment advisor and ERISA counsel, making well-reasoned decisions based on the information gathered, and documenting the entire process. As part of this process, the expense ratios of the plan investment funds should be considered.

Eighth, plan fiduciaries should ensure that they have adopted an investment policy statement and a committee charter. The investment policy statement should define the purpose of the plan and its investment objectives and describe the process for selecting, monitoring, and removing plan investments. The investment policy statement also can address plan fees. The charter should define the committee structure and include the number of committee members, the selection and removal process of members, the frequency of meetings, voting procedures for the committee, as well as the procedure for generating minutes for each meeting. Failure to adhere to the investment policy statement and charter could be a breach of fiduciary duty, so prudent plan sponsors would be wise to have these documents drafted or reviewed by ERISA counsel.

Conclusion

ERISA requires all fiduciaries of all plans regardless of their size to comply with their fiduciary responsibilities. In addition, litigation involving excessive fees continues unabated. Plan fiduciaries need to be diligent and take great care when evaluating their plan fees. As explained above, plan fiduciaries need to take a wide variety of actions to ensure that their plan fees are reasonable. Being a prudent fiduciary also means hiring an investment professional to advise on the financial aspects of the plan and hiring ERISA counsel to advise on the legal aspects. By making prudent choices with the help of qualified experts, plan fiduciaries will be compliant with the law and protected as much as possible from lawsuits. Plan fiduciaries also should continue to monitor excessive fee cases and other ERISA cases to ensure that any new theories of liability espoused by plaintiff lawyers are being addressed.

Notes

1. Jacobs, et al., v. Verizon Communications Inc., et al., No. 16-1082, S.D.N.Y., complaint filed February 11, 2016.

2. White, et al., v. Chevron Corporation, et al., No. 3:2016-cv-00793, N.D. Cal., complaint filed March 9, 2016.

3. Sulyma, et al., v. Intel Corp., et al., No. 5:15-cv-04977, N.D. Cal., complaint filed October 29, 2015.

4. Troudt, et al., v. Oracle Corporation, et al., No. 1:16-cv-00175, D. Colorado, complaint filed January 22, 2016.

5. Bernaola, et al., v. Checksmart Financial LLC, et al. , No. 2:16-cv-00684, S.D. Ohio, complaint filed July 14, 2016.

6. Damberg, et al., v. LaMettry's Collission, Inc., et al., No. 16-cv-1335, D. Minn., complaint filed May 18, 2016.

7. Cates, et al., v. Columbia University, et al., No. 1:16-cv-06524, S.D.N.Y, complaint filed August 17, 2016.

8. Cunningham, et al., v. Cornell University, et al., No. 1:16-cv-06525, S.D.N.Y, complaint filed August 17, 2016.

9. Divane, et al. v. Northwestern University, et al., No. 1:16-cv-08157, N.D. Ill., complaint filed August 17, 2016.

10. Munro, et al., v. University of Southern California, et al., No. 2:16-cv-06191, C.D. Cal., complaint filed August 17, 2016.

11. Bell, et al., v. Anthem, Inc., et al., No. 1:15-cv-02062, S.D. Ind., complaint filed December 29, 2015.

12. *See id*.

13. ERISA Section 404(a)(1).

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