

LEGAL UPDATE

District Court Denies Motion to Dismiss Complaint for Misapplication of Plan Forfeitures

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Serious attention should be given to the filing of several class action lawsuits alleging that plan fiduciaries violated ERISA by applying forfeitures to reduce employer contributions instead of applying them to reduce plan administrative expenses borne by plan participants.

On May 24, 2024, the United States District Court for the Southern District of California (Judge Benitez) issued the first substantive ruling regarding these allegations, denying Qualcomm's motion to dismiss. *Perez-Cruet v. Qualcomm Inc., et al.*, 23-cv-1890 (S.D. Cal. 5/24/2024). In a very organized manner, over 16 pages, the district court in *Qualcomm* addressed and overruled arguments seeking to dismiss six substantive causes of action based on allegations asserting the misuse of plan forfeitures. In particular, the Court concluded that Plaintiff had plausibly alleged violations of ERISA §§ 404(a)(1)(A) & (B), 403(c)(1) and 406(a)(1)(A) & (D) as well as 406(b).

In finding that the Plaintiff had made a plausible complaint for a violation of ERISA § 404(a)(1), the Court described the exact nature of the harm alleged by Plaintiff as well as its basis for concluding that Plaintiff's claim of disloyalty was plausible:

Dividing total administrative expenses among all participants suggests that a participant like plaintiff incurred an average administrative expense of \$44 per year. Had Defendants used the \$1,222,072 of forfeited nonvested contributions from 2021 toward paying Plan administrative expenses, all Plan participants would have benefited by incurring no administrative expense charge to their accounts. Instead, all Plan participants had to pay for administrative expenses that could have been reduced to zero had the Defendants chosen to use forfeited contributions in that way. . . . Thus, Plaintiff plausibly claims that the Defendants breached their fiduciary duty to Plan participants by making a choice that put the employer's interests above the interests of the Plan participants.

On that same basis, by alleging that Qualcomm had acted against the best interest of participant, the Court also concluded that Plaintiff had articulated a plausible claim of imprudence.

The Court then found that Plaintiff had plausibly alleged violations of ERISA § 403(c)(1) (ERISA's anti-inurement section). In so doing, the Court rejected Qualcomm's argument that forfeited nonvested pension contributions could be analogized to mistaken contributions under 403(c)(2)(A) (ii). Interestingly, at the same time, the Court left open for further consideration the issue of whether nonvested forfeited contributions are plan "assets" altogether:

Plaintiff contends that nonvested forfeited contributions are to be considered plan "assets." Plaintiff has not cited a case and this Court has not found one. ERISA does not define "assets." Consequently, whether nonvested forfeited contributions fall within the definition of "assets" is still an open question.

On this topic, the 16-page decision notes - in several places - the lack of regulatory and precedential guidance with regard to whether employer contributions, vested or not, are plan assets. Even so, it does seem this Court is ready to conclude that nonvested amounts are, in fact, plan assets:

Using the functional approach required by Acosta, it is easy to come to the conclusion that nonvested employer contributions may not be used to benefit the employer / fiduciary by reducing its own financial burden to make contributions in the future when done at the expense of not defraying the administrative costs borne by participants and beneficiaries. Nonvested contributions fall within the functional definition of assets of the pension plan.

The Court also denied Qualcomm's motion to dismiss Plaintiff's 406(a)(1)(A) & (D) and 406(b) claims. In so doing, the Court observed that "neither side has identified a court decision that adopts their interpretation of § 1106, and this Court has found none" and that "[a] plausible § 1106(b) violation is the easier claim for relief for Plaintiff to make based on a plain reading of the statute" (apparently because the self-dealing nature of Qualcomm's alleged misconduct appears straightforward to the Court).

Qualcomm's final argument - based on Treasury's proposed language that would give plans the choice of using

forfeited contributions to fund an employer's future contributions (88 FR 12282-01, Feb. 27, 2023) - was also rejected by the Court.

The proposed regulation has not yet been adopted. And it is noteworthy that the regulation is proposed by the Secretary of the Treasury rather than the Secretary of the Department of Labor. ERISA specifies that it is the Secretary of Labor who has authority to define what are assets of a pension plan. If adopted, the rule would certainly mean favorable tax treatment by the Internal Revenue Service of plan actions taken by fiduciaries in Defendants' shoes. But the rule has not yet been adopted and has no force of law. What persuasive value it does have is not sufficient to persuade this Court that Plaintiff's claim is implausible.

As a result of the Court's decision, none of the claims in Plaintiff's action were dismissed. Presumably, the case will now proceed with discovery and other procedural matters (such as class certification).

Thoughts:

This ruling is a big win, not only for the Plaintiff in the *Qualcomm* case, but also for the plaintiffs in the other recently filed forfeiture actions as well. At this time, copies of the ruling have been filed in four other forfeiture cases in which motions to dismiss are currently pending including (a) *Dimou v. Thermo Fisher Scientific Inc., et al.*, 23-cv-1732 (S.D. Cal.); (b) *McManus v. The Clorox Company*, 23-cv-5325

(N.D. Cal.); (c) *Rodriguez v. Intuit Inc., et al.*, 23-cv-5053 (N.D. Cal.); (d) *Hutchins v. Hp Inc., et al.*, 23-cv-5875 (N.D. Cal.). And, of course, plaintiff's win is likely to encourage the filing of additional forfeiture lawsuits as well.

While the forfeiture cases, including *Qualcomm*, likely have far to go before they reach a final resolution, the court's ruling should serve as signal for plan sponsors to review the forfeiture provisions of their defined contribution plans to determine what, if any, actions might be advisable to reduce the risk of litigation. For example, consideration should be given to whether fiduciary decisions relating to forfeitures could be seen as relieving the employer of an obligation to the plan or as imposing additional costs on participants and whether any particular action should be taken now that might mitigate litigation risks going forward. Plan sponsors and relevant fiduciaries should also be aware that decisions on pending motions to dismiss in other cases challenging the allocation of forfeitures may provide additional guidance on these issues. Note, however, that decisions in these cases challenging the allocation of forfeitures will likely have no effect on the tax qualified status of the plan.

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