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Benefits Alert

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ERISA row related to how employers use 401(k) forfeitures deepens

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Two September decisions push back against the rising tide of novel ERISA forfeiture claims.

What's the impact?

- Since last fall, plaintiffs have filed at least twenty ERISA class actions claiming violations of fiduciary duties related to the use of 401(k) plan forfeitures.
- Despite guidance from the Treasury Department, the Department of Labor, and case-specific plan design suggesting otherwise, this new theory continues to develop.
- Two conclusory decisions that allowed so-called forfeiture claims to proceed are fueling the trend; however, two recent decisions—one focusing on fiduciary discretion, the other on the bounds of ERISA—add thoughtful discussion to the debate.

Defendants in these cases are sponsors of 401(k) retirement plans, the assets of which are held in trust and funded by a combination of wage withholdings and employer contributions. Although participants are immediately vested in their own contributions, employer contributions may vest

only after a set period. If the participant discontinues service before the employer contributions become fully vested, the unvested contributions are forfeited.

Generally, the claims assert that employers or other retirement plan administrators, acting as fiduciaries exercising discretionary authority and control over plan assets, violate ERISA when using plan forfeitures to offset future employer contributions, rather than to pay administrative costs of the plan otherwise paid by participants or reallocate the forfeitures to remaining participants. Defendants have argued in part that they were following plan document instructions, that Treasury regulations foreclose the claims, and that allocating forfeitures is a settlor—not a fiduciary—function, and more.

Decisions on motions to dismiss ERISA forfeiture claims

Since the spring of 2024, there have been five decisions on motions to dismiss forfeiture claims.[1] First, *Qualcomm* denied the motion (and reconsideration) in a cursory opinion considered by many to lack meaningful analysis, concluding that "Defendants may have complied with the Plan's terms which permit a choice" but that "the duty of prudence trumps the instructions of a plan document[.]"[2] Then, unpersuaded by *Qualcomm*, *HP* concluded that the complaint over-reached and, therefore, should be dismissed, but the court granted the plaintiffs an opportunity to replead with specific facts. Next, in line with *Qualcomm*, the *Intuit* court allowed claims to proceed, holding the plaintiff had plausibly alleged not only that the employer did not comply with the terms of the plan document but also that "a prudent employer in this particular context would have at minimum engaged in a 'reasoned and impartial decision-making process' considering 'all relevant factors' before determining how to use the forfeited funds in the best interest of the participants and beneficiaries."[3]

BAE Systems court weighs fiduciary discretion

More recently, in *BAE Systems*, plaintiff claimed that under ERISA, despite any plan provisions to the contrary, defendant had a fiduciary duty to use the forfeitures to pay administrative expenses, given its obligation to act solely in the best interests of the plan participants and that any other use would place defendant's interest over those of the participants. Plaintiff also

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[1] *Perez-Cruet v. Qualcomm Inc.*, No. 23-CV-1890-BEN (MMP), 2024 WL 2702207 (S.D. Cal. May 24, 2024), *reconsideration denied*, No. 23-CV-1890-BEN (MMP), 2024 WL 3798391 (S.D. Cal. Aug. 12, 2024); *Hutchins v. HP Inc.*, No. 23-CV-05875-BLF, 2024 WL 3049456, -- F.Supp.3d -- (N.D. Cal. June 17, 2024); *Rodriguez v. Intuit Inc.*, No. 23-CV-05053-PCP, 2024 WL 3755367, -- F.Supp.3d -- (N.D. Cal. Aug. 12, 2024); *Naylor v. BAE Systems, Inc.*, No. 24-CV-00536 (AJT/WEF), 2024 WL 4112322 (E.D. Va. Sept. 5, 2024); *Dimou v. Thermo Fisher Scientific, Inc.*, No. 23-1732 (S.D. Cal. Sept. 19, 2024).

[2] *Qualcomm*, 2024 WL 2702207 at *6-7.

[3] *Intuit*, 2024 WL 3755367 at *10.

alleged that defendant breached its duties of prudence and loyalty by failing to have any process in place to consider what to do with the forfeitures.

After recognizing that ERISA plans are contractual documents and walking through several "unambiguous, mandatory directions with respect to the use of forfeitures," the court pushed back.[4] The court reasoned that "[p]laintiff's position regarding forfeitures reduce[s] to an argument that Defendant was required by ERISA to disregard the terms of the Plan and, contrary to the terms of the Plan, prioritize the use of forfeitures for, *inter alia*, the payment of administrative costs or a windfall to Plan participants, a proposition uniformly rejected by the courts." Accordingly, the court dismissed the claims regarding fiduciary breaches relating to forfeitures for failure to state a claim.

Notably, the *BAE Systems* court distinguished plaintiff's reliance on *Qualcomm* and *Intuit* based on the discretion afforded by the plan terms to the fiduciaries. In *Qualcomm* and *Intuit*, the plan terms permitted a discretionary choice for the use of forfeitures. Here, by contrast, "the Plan's applicable provisions do not allow for a similar choice for the use of forfeitures."

The court continued that plaintiff's claim that defendant violated ERISA's anti-inurement provision failed for the same reason. The plan guaranteed the order in which forfeitures would be used, and plaintiff failed to establish that following such plan terms is a fiduciary violation. Accordingly, plaintiff could not establish that plan assets inured to the employer's benefit or were used for any reason other than to provide benefits to participants and defray reasonable administrative expenses.

Finally, the court made quick work of plaintiff's prohibited transaction claims, holding that "[t]o the extent that Defendant established the Plan terms, it did so in its capacity as a 'settlor,' which does not give rise to fiduciary duties under ERISA."

The court dismissed the amended complaint without prejudice, which does allow the plaintiff to refile a claim with amendments.

Thermo Fisher court holds claim "too broad to be plausible," and plaintiff reacts with revised Second Amended Complaint

Unlike in *BAE Systems*, the *Thermo Fisher* plaintiff alleged that the fiduciary defendants exercised discretionary authority over how forfeitures are reallocated, and the plaintiff challenged the decision of fiduciaries "wearing two hats." At the outset, therefore, the court differentiated settlor/sponsor decisions from fiduciary decisions.[5] The court explained that "[g]enerally, decisions concerning the design, establishment, or modification of an employee

[4] *BAE Systems, Inc.*, 2024 WL 4112322 at *4-5.

[5] *Thermo Fisher*, No. 23-1732 at *12-13.

benefit plan are not fiduciary because they do not implicate program management," whereas "common transactions in dealing with a pool of assets [like] selecting investments. . . are fiduciary in nature."

Defendants argued that the first amended complaint recast the company's funding decisions as fiduciary decisions. However, plaintiff responded that the defendants acted as fiduciaries when deciding how the forfeitures would be allocated. Following *HP*, the court concluded that the decision to include a plan term setting forth various permissible uses for forfeitures is a settlor function, but implementing that decision is a fiduciary function. Thus, the claims implicated a fiduciary decision.

The court was further persuaded by *HP* on two important points. First, the court reasoned that "because ERISA does not require a fiduciary to maximize pecuniary benefits in favor of the plan participants, the fiduciary duty provisions do not create an unqualified duty to pay administrative expenses, especially when the plan document does not create an entitlement to such benefits." Second, the court concluded that finding otherwise "'would improperly extend ERISA beyond its bounds and would be contrary to the settled understanding of Congress and the Treasury Department regarding [401(k) type] defined contribution plans,' which historically allowed the use of forfeitures in defined contribution plans to reduce employer contributions."

The court concluded that "because ERISA's fiduciary provisions neither created a benefit nor abrogated Treasury regulations and settled rules regarding the use of forfeitures in defined contribution plans, the plaintiff's theory of fiduciary liability was too broad to be plausible." The court dismissed the complaint without prejudice.

Last week, the *Thermo Fisher* plaintiff filed a strategic Second Amended Complaint, revising her legal theory. Plaintiff now claims that defendants "are presented with a conflict of interest in administering the Plan and managing and disposing of its assets." Additionally, plaintiff alleges that defendants "failed to consult with an independent non-conflicted decisionmaker to advise them in deciding upon the best course of action for allocating the forfeitures[.]" In so doing, plaintiff added a layer to her claim akin to more garden variety ERISA class actions that attack a retirement plan committee's process as a means of sufficiently stating a claim.

Learn from ERISA forfeiture cases

BAE Systems and *Thermo Fisher* are important for two reasons. First, *BAE Systems* provides insight into how an employer may better avoid getting caught up in the wave of forfeiture claims by removing fiduciary discretion from the plan document as to the use of forfeitures. Second, *Thermo Fisher* reinforces the thoughtful reasoning of *HP* and considers strong arguments by the plan fiduciaries that *Qualcomm* and *Intuit* largely ignored. As these claims continue to develop beyond the pleadings stage, plan fiduciaries should consult with counsel on how to best prepare

for a potential forfeiture suit, including possible amendments to plan language related to forfeitures.

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