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The Sting: ERISA Fee Litigation Harms Participants, Stymies Innovation

The explosion in 401(k) fee litigation – well over 200 lawsuits have been filed since 2019, according to Bloomberg Law – harms plan participants and retirement savings while generating huge paydays for lawyers. The cause is federal judges refusing to throw out class action suits built on nothing more than hindsight and conjecture.

The formula for the class action gold rush is simple and easily duplicated.

First, would-be counsel mines readily available 401(k) and other defined contribution plan databases for plans with decent-sized assets and participant headcounts that have not yet been sued.

Once a target has been selected, it is short work, with hindsight, to find which investments have underperformed or had higher fees than its "peers" and create an apples to oranges comparison showing that the target's recordkeeping fees were high.

Finally, after finding a couple of disgruntled employees or former employees to serve as class representatives, file a federal action alleging that the plan sponsor breached its ERISA fiduciary duties to pay reasonable fees and select prudent investments.

If, as happens all too often, the court allows the lawsuit to proceed without anything more than Monday morning quarterbacking, chances are the employer will settle. Settling is less expensive than winning in court.

While great for the lawyers on both sides and the class representatives (receiving $10,000 to $20,000 for "renting" their ERISA status to class counsel), the same cannot be said for the average plan participants who may have only a few hundred dollars added to their 401(k) accounts. Too small for many to even notice, let alone affect their retirement finances.

THE REAL VICTIMS

While employers and their liability insurers pay for these settlements, the real victims are plan participants and retirement programs. The pervasive threat of litigation stymies program innovation. Before adding creative financial education, plain English communication, autopilot features, lifetime income alternatives, emergency savings or different investment approaches, employers and plan service providers have to consider the likelihood of a lawsuit as "reward" for trying a new approach to improve retirement outcomes. It is far safer to do

nothing extra than experiment with alternatives that might not work out, increase plan costs or be difficult to defend in court.

Business will innovate to the boundary that regulation allows. 401(k) ERISA fee litigation is regulation by class action extortion, hindering innovation and discouraging employers from improving (or even adopting) retirement plans.

Of course, not every plan is properly run and some employers do skirt or are ignorant of their ERISA fiduciary duties. Indeed, a fiduciary unthinkingly choosing inappropriate investments or a high-fee poorly performing service recordkeeper without regard to the level of services should face an ERISA action.

Courts that set a low bar to allowing ERISA class actions to proceed abdicate their responsibilities.

Instead, courts should require plaintiffs to objectively demonstrate a colorable fiduciary violation before allowing a case to proceed. This includes apples to apples evidence that the fees (based on service quality, levels and plan characteristics) or investments were overpriced or of poor quality.

Judges should recognize that, in any given year, only one investment fund can be number one and low fees can be expensive (due to poor performance/services).

HUGHES

Part of the problem with judicial inaction is due to a misreading of the recent Supreme Court ruling in Hughes v. Northwestern. Hughes correctly held that a fiduciary cannot escape responsibility from offering an imprudent investment by also offering good investments. However, a number of district and circuit courts have been using Hughes as an excuse to allow even weakest (spurious) suits to proceed.

But not in the U.S. Court of Appeals for the Sixth Circuit, where the courts have begun to toss ERISA fee complaints unless plaintiffs show some solid, fact-based allegations of wrongdoing. Other circuits should consider the harm to retirement outcomes before rubberstamping ERISA fee litigation.

An additional way to discourage unmerited class actions is to impose ERISA's reasonable fee rules on plaintiffs' lawyers. When an attorney takes a percentage of the settlement, the money comes from the plan participants' pockets. This fee should be scrutinized for reasonableness like any other fee that the plan or participants pay. When the lawyers make millions and the participants hundreds, I question whether these fees are reasonable. Fees of 5 to 10% of the settlement would be more in line to the value added.

Further, courts should use their ERISA authority to require a class action lawyer bringing a specious suit to pay the employer's costs in defending.

ERISA does not mandate a particular investment lineup or record-keeper or set maximum fees for good reason. To encourage innovation and allow fiduciaries to determine what is best for their participants, courts should allow each plan to set its own course.

Until fiduciaries develop prophetic superpowers, courts should use their authority to prevent the harm caused by unwarranted litigation.

The views set forth herein are the personal views of the author and do not necessarily reflect those of the law firm with which he is associated.

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Superseding Cause Under ERISA

By Barry L. Salkin

In this article, the author discusses the superseding cause doctrine, and examines whether the doctrine applies under the Employee Retirement Income Security Act.

The doctrine of superseding[1] cause, defined under Section 440 of the Restatement (Second) Torts as an act of a third person or other force which by its intervention prevents the actor from being liable for harm to another which his antecedent negligence is a substantial factor in bringing about,"[2] is related to the common law concept of proximate cause.[3] Proximate cause has been defined as "a cause that produces a result in a natural and probable sequence and without which the result would not have occurred. Such cause need not be the only cause of a result. It may act in combination with other causes to produce a result."[4]

In Ruiz v. Victory Properties, LLC, the Connecticut Supreme Court[5] stated that "the legal construct of proximate cause serves to establish how far down the causal continuum tortfeasors will be held liable for the consequences of their actions. The test for proximate cause is whether the defendant's conduct was a substantial factor in producing the plaintiff's injury. This substantial factor test reflects the inquiry fundamental to all proximate cause questions, namely, whether the harm [that] occurred was of the same general nature as the foreseeable[6] risk created by defendant's negligence."

The doctrine of superseding cause is, "at its core, a legal construct that serves as a limitation on liability."[7] As the Supreme Court stated in Exxon Co., USA v. Sofec, Inc., "Superseding cause operates to cut off the liability of an admittedly negligent defendant, and there is properly no apportionment of comparative fault where there is an absence of proximate causation."[8]

In Berry v. Quality Steel Products, Inc., the Connecticut Supreme Court explained that "the function of the doctrine [of superseding cause] is to define the circumstances under which responsibility may be shifted entirely from the shoulders of one person who is determined

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to be negligent to the shoulders of another person, who may also be determined to be [culpable], or to some other force.

Thus, the doctrine of superseding cause serves as a device by which one admittedly negligent party can, by identifying another's superseding conduct, exonerate himself from liability by shifting the causation element entirely elsewhere. If a third person's culpability is found to be the superseding cause of the plaintiff's injuries, that [culpability], rather than the negligence of the party attempting to invoke the doctrine of superseding cause, is said to be the sole proximate cause of the injury."[9] That is, as a matter of policy,[10] a superseding cause is an intervening action or force that shields from liability even a defendant whose own negligence was a substantial factor in bringing about a plaintiff's harm.[11]

In elaboration of the foregoing, Section 442B of Restatement (Second) of Torts provides that "if the negligent conduct of the actor creates or increases the risk of a particular harm and is a substantial factor in causing that harm, the fact that the harm is brought about through the intervention of another force does not relieve the actor of liability, except where the harm is intentionally caused by a third party and is not within the scope of the risk created by the actor's conduct."[12]

The Restatement lists factors to consider in determining whether an intervening force[13] is a superseding cause of harm to another:

(a) The fact that its intervention brings about harm different in kind[14] from that which otherwise would have resulted from the actor's negligence;

(b) The fact that its operation or the consequences thereof appear after the event to be extraordinary rather than normal in view of the circumstances existing at the time of its operation;

(c) The fact that the intervening force is operating independently of any situation created by the actor's negligence[15] or, on the other hand, is or is not a normal result of such a situation;

(d) The fact that the operation of the intervening force is due to a third person's act or to his failure to act;

(e) The fact that the intervening force is due to an act of a third person which is wrongful towards the other and as such subjects the third person to liability to him; and

(f) the degree of culpability of a wrongful act of a third person which sets the intervening force in motion.

Comment (c) of Section 442B, which makes reference to both intentional torts and criminal acts by third person, provides in relevant part that Section 442B "does not apply where the harm of which the risk has been created or increased by the actor's conduct is brought about by the intervening act of a third person which is intentionally tortious or criminal, and is not within the scope of the risk created by the original negligence. Such tortious or criminal acts may in themselves be foreseeable, and so within the scope of the created risk, in which case the actor may still be liable for the harm, under the rules stated in 448 and 449. But if they are not, the actor is relieved of responsibility by the intervention of the third person."

Section 448 of Restatement (Second) of Torts provides: "The act of a third person in committing an intentional tort or crime is a superseding cause of harm to another resulting therefrom, although the actor's negligent conduct created an opportunity to the third person to commit such a tort or crime, unless the actor at the time of his negligent conduct realized or should have realized the likelihood that such a situation might be created, and that a third person might avail himself of the opportunity to commit such a tort or crime."

Finally, Section 449 of the Restatement (Second) provides that "If the likelihood that a third person may act in a particular manner is the hazard or one of the hazards that makes the actor negligent, such an act, whether innocent, negligent, intentionally tortious, or criminal does not prevent the actor from being liable for harm caused thereby."

Thus, when harm results from the intentional tortious or criminal conduct of a third party, a defendant is liable only if the risk created by the defendant's negligence included the hazard that that the defendant's conduct would induce a third party to commit such an act.[16]

In such instances, the liability of a defendant depends on the foreseeability of the third party's criminal misconduct.[17] In any case in which there might be a reasonable difference of opinion s to the foreseeability of a particular risk or the reasonableness of the defendant's conduct with respect to it, the question is for the jury.[18]

Expressed more precisely, even if the risk of a third party's intervention is a generally foreseeable consequence of a defendant's action, it is a question of fact whether the third party's intervening action fell somewhere within the risk created by defendant's negligence (i.e., within the scope of that risk). In most instances, this will be a factual matter for a jury.[19] However, if the jury determines that the superseding action that occurs falls outside of the risk of third party intervention created by the defendant's negligence, the otherwise negligent defendant will have no liability.

THE SUPERSEDING CASE DOCTRINE UNDER THE EMPLOYEE RETIREMENT INCOME SECURITY ACT (ERISA)

Two ERISA cases discuss the superseding cause doctrine, but neither case resolves the issue as to whether the doctrine of superseding cause applies under ERISA.

In Hunt v. Magnell,[20] a Minnesota district court assumed without deciding that the superseding cause doctrine would apply under ERISA, but nonetheless denied defendant's motion to dismiss, because of the existence of genuine issues of material fact.

The second case, In Re State Street Bank and Trust Co. Fixed Income Funds Investment Litigation.[21] arose out of the subprime mortgage crisis. In that case, State Street Bank, as defendant, sought to apply the six relevant factors in determining if there was a superseding case. The district court concluded that one of the factors was clearly satisfied, and another was arguably satisfied, but concluded that satisfying two of the six factors cited in Restatement (Second) of Torts 442 was insufficient to grant State Street's motion for summary judgment.

The district court also held that State Street Bank was misapplying the superseding cause doctrine, using it to seek to reduce its damages rather than to absolve itself from liability, which was the purpose of the superseding cause doctrine.

AN INTERESTING CLOSELY RELATED NON-ERISA CASE

While Strick v. United Retirement Plan Consultants, Inc.[22] dealt with claims of professional negligence and breach of contract,[23] rather than breach of fiduciary duty under ERISA, the case involved the termination of a tax-qualified plan and also dealt with the issue de jure, a cybersecurity breach, a criminal action which presents the superseding cause issue most starkly.

Defendant's causes of actions stemmed from defendant's failure to complete the plan termination and distribute plan assets within the standard IRS time frame for distribution of plan assets upon plan termination.[24]

Plaintiff's theory of the case was that the delay in effectuating the distribution made the plan more vulnerable to cybersecurity threats. There were no allegations that the defendant's procedures were inadequate in any way, which differentiates this case from most of the cybersecurity breach cases filed to date, and the service provider's actions, other than the delay in distributing assets, was totally unrelated to the action that caused the plan's loss.

Rather, the plan sponsor, believing that he was speaking with one of defendant's employees, wired $154,928 from the plan to a criminal actor. In response, defendants asserted that even if plaintiffs could prove that defendant's negligence was a cause in fact of the theft from the plan, defendant could not be held liable if the criminal actors were the superseding cause of the injury.

Citing precedent from the U.S. Court of Appeals for the Ninth Circuit, the district court explained that a superseding cause is a later cause of independent origin that prevents an actor from being liable for harm caused by that actor's negligence.[25] As the Supreme Court has stated, "Superseding cause operates to cut off the liability of an admittedly negligent defendant, and there is properly no apportionment of comparative fault, where there is an absence of proximate causation."[26] A superseding cause is more than a subsequent act in the chain of causation, but rather must be "an act that was not reasonably foreseeable at the time of defendant's negligent conduct."[27] An act is not reasonably foreseeable if when "looking at the matter with hindsight, it seems extraordinary."[28]

The California district court then discussed California law with respect to the superseding cause doctrine in the context of an intentional tort or crime: "The act of a third person in committing an intentional tort or crime is a superseding cause of harm to another resulting therefrom, although the actor's negligent conduct created a situation which afforded an opportunity to the first person to commit such a tort or crime, unless the actor at the time of his negligent conduct realized or should have realized the likelihood that such a situation might be created, and that a third person might avail himself of the opportunity to commit such a tort or crime."[29]

In response, plaintiff alleged that "given the prevalence of cybercrimes, the compromise of electronic data, spoofing, hacking, and the like, a jury can reasonably conclude the likelihood of a bad actor to impose himself into the exchange was foreseeable."[30]

However, the district court was unpersuaded, because plaintiffs provided no evidence that the criminal act was not highly unusual, extraordinary, and unreasonably likely to happen. The district court's analysis may have been correct, although in general the issue of foreseeability is a question for the jury.[31]

Rhode Island Laborers Health & Welfare Fund v. Phillip Morris[32] is a RICO[33] case rather than an ERISA case, also discusses the superseding cause concept in the employee benefits context.

In that case, the plaintiff alleged that because of defendant's fraudulent misrepresentations about and concealment of the health related risks of using tobacco and an agreement among defendants to forego the development of safer tobacco products, the plaintiff fund was unable to curtail the effect or use of tobacco participants, resulting in

vast expenditures on tobacco related illnesses that could have been avoided if defendants had been honest and forthright about the information that they possessed.

Defendants' response was to be anticipated. Whatever injury the plaintiff fund may have incurred was purely derivative of the physical injuries sustained by participants in the Fund, and was therefore an indirect injury and too remote to allow recovery.

The counter argument of the Fund was that because of the intentional nature of the alleged misconduct by the defendants, and because the actions and injuries of the individual smokers was foreseeable and their addiction intended, the smokers themselves, while perhaps an intervening force, should not break the chain of causation between defendant's misconduct and the injury of the plaintiff fund.

However, the district court did not address that issue, because the number of contingencies that would have to be realized before the plaintiff fund could suffer any injury involved both speculation and conjecture. Therefore, the plaintiff fund could not establish that defendant's misconduct was the proximate cause of its injury.

CONCLUSION

While some causation issues under ERISA are frequently litigated, such as which party has the burden of proof in establishing that a breach of fiduciary duty has or has not occurred once plaintiff has established a prima facie case, other issues, such as the type of causation required under ERISA Section 409, are infrequently discussed.

However, with the increase in cybersecurity incidents directed towards tax-qualified plans, and likely to affect other types of benefits plans as well, it is likely that these issues will be increasingly litigated.

NOTES

1. A practice note for attorneys doing online research on this subject: while most cases use the word superseding, some courts employ the word superceding.

2. Page 465 (1965).

3. Exxon Co., USA v. Sofec, Inc., 517 U.S. 830, 836-839 (1996). Although Exxon v. Sofec was a case in admiralty, its holding regarding the proximate cause doctrine has been applied in other contexts. See Staub v. Proctor Hospital, 562 U.S. 411, 131 S. Ct. (2011). In In Re State Street Bank and Trust Co. Fixed Income Funds Investment Litigation, 772 F. Supp. 2d 519 (S.D.N.Y. 2011), fn. 11, the U.S. District Court for the Southern District of New York stated that it is possible that the doctrine of superseding cause is incorporated in a causation standard that does not fully import the tort law idea of proximate causation, but because the district court denied summary judgment

even assuming that proximate cause was the applicable standard and further because defendant did not raise the issue, resolution of that issue was not necessary. As a procedural matter, while superseding cause may be pled as an affirmative defense, there is no obligation to do so.

4. Howard v. Bennett, 894 N.W. 2d. 391, 395 (S.D. 2017), quoting Hamilton v. Sommers, 855 N.W. 2d 855, 867 (S.D. 2014).

5. 315 Conn. 320, 107 A. 3d 381 (2015).

6. As the Supreme Court stated in Exxon, "a cause can be thought of as 'superseding' only if it was a cause of independent origin and not foreseeable."

7. Snell v. Norwalk Yellow Cab, Inc., 212 A. 3d 646 (Conn. 2019).

8. 517 U.S. 830, 836 (1996).

9. 263 Conn. 434-435. See also Braun v. New Hope Township, 646 N.W. 2d 737,740 (S.D. 2002) ("When the natural and continuous sequence of causal connection between the negligent conduct and the.injury is interrupted by a new and independent cause, which itself produces the injury, that intervening cause operates to relieve the original wrongdoer of liability."

10. Kwahl v. Hoffer, 181 Conn 355, 360 (1980) ("Policy considerations generally underlie the doctrine of proximate cause.").

11. Exxon, supra, n.2 ("The doctrine of superseding cause is . . . applied where the defendant's negligence in fact substantially contributed to the plaintiff's injury, but the injury was actually brought about by a later cause of independent origin that was not foreseeable.").

12. Page 469 (1965).

13. Restatement (Second) of Torts 441 defines an intervening force as "one which actively operates in producing harm to another after the actor's negligent act or omission has been committed."

14. In some extreme cases, a difference in degree can amount to a difference in kind. Restatement (Second) of Torts, 451, comment a compares "expectable winds" and an "extraordinary cyclone."

15. The words "situation created by the actor's negligence" are used to denote the fact that that the actor's negligent conduct is a substantial factor in bringing about the situation and that therefore the actor would be liable for creating the situation if the situation were in itself a legal injury.

16. Snell v. Norwalk Yellow Cab, Inc., 212 A. 3d 646, 670 (Conn. 2019).

17. Id. See also Santaiti v. Town of Ramapo, 162 A. 3d 921, 927 (N.Y. App. Ct.) ("Although an intervening intentional or criminal act will generally sever the liability of the original tort-feasor," this principle "has no application when the intentional or criminal intervention of a third party or parties is reasonably foreseeable."); Small v. McKennan Hospital, 437 N.W. 2d. 194, 202 (S.D. 1989); Wallinga v. Johnson, 131 N.W. 2d 216 (Minn. 1964); Water Works Board of the City of Birmingham v. US Bank National Association, 2020 WL 3077147 (D. S.D. June 10, 2020).

18. Howard v. Bennett, 894 N.W. 2d 391,395 (S.D. 2017).

19. See, for example, Holmes v. Wegman Oil Co., 492 N.W. 2d 107, 114 (S.D. 1992).

20. 758 F. Supp. 1292, 1300 (D.Minn. 1991) Defendants had alleged that plaintiff's negligence and fraudulent activity by one of the principals in the investment that had generated the losses was a superseding cause absolving it from responsibility.

21. 772 F. Supp. 2d 519 (S.D.N.Y. 2011).

22. 2018 WL 6004529 (C.D. Cal. July 13, 2018).

23. The motion to dismiss for breach of contract was denied, but the contract issue is not related to the superseding cause issue and is not further discussed.

24. Rev. Rul. 89-87, 89-2 C.B. 81 indicates that assets should be distribute as soon as administratively feasible after plan termination, which period should generally not exceed 12 months. See also Retirement Plan FAQs Regarding Plan Termination.

25. Farr v. NC Machinery Co., 186 F. 3d 1165, 1168-69 (9th Cir. 1999). Section 440 of Restatement (Second) of Torts defines superseding cause as "an act of a third person or other force which by its intervention prevents the actor from being liable for harm to another which his antecedent negligence is a substantial factor in bringing about." The Restatement (Third) of Torts, Section 34, rejects the concept of superseding cause as a separate doctrine, and treats the remote actor issue as no different than other tort causation issues. It is possible that, at least in the noncriminal or intentional tort context, future courts presented with a potential superseding cause issue will look to Restatement (Third) rather than Restatement (Second).

26. Exxon Co. US v. Sofec, Inc., supra, n.2.

27. US Air v. US Dept. of the Navy, 14 F. 3d 1410, 1413 (9th Cir. 1994).

28. United States v. Pineta-Doval, 614 F. 3d 1019, 1029 (9th Cir. 2020).

29. Kane v. Hartford Accident & Indemnity Co., 98 Cal. App. 3d 350,360 (1979), quoting Restatement (Second) of Torts Section 448.

30. 2018 WL 60045299 pg 4. See Koepke v. Loo, 18 Cal. App. 4th 1444, 1449 (1991) ("If the likelihood that a third party may act in a particular manner is the hazard or one of the hazards which makes the party negligent, such an act, whether innocent, negligent, intentionally tortious or criminal, does not prevent the actor from being liable for the harm caused thereby.").

31. Lombardo v. Huysentryst, 91 Cal. App. 4th 656, 666 (2001). Cf. Buse v. The Vanguard Group of Investment Companies, 1996 WL 369007 (E.D. 2007); (applying Indiana law); Waterworks Board of the City of Birmingham v. US Bank National Association, 2020 WL 3077147 (D.S.D. June 10, 2020).

32. 99 F. Supp 2d. 174 (D.R.I. 2000).

33. Racketeer Influenced and Corrupt Organizations Act.