

LEGAL UPDATE

Process Remains Critical Factor in ERISA 401(k) Plan Litigation

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In recent years, there has been high profile litigation against major corporate plan sponsors for their management of investments and plan fees, resulting in some significant settlements. More recently, similar claims were filed against major colleges and universities for their alleged mismanagement of their Code Section 403(b) plans. Also, civil actions have been filed against plan sponsors of mid-sized 401(k) plans. Numerous lawsuits have also been brought against plan sponsors who offer proprietary products to their employees. In such an environment, it is not surprising that many plan sponsors are seeking to outsource their fiduciary responsibility to third parties, whether they be 3(21) investment advisors or 3(38) investment managers. In such an environment, a recent decision by the Northern District of California provides a welcome counterpoint: the fact that a detailed complaint has been filed alleging various breaches of the duty of loyalty and duty of prudence does not mean that there was any breach of fiduciary duty whatsoever.

In *White v. Chevron Corporation*, the plaintiffs alleged that defendants violated their duty of loyalty by offering a money market fund instead of a stable value fund; by offering higher cost funds rather than less expensive funds; and by retaining a particular fund despite its underperformance. The District Court quickly dismissed this aspect of the complaint, because plaintiff failed to allege any facts sufficient to raise a plausible inference that any of the defendants (Chevron) took actions for the purpose of benefiting themselves or a third party entity with connections to Chevron, at the expense of plan participants, or that they acted under any perceived or actual conflict of interest in administering the plan.

Plaintiff also alleged four violations of the duty of prudence: (1) the failure to offer Plan participants the option of investing in a stable value fund in place of (or in addition to) a money market fund; (2) providing funds with unreasonably high management fees; (3) entering into a revenue sharing arrangement with Vanguard, designated as the plan's recordkeeper, which caused the plan to pay unreasonably high administrative fees; and (4) delaying in removing an

underperforming fund as an investment option. The Court found all of these allegations to be without merit, and granted defendant's motion to dismiss, although plaintiff could file an amended complaint to address this complaints.

With respect to the claim that a stable value fund should have been offered, the Court noted that nothing either in ERISA or the plan's investment policy statement required a plan to offer a stable value fund. The Court cited the decision of the Court of Appeals for the Seventh Circuit in *Hecker v. Deere & Co.* for the proposition that "nothing in [ERISA] requires plan fiduciaries to include any particular mix of investment options in their plan," and held that offering a money market fund as one of an array of mainstream investment options along the risk/reward spectrum more than satisfied Chevron's duty of prudence. It was critical of plaintiff's reliance on hindsight outcomes to determine the prudence of any investment. It stated that the actions of a fiduciary are judged "based on information available to the fiduciary at the time of each investment decision and not from the vantage point of hindsight," and that the proper standard for evaluating the prudence of an investment decision "is whether the fiduciaries, at the time they engaged in the challenged transactions, employed the appropriate methods to investigate the merits of the investment and to structure the investment."

With respect to the claim that defendants provided funds with excessive management fees, the District Court indicated that fiduciaries have latitude to value investment features other than price, and indeed are required to do so. Where a plan offers a diversified array of investment options, the fact that some other funds might offer lower expense ratios is not relevant because ERISA does not require fiduciaries "to scour the market to find and offer the cheapest possible funds (which might, of course, be plagued by other problems)." As was true with respect to the question of money market funds versus stable value funds, there are no *per se* investment rules for ERISA fiduciaries to follow. While it is true as a general proposition that retail-class mutual funds generally have higher expense ratios than their institutional class

counterparts that did not mean that a fiduciary should only invest in institutional class funds. Following Ninth Circuit precedent, it explained that “there are simply too many relevant considerations for a fiduciary, for that type of bright-line approach to prudence to be tenable.” Finally, the Court indicated that courts consider the total menu of investment options in assessing whether excessive fee allegations are plausible. Thus, with respect to this element of the complaint, the plaintiff’s allegations were dismissed because they were based solely upon speculation “that the plan fiduciaries ‘could have’ provided lower cost versions of the funds, or ‘could have’ had the same advisers manage the funds in a separate account, or ‘could have’ structured the investments differently.”

With respect to the revenue sharing arrangement with Vanguard, the District Court rejected plaintiff’s assertion that fees under a revenue-sharing arrangement are necessarily excessive, concluding in this context as well that “such a per se rule is without support,” and noting that revenue sharing is a common and acceptable industry practice that often inures to the benefit of plan participants. It also rejected plaintiff’s contention that Chevron was required to solicit competitive bids on a regular basis, and, in any event, plaintiff failed to allege that the same services were available for less on the market.

With respect to the fourth claim, the delay in removing an underperforming fund, the District Court stated that

“poor performance, standing alone, is not sufficient to create a reasonable inference that plan administrators failed to conduct an adequate investigation—either when the investment was selected or as its underperformance emerged—as ERISA requires a plaintiff to plead some other objective evidence of imprudence.” Further, a plan fiduciary might retain investments through a period of underperformance as part of a long-range investment strategy.

One cautionary note to plan administrators. As the DOL recently stated in the preamble to the various prohibited transaction exemptions in connection with the conflict of interest regulations, the prudence standards of ERISA are not solely procedural in nature. Rather, the prudence standard “is an objective standard of care that requires investment advice fiduciaries to investigate and evaluate investments, make recommendations, and exercise sound judgment in the same way that knowledgeable and impartial professionals would.” In a case frequently cited by the DOL, “[T]his is not a search for subjective good faith—a pure heart and an empty head are not enough.” Documentation of one’s procedures is an important and recommended activity, but they will be unavailing if the plan’s procedures are flawed.

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