



Fiduciary Update | August 2023

Delegated Investment Managers: Challenges Yield Mixed Results

Delegated 401(k) investments have been an infrequent target of litigation. This quarter, we saw three cases in that area. In delegated situations, plan fiduciaries retain an investment advisor as an investment manager to implement a plan's investment policy statement and make individual investment decisions as a fiduciary to the plan. Plan sponsor fiduciaries are responsible for monitoring the delegated investment manager.

- **\$124.6 million fiduciary liability.** A global outsourcing firm had a retirement plan with separate participant-directed 401(k) and profit-sharing components. Total plan assets were more than \$1 billion, and the profit-sharing side held about half of the total. The plan's fiduciaries were responsible for investing the profit-sharing assets and retained a delegated investment manager to manage those assets. The plan sponsor fiduciaries authorized the investment manager to use its non-diversification strategy for 100 percent of the profit-sharing assets, which it did. This was in direct conflict with ERISA's clear mandate that "fiduciaries shall diversify the investments of the plan so as to minimize the risk of large losses." At one point, more than 45 percent of the profit-sharing component's assets were held in the stock of a single company: Valeant Pharmaceuticals. In a six-week period, the Valeant stock lost 61 percent of its value.

The U.S. Department of Labor (DOL) investigated and sued the investment manager and the other plan fiduciaries. *Scalia v. Ruane, Cunniff & Goldfarb* (S.D. NY filed Oct. 2019). The investment manager was sued for failing to diversify the profit-sharing investments to minimize the risk of large losses, as mandated by ERISA. The other plan fiduciaries, including the



individual committee members, were sued for failing to properly monitor the investment manager's activities, including its non-diversified approach. The case was recently settled for \$124.6 million. Allocation of the settlement liability among the fiduciaries has not been disclosed.

This case is a reminder that in delegated situations, plan fiduciaries must monitor the work of their discretionary investment managers and be aware of how they are investing plan assets and meeting ERISA investment standards.

- *\$9.5 million fiduciary settlement.* A pharmaceutical company retained a delegated investment manager to manage the investments in its 401(k) plan. Early in its work, the investment manager moved most of the plan's investments into its proprietary collective trust investments. Approximately four years later, plan participants sued the investment manager, alleging that it acted in its own interests rather than for the plan's participants and beneficiaries. The investment manager denied these allegations. The other plan fiduciaries, including committee members, were sued for permitting the investment manager to use only its proprietary collective trust investments, which had a short performance history. They were also sued for paying excessive investment expenses.

Soon before trial, the case was settled for \$9.5 million. *Miller v. Astellas US LLC* (N.D. Ill. filed July 2020).

- *Plan fiduciaries settle for \$12.5 million—Delegated investment manager wins.* A suit with allegations similar to *Miller v. Astellas* was filed against Lowe's Home Improvement and its delegated investment manager. The Lowe's fiduciaries settled for \$12.5 million after three years of litigation. The suit against the delegated investment manager proceeded to trial, and the investment manager won. The decision was upheld on appeal. *Reetz v. Aon Hewitt Investment Consulting, Inc.* (4th Cir. 2023).

ESG Cases Begin

Plan participants sued American Airlines for including funds that advance environmental, social, and governance (ESG) causes in their 401(k) plans. The complaint broadly alleges that ESG funds violate ERISA because they support objectives other than plan participants' financial security in retirement. However, it does not provide specifics. It also alleges that many of the socially responsible funds offered are more expensive than—and underperform—non-ESG funds.

The complaint identifies 25 ESG funds as being in the American Airlines plans. This seems unlikely unless the plaintiffs have included ESG funds available in the plan's self-directed brokerage account. From a recent Form 5500 for the American Airlines 401(k) plans, it is not apparent that any of the ESG funds identified are in the plans. It is generally accepted that plan fiduciaries are not responsible for the investments offered in properly structured self-directed brokerage programs. *Spence v. American Airlines* (N.D. Tex. filed June 2023). It will be interesting to see if the court addresses the availability of ESG investments in self-directed brokerage programs.

This suit is filed against the regulatory backdrop of frequently changing standards announced by the DOL for the use of ESG investments in retirement plans. Although the DOL's position has varied, the underlying ERISA requirement that plan fiduciaries act exclusively in the best interests of participants and beneficiaries in their plans has not changed since its adoption in 1974.

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, with one new twist. Here are a few updates.

In the last quarter, at least 15 court decisions were issued on motions to resolve fees lawsuits. Some cases were decided in fiduciaries' favor, and others will proceed.

Here are three notable recent cases:

- In the first case of this type to be decided by a jury, the plan fiduciaries won—or at least they had no liability. Fiduciaries of Yale University's 403(b) plan were sued for mismanagement of the plan, including overpaying administration fees, retaining expensive and poor performing investments, and offering too many investments. The jury found that the plan fiduciaries breached their duty of prudence by allowing unreasonable fees to be charged, and that their actions resulted in a loss to the plan. However, they also found that prudent fiduciaries could have made the same decisions. In the end, the jury found that no losses were proved by the plaintiffs. The fiduciary won outright on the investment issues. *Vellali v. Yale University* (D. CT 2023)
- A second case includes the now-familiar claims of overpayment for recordkeeping and investment fees. It goes on to allege that, by using revenue sharing to pay for plan recordkeeping, the fiduciaries discriminated against plan participants who invested in funds that produced revenue sharing. Investors in the revenue-sharing funds are effectively paying the recordkeeping fees of participants in the non-revenue sharing funds. To date, we have not seen a court rule on this issue. *Zimmerman v. Cedars-Sinai Medical Center* (C.D. Cal. filed June 2023).
- Another of the suits challenging the use of BlackRock's LifePath target-date funds has been dismissed. The judge held that a meaningful benchmark was not provided in the complaint. The



LifePath funds are index funds that become more conservative up to retirement, but not through or past retirement. Two of the four comparison funds were actively managed, and although the other two were indexed, they continued to become more conservative through retirement. The judge concluded that, “the complaint fails to take a claim of fiduciary duty violation from the realm of ‘possibility’ to ‘plausibility.’” *Lockett v. Wintrust Financial Corp.* (N.D. Ill. 2023).

Plan Sponsors Have Wide Discretion in Severance Plan Design

After layoffs at Northrop Grumman, some employees received severance benefits, and others did not. Disappointed, laid-off employees sued. The Northrop Grumman severance plan provides that those who work at least 20 hours per week are eligible for benefits if they receive a personally addressed memo from a vice president of Human Resources. The employees who did not receive severance benefits had not received a required memo. They contended that the memo requirement was only a ministerial act confirming the eligibility of those regularly scheduled to work at least 20 hours a week.

The district court found in favor of the company, noting that the plan document gives the human resources department discretion to decide who, if anyone, receives severance benefits, as ERISA permits. The disappointed former employees appealed. The appellate court affirmed the decision in favor of Northrop Grumman. The court pointed out that the design of a plan, which may include discretion, is not a fiduciary function. But administering a plan according to its terms is a fiduciary function. As the judge said, “A plan sponsor always may, indeed always *must*, apply a pension or welfare plan as written.” *Carlson v. Northrop Grumman Severance Plan* (7th Cir. 2023).

Health Plan Fiduciary Claims Ramping Up

We have been reporting on the veritable avalanche of 401(k) and 403(b) plan fee-related cases for years. So far, there have been few cases alleging fiduciary breaches in connection with health plans. That appears to be changing.

The Schlichter law firm, which filed the first group of 401(k) fees lawsuits in 2007 and 2008, has been using social media to identify “current employees who have participated in healthcare plans” at Target, State Farm, Nordstrom, and PetSmart. The Consolidated Appropriations Act of 2021 and newly issued regulations with transparency requirements for health plans appear to be the foundation for potential claims.

There is also an increasing number of claims by plan sponsors against third-party administrators (TPAs). For instance, Kraft Heinz has sued its TPA under ERISA for improperly overpaying claims and failing to turn over plan data in connection with processing claims, among other things. *Kraft Heinz Company Employee Benefits Board v. Aetna Life Insurance Company* (E.D. Tex. filed June 2023).



These pages will not include detailed reporting on fiduciary issues in the health space. Plan sponsors and fiduciaries are encouraged to consult with their healthcare advisors.