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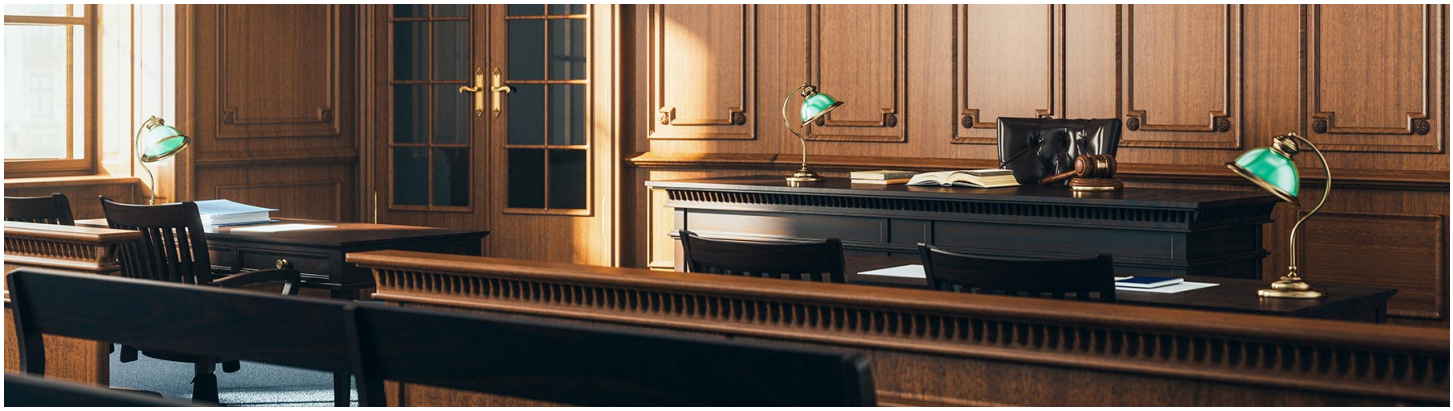

Fiduciary Update | May 2025

Supreme Court Opens Doors to More Litigation—Increased Defense Costs and More Settlements Likely

The Supreme Court has issued a decision that will make virtually all retirement plan fiduciaries subject to being sued for committing a prohibited transaction (PT). The Employee Retirement Income Security Act (ERISA) provides a host of prohibited transaction exemptions (PTEs) that permit plan fiduciaries who have acted properly to avoid liability. However, to avoid liability, litigation must get underway and plan fiduciaries must establish that an exemption applies. There will be no quick resolutions of these cases with motions to dismiss. *Cunningham v. Cornell University* (S. Ct. 4.17.25).

The course that any litigation may take—and what may be exposed—is unpredictable. The *Cornell* decision makes it more important than ever that plan fiduciaries have and follow a thorough governance and documentation process.

ERISA's definition of a PT is sweeping, including most business transactions that retirement plans engage in as part of their necessary operations. This includes services as basic and essential as 401(k) plan recordkeeping. An extensive list of PTEs permits these necessary services. The issue in *Cornell* was whether a PT claim must initially allege that no exemptions apply or, alternatively, whether fiduciaries are required to prove that an exemption does apply. Under this decision, once a PT claim is made, the burden is on plan fiduciaries to prove that an exemption applies.

For context, a PT is any transaction between a plan and a party in interest. Parties in interest include those that would likely have a conflict of interest if hired by a plan, such as plan fiduciaries and their family members. The idea is that agreements with retirement plans should be arm's-length situations and not insider deals. The party-in-interest definition also includes all plan "service providers." The current consensus among commentators appears to be that paying a plan service provider with plan assets is a PT.

The Supreme Court did not consider the fair-dealing purposes of the law. Rather, its unanimous decision focused on the structure of how the law is written. ERISA first establishes the broad rule against PTs, and then, in a separate section, creates exceptions to the rule.

Applying rules for interpreting laws, the Court reasoned that by being in a separate section of the law, PT exceptions are "affirmative defenses" and must be raised and proved by the plan fiduciaries accused of a PT. The opinion noted that the Court must "read the law the way Congress wrote it."

Placing the responsibility for raising PT exemptions on fiduciaries dramatically lowers the bar for plaintiffs to make PT claims that will survive motions to dismiss. A concurring opinion in *Cornell* observes that all a plaintiff must do to file a complaint that will survive a motion to dismiss is allege that the plan fiduciaries did something that, "as a practical matter, [they] are bound to do." It went on to observe, "In modern civil litigation, getting by a motion to dismiss is often the whole ball game because of the cost of [litigation]."

The Court acknowledged the likely surge of litigation that will flow from its decision and provided coaching to lower courts on judicial management processes that may help to short-circuit meritless claims.

Supreme Court Seeks Executive Branch Input on Who Must Prove Loss Causation in Fiduciary Breach Cases

In *Pizarro v. Home Depot, Inc.* (11th Cir. 2024), the court of appeals decided that, in fiduciary breach suits, the plaintiffs must prove there was a loss and that the loss was caused by the offending plan fiduciaries. The Home Depot plan fiduciaries allegedly paid excessive fees for investment advice to plan participants and retained underperforming funds. However, the plaintiffs failed to show that the alleged fiduciary breaches caused a financial loss, and the case was decided in favor of the plan's fiduciaries. The U.S. Court of Appeals for the 11th Circuit affirmed. The 10th Circuit has taken the same position: that plaintiffs are responsible for proving a loss. Other appellate courts—the 1st, 4th, 5th, and 8th Circuits—have held that fiduciaries must prove their actions did not cause a loss.

The disappointed plaintiffs in the *Home Depot* case have asked the Supreme Court to accept an appeal of the 11th Circuit's decision and resolve the conflicting decisions on the issue among the circuit courts. *Pizarro v. Home Depot, Inc.* (S. Ct., Pet. for Cert. filed 12.3.24).

Unlike other appellate courts, the U.S. Supreme Court generally decides which cases it will hear. The Court has not decided whether it will accept the appeal. However, indicating its interest in the case, it has asked the solicitor general to "express the views of the United States" on the issue. In the *Home Depot* circuit court appeal, the Department of Labor (DOL), under the Biden Administration, supported requiring fiduciaries to prove that their actions did not cause a loss.

Executive Action: No Retirement Plan Investments Allowed in "Foreign Adversary Companies"

On February 21, 2025, President Trump issued a presidential action titled “America First Investment Policy.” It is quite broad. With respect to retirement plans, it says, “To protect the savings of United States investors and channel them into American growth and prosperity, my Administration will […] restore the highest fiduciary standard required by the Employee Retirement Income Security Act of 1974, seeking to ensure that foreign adversary companies are ineligible for pension contributions.”

It then directs the Secretary of Labor to “publish updated fiduciary standards under the Employee Retirement Income Security Act of 1974 for the investment in public market securities of foreign adversary companies.”

The following are identified as “foreign adversaries.”

- The People’s Republic of China, including the Hong Kong Special Administrative Region and the Macau Special Administrative Region
- The Republic of Cuba
- The Islamic Republic of Iran
- The Democratic People’s Republic of Korea
- The Russian Federation
- The Regime of Venezuelan Politician Nicholás Maduro

A definition is not provided for “foreign adversary companies.”

Also, there is no deadline for action by the secretary of labor. Legislation intended to prevent ERISA-covered retirement plans from investing in foreign adversary companies has been introduced in both the House of Representatives and the Senate. We will continue to monitor developments.

DOL Adopts New Process for Self-Correction of Late Contributions

One of the most frequent errors among retirement plans is the late deposit of participant 401(k) contributions. Generally, 401(k) contributions must be deposited with the recordkeeper no later than income tax withholding is due to be deposited with the federal government. When a late deposit happens, the deposit must be made (with lost earnings) and the appropriate excise taxes paid along with an IRS Form 5330 filing.

In the event of a late deposit, plan sponsors may, but are not required to, file with the DOL under the Voluntary Fiduciary Correction Program (VFCP). If accepted, the DOL will issue a no-action letter.

The DOL has recently expanded the VFCP to include a streamlined process for correcting late employer deposits of participant deferrals and some participant loan failures. It is called the Self-Correction Component (SCC). Through this process, documentation of the error is submitted to the DOL online. Then, rather than sending a no-action letter, the DOL sends only an email acknowledging the submission.

To participate in the SCC program, plan sponsors must meet specific recordkeeping requirements. SCC is available only if the amount of lost earnings is less than $1,000 and if late payments and earnings are corrected within 180 days of when salary deferrals were withheld from participants' compensation.

Jury Awards $38.8 Million for Overpayment of Recordkeeping Fees

In a rare jury trial on an ERISA issue, a New York jury has decided that fiduciaries in the Pentegra multiple employer plan (MEP) paid excessive administrative fees. A verdict of $38.8 million was handed down. *Khan v. Bd. of Dirs. of Pentegra Defined Contribution Plan* (S.D. N.Y., Jury Verdict 4.23.25). Breaking with most other courts, a few federal courts in the 2nd Circuit (New York, Connecticut, and Vermont) have permitted jury trials.

The Board of Directors of Pentegra Defined Contribution Plan (Board of Directors) is the plan sponsor of an MEP that has been adopted by approximately 250 banks, has approximately $2 billion in assets, and includes approximately 25,000 participants. The Board of Directors retained Pentegra Services Inc. (PSI) to be the plan's administrator.

PSI took on extremely broad responsibilities, including monitoring its own fees. PSI was selected to serve the Pentegra plan without a competitive bid process or negotiations, and its contract has been renewed without any fee benchmarking since it was retained in 2007. The president and CEO of PSI is a member of the Board of Directors.

The above facts are drawn from a court decision on a motion filed in the case. The basis for the jury's decision is not known. However, the facts of the case likely gave the plaintiff's lawyers plenty of scenarios to weave in their presentation to the jury.

Plan Fiduciaries Win Challenges to Retaining Underperforming Investments

This quarter, a number of suits alleging that plan fiduciaries breached their duty of prudence by retaining underperforming investments have been resolved in the fiduciaries' favor. The following are highlights.

- *Enstrom v. SAS Institute.* (E.D. N.C. 2025): SAS Institute was challenged for retaining underperforming investments. Deciding for the plan's fiduciaries, the judge noted:
    - The appropriate inquiry focuses on the process that the fiduciary used to make the challenged decision, not the results of the decision.
    - Fiduciary duties require prudence, not prescience.
    - A plaintiff must plausibly allege that a prudent fiduciary in like circumstance would have acted differently.
    - Plaintiffs use a suite of exotic performance metrics to make their point. Even under

ERISA, plaintiffs must plead facts that are sufficient to state a claim that is plausible on its face.
    - The challenged funds generally provided returns within 1 to 2 percentage points of the plaintiff's handpicked comparator. Alleged underperformance of between 1 and 4 percent of a benchmark fails to state a plausible ERISA claim.
- *Cutrone v. AllState Corp.* (N.D. Ill. 2025): AllState was challenged for retaining Northern Trust's underperforming target-date funds. Deciding for the plan's fiduciaries, the judge noted:
    - The plaintiffs did not provide useful benchmarks against which to judge the allegedly underperforming funds.
    - The fund's own custom benchmark was close to an apples-to-apples comparison and showed a performance variance of only +/- 0.20 percent.
    - The plan's independent investment consultants "consistently blessed" the funds as being suitable for inclusion in the plan.
- *Johnson v. Russell Investments Trust Company* (S.D. Fla. 2025): Russell and Royal Caribbean Cruises were sued for retaining Russell Investments target-date funds. Deciding for the plan's fiduciaries, the judge noted:
    - Underperformance in a five-year snapshot of a fund that is supposed to grow for 50 years does not show that the fund is objectively imprudent.
    - After finding that the Russell funds were not objectively imprudent, the judge rejected challenges to the investment review process, saying, "A fiduciary who relies on prayer, astrology, or just blind luck will be shielded from liability if the beneficiary cannot show that the resulting investment is imprudent."
- *Partida v. Schenker, Inc.* (N.D. Cal. 2025):Schenker was sued for retaining the underperforming Wells Fargo Growth Fund. Deciding for the plan's fiduciaries, the judge noted:
    - There is nothing presumptively imprudent about a retirement plan retaining investments through periods of underperformance as part of a long-term strategy.
    - A passively managed (index) fund is an inappropriate benchmark against which to evaluate actively managed funds.
    - There may be good reasons to use high-cost share classes. Higher-cost share classes may offer revenue sharing that benefits the plan.

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