

**COMPLIANCE** | October 8, 2020

# Lessons From a Rare ERISA Excessive Fee Suit Summary Dismissal

The complexity of retirement plan lawsuits often makes district court judges reluctant to grant summary judgement against plaintiffs, but Salesforce has succeeded in defeating a complaint alleging it committed various fiduciary breaches.

Reported by [JOHN MANGANARO](#)

A ruling recently issued by the U.S. District Court for the Northern District of California deserves a second look from retirement plan sponsors, for providing a couple of lessons.

Of note, the ruling [grants summary judgement in favor of the defense](#)—which is a fairly uncommon outcome in the ongoing rush of Employee Retirement Income Security Act (ERISA) lawsuits. This is not the case because plaintiffs are having all the success in terms of the ultimate outcome of many of these lawsuits, but rather because the structure and inherent complexity of retirement plan lawsuits often makes federal district court judges reluctant to squash plaintiffs' claims at such an early stage.

Generally speaking, granting summary judgement precludes more formal discovery and the generation of what often turns out to be mountains of potentially germane documentary evidence. This line of thinking was recently—and clearly—explained in a ruling filed in U.S. District Court for the Western District of Tennessee, Western Division, which [denied a motion to dismiss an ERISA lawsuit against Autozone](#). As in the Salesforce lawsuit, the defendants in that ongoing case are accused of offering imprudently expensive and poorly performing actively managed mutual funds.

## A Lesson About Active Management

“AutoZone’s argument that the court should give limited weight to fee comparisons between [actively managed funds] and low-cost Vanguard index funds invites the kind of factual analysis that is inappropriate at the pleading stage,” the Tennessee district court ruling states. “This court declines to rule on the reasonableness of comparing actively managed funds to passively managed index funds on a motion to dismiss. While plaintiffs must allege more than inapt investment comparisons to make the necessary inference of imprudence to survive a 12(b)(6) motion, at the pleading stage, taking all factual allegations in plaintiffs’ favor, the court finds the complaint sufficiently states a claim for breach of fiduciary duty based on AutoZone’s selection and management of [the active] funds.”

One ancillary effect of the reluctance of federal judges to dismiss such lawsuits prior to discovery is that many of the underlying issues of law have not been clarified, because so many plan sponsors simply choose to settle the cases rather than pay the legal fees associated with fighting them. From a purely economic point of view, this can make a lot of sense, as settlements generally range anywhere from a few million dollars to multiple tens of millions. These figures, especially on the lower end, are easily matched by the legal fees required to fight a complex ERISA lawsuit, even when a defendant eventually emerges victorious. Fiduciary liability insurance [also plays a role here](#), as insurers may prefer to pay to settle claims early and on favorable terms, rather than enter a protracted lawsuit process that could result in sizable damages in addition to the legal fees.

Wagner Law Group Partner Tom Clarke summarizes this state of affairs well, noting that the tremendous flow of ERISA lawsuits has accomplished surprisingly little from a legal theory point of view. Speaking during a recent webinar hosted by PLANSponsor, he used the example of plan participant data, and whether lawsuits seeking to define whether participant data is a plan asset (and thus protected by ERISA) have done anything to answer that important question.

“So far, the participant data litigation hasn’t accomplished anything from a legal clarity point of view,” Clark said. “Although parties in some lawsuits have snuck the assumption that plan data is protected by ERISA into their

settlement agreements, this does not mean it has been established as a matter of law. Just because something is included in a settlement doesn't make participant information a plan asset."

Returning to the Salesforce ruling, the California district court does not hesitate to summarily address the issue of active management's use in retirement plans. The ruling says this is because the plaintiffs' arguments are far too broad and generalized to state an actionable claim.

"Passively managed funds ... ordinarily cannot serve as meaningful benchmarks for actively managed funds, because the two types of funds have different aims, different risks and different potential rewards that cater to different investors," the ruling states. "Actively and passively managed funds have, for example, different management approaches, and analysts continue to debate whether active or passive management is a better approach. Further, actively managed funds can offer investors the chance to earn superior returns, access specialized sectors or take advantage of alternative investment strategies, while also allowing rapid turnover both in the funds' holdings and the participants' investments. Passively managed funds typically disallow new investments for a month or more following any withdrawal."

In light of such differences, the ruling states, a plaintiff's bare allegations that passively managed funds were available as cheaper alternatives to the actively managed funds offered in the plan "do not suffice to demonstrate imprudence."

"In support of their asserted comparison, plaintiffs allege the passively managed funds have the same investment style or materially similar characteristics as certain actively managed funds offered in the plan," the ruling states. "Such conclusory allegations, however, are not sufficient to state a claim for relief."

## A Lesson About Revenue Sharing

The Salesforce ruling also offers an important lesson about share classes. In their complaint, the plaintiffs argued that the use of nominally more expensive mutual fund share classes that use revenue sharing—i.e., rebate payments that help offset recordkeeping and administrative fees—is inherently imprudent.

Similar claims have been permitted to advance to discovery in many cases, which in turn means that [many settlements have been reached in this area](#). Thus again, the courts have actually provided relatively little guidance in terms of the plaintiffs' original questions about the prudence of certain plan design decisions having to do with the provision of "retail" share classes and the use of revenue sharing. This is why the Salesforce ruling can be seen as instructive, though of course its impact may be limited outside the 9th U.S. Circuit.

The dismissal ruling explains that the court found compelling the defense's arguments that the plan engaged in revenue sharing in an appropriately considered, prudent and loyal manner.

"The Form 5500 filings for the plan indicate the fees charged in connection with the JPMorgan SmartRetirement Institutional and Class R5 funds were used to pay for recordkeeping and other administrative services provided to the plan, an arrangement which frequently inures to the benefit of ERISA plans," the ruling states, citing a precedent set by a case known as *Terraza v. Safeway Inc.* "Known as 'revenue sharing,' this arrangement provides an obvious, alternative explanation for why the plan did not offer the lowest cost share class for those funds, and plaintiffs fail to allege any facts to support their conclusory allegation that the plan did not receive any services or benefits based on its use of more expensive share classes."

Comparing its ruling in this matter with other cases, the California district court says this particular matter is "readily distinguishable" as a case in which summary judgement is appropriate.

"First, in a number of those cases, the plaintiffs therein had alleged numerous acts of wrongdoing, which, when viewed collectively, were found sufficient to state a claim," the dismissal ruling explains. "In others, there is no indication that the defendant therein submitted for the court's consideration the same type of evidence regarding revenue sharing as defendants have submitted here. To the extent the cases on which plaintiffs rely have held allegations identifying lower-cost share classes are, without more, sufficient to state a claim for imprudence, this court is not persuaded by the reasoning therein. ... Accordingly, plaintiffs fail to state an imprudence claim predicated on a comparison of share classes."

It is important to note that the Salesforce litigation plaintiffs have been granted leave to amend the flaws in their complaint, with a new filing deadline of October 23. For this reason, it is possible that the Salesforce case could be revived, but either way the lessons will still stand with respect to what it takes for plaintiffs to survive a motion to dismiss in this context.

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