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Process Prevails in ERISA Excessive Fee Victories

Under ERISA, prudence is process, process, and more process.

By following a broadly inclusive investment choice process, Northwestern University's 403(b) plan fiduciaries secured dismissal of the lawsuit now under consideration by the Supreme Court.[1] In contrast, New York University's 403(b) plan fiduciaries were unable to dismiss allegations that by failing to offer available institutional class shares, instead of the offered retail class option, they violated their fiduciary duties.[2]

The U.S. solicitor general, working with the Department of Labor (DOL), told the Supreme Court to take the *Northwestern* case because the decision is inconsistent with other decisions, the issues raised are of significant importance, and at least two of the *Northwestern* plaintiff claims (not using the lowest-cost share class and failing to take steps to attempt to reduce recordkeeping fees) state a plausible claim for breach of the ERISA duty of prudence.

The Supreme Court's decision in *Northwestern* could bring some clarity and uniformity to the pleading standard for breach of fiduciary allegations related to plan expenses and investment options. The

[1] *Hughes v. Northwestern University*, 953 F.3d 980 (7th Cir), cert granted 141 S.Ct. 221 (2021). While there are statutory differences between §403(b) and §401(k) plans, the principles governing litigation over fiduciary duties in both draw from one another.
[2] *Sacerdote v. NYU*, 9 F.4th 95 (2nd Cir 2021).

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Northwestern and *NYU* decisions underscore a key difference in outcome, at least so far, in motion to dismiss litigation.

While the Supreme Court's forthcoming decision will guide critical motion to dismiss litigation, two recent decisions show that for successful outcomes on the merits, substantial and detailed evidence of process as applied may carry the day.

California and North Carolina district courts have dismissed major class action challenges to AT&T and Lowe's 401(k) plan recordkeeping fees based on extensive step-by-step documentation that the plan fiduciaries acted prudently in monitoring the plan's recordkeeping expenses.

These cases provide a useful guide for the type of evidence needed in ERISA breach of fiduciary claims and likely variants. First, plan sponsors should establish the right processes and operational compliance practices providing evidence of a thorough investigation and independent validation of procedural and substantive process standards to demonstrate that plan fiduciaries have acted in a prudent manner. Next, plan sponsors should document discussions, advice, and reasons for decisions, in detail.

Alas v AT&T Services, Inc.[3]

AT&T defeated a class action involving more than 245,000 members of its 401(k) plan. The complaint accused AT&T of failing to evaluate and monitor the recordkeeping fees it paid to its third-party administrator (TPA).

Granting its motion for summary judgment, the U.S. District Court for the Central District of California said AT&T presented "extensive evidence" that its benefit plan committee acted prudently in monitoring the plan's recordkeeping expenses.

Not only did the benefits committee periodically review disclosures and invoices from the TPA, the court said, but it also hired outside experts to evaluate the reasonableness of the TPA's compensation and obtained a lower price for recordkeeping fees after hiring the experts to consult on the negotiations of a new contract.

Background

The Plan participants argued that the AT&T fiduciaries failed to implement a process to control the administrative expenses that participants in the 401(k) Plan paid to the TPA as Plan recordkeeper. The participants also argued that AT&T fiduciaries failed to analyze and evaluate the compensation paid to the TPA from the entity, which provided computer-based investment advice to Plan participants. According to the participants, as a result of the AT&T fiduciaries' failure to perform their fiduciary duties, the participants paid "grossly excessive fees" to the TPA.

The participants also argued that AT&T fiduciaries engaged in a prohibited transaction with the TPA in violation of ERISA §406(a). According to the participants, the AT&T fiduciaries failed to obtain from the TPA the required disclosures of direct and indirect compensation in connection with all the services that it was providing, resulting in the AT&T fiduciaries' failing to ascertain whether the TPA's total compensation was reasonable.

[3] C.D. Cal., No 2:17-cv-08106, 9/28/21.

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On June 14, 2021, defendants filed a motion for summary judgment as to all claims along with a statement of undisputed facts containing 49 facts, and the declarations of the plan fiduciaries, including 57 exhibits.

Decision

i. Duty of Prudence

The participants argued that the AT&T fiduciaries violated the duty of prudence under ERISA §404(a)(1) by failing to monitor and oversee the recordkeeping expenses paid to the TPA. The AT&T fiduciaries in response argued they maintained a process to evaluate and control the recordkeeping expenses.

According to the court, the AT&T fiduciaries presented extensive evidence that they acted prudently in monitoring the Plan's recordkeeping expenses. The facts showed that members of AT&T Services Benefits team periodically reviewed 408(b)(2) disclosures and invoices from the TPA to ensure the compensation for recordkeeping was reasonable. The AT&T fiduciaries also hired outside experts to evaluate the reasonableness of the TPA's compensation. Specifically, in 2016 they hired Deloitte to consult on the negotiation of a new contract with the TPA, at which time Deloitte confirmed that the Plan had a lower recordkeeping rate than other plans. After new negotiations in 2017, the AT&T fiduciaries obtained an even lower price for recordkeeping services, with an annual rate of $20 per participant.

Moreover, the AT&T fiduciaries' contracts with the TPA included a "most favored customer" clause, which ensured that the TPA's fees were "not less favorable than those currently extended to any other" similarly situated customer.

The court concluded that the AT&T fiduciaries met their burden of showing no factual dispute existed as to whether they breached their duty of prudence in evaluating and monitoring the recordkeeping fees paid to the TPA. According to the court, the monitoring that the AT&T fiduciaries engaged in, both through periodic reviews and through the hiring of outside experts, sufficed to show "care, skill, prudence, and diligence" in negotiating the Plan's recordkeeping fees. Also, the court said, participants produced no evidence from which a reasonable jury could find that the AT&T fiduciaries acted imprudently.

ii. Prohibited Transactions

The participants argued that the AT&T fiduciaries engaged in prohibited, non-exempt transactions with the TPA in violation of ERISA §406(a).

However, the court said, ERISA §408 (b) provides a statutory exemption for contracting or making reasonable arrangements with a party in interest for services necessary for the establishment or operation of the plan, if no more than reasonable compensation is paid therefor.

According to the court, there is no dispute that the services of the TPA and the entity that provided computer-based investment advice to Plan participants were necessary. The question of whether the fees were reasonable turned largely on the parties' disagreement about how to evaluate the TPA's total compensation. For recordkeeping and administrative services, the AT&T fiduciaries alleged that the Plan paid $31 per participant to the TPA in 2011, which was negotiated down to $29 as of Aug. 1, 2012. They also argued that they subsequently negotiated a further reduction that resulted in recordkeeping fees of $20 per participant, effective Jan. 1, 2018. The participants claimed that these figures did not reflect the true compensation paid for recordkeeping and administrative services to the TPA because the per-participant charge was simply one of many charges for Plan services. For example, they argued that

AT&T's figures failed to take into account the undisclosed "indirect" compensation the TPA received from the entity that provided computer-based investment advice to Plan participants.

The court decided that the AT&T fiduciaries had no duty to investigate or consider the third-party compensation the TPA was receiving from the entity that provided computer-based investment advice to Plan participants, and therefore their failure to do so did not make their compensation agreement unreasonable.

The participants next argued that the AT&T fiduciaries failed to satisfy the disclosure requirements contained in DOL Reg § 2550.408b-2, which requires the TPA to disclose "all indirect compensation that the covered service provider . . .reasonably expects to receive in connection with the services."

Having reviewed AT&T's exhibits containing the disclosures, the court concluded that the TPA's disclosures clearly provided a "reasonable" description of the direct and indirect compensation that it received from the entity that provided computer-based investment advice to Plan participants and that the direct and indirect compensation were both represented according to the DOL 408(b)(2) regulation.

Accordingly, the court held that the AT&T fiduciaries met their burden of showing that no factual dispute existed as to whether they engaged in prohibited transactions.

Reetz v. Lowe's Companies Inc.[4]

In a 120-page decision, a North Carolina district court found that a large consulting firm (Consulting Firm) did not breach its fiduciary duty as an investment advisor to the Lowe's 401(k) Plan in proposing and encouraging Lowe's to change the Plan's investment structure and menu of investment options, nor did it violate ERISA in its efforts to "cross-sell" its delegated fiduciary services when Lowe's "a large, sophisticated corporation," independently decided to engage the Consulting Firm. Also, the court concluded that although the Consulting Firm's growth fund that the Consulting Firm selected as the Plan's delegated fiduciary investment manager did not generate as much investment gains as other investment options that, in hindsight, would have fared better, it did not breach its fiduciary duty to the Plan in selecting and maintaining the Consulting Firm's growth fund as the primary actively managed equity investment option in the Plan.

In rejecting the claims of a certified class of about 250,000 current and former Lowe's employees, the court decided that "[the Consulting Firm] acted loyally and prudently with respect to its recommendations to change the plan's investment choices, which were consistent with its industry research and the thinking of other financial consultants, as well as its selection and retention of the [Consulting Firm's growth fund] in the plan, which was similarly reasonable based on [the Consulting Firm's] investment expertise and legitimate strategic choices."

Background

Reetz sued Lowe's Cos. Inc. and the Consulting Firm in 2018, alleging that Lowe's and the Consulting Firm cost Lowe's employees $100 million by shifting investments in their retirement plans in an "extraordinarily irresponsible" move three years earlier.

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[4] W.D.N.C., No. 5:18-cv-0075, 10/12/21.

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In April 2021, Lowe's announced that it was settling out of the suit. In May, it asked the court to accept a $12.5 million settlement, with attorneys receiving $4.2 million in fees and costs.

The Consulting Firm proceeded to a bench trial, which took place over five days in June and July. On Oct. 12, the North Carolina district court sided with the Consulting Firm on all claims.

According to the court, Lowe's resources allowed it to completely and competently evaluate the Consulting Firm's service offerings and compare it with other options. In this regard, the court emphasized that Lowe's witness testified that the company understood the difference between the Consulting Firm's fiduciary advice related to the plan's restructuring and its sales efforts related to the delegated services.

"While [the Consulting Firm] had limited experience as a delegated services manager for defined contribution plans, it had extensive experience and resources as an investment advisor, so it was not imprudent for [the Consulting Firm] to suggest that Lowe's consider using [the Consulting Firm's] delegated services," the court said.

The court also rejected the argument that the Consulting Firm breached its fiduciary duty to the plan given that the Consulting Firm's growth fund did not generate as much growth as other investment options. The workers presented no evidence that the Consulting Firm fund was an unreasonable investment based on the competence of the underlying investment managers or asset allocations, the court said.

Plaintiff's "hindsight attacks" on the Consulting Firm's Growth Fund based on historical results are "unpersuasive," the court said, and, the dynamics of the market could have changed at any time, making the Consulting Firm's growth fund not only reasonable but likely more profitable for plan participants.

Also, the court pointed out that neither Lowe's nor its "well-qualified" independent fiduciary consultant, Arthur J. Gallagher & Co., ever suggested that the Consulting Firm should remove the fund.

"If an independent investment consulting fiduciary (with its own fiduciary obligations which have not been challenged) did not view the inclusion of the Growth Fund in the Lowe's plans during the relevant period as improper, then it is difficult for the court to conclude that [the Consulting Firm] should, as a matter of law, have removed the Growth Fund from the plan lineup," the court said.

In this regard, the court observed that in the absence of any testimony from a Gallagher witness to explain or dispute the statements attributed to it in the Committee minutes and the lack of evidence of any Gallagher action to seek removal of the Consulting Firm or the Consulting Firm growth fund, it found no basis to conclude that Gallagher's reporting and fiduciary advice to the Committee regarding the growth fund did not reflect its honestly held views and thus took those comments as fact value.

Finally, the court pointed out that an investment consulting fiduciary's "cross-selling" of additional fiduciary services and/or financial products is, "when viewed more broadly and realistically," an attempt to leverage an existing relationship for the fiduciary's benefit. In other words, the fiduciary consultant hopes to be able to use the trust and regard that he or she has established with the client to make it more likely that the client will consider doing additional business with the firm. To hold otherwise "blinks at reality." However, the court concluded that such "cross-selling" is not wrong or *per se* unlawful. Indeed, the court said, it is natural and entirely appropriate for successful commercial relationships to expand over time for the benefit of all involved. While the Consulting Firm encouraged Lowe's to buy its delegated services during the sales process, the court said, it was clearly left for Lowe's to decide for itself whether to use and ultimately whom to engage as a delegated investment manager.

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In this regard, the court emphasized that the Consulting Firm's consultants never made a recommendation that Lowe's choose the Consulting Firm for this work. In the sales process, the Consulting Firm presented its delegated services not as a fiduciary recommendation from an advisor but as a vendor seeking potential business, and the Committee fully understood that it needed to make the decision on whom to select independently. Therefore, the court concluded that the Consulting Firm did not act as a fiduciary with respect to Lowe's decision to engage the Consulting Firm as a delegated fiduciary investment manager for the Plan.

Conclusion

What characterizes both decisions are the extensive documentary presentations the fiduciaries made in each. The process each set of fiduciaries followed included numerous meetings to consider options and costs and benefits of alternatives, in each instance seeking and receiving expert advice, all of which was evidenced by minutes, notes, emails and testimony or declarations derived from them. Therefore, fiduciaries who institute processes that are robust at the front end may be significantly advantaged if they ever have to respond to fiduciary breach claims.

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