Fiduciary Liability Exposures: Excessive Fee Litigation in Review

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OVERVIEW

If your company has purchased, or explored purchasing, fiduciary and/or director & officer liability insurance, you are likely familiar with underwriters' concerns around "excessive fee litigation" exposure. This litigation has become increasingly troublesome for companies offering retirement plans. The general allegations in these cases arise out of the theory that fiduciaries of employer-sponsored plans allow providers to be paid excessive fees from plan assets. Some of the more common allegations include the following:

- Record-keeping fees being paid as a percentage of assets, rather than on a flat-fee or fixed basis.
- Failing to remove underperforming investment funds.
- Failing to offer less expensive investment funds.
- Failing to negotiate lower fees and/or seek competitive bids for third party services through a Request for Proposal ("RFP") process.
- Failing to monitor third party fees.

When excessive fee litigation became a trend, there were several targeted industries, including higher education, healthcare and financial institutions. Today, however, retirement plans across nearly all industries are at risk of exposure to an excessive fee claim. According to a recent report issued by Euclid Fiduciary, the majority of cases are now being filed against plans under $1 billion in assets, and 10% of all cases filed are against plans under $500 million in size.[1]

Statistics and Driving Forces

Excessive fee cases have been consistently filed over the last six years. Between 2020 and today, more than 150 excessive fee cases have been filed. In 2021, there were 54 excessive fee cases filed. In the first half of 2022, there were 42 excessive fee cases filed. It is estimated that between 75-100 excessive fee cases will be filed by the end of 2022.[2]

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[1] "A Special Report from Euclid Fiduciary: Insights from the First Twenty-Five Excessive Fee and Investment Imprudence Cases of 2022" https://www.euclidspecialty.com/fiduciary-insights-from-the-first-twenty-five-excessive-fee-and-investment-imprudence-cases-of-2022/

[2] *Id.*

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There is a small group of law firms that are leading the charge in excessive fee litigation filings, including Capozzi Adler, P.C., Miller Shah LLP, and Walcheske & Luzi, LLC. These three firms filed the majority of cases in 2022. In fact, these firms have a dedicated practice of excessive fee litigation and websites that include a listing of their high profile cases (pending and resolved) in the media. In August 2022, although still subject to court approval, Capozzi Adler settled a 403(b) class action against Rush University Medical Center for $3 million in what may be viewed as "record time" (i.e., within six months of the case being filed and while a motion to dismiss was pending). Some new law firm entrants (like Pavlack Law, LLC) are also filing weaker, but copycat versions of, excessive fee lawsuits in the hope of capitalizing on this trend.

Recent Excessive Fee Litigation Dismissals

The large majority of excessive fee cases have at least, in part, survived a motion to dismiss. However, two recent dismissals in the Sixth and Seventh Circuit Courts of Appeals could impact the future of excessive fee filings.

CommonSpirit Health

In *Yosaun Smith, et al. v. CommonSpirit Health aka Catholic Health Initiatives and Catholic Health Initiatives Retirement Plans Subcommittee*, the Sixth Circuit Court of Appeals recently affirmed the decision of a Kentucky federal district court's dismissal of a 401(k) excessive fee case. *(*Case No. 21-5964 (6th Cir., June 21, 2022)). In *CommonSpirit*, the plaintiff alleged that her retirement plan should have offered a different mix of fund options. Specifically, the plaintiff claimed that the plan should have replaced actively managed mutual funds with passively managed mutual funds. CommonSpirit appointed a committee to administer the plan, which served more than 105,000 people and managed more than $3 billion in assets. The plan offered 28 different funds in which employees could invest their contributions. Smith sued CommonSpirit and the plan's administrative committee for breach of fiduciary duty in violation of ERISA. Smith claimed that CommonSpirit breachd its fiduciary duty of prudence by offering several actively managed investment funds when index funds available on the market offered higher returns and lower fees. Smith separately alleged that the plan's recordkeeping and management fees were excessive.

CommonSpirit moved to dismiss the complaint. The federal district court granted dismissal, stating that the plaintiff failed to allege facts from which it could plausibly infer that CommonSpirit acted imprudently in violation of ERISA.

On appeal, the Sixth Circuit affirmed the district court's ruling. In its decision, the Sixth Circuit held that ERISA "does not give the federal courts a broad license to second-guess the investment decisions of retirement plans." The Court held that ERISA provides a cause of action only when retirement plan administrators breach a fiduciary duty by (for example) offering imprudent investment options. As to the fee claims, the Court held that, where fees are clearly set by market forces, a claim for violation of ERISA fails and that "nothing in ERISA requires every fiduciary to scour the market to find and offer the cheapest possible fund (which might, of course, be plagued by other problems)" (citing *Hecker v. Deere & Co*., 556 F.3d 575 (7th Cir. 2009)). The *CommonSpirit* Court ultimately held that, "because Smith has not alleged

facts from which a jury could plausibly infer that CommonSpirit breached any such duty and because Smith's other claims do not get off the ground, we affirm the district court's dismissal of her complaint."

Smith was represented by Miller Shah, LLP, Goldenberg Schneider, LPA, and Capozzi Adler, P.C.

Oshkosh Corporation

Albert v. Oshkosh Corporation, et al., Case No. 21-2789 (7th Cir. Aug. 29, 2022). In *Oshkosh*, the plaintiff alleged that his former employer, a subsidiary of Oshkosh Corporation, breached its fiduciary duties by authorizing the retirement plan to pay unreasonably high fees for recordkeeping and administration, failing to adequately review the plan's investment portfolio to ensure that each investment option was prudent, and unreasonably maintaining investment advisors and consultants for the plan despite the availability of similar service providers with lower costs or better performance histories.

On September 2, 2021, the federal district court granted the defendants' motion to dismiss. On appeal, in affirming the district court's dismissal, the Seventh Circuit first held that ERISA does not require fiduciaries to act as personal investment advisers to plan participants (citing *White v. Marshall & Ilsley Corp.*, 714 F.3d 980 (7th Cir. 2013)). With respect to the claims of excessive recordkeeping fees, the Seventh Circuit also cited *Smith v. CommonSpirit*, discussed above, holding that where the complaint "failed to allege that [recordkeeping] fees were excessive relative to the services rendered" an ERISA plaintiff fails to state a duty of prudence claim (*Smith*, 37 F.4th 1160, 1169 (6th Cir. 2022)).

Next, the Seventh Circuit held that the plaintiff's duty of loyalty claims also failed. The Court opined that there were no allegations of kickbacks or motive to further the fiduciary's own interests, and the plaintiff failed to identify any comparator investment advisors. The Court held that the plaintiff's claim that Oshkosh failed to monitor the fees likewise failed since the duty to monitor claims were derivative of the breach of fiduciary duty claim, which (as discussed) failed.

Albert was represented by Walcheske & Luzi, LLC.

While these two cases were only recently decided, the opinions issued by the Sixth and Seventh Circuits could shift the pendulum with more cases being decided in favor of defendants at the motion to dismiss phase. Unfortunately, however, even if a motion to dismiss is granted in its entirety, these cases continue to be costly to both defend and exit at the trial and appellate levels.

Settlements

For those companies unable to exit a case through successful motion practice, resolution through settlement (which can also be costly) is a common next step to avoid protracted litigation and unknown risks at trial. According to Chubb's *Excessive Litigation Over Excessive Plan Fees* publication, roughly $1 billion has been paid in excessive fee settlements between 2016 and 2020, with over $350 million of that amount going

towards plaintiffs' attorneys' fees.[3] These settlements ranged from less than $1 million to over $55 million. In 2020, the average excessive fee settlement was $14.5 million – which is $3 million more than the average settlement value in each of the three precedent years. Moreover, and according to the Euclid Fiduciary Report, plans under $1 billion settle for approximately 30-40% of the damages model, with plans over $1 billion settle closer to 10% of the damages model.

Recently, Costco agreed to settle an excessive fee class action for $5.1 million arising from a $15 billion plan. (*See Dustin Soulek v. Costco Wholesale Corp*., Case No. 1:20-cv-00937, E.D. Wis.). The settlement, which was approved by the court on July 19, 2022, includes a stipulation that the requested attorneys' fees for plaintiffs' counsel may not exceed $1.5 million – which is just less than 30% of the settlement amount. The plaintiffs in *Costco* were represented by Walcheske & Luzi, LLC.

Fiduciary Market Reaction to Excessive Fee Litigation

Excessive fee litigation remains at the forefront of the underwriting community's concerns. With increased claims frequency, we are seeing carriers add a dedicated excessive fee or mass/class action retention of $500,000 to $1 million+. Insureds in the higher education space may see a significantly higher retention, co-insurance, or even an outright exclusion for excessive fee claims. In general, we strongly recommend an excessive fee retention instead of a mass/class retention where available. We are also seeing that excessive fee questionnaires or, at a minimum, additional separate excessive fee questions, have become a standard part of the underwriting process. If you would like to learn more about how HUB International's Professional & Executive Risks – ProEx Practice can assist you in securing fiduciary liability insurance coverage, please reach out to:

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[3] *See* https://www.chubb.com/us-en/business-insurance/fiduciary-excessive-fee-litigation.html