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Benefits Alert

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First reasoned ERISA forfeitures decision dismisses complaint

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After thoughtful deliberation, federal trial judge in Silicon Valley dismisses ERISA 401(k) plan "forfeitures" suit against HP Inc., albeit with leave to amend.

What's the impact?

- Ten lawsuits have been filed since September 2023 alleging a novel theory of liability against ERISA plan sponsors for their use of forfeited employer matching retirement-plan contributions. Two motions to dismiss have been decided. One decision is useful, the other is not.
- Plan fiduciaries should consult with counsel to assess the language in their 401(k) plans or 403(b) plans governing the use of employer contributions that non-vested participants forfeit when they leave the company.

Since September 2023, ten lawsuits have been filed alleging a novel theory of liability against ERISA plan sponsors for their use of forfeited employer matching retirement-plan contributions. The first eight suits are cookie-cutter complaints filed by the same plaintiffs' law firm; the last two

are copycat complaints filed by a different firm. This appears to be the first foray into ERISA class action litigation by both firms.

Motions to dismiss have been filed or will be filed in all the lawsuits. Two of the motions were decided in the last two months.

- In ***Hutchins v. HP Inc.***,[1] the court carefully considered and addressed the arguments advanced by Hutchins and HP. It concluded that the complaint over-reached and therefore should be dismissed, but the court granted the plaintiffs an opportunity to replead with specific facts to try to support a plausible breach of fiduciary duty.
- In ***Perez-Cruet v. Qualcomm Inc.***,[2] the court's opinion was bereft of meaningful analysis and deliberation. It breezily denied Qualcomm's motion to dismiss and now is subject to a pending motion for reconsideration or, in the alternative, certification for interlocutory appeal.

Notably, *Hutchins v. HP Inc.*, which was the latter-decided of the two, specifically found the *Perez-Cruet* opinion "conclusory" and unpersuasive.

Lawsuits target employer matching contribution forfeitures

At the core of each lawsuit are two questions: (1) When retirement plan language provides that the plan sponsor may use employer contribution forfeitures either to offset future employer contributions or to pay administrative expenses otherwise borne by plan participants, does the plan sponsor necessarily act in a fiduciary capacity when it makes the choice? and (2) If the sponsor is wearing its fiduciary hat, does the sponsor breach its duties if it does not use the forfeitures to pay administrative expenses?

Many plans contain language providing such a choice, and plan sponsors typically use the forfeitures to offset future employer contributions. The lawsuits claim that this widespread and longstanding practice amounts to a breach of fiduciary duty and results in other violations of ERISA. The *Hutchins* decision shows why, even if the sponsor is acting in a fiduciary capacity, the decision to use forfeitures to offset future employer contributions is not a breach, absent specific facts supporting that the sponsor *specially* benefitted from the use.

Hutchins v. HP Inc.

HP sponsors and administers a 401(k) plan that is funded by voluntary wage withholdings and matching employer contributions, which are deposited into a trust fund. The employer matching contributions are subject to a three-year cliff vesting schedule. An individual who leaves HP prior

[1] *Hutchins v. HP Inc.*, 5:23-cv-05875-BLF, 2024 WL 3049456 (N.D. Cal. Jun. 17, 2024).

[2] *Perez-Cruet v. Qualcomm Inc.*, 23-cv-1890-BEN, 2024 WL 2702207 (S.D. Cal., May 24, 2024).

to completion of the three-year period forfeits the amount of employer matching contributions in his or her individual account. The plan expressly provides that forfeited employer matching contributions may be used to reduce future employer matching contributions or to pay plan expenses that otherwise are paid by participants.

Plaintiff's complaint was premised on the theory that the decision how to use forfeited contributions is subject to ERISA's fiduciary duties, and a failure to use the forfeitures to pay administrative costs always violates ERISA's fiduciary duties, its anti-inurement rule, and certain of its prohibited transaction rules. The court rejected the theory.

At the outset, however, the court rejected HP's argument that it was acting in its settlor rather than fiduciary capacity when deciding to allocate forfeited amounts to reduce employer matching contributions. The court reasoned that the decision whether to include a term in a retirement plan allowing forfeitures to be used either to reduce employer contributions or to pay plan expenses was a settlor function, but the *implementation* of that decision is a fiduciary function because the forfeitures were plan assets over which the company exercised discretion and control.

The court then turned to the gravamen of the plaintiff's fiduciary breach claim and concluded that, if correct, it proved too much. "The import of these allegations is that, if given the option between using forfeited funds to pay administrative costs or to reduce employer contributions, a fiduciary is *always* required to choose to pay administrative costs. But the flaw in such a theory is that it is not limited to any particular circumstances that may be present in this case . . . . As pled, Plaintiff's theory would require any fiduciary to use forfeited amounts to pay administrative costs regardless of any such context or circumstances."[3] That cannot be correct.

First, the court noted, ERISA does not mandate what benefits an employer must provide. Second, under the statute and IRS regulations, it is well established that forfeitures may be reallocated to remaining participants under a nondiscriminatory formula, used to reduce future employer contributions, or used to offset administrative expenses of a plan. Accordingly, the plaintiff's breach of fiduciary duty claim was implausibly broad.

The court also rejected plaintiff's claim that HP was violating ERISA's anti-inurement rule by using forfeited employer matching contributions to reduce future employer matching contributions. The plaintiff claimed the practice was tantamount to using plan assets to forgive the employer's debts. The court explained this was not the case because the forfeited employer matching contributions never leave the trust or are returned to the employer. Instead, they are used to pay retirement benefits to plan participants. "The fact that HP benefits through the reduction in its future matching contributions does not make the use of forfeited amounts in this way a violation of the anti-inurement provision—the benefit that HP receives is incidental to the

[3] *HP Inc.*, 2024 WL 3049456, at *6.

payment of pension benefits."[4] To claim a breach under principles set forth in the anti-inurement case law, the court held, the plaintiff will have to plausibly allege that HP specially benefited from the use of the forfeitures.

Last, the court rejected the plaintiff's claim that HP's use of forfeitures to offset future employer matching contributions is a prohibited transaction. The court agreed with HP that the Supreme Court has held that the payment of benefits is not a "transaction" in this context, and therefore the practice could not be a prohibited transaction.

Perez-Cruet v. Qualcomm Inc.

Like HP, Qualcomm sponsors and administers a defined contribution retirement plan that includes matching employer contributions. The employer matching contributions vest over a two-year period at the rate of 50% per year. An employee who leaves before the end of the vesting period forfeits the balance of nonvested employer matching contributions in his or her plan account. The Qualcomm plan provides that forfeited employer matching contributions may be used to reduce future employer matching contributions or to pay plan expenses that otherwise are paid by participants.

The Qualcomm complaint asserts the identical claims and theories as the HP complaint. The court, however, denied the defendant's motion to dismiss based on only the shallowest analysis. For example, the court cited a 2018 Ninth Circuit decision for the anodyne proposition that ERISA expressly provides that "a fiduciary must discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and for the exclusive purpose of providing benefits to participants and their beneficiaries."[5] The court then concluded, without explanation or effort to address the overbreadth problem, that the complaint sufficiently alleged self-dealing and breach of ERISA's duty of loyalty with respect to Qualcomm's use of forfeitures.

The court also cited the same 2018 Ninth Circuit decision for the equally anodyne proposition that ERISA provides that the employer has the express duty under [29 U.S.C.] § 1104(a)(1)(A)(ii) of "defraying reasonable expenses of administering the plan."[6] From this the court announced that the complaint was sufficient because "Defendants did not defray the expenses of administering the Plan."[7] But the court omitted the word "reasonable," allowing it to read the statutory requirement out of context and completely alter its meaning. The requirement under § 1104(a)(1)(A)(ii) of "defraying reasonable expenses of administering the plan" is a limitation on the kinds of plan expenses that a plan fiduciary may use plan assets to pay (only those which are

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[4] *Id*. at *8.

[5] *Qualcomm*, 2024 WL 2702207, at *2 (internal quotations omitted). The

[6] *Id*. at *2.

[7] *Id*.

reasonable). It manifestly is ***not*** a command that employers must pay the plan's expenses. To borrow from *A View from the Top*: "the em-PHA-sis is on the wrong sy-LLA-ble."

The rest of the *Qualcomm* opinion suffers from the same quality of reasoning.

What is the takeaway for plan sponsors?

Before the filing of these lawsuits, it was common for plan sponsors and advisors to regard the decision under a plan's forfeitures provision as implicating only a settlor function, or, if it did implicate fiduciary duties, it did not present self-dealing or other issues rising to the level of a breach. The court's reasoning in *Hutchins v. HP Inc.* supports the latter. If it is widely adopted by other courts, then these lawsuits soon should suffer the fate they deserve. One option for plan sponsors to consider with their counsel is whether to revise the plan to provide for only one possible use for forfeited employer contributions, thereby eliminating discretion.

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