401(K) PLAN SPONSOR ERISA FIDUCIARY LITIGATION UPDATE: *WHITE V. CHEVRON CORPORATION*

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Employee Benefits Alert

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On August 29, 2016, the District Court for the Northern District of California dismissed the lawsuit filed against Chevron Corporation by several participants in the Chevron Employee Savings Investment Plan (the "Plan"). This is an important decision as it is the first decision in the "second" wave[1] of lawsuits filed against 401(k) plan fiduciaries during the past year under the Employee Retirement Income Security Act of 1974 ("ERISA") for failure to properly manage 401(k) plans. In dismissing the case, the court rejected a number of claims commonly raised in these lawsuits:

CAPITAL PRESERVATION FUND

The plaintiffs alleged that the Plan's fiduciaries breached the fiduciary duty of prudence under ERISA because (1) they selected a money market fund as the Plan's capital preservation fund rather than a stable value fund, which would have provided a greater, guaranteed return and (2) the selection was inconsistent with the Plan's Investment Policy Statement.

The court stated that in order for this claim to succeed, the plaintiffs must allege facts that raise an inference that the process used by the Plan fiduciaries to select the capital preservation fund was imprudent, which the plaintiffs did not do. The court rejected the plaintiffs' focus on the relative performance of money market funds and stable value funds as an "improper hindsight-based challenge to the Plan fiduciaries' decision-making."

With regard to the Investment Policy Statement, the court stated that the Investment Policy Statement did not require that the Plan fiduciaries select a stable value fund for the Plan's capital preservation fund. Rather, the Investment Policy Statement simply required that the capital preservation fund must provide for a high degree of safety and capital preservation, must be liquid and daily valued, and must promote participant flexibility in allocating accounts. The selection of a money market fund was consistent with those requirements.

EXCESSIVE INVESTMENT MANAGEMENT FEES

The plaintiffs alleged a series of claims with an underlying theme that the investment funds selected by the Plan fiduciaries were too expensive: (1) the Plan fiduciaries had selected higher-cost retail class mutual fund shares rather than lower-cost institutional class chares, (2) other investment funds with lower expense ratios could have been selected, and (3) the Plan fiduciaries chose mutual funds rather than alternative funds such as separately

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managed accounts or collective investments trusts, which, in light of the Plan's size and attendant bargaining power, the fiduciaries could have accessed at lower cost.

The court rejected all of these excessive cost claims. It noted that ERISA fiduciaries not only may, but have a duty, to consider more than simply cost when selecting investment funds and that fiduciaries may chose more expensive options for a variety of different reasons (e.g., greater liquidity or anticipated superior performance). The court reiterated what has been said by a number of other courts — i.e., that fiduciaries do not have duty to "scour the market to find the cheapest possible funds." Moreover, a focus on the costs of one specific fund may be inappropriate to the extent it fails to consider the role of the fund in a broader investment array, in which a mix of different funds with higher and lower costs may be appropriate. The court observed that the Plan fiduciaries had changed the available investment options from year-to-year, which suggested that the fiduciaries were indeed monitoring the funds and engaging in a process for evaluating cost. It also noted that the expense ratios of the funds ranged from 0.05% to 1.24%, which "fits well within the spectrum that other courts have held to be reasonable as a matter of law."

EXCESSIVE RECORDKEEPER COMPENSATION

The plaintiffs alleged that the Plan's recordkeeper received excessive compensation principally as a result of (1) its collection of revenue sharing from the Plan's mutual fund investments and (2) the failure of the Plan's fiduciaries to periodically bid out the recordkeeping work, which would have forced the recordkeeper to compete on (and, thus, reduce) the price for its services. The court rejected the revenue sharing claim because the plaintiffs had not provided any facts alleging that the total amount of revenue sharing collected by the recordkeeper was excessive. The court affirmed the principal that allowing a recordkeeper to retain revenue sharing as part of its compensation for providing services is not per seimproper or unreasonable. The court noted that after two years of allowing the recordkeeper to collect revenue sharing, the Plan fiduciaries changed the compensation arrangement to use lower cost fund classes (with lower revenue sharing payments to the recordkeeper) and to compensate the recordkeeper based on a per-participant fee formula, which suggested that the fiduciaries were in fact monitoring the amount of revenue sharing that was being paid to the recordkeeper. The court also rejected the claim that the failure to periodically bid out recordkeeping services was a breach of fiduciary duty because the plaintiffs had provided no evidence that Plan fiduciaries could have obtained less expensive recordkeeping services by doing so. The court dismissed any notion that ERISA fundamentally requires a periodic competitive bidding of services.

FAILURE TO REMOVE IMPRUDENT FUND

The plaintiffs alleged that the Plan's small cap value fund, which had been offered from February 2010 through April 2014, should have been removed long before April 2014 because of its excessive investment management fees and its underperformance relative to its benchmark index. The court rejected this claim, stating that it may not be unreasonable for a fiduciary to retain an investment option during a period of underperformance. Mere underperformance is, alone, insufficient to state a claim of breach of fiduciary duty, as is an allegation that other funds would have performed better. The court again emphasized the need to evaluate fiduciary decision-making

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at the time of the investment and not in hindsight. As the plaintiffs did not allege facts to suggest that the Plan fiduciaries could have predicted the fund's poor performance, this claim was dismissed.

DUTY TO MONITOR

The plaintiffs alleged that the employer breached the ERISA duty of prudence by failing to monitor the Plan's fiduciaries that it appointed. The court dismissed this claim because the plaintiffs had not identified which fiduciaries the employer had failed to properly monitor or alleged any facts that showed how the monitoring process was deficient or that gave rise to a reasonable inference of such a deficiency.

This case is a significant win for plan sponsors in the 401(k) fiduciary litigation battle. As it can be costly for plan sponsors to fully litigate these cases on their merits, it often becomes important for plan sponsors to get these cases dismissed early in the proceedings. A failure to do so increases the financial pressure to settle — even when the prospects are good for successfully defending the claims on their merits.

The court makes clear repeatedly that there are few, if any, per se fiduciary breaches with respect to 401(k) investment management decisions. Accordingly, in order to survive early dismissal, plaintiffs will need to do more than make summary allegations of breach; rather, they will need to allege specific facts that give rise to a "reasonable inference" of wrongdoing. Moreover, as is well settled, those facts must be oriented toward a failure of the decision-making process rather than to a hindsight analysis of results. Plaintiffs who cannot allege those facts will have difficulty getting a court to engage in a fulsome evaluation of an alleged fiduciary breach. In this way, this case, like many court decisions that preceded it, highlights the importance of "procedural diligence" for 401(k) plan fiduciaries. Those who engage in a process of reasoned decision-making, and who document the process, the decision and the rationale for the decision are well positioned to survive claims of breach of fiduciary duty regardless of the outcome of the decision.

NOTES:

[1] The "second wave" of litigation refers to the lawsuits filed against 401(k) and 403(b) plan sponsors beginning in the latter part of 2015 and throughout 2016. A "first wave" of litigation was commenced against nearly two dozen plan sponsors during 2006–2008.

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