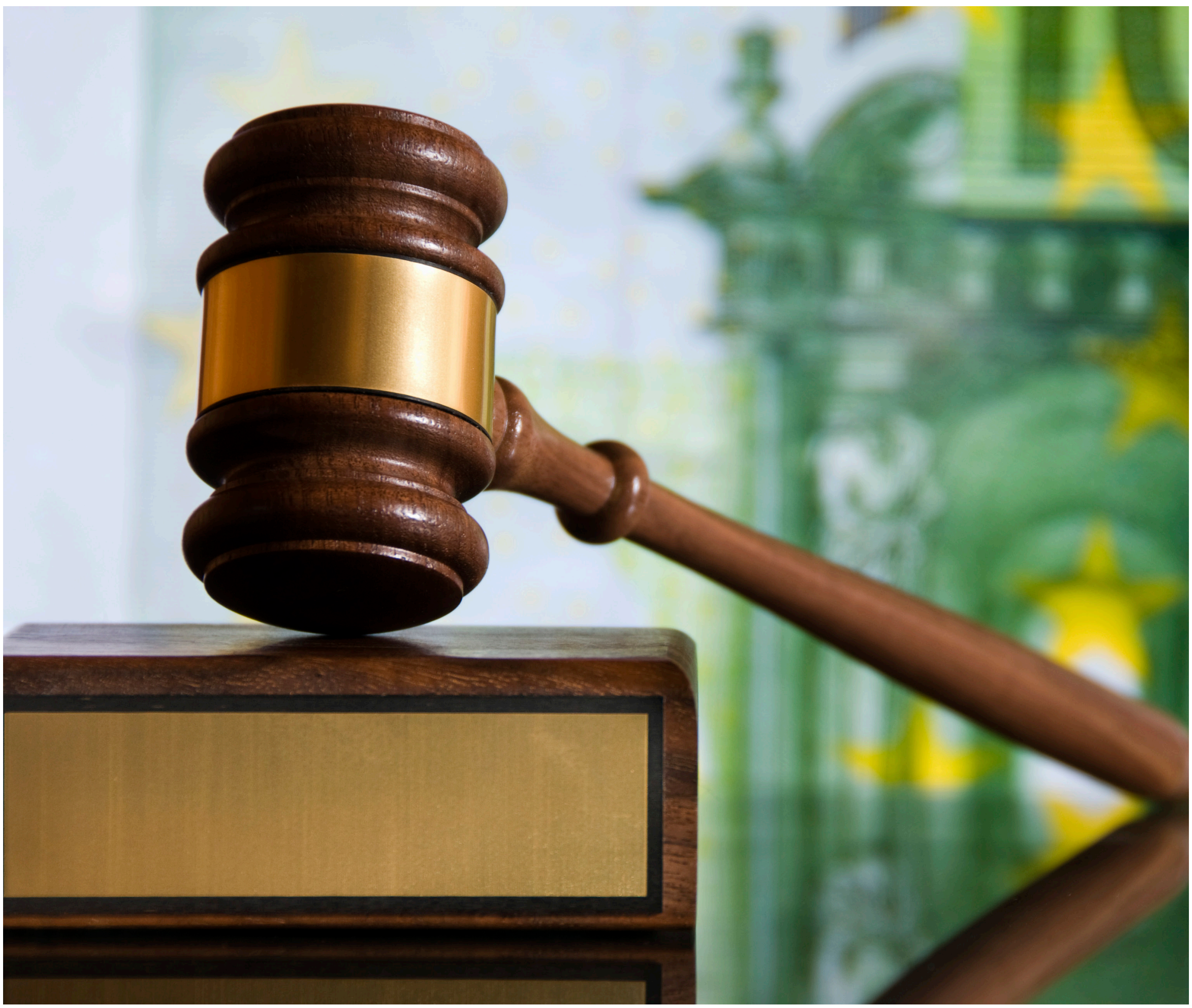
ERISA Fee Litigation Update: Settlements Are Up, Legal Hurdles Falling



WHAT LIES AHEAD IN THE ERISA FEE CASES? WHAT CAN PLAN SPONSORS AND FIDUCIARIES DO TO PREPARE? HOW WILL IT SHAPE FIDUCIARY LIABILITY?

After nearly a decade of Employee Retirement Income Security Act (ERISA) fee litigation, we can begin to draw conclusions about the law governing these cases, make predictions about the specific issues that are likely to be the focus of litigation going forward, and highlight the practical insurance and process considerations that ERISA plan sponsors and fiduciaries would be wise to consider as they prepare for what lies ahead.

On a single day in September 2006, a wave of ERISA lawsuits challenging the "excessive" fees and expenses charged by some of the nation's largest 401(k) plans were filed. The targets of these "ERISA fee cases"— as they have come to be known — were Fortune 500 Companies that sponsored large retirement plans and the fiduciaries that managed those plans. This first wave of ERISA fee cases was ambitious in scope and directly challenged long-standing practices in the retirement investment industry.

The cases brought against Lockheed and Boeing are prime examples of this first wave of ERISA fee cases.[1] They challenged the allegedly "excessive" fees and expenses that were charged to participants in the Lockheed and Boeing plans and the composition and management of specific investment funds offered in those plans. Both cases were intensely litigated on several fronts, but, as litigation wore on, alleged conflicts of interest and self-dealing became the focus and procedural prudence emerged as the touchstone for evaluating fiduciary conduct.

A second wave of more targeted ERISA fee cases followed, which was shaped by the first. These cases were aimed primarily at the fees and expenses that financial service companies collected from participants in their own 401(k) plans, and from participants in the plans of clients that offered the financial service company's "proprietary" menu of investment funds. Second-wave cases were more narrowly focused than first-wave cases and, in general, they relied more heavily on specific allegations of conflicts of interest and self-dealing from the onset. Many second-wave cases also sought to reach back further in time than first-wave cases and, as a consequence, were more susceptible to limitations defenses.

The case filed against Ameriprise Financial in 2011 is a ready example of the second wave of ERISA fee cases.[2] It challenged Ameriprise's use of its own investment products and services in its retirement plan and focused on the "inherent" conflicts of interest and self-dealing that arise in that circumstance. Many fee cases brought against financial services companies have proceeded on behalf of a purported "class of plans" who all used financial products offered by a given company. The ERISA fee case against Nationwide is perhaps the first to advance a class of plans approach.[3] Originally filed in 2001, the Nationwide case presaged both waves of ERISA fee cases in at least one other important respect: it challenged longstanding practices in the financial services industry (like

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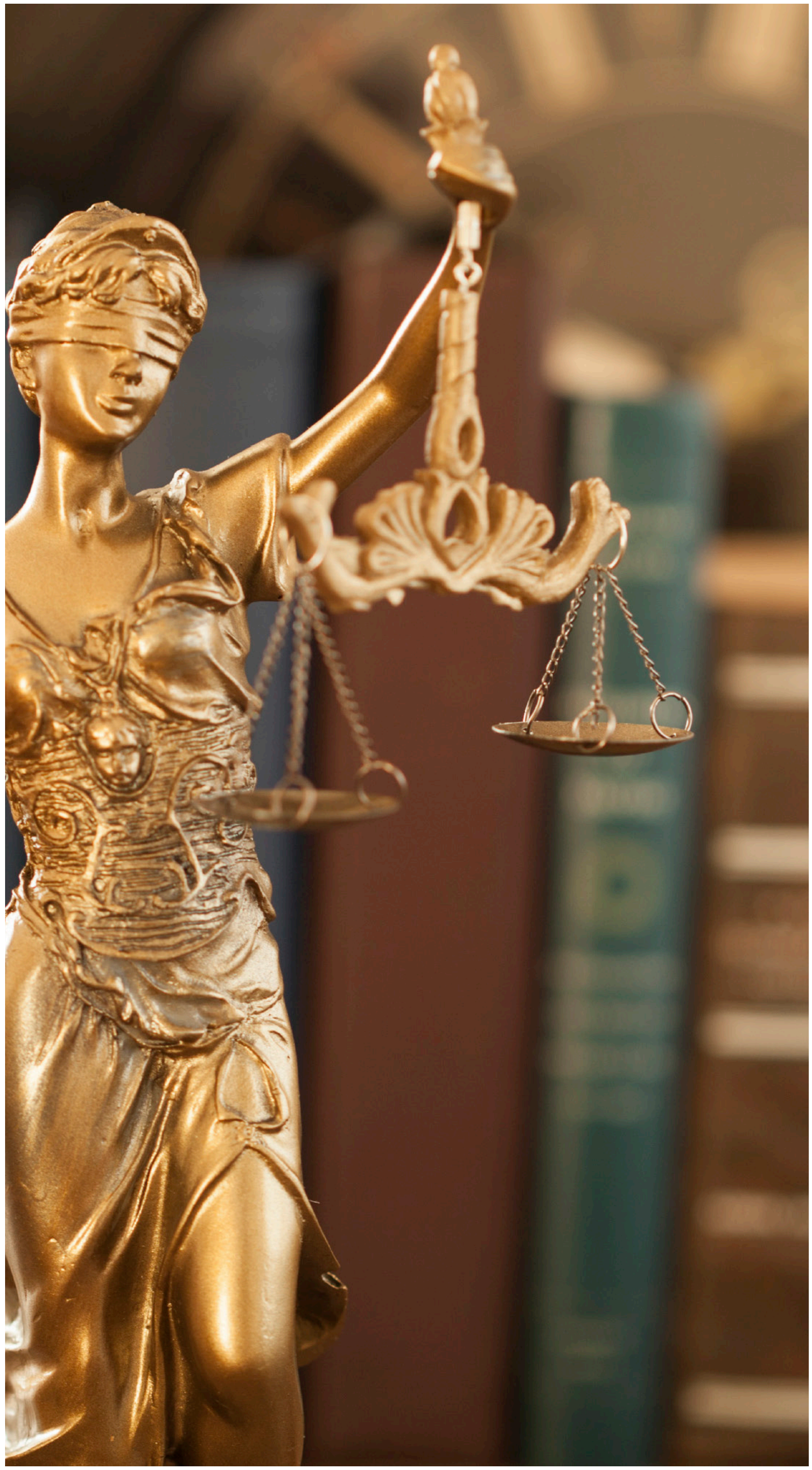
"revenue sharing") and was seen by some as a frontal assault on core lines of business.

After a half decade of frustration for the plaintiffs in the first wave of ERISA fee cases, the pendulum began to swing back in their favor. Whittled down by intense motion practice and appellate rulings that were mostly favorable to defendants, several first-wave ERISA fee cases were resolved in 2010 for low eight-figure sums — sizable recoveries, but far less than plaintiffs had sought and a fraction of the damages they alleged. More recently, another group of ERISA fee cases — including both first- and second-wave cases — have begun to resolve, and the trend is clear: settlement amounts are on the rise.

For example, after over a decade of hard-fought litigation, the class of plans case against Nationwide settled for $140 million in early 2015. And the proprietary fee case against Ameriprise Financial was resolved for $27.5 million earlier this summer, just before trial was set to begin. The Lockheed and Boeing cases were also resolved on the eve of trial — Lockheed for $62 million and, in a settlement that became public in November 2015, the Boeing ERISA fee case was resolved for $57 million.

Adding to the uncertainty around ERISA fee cases, the US Supreme Court issued a unanimous decision in May that may table the most effective tool for limiting or eliminating fee cases at a preliminary stage in proceedings: ERISA's six-year limitations period for breach of fiduciary duty claims.[4] In doing so, the Supreme Court declared that ERISA plan fiduciaries have a "continuing duty of some kind" to monitor investment fees



and performance in real time, but the Court expressed no view on the scope of that duty, and it offered no guidance on how it applies in the real world.

WHAT ARE THE NEXT LEGAL BATTLEGROUNDS IN ERISA FEE LITIGATION?

The next key procedural battleground in ERISA fee cases may be class certification. Indeed, given the tightening standards that federal courts apply at the class certification stage and the nature of the allegations at the heart of many ERISA fee cases, the presence (and even predominance) of individualized issues may limit the size of classes, or even preclude certification all together. That is because, at some level, most ERISA fee cases focus on fee and performance disclosures. Since courts often require a showing of detrimental reliance in order to pursue misrepresentation or other disclosure-based claims, the class vehicle may not be appropriate in some ERISA fee cases. And related issues could preclude certification of class of plans cases altogether. For example, one court recently refused to certify a class in the ERISA fee case against Transamerica Insurance, finding that, although the plaintiffs challenged a common menu of investment funds, differences among the different plans in which that menu was offered, and the need for participants in each to show detrimental reliance before pursuing disclosure-based claims, precluded certification of a class.[5]

In terms of substance, the future of ERISA fee cases will likely be focused on defining the scope and contours of the "ongoing duty" to monitor that the Supreme Court acknowledged earlier this year. In particular, courts will need to decide if it differs from, and is more demanding than, the standard previously applied in ERISA fee cases: the duty of a retirement plan fiduciary is to follow a reasonable procedure for selecting and monitoring investment options, not to choose the best-performing, lowest-cost investments or face liability for failing to do so. Whether the Supreme Court's "ongoing duty of some kind" is more demanding, and how it applies at the early stages of a case, is likely to be a key battleground as we move into the second decade of ERISA fee litigation.

By David Tetrick, Jr., Partner at King & Spalding, and Darren A. Shuler, Counsel at King & Spalding

The future of ERISA fee cases will likely be focused on defining the scope and contours of the "ongoing duty" to monitor that the Supreme Court acknowledged earlier this year.

1. *Abbott v. Lockheed Martin Corp.*, 06-cv-701 (S.D. Ill.) and *Spano v. Boeing Co.*, 06-cv-743 (S.D. Ill.).
2. *Krueger v. Ameriprise Financial*, 11-cv-02781 (D. Minn.).
3. *Haddock v. Nationwide Fin. Servs.*, 01-cv-1552 (D. Conn.).
4. *Tibble v. Edison Int'l.*, 134 S. Ct. 2459 (2014).
5. *Santomenno v. Transamerica Ins. Co.*, 12-cv-02782 (C.D. Cal).

INSURANCE IMPLICATIONS

Are your plan and its fiduciaries adequately insured?

ERISA fee cases can be expensive: Settlement amounts are on the rise, and given the intense motion practice and discovery of procedural prudence over potentially long periods of time, the cases can result in defense costs that reach high-seven or low-eight figures. As a result, plan sponsors may find that they are underinsured relative to the risk and would be wise to revisit their policy limits.

Just a few years ago, it was difficult to identify any ERISA fee settlement. But there have been at least 11 such settlements against plan sponsors since 2010, totaling almost $320 million. And that number does not include defense costs.

Maintaining adequate limits is critical, particularly since ERISA permits plan fiduciaries to be held personally liable for plan losses. Some key considerations when determining what limit to purchase are:

- **Peer benchmarking.** How much coverage do similar plans have?
- **Historical claims.** What size claims and losses have similar plans experienced?
- **Settlements covered by the policy.** How does the benefits exclusion in ERISA fiduciary policies affect covered losses?

Identifying what limit to purchase is important, but rarely clear cut. Historical claims tell us what happened in the past, but are not necessarily indicative of future settlements and defense costs. Past experience may not provide clear guidance, especially where the trend line indicates that a change may be underway.

Peer benchmarking is also useful, as it allows the insured to consider what coverage similar plans purchase.

Though fiduciary policies typically exclude payment of benefits due under ERISA plan terms (as the insurer does not want to assume a plan's contractual obligation), settlements of excessive fee claims are generally covered since they are not considered "benefits."

With the pace of resolutions quickening and the size of ERISA fee settlements on the rise, plan sponsors and fiduciaries should evaluate their policy limits on a regular basis.

By Cathy Cummins, Managing Director at Marsh

ESTABLISHING A PROCESS

Does your plan follow a prudent process with respect to fees and expenses?

To avoid litigation risk, it is critically important that plan fiduciaries set and follow procedures relating to the establishment and monitoring of defined contribution (DC) plan fees, document their efforts through committee minutes or other official records, and hold their recordkeepers and other service providers accountable for providing agreed-upon services. While fiduciaries are not required to select the lowest cost service provider, they must ensure that services are appropriate for participants and that fees are reasonable in light of the services being provided and market conditions.

Most DC plan fee litigation hinges on procedure rather than outcome. A written fee policy can help by setting out activities and procedures designed to promote proper fee oversight and management. Steps include:

- Identifying and documenting fees charged to plan assets (including fees charged against participant accounts) or paid by the plan sponsor.
- Delegating responsibilities regarding fees.
- Developing procedures for approving expenses and fees to be charged to plan assets.
- Creating procedures for allocating fees among participant accounts.
- Documenting efforts to help ensure that plan fees are reasonable in light of the services provided, including ongoing monitoring of fees and expenses.
- Developing procedures for ensuring that annual reporting and disclosure requirements are met, including government filings and participant fee disclosures.

The following best practices, based on US Department of Labor guidelines, case law, and marketplace experience, may be helpful in ensuring fiduciary requirements are met:

- Continually benchmark and negotiate investment fees, considering both fund vehicle and asset size.
- Benchmark and negotiate recordkeeping and trustee fees at least every other year.
- Negotiate vendor contracts to ensure that service standards and liability provisions are in the best interests of plan participants and beneficiaries.
- Monitor actual fees paid against contractual requirements.
- Review the allocation of fees paid directly or indirectly by participants to ensure it is fair and reasonable.

By Bill McClain, Principal at Mercer

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