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A legal update from Dechert's White Collar and Securities Litigation and Employee Benefits and Executive Compensation Groups

Plaintiffs' Bar Files ERISA Claims Alleging Excessive 401(k) Fees

On the heels of many defeats in their attempts to bring excessive fee litigation based on revenue sharing in the mutual fund industry under the Investment Company Act of 1940, the plaintiffs' bar has shifted its focus once again—now attempting to use the vehicle of the Employee Retirement Income Security Act of 1974 ("ERISA")[1] for fiduciary duty claims.

In the last few weeks, a St. Louis-based firm, Schlichter, Bogard & Denton, has commenced virtually identical lawsuits against several large companies in federal courts in Connecticut, Illinois, California, and Missouri. The suits allege that the companies and various officers breached their fiduciary duties with respect to 401(k) plans by allowing the plans to charge excessive and unreasonable fees and by failing adequately to inform the participants of these fees. These lawsuits resemble the excessive fee "revenue sharing" class actions brought in the last few years against investment company advisers—nearly all of which have been defeated at the motion to dismiss stage.

Thus far, other plaintiffs' firms have not followed suit with similar actions but, given the challenges to recovery under the Investment Company Act of 1940 and the broad fiduciary duties laid down under ERISA, companies and other entities with large 401(k) plans may be targeted with similar claims, especially if these latest cases were to gain traction in the federal courts.

Fiduciary Duties Under ERISA

Under ERISA, an employer that provides a 401(k) plan to its employees is a "Plan Sponsor" and may also serve as "Plan Administrator." Both the Sponsor and Administrator are fiduciaries of the 401(k) plan. ERISA requires that that the Sponsor and Administrator ensure that fees borne by the plans be reasonable, and be incurred solely for the benefit of plan participants. In addition, 401(k) plans generally provide for participant-directed investment and are designed to comply with the rules under ERISA Section 404(c) which permit Plan Sponsors and Administrators to avail themselves, under certain circumstances, of a statutory safe harbor from fiduciary liability for the results of such investment elections. The safe harbor under ERISA Section 404(c) is available only where the fiduciaries allow the participants "the opportunity to obtain sufficient information to make informed decisions with regard to investment alternatives available under the plan."[2]

The Allegations

Plaintiffs claim that the defendant companies and their officers involved in plan administration breached their fiduciary duties with respect to plan expenses and fees by subjecting the plans and their participants, either directly (through "hard dollar" payments) or indirectly (through revenue sharing arrangements) to excessive fees and expenses and/or failing to disclose adequately those fees and expenses. Plaintiffs also make breach of fiduciary duty allegations regarding employer stock funds. While each of the complaints filed thus far contains minor variations, the basic allegations are the same across most complaints.

"Hard dollar" fees, as described in the complaints, are expenses and fees paid directly to service providers. In addition to the general allegations that the fees were excessive, in some of their complaints,

[1] 29 U.S.C. 1001 et seq.

[2] 29 C.F.R. §2550.404c-1(b)(i)(2)(B).

plaintiffs allege that when multiple plans and funds are organized under a so-called "master trust," the disclosure of "hard dollar" payments may be incomplete, unclear, and inaccurate, unless the plan discloses both "hard dollar" fees paid directly by the plans and the applicable portion of "hard dollar" fees paid by the master trust. Plaintiffs claim that by failing to identify, take into account, and make clear both sources of "hard dollar" fees, the defendants have breached their fiduciary duties.

Revenue sharing, as described by the plaintiffs, is asset-based compensation paid by the plan to service providers that exceeds the actual costs of the services rendered. Plaintiffs claim that defendants breached their fiduciary duties by failing to ensure that revenue sharing payments were used for the benefit of the funds and their participants. Plaintiffs also allege that defendants breached their fiduciary duties by failing to disclose adequately the revenue sharing arrangements.

Employer stock funds are choices within some companies' 401(k) menus that invest only in the stock of the company itself. With regard to these employer stock funds, plaintiffs challenge the applicable fees and expenses of such funds and allege that defendants violated their fiduciary duties by allowing the fund to maintain excess cash, thereby impairing investor returns.

The Proposed Class Definition

In each of the complaints, plaintiffs seek to bring claims on behalf of an open-ended class of all present, past, and future participants in the company 401(k) plans that have been or will be affected by the allegedly excessive fees. This definition contains no time-frame restrictions whatsoever. While this definition is certainly open to challenge, its breadth is nonetheless daunting.

Counts of the Complaints

In each of the complaints, plaintiffs allege two counts. In Count 1, plaintiffs allege that defendants breached their fiduciary duties under ERISA Section 502(a)(2). They seek monetary payments to restore to the plans the losses allegedly experienced.

In Count 2, plaintiffs allege, *in the alternative*, a cause of action under ERISA Section 502(a)(3)—which provides for equitable relief to address or enforce violations of ERISA. Plaintiffs pray for an accounting of all transactions, disbursements, and dispositions with respect to all plans. They also ask the court to impose a surcharge to the extent that defendants cannot account for all fees paid.

Conclusion

These claims need to be approached with an eye towards not only fiduciary obligations under ERISA, but also with a keen understanding of mutual funds, their structure, fees, and legal obligations. Indeed, some defenses that were successful in the revenue sharing cases may be available here. For instance, defendants may be able to argue that plaintiffs' claims fail as a matter of law because plaintiffs have not alleged facts to support their conclusory theory that fees were excessive. Moreover, defendants may be able to avoid liability by establishing that all material information had been disclosed and that, as a result, they are protected by the statutory safe harbor in ERISA Section 404(c).

Our securities litigators have extensive experience in matters involving nearly identical revenue sharing and excessive fee allegations. Together with our employee benefits attorneys who specialize in ERISA, we are closely monitoring these cases, and would welcome the opportunity to discuss these issues with you. For more information, please contact one of the individuals listed on page 3.

Dechert LLP

Practice group contacts

If you have questions regarding the information in this legal update, please contact the Dechert attorney with whom you regularly work or one of the attorneys listed. Visit us at www.dechert.com/employeebenefits or www.dechert.com/securities.

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