VOL. 35, NO. 4 WINTER 2022

BENEFITS LAW JOURNAL

From the Editor

The Sting: ERISA Fee Litigation Harms Participants, Stymies Innovation

The explosion in 401(k) fee litigation – well over 200 lawsuits have been filed since 2019, according to Bloomberg Law – harms plan participants and retirement savings while generating huge paydays for lawyers. The cause is federal judges refusing to throw out class action suits built on nothing more than hindsight and conjecture.

The formula for the class action gold rush is simple and easily duplicated.

First, would-be counsel mines readily available 401(k) and other defined contribution plan databases for plans with decent-sized assets and participant headcounts that have not yet been sued.

Once a target has been selected, it is short work, with hindsight, to find which investments have underperformed or had higher fees than its "peers" and create an apples to oranges comparison showing that the target's recordkeeping fees were high.

Finally, after finding a couple of disgruntled employees or former employees to serve as class representatives, file a federal action alleging that the plan sponsor breached its ERISA fiduciary duties to pay reasonable fees and select prudent investments.

If, as happens all too often, the court allows the lawsuit to proceed without anything more than Monday morning quarterbacking, chances are the employer will settle. Settling is less expensive than winning in court.

While great for the lawyers on both sides and the class representatives (receiving $10,000 to $20,000 for "renting" their ERISA status to class counsel), the same cannot be said for the average plan participants who may have only a few hundred dollars added to their 401(k) accounts. Too small for many to even notice, let alone affect their retirement finances.

THE REAL VICTIMS

While employers and their liability insurers pay for these settlements, the real victims are plan participants and retirement programs. The pervasive threat of litigation stymies program innovation. Before adding creative financial education, plain English communication, autopilot features, lifetime income alternatives, emergency savings or different investment approaches, employers and plan service providers have to consider the likelihood of a lawsuit as "reward" for trying a new approach to improve retirement outcomes. It is far safer to do nothing extra than experiment with alternatives that might not work out, increase plan costs or be difficult to defend in court.

Business will innovate to the boundary that regulation allows. 401(k) ERISA fee litigation is regulation by class action extortion, hindering innovation and discouraging employers from improving (or even adopting) retirement plans.

Of course, not every plan is properly run and some employers do skirt or are ignorant of their ERISA fiduciary duties. Indeed, a fiduciary unthinkingly choosing inappropriate investments or a high-fee poorly performing recordkeeper without regard to the level of services should face an ERISA action.

Courts that set a low bar to allowing ERISA class actions to proceed abdicate their responsibilities.

Instead, courts should require plaintiffs to objectively demonstrate a colorable fiduciary violation before allowing a case to proceed. This includes apples to apples evidence that the fees (based on service quality, levels and plan characteristics) or investments were overpriced or of poor quality.

Judges should recognize that, in any given year, only one investment fund can be number one and low fees can be expensive (due to poor performance/services).

Part of the problem with judicial inaction is due to a misreading of the recent Supreme Court ruling in Hughes v. Northwestern. Hughes correctly held that a fiduciary cannot escape responsibility from offering an imprudent investment by also offering good investments. However, a number of district and circuit courts have been using Hughes as an excuse to allow even weakest (spurious) suits to proceed.

But not in the U.S. Court of Appeals for the Sixth Circuit, where the courts have begun to toss ERISA fee complaints unless plaintiffs show some solid, fact-based allegations of wrongdoing. Other circuits should consider the harm to retirement outcomes before rubber-stamping ERISA fee litigation.

An additional way to discourage unmerited class actions is to impose ERISA's reasonable fee rules on plaintiffs' lawyers. When an attorney takes a percentage of the settlement, the money comes from the plan participants' pockets. This fee should be scrutinized for reasonableness like any other fee that the plan or participants pay. When the lawyers make millions and the participants hundreds, I question whether these fees are reasonable. Fees of 5 to 10% of the settlement would be more in line to the value added.

Further, courts should use their ERISA authority to require a class action lawyer bringing a specious suit to pay the employer's costs in defending.

ERISA does not mandate a particular investment lineup or record-keeper or set maximum fees for good reason. To encourage innovation and allow fiduciaries to determine what is best for their participants, courts should allow each plan to set its own course.

Until fiduciaries develop prophetic superpowers, courts should use their authority to prevent the harm caused by unwarranted litigation.

The views set forth herein are the personal views of the author and do not necessarily reflect those of the law firm with which he is associated.

David E. Morse
Editor-in-Chief
K&L Gates LLP
New York, NY