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Disney and *Chevron* 401(k) Fee Litigation: Court Skepticism Can Provide Some Important Limits to Fee Litigation

BY ROBERT RACHAL

There has been a substantial recent uptick in settlements, judgments and in cases filed challenging fees and the prudence of investments offered in 401(k) and now 403(b) plans. *See, e.g.*, Robert Rachal & Tulio Chirinos, *View from Proskauer: ERISA Fee Litigation Continues to Expand with New Claims Seeking to Impose Heightened Fiduciary Standards for 401(k) Plans*, BNA Pens. & Ben. Daily (July 29, 2016).

But recent court rulings in *In re Disney ERISA Litigation*, No. CV 16-2251 PA (JCx) (C.D. Cal., Nov. 14, 2016), and in *White v. Chevron Corp.* (N.D. Cal., Aug. 29, 2016), indicate that some courts are taking a harder look at these claims, rejecting use of hindsight and plaintiffs' *per se* cost-focused rules to judge investments. These courts rejected adoption of any ''assumption of imprudence'' based solely on allegations of costs. If followed, *Disney* and *Chevron* may provide significant ways to limit the adverse impacts of this rising fee litigation.

Disney

In *In re Disney ERISA Litigation*, a consortium of experienced ERISA plaintiffs' counsel challenged Disney's inclusion of the Sequoia Fund as an investment option in Disney's 401(k) plan, principally because this mutual fund had concentrated investments in Valeant Pharmaceuticals' stock, which suffered substantial losses in late 2015. According to plaintiffs, the Disney plan should have removed this fund at some unspecified time before then because there were serious concerns and questions about Valeant's business model and accounting methods in the public domain *before* Valeant's stock begin its precipitous decline in October 2015.

The district court caught the flaw in this theory, *i.e.*, since the stock price had stayed up after these disclosures, other market investors had rejected these concerns and instead saw positive prospects in the company. Relying on the U.S. Supreme Court's decision in *Fifth Third Bancorp v. Dudenhoeffer*, 134 S. Ct. 2459 (2014), the *Disney* district court noted (i) procedurally, that motions to dismiss are an important mechanism to weed out meritless claims challenging the prudence of plan investments, and (ii) substantively, allegations that a fiduciary should have discerned that the market was over or undervaluing stock are, as a general rule, implausible absent special circumstances suggesting flaws in the market's ability to price securities. The court found no facts suggesting this.

The court also noted that the Sequoia Fund's concentrated investment strategy was disclosed to the plan investors, and that in the plan's mix of investments, this concentrated fund was offered as one with higher growth potential and commensurate risk. Finally, the court was skeptical, at least absent special circumstances, of imposing duties on plan fiduciaries to ac-

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tively monitor not just mutual funds, but also their underlying investments in the market.

Chevron

Chevron v. White appears to be a case in which a lead plaintiff's firm in ERISA fee litigation, Schlichter, Bogard & Denton, sought to push the envelope. Chevron has a very large 401(k) plan with $19 billion in assets as of December 31, 2014, with an overall low cost fee structure. Plaintiffs principally challenged discrete practices, effectively arguing for applying *per se* cost-focused rules in plan management. The district court rejected these challenges:

- ***Stable value instead of money market funds***. Plaintiffs argued that plans should offer stable value funds instead of money market funds as the capital preservation option since they had outperformed money market funds in the current low interest rate environment. The court stated that it was not going to infer an imprudent process from the plan's failure to include a stable value fund. Instead, it noted that this was an improper hindsight-based challenge, that lots of plans continued to offer money market funds, and that plaintiffs had failed to allege any facts suggesting that defendants had used a flawed process in considering these issues.

- ***Claims could have offered cheaper investment options***. The court noted that fiduciaries have latitude to and should consider investment features other than price. The court rejected the claim that only institutional class funds or collective trusts may be offered in the plan, and noted that plaintiffs' own allegations suggested that the plan fiduciaries were periodically monitoring fund costs, including by moving to lower cost funds, and by offering a diverse mix of investment options, including low cost funds.

- ***Claims imprudent to use asset-based fees to compensate record keepers***. Plaintiffs argued it was imprudent to use asset-based fees to compensate the plan's record keeper, particularly since the assets increased 22% during the 2010 to 2012 period in which it was in place. The court noted that there was no prohibition against using revenue sharing to compensate record keepers, and that the allegations showed that defendants were monitoring these costs, including eliminating funds that provided revenue sharing and moving to a per-participant fee structure after two years. The court also rejected plaintiff's attempt to impose a *per se* rule requiring competitive bidding on record keepers, and instead noted that plausible claims require allegations showing that the record keeping fees were in fact unreasonable.

Plaintiffs also challenged the continued offering of an actively managed small cap fund, arguing it should have been removed sometime earlier than it was. The court noted that plaintiffs' allegations again showed that defendants were actively monitoring this fund, and that there was no plausible claim of imprudence based on not immediately removing the fund because of short term underperformance.

Perspectives

From the defense perspective, *Disney* and *Chevron* can be important cases to provide some needed limits on fee litigation. On procedure, applying *Dudenhoeffer's* aggressive use of motions to dismiss to weed out meritless claims can save plan fiduciaries from burdensome litigation, which otherwise can too often force changes in plan practices regardless of the ultimate merits of the claims.

On substance, the *Disney* and *Chevron* courts rejected adoption of ''assumptions of imprudence'' or similar *per se* rules that could have substantial untoward consequences regarding plan investments. The U.S. Department of Labor and the courts long ago observed that cost should *not* be the only criteria to evaluate plan providers. Yet some of plaintiffs' claims in these lawsuits were, at least implicitly, based on this assumption, and also on the improper use of hindsight to judge plan investments. If a costs-only approach and hindsight could be used to state claims on plan investments, *every* plan using actively managed funds would be at risk, and many large plans may be compelled to use collective trusts. But active management is required to keep markets efficient and can outperform passive management, while mutual funds offer liquidity and market competition, and are subject to substantial federal regulation to protect investors that does not apply to collective trusts.

In sum, the plan environment that would arise from the adoption of plaintiffs' cost-driven theories may not be an optimal one for plan participants, and in fact risks causing them substantial harm. In that sense, cases like *Disney* and *Chevron* can provide important litigation limits to protect plans and participants from these negative incentives.

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