

ERISA Litigation Surging - Focus on Fees

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Article By

[Rachel L. Fried](#)

[Covington & Burling LLP](#)

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After a few years of decline, litigation involving 401(k) plans “has surged again recently,” according to a [study](#) published by the Center for Retirement Research at Boston College. This is likely not news to 401(k) sponsors and service providers, who are confronted with this reality on a near daily basis. However, the study is a fascinating read, in part because it chronicles many cases brought since 2006, but also because it discusses the consequences of all this litigation—both the good and the not-so-good.

Complaints filed by participants of 401(k) plans against their plan fiduciaries over the past ten years follow a pattern. Section 401(k) plan litigation exploded during the recession in 2008, with many allegations targeting funds holding employer stock whose value plummeted. The number of lawsuits peaked at 107 in 2008, and 2009 remains second on the list for number of 401(k) lawsuits filed over the past 12 years.

Section 401(k) litigation tapered off during the first few years of this decade, with the Supreme Court’s 2014 *Dudenhoeffer v. Third Bancorp* decision delivering a devastating blow to the so-called “stock drop” cases. Although the Court agreed with the Sixth Circuit that employer stock ownership plan (ESOP) fiduciaries are not entitled to a special “presumption of prudence,” its discussion of the difficulty such allegations faced in meeting the pleading standard led to many dismissals.

But starting around 2015, the study finds, 401(k) litigation began to surge again.

The more recent cases focus on “excessive fees” paid either for actively managed investment funds or for record-keeping and other administrative services. There has been a corresponding shift in who is sued: record-keepers, third-party administrators, and other plan service providers are increasingly named as defendants, in addition to or instead of the employees or fiduciary committees of plan sponsors. The plaintiffs in many of these “excessive fees” cases probe the complicated—and sometimes opaque—fee structures between plan service providers such as record-keepers and investment advisors for what plaintiffs believe to be hidden kickbacks.

The authors of the study point to some consequences—good, bad, and mixed—of the 401(k) litigation trends they’ve identified:

- Section 401(k) litigation—particularly surrounding administrative and record-keeping fees—has coincided with increased fee transparency and an observed decrease in administrative fees over the past 15 years. While some of these changes are attributable to the Department of Labor’s focus on fees, including the disclosures that it has required under section 408(b)(2) of ERISA since 2012, the increase in litigation has undoubtedly caused an increased focus on 401(k) plan fees.
- However, section 401(k) litigation has also had some other, perhaps unintended, consequences. The fear of excessive investment fee claims may be causing plan fiduciaries to “play it safe” when choosing plan investment options. Fiduciaries may avoid offering “creative” investment options like annuities, which would cost more than investments but which might serve some participants better in the long run. The study also notes an increasing penchant for passively managed investment options, such as index funds, as another consequence of excessive fees litigation, although observers debate whether this is ultimately a good or bad thing for 401(k) plan participants.

But one question remains: why the recent surge in excessive fees litigation? The tide of stock drop cases ensued an observable phenomenon—a large drop in stock prices. The current surge is not so easily traced to an event.^[1] However, two possible explanations come to mind. The first is that such lawsuits follow from the increased fee disclosures; once fees become visible, it is easier to assess whether they are “excessive.” The second, more cynical explanation is the more old-fashioned one: “that’s where the money is.” The amount of assets in retirement plans has grown substantially in the past decade (see a recent [EBRI Study](#) on this issue), as has the amount of attorneys’ fees recovered in these lawsuits. Of course, both of these accounts, and an unknown number of others, may partially explain the recent swell in 401(k) litigation over excessive fees. In any case, this recent surge may well be a continuing trend.

[1] I do not mean to suggest that the 2008 recession caused the rise in stock drop cases ten years ago. Causation is complex, and often even seemingly obvious explanations are complicated by other, less visible factors.

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