CAPTRUST

Fiduciary Update | May 2023

401(k) and 403(b) Fee Cases Continue

The flow of cases alleging fiduciary breaches through the overpayment of fees and the retention of underperforming investments in 401(k) and 403(b) plans continues but without significant new developments. Here are a few updates.

- In the past quarter, at least 20 court decisions were issued on motions to dismiss fees lawsuits.
    - A slight majority of cases were dismissed: nine vs. eight, with another three being partially dismissed.
    - To avoid dismissal, some courts require a complaint to include facts that **plausibly** allege a fiduciary breach occurred, while other courts require only allegations that support the **possibility** a fiduciary breach occurred. Courts applying the plausibility standard are more likely to dismiss cases. Whether cases are dismissed or allowed to proceed seems to depend considerably on where they are filed.
- Quotes and highlights from recent cases help tell the story:
    - The allegation that all recordkeepers offer the same or similar services “defies common sense.” *Krutchen v. Ricoh USA Inc.* (E.D. PA 2023).
    - The court could not conclude that the plan fiduciaries had a sound investment review process in place, so the case will proceed to trial. *Jacobs v. Verizon Communications Inc.* (S.D. NY 2023).
    - Refusing to allow the filing of a new complaint in a case that had already been dismissed because it lacked sufficient grounds to proceed, the court said: “The case appears be a lawsuit in search of a theory. â€¦ Plaintiffs identify ways in which plan management could

be different, or even improved, but they have not alleged facts to support a plausible inference that the defendants have failed as fiduciaries." *Wilcox v. Georgetown University* (D. DC 2023).

- One settlement was approved. The plan had assets of approximately $400 million in 2020, and the suit was settled for $990,000, with $330,000 going to the plaintiffs' lawyers. This represented approximately $65 per participant. The judge reduced the requested fee of $10,000 per named participant to $7,500. *Dover v. Yanfeng United States Auto Interior Sys* (E.D. MI 2023).
- We previously reported on *Hughes v. Northwestern University*, in which the Supreme Court reversed dismissal of a fees case and sent it back to the lower courts. Following the Supreme Court's guidance, the U.S. Court of Appeals for the Seventh Circuit found that the complaint in that case includes sufficient allegations to avoid dismissal. The Seventh Circuit is one of the jurisdictions that requires allegations supporting a plausible—not just a possible—fiduciary breach. *Hughes v. Northwestern University* (7th Cir. 2023).
- Last quarter we reported on a Connecticut case permitting a jury trial on some ERISA fiduciary claims. A recent press report indicates that a settlement has been reached in that case. In another decision from the district court in Connecticut, a judge denied a motion to strike a jury demand, apparently permitting a jury trial. *Vellali v. Yale University* (D. CT 2023). It will be interesting to see if the possibility of a jury trial hastens a settlement in this case.

Use of Participant Account Forfeitures: New IRS Proposed Regulations

Many plans include a provision that if a plan participant terminates employment before being fully vested in their employer contributions, the nonvested portion will be forfeited. Participants are always fully vested in their own deferrals. It has been generally understood that forfeitures could be used to do any of the following:

- Pay permissible, reasonable plan expenses,
- Offset future employer contributions,
- Restore previously forfeited participant accounts, or
- Increase participant accounts.

Under the new proposed regulation:

- All forfeitures must be used no later than 12 months after the end of the plan year in which the forfeitures were incurred.
- As a transition rule, all forfeitures occurring before 2024 will be treated as occurring during the 2024 plan year and so must be used by the end of the 2025 plan year.

The proposed regulation also includes a provision that defined benefit plan forfeitures cannot be used to reduce required employer contributions.

Fiduciaries should receive and review regular annualized reporting on plan forfeitures from their recordkeepers to monitor this issue.

No Good Deed Goes Unpunished: 1947 Pension Trust Creates $38 Million ERISA Liability

In 1947, Mary Chichester du Pont—one of America's richest matriarchs and part of the DuPont chemical company—created an *employee pension trust* to support domestic employees and those who provided secretarial, accounting, or other assistance to du Pont family members. The trust was intended to pay an annual pension equal to 60 percent of wages to those with at least 10 years of service. Each family member with covered employees was defined as a *qualified employer*. The trust was funded with 50 shares of DuPont stock, which had grown to 112,772 shares in 1999, worth about $7.4 million at that time. The trust has current assets of about $2.7 million.

In 2015, two of Ms. du Pont's grandchildren contended that their domestic employees are entitled to benefits under the trust, and a dispute arose. This brought into clear focus whether the 1947 arrangement falls under ERISA, which was passed in 1974. It does. There is no exception for programs that preexisted ERISA. In the years before the dispute arose, administrators and trustees received conflicting opinions on whether ERISA applied, but they took no action to resolve the issue.

As would be expected, the fallout of the court's finding that ERISA applies is considerable. A recent decision finds:

- The plan trustee and all du Pont family members with employee-participants in the program are considered plan fiduciaries.
- All plan fiduciaries have breached their duties under ERISA in a variety of ways.
- There are currently 246 known potential plan participants and beneficiaries to whom liabilities are owed—active, terminated, or retired. All employees of all qualified employers are eligible for benefits under the terms of the trust.
- The trust's liabilities are $37 million to $38 million. Current assets are $2.7 million.
- The plan must be immediately funded under ERISA's funding requirements.
- All plan fiduciaries are jointly and severally liable for all the plan's liabilities. That is, each fiduciary is fully liable for the entire amount.

Given the complexities, the judge has appointed a special master—an independent businessperson or lawyer—to hold the defendants' feet to the fire and report back to the judge. The special master and all providers the special master hires will be paid by the plan fiduciaries, with an initial retainer of $100,000. *Wright v. Elton Corporation* (D. DE 2023).

This case is a good reminder that benefits provided by employers to employees may be covered by ERISA even if that is not immediately apparent. It is also a reminder that problems do not age well.

Oops! Board Action Alone Did Not Terminate Severance Plan

A company's employee benefit program included a severance plan. With layoffs pending, the company decided to terminate its severance plan and eliminate those costs. Prior to the implementation of planned layoffs, the company's board of directors adopted a resolution terminating the severance plan. Disappointed employees who had been laid off sued, claiming they were entitled to severance plan benefits.

The severance plan was set out in full in the company's employee handbook, and the company clearly retained the right to eliminate benefits. However, the handbook also said that action by the human resources (HR) department was required to modify the handbook. The district court found that the board of directors' resolution terminated the severance plan as an act of the company and denied benefits to the laid-off employees.

The court of appeals found that the board action alone was not enough to terminate the severance plan. As prescribed in the employee handbook, action by the HR department—in writing—was required. Not requiring HR department action would effectively delete that provision, which the district court was not permitted do. *Messer v. Bristol Compressors International LLC* (4th Cir. 2023).

DOL Weighs In on Supplemental Life Insurance: Evidence of Insurability

We have previously reported on situations in which employees intended to enroll in supplemental life insurance coverage but did not complete evidence of insurability (EOI) requirements. Then, upon the death of the insured, and to the surprise of survivors, coverage was denied even though premiums for the coverage had been paid. The insurer would typically return these premiums.

Following an investigation, the U.S. Department of Labor (DOL) announced a settlement with Prudential Insurance Company of America on denials of supplemental life insurance coverage due to lack of EOI. The investigation found that even though premiums were collected for extended periods, numerous claims were denied because EOI had not been provided. From 2017 to 2020, more than 200 claims were denied on this basis. The investigation also showed that premiums had been collected back as far as 2004, even though EOI was not in place.

According to the DOL's settlement news release:

- Prudential will not deny coverage based only on lack of EOI if it has received at least three months of premiums.
- People who are currently insured by Prudential cannot be denied coverage based on EOI more than a year after they started paying premiums or based on evidence that they were no longer insurable after first making premium payments.
- Prudential will reprocess claims back to 2019 and pay benefits that were previously denied based solely on lack of EOI.
- A parallel investigation into other insurers found similar practices. DOL Assistant Secretary for Employee Benefits Security Lisa Gomez said that the DOL will take appropriate action against other insurers who “play a game of gotcha to wrongfully deny benefits based on technicalities.”
- Group policyholders, like employer plan sponsors, who collect premiums may be liable for supplemental life insurance claims by beneficiaries if they failed to notify participants that Prudential had not approved their EOI.

Plan sponsors should work with their insurers or other providers to confirm that appropriate processes are in place to avoid issues like these.

Beneficiary/Slayer Denied Retirement Plan Benefits

Most states have a so-called *slayer statute*, which prevents murderers from benefiting from their crimes. In a recent Oregon case, a provision of this type was applied—with a twist. Tracy Cloud was convicted by a jury of murdering her husband, Philip Cloud. Although Tracy claimed self-defense, the evidence did not support her case, and there were financial incentives for the murder.

Philip was an employee of Intel Corporation and participated in Intel’s retirement plans. Tracy was his beneficiary. Soon after Tracy was convicted, the executor of Philip’s estate filed a suit to prevent Tracy from receiving the benefits from Philip’s plan accounts, and rather to disburse those funds to the estate.

Tracy objected on the grounds that an appeal of her murder conviction is pending. The district court acknowledged that disposition of Philip’s retirement plan benefits would depend on the outcome of Tracy’s appeal and stayed, or suspended, the case until the appeal is decided. *Munger v. Intel Corporation* (D. OR 2023).