

NEWS Retirement

401(k) lawsuits over 'forfeited' money get a lifeline



Sherrie Boutwell, partner at Boutwell Fay, and Andrew Oringer, of the Wagner Law Group.

There is one way to help avoid such litigation in the future, one lawyer says: Get rid of vesting schedules.

June 3, 2024 *By Emile Haliez*



A new type of 401(k) lawsuit recently survived its first big challenge, paving the way for others like it – and potential settlements.

The case alleges that telecommunications company Qualcomm ran afoul of the Employee Retirement Income Security Act by using “forfeited” 401(k) money to pay for company contributions to workers’ accounts rather than offsetting some of the administrative costs that all participants pay. The line of litigation has surprised benefits lawyers, since the Internal Revenue Service has allowed employers to use such 401(k) contributions that way, as long as the plans’ documents permit it. The money is the employer contribution that employees forfeit when they leave their jobs before certain vesting milestones. In [Qualcomm’s](#) case, workers become 50 percent vested for employer contributions on their first anniversary and 100 percent on the second, according to court documents.

Since one law firm began filing those cases last year, observers said they did not expect the cases to go very far. However, there are [reportedly](#) at least [nine such lawsuits now pending](#), and the recent development in the Qualcomm case represents a tailwind for the plaintiffs. On May 24, the judge presiding over that case denied the defendant’s motion to dismiss, which means that the plaintiffs cleared a major hurdle. Some of the other companies that have been sued are HP, Honeywell, Clorox, Mattel, Intuit, and Thermo Fisher Scientific.

“No one has seen this claim before... although the tax code has allow this sort of [use of forfeited plan assets] for so many years,” said Sherrie Boutwell, partner at Boutwell Fay. “Getting past a motion to dismiss really means every plan sponsor should be taking a look at this – they should take a look at their plan documents. They should consult with counsel.”

Most 401(k) plans use preapproved plan documents drafted by the big 401(k) providers, and those usually give the plan sponsor discretion about how forfeited plan assets are used, Boutwell said. That discretion includes being able to use the money for future employer contributions to other employees, but it could also mean choosing to offset administrative expenses for employees, she said.

While the IRS has allowed that practice, so too has the Department of Labor – at least when plan sponsors have followed what is permitted in their plan documents, said Andrew Oringer, partner and general counsel at The Wagner Law Group.

“In a lot of cases, there is flexibility in the plan documents,” Oringer said.

“There was hope that these lawsuits would not get past the motion to dismiss phase,” he said. “Plaintiffs’ lawyers may well be emboldened to bring more of these lawsuits, especially in light of the prevalence in the market of this practice. And the possibility that these cases are now going to generate settlements potentially goes up.”

It could be “the next flavor” of ERISA litigation he said. That adds to numerous lines of cases that have tackled investment management fees, record keeping and administrative costs, investment performance, self-dealing, and other areas.

“We are very surprised that the California federal court [found the Qualcomm forfeiture case plausible](#). We think the decision is wrong because forfeitures are derived from excess employer contributions and there is no requirement to offset forfeitures against plan expenses,” said Daniel Aronowitz, president of Encore Fiduciary, in an email. Further, Qualcomm followed the language in its plan document, so it does not appear to have violated what the DOL and IRS have long allowed, he noted.

“We further think the decision is wrong to consider the offset of plan forfeitures as a fiduciary function. It is not,” he said. “Long-standing ERISA authority holds that decisions on how to fund a plan or the level of plan contributions constitute settlor functions – not fiduciary functions.”

The order could be overturned on appeal, which is something that plaintiffs’ attorneys should keep in mind before filing similar cases around the use of forfeited 401(k) assets, he said.

For plan sponsors that want to avoid the issue entirely, there is a simple solution, he said.

“We would recommend that they consider: (1) eliminating any vesting period in the plan, which would eliminate the issue entirely; or (2) amend the plan document to eliminate any discretion as to whether the plan has a choice between offsetting plan contributions or defraying participant expenses.”

Related Topics: [401\(k\) lawsuits](#), [ERISA](#), [Lawsuits](#)

Learn more about [reprints and licensing](#) for this article.

Newsletters

Subscribe for original insights, commentary and analysis of the issues facing the financial advice community, from the InvestmentNews team.

Recent Articles by Author



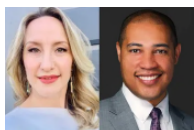
401(k) lawsuits over ‘forfeited’ money get a lifeline

There is one way to help avoid such litigation in the future, one lawyer says: Get rid of vesting schedules.



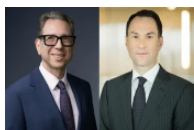
Cheating for CE credits is on the rise

A rash of cheating reported to Finra raises the question: Are continuing education requirements really that bad?



For many wanting to quit work around 60, phased retirement can be the answer

The increasingly popular strategy lets people transition socially and financially, advisors say.



Where the DOL’s fiduciary rule intersects with HSAs

For those who want to avoid becoming fiduciaries, be wary of the line between education and advice, lawyers warn.



Awaiting a verdict on Trump, market likely to say ‘meh’

‘Absent Trump being in jail, none of this stuff is going to matter,’ says one advisor.