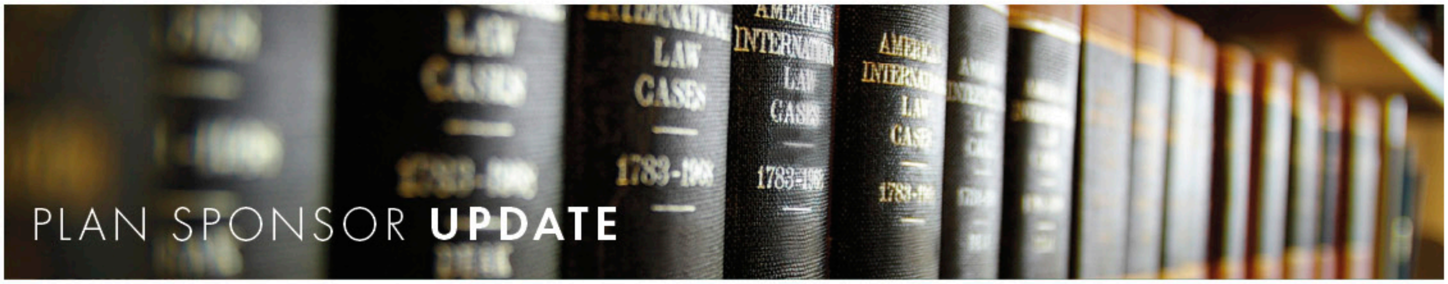

AN ANALYSIS OF LEGISLATIVE AND REGULATORY ISSUES AFFECTING PENSIONS

June 2017

SECOND DISMISSAL FOR WHITE V. CHEVRON FEE COMPLAINT

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Summary of the Situation

On May 31, 2017, the United States District Court for the Northern District of California dismissed, for the second time, plaintiffs' complaint in *White v. Chevron*. In its earlier, 2016, decision, the court dismissed plaintiffs' complaint for failure to state a claim but gave them leave to amend, and this 2017 decision is on plaintiffs' amended complaint.

Chevron has many facts in common with other 401(k) plan fee cases – plaintiffs generally challenge as imprudent the use of certain funds in the plan's fund menu and the revenue sharing-based fees paid to the plan's recordkeeper. The new decision is interesting for its discussion of plaintiffs' duty of loyalty claim and its dismissal of plaintiffs' claims based on the availability of "identical lower-cost share classes."

Who is most impacted by this?

Sponsors of DC plans.

Key takeaways for clients

- *Background*: The plaintiffs in this case are participants in Chevron's 401(k) plan. They claim that defendants (plan fiduciaries) breached their ERISA "duties of loyalty and prudence" in connection with (among other things) (1) the selection of funds with unreasonably high management fees, (2) the payment of excessive fees for recordkeeping and (3) the selection of a money market fund instead of a stable value fund as the plan's capital preservation option.

Key takeaways for clients (cont'd)

- *Breach of duty of loyalty claim*: For the most part, and like most other 401(k) plan fee litigation, most of plaintiffs' arguments go to the issue of prudence – that the fees paid, e.g., for fund management and recordkeeping, were "excessive." In their amended complaint, however, plaintiffs do make one (new) argument that raises a "loyalty" question. Plaintiffs claim that Vanguard (which operated the majority of the plan's investment fund offerings and was plan recordkeeper) was also (as a mutual fund operator) Chevron's "largest shareholder" and that Vanguard "'overwhelmingly" supports "management sponsored proposals regarding executive compensation and matters of corporate governance of companies in the Standard & Poor's 500-stock index." Chevron, of course, is in the S&P 500. Thus, with respect to the excessive recordkeeping fees claim, "plaintiffs contend that Vanguard's practice of regularly voting in favor of Chevron on shareholder resolutions motivated defendants [that is, Chevron plan fiduciaries] to retain Vanguard as the Plan's recordkeeper on a no-bid basis."

- The court found this claim "unsupported by any facts, other than 'facts' alleged on information and belief or based on pure conjecture" and that it was undercut by "facts that show that, despite any purported 'conflict,' Chevron repeatedly took actions to reduce Vanguard's fees over the class period." Moreover, plaintiffs "alleged no facts showing that the Plan fiduciaries were aware of Vanguard's allegedly 'pro-management' voting position, or that it influenced Chevron's retention of Vanguard in any way." The court noted that Vanguard "is a significant shareholder in just about every public company, simply because of its outsized role in index fund investing." In dismissing the claim that Vanguard's majority shareholder status somehow presented a conflict for Chevron plan fiduciaries, the court stated: "Plaintiffs plead no facts showing that Vanguard did anything unique with respect to Chevron; to the contrary, they allege that Vanguard took pro-management positions for all companies across the S&P 500, and as a block, across all of its funds." Finally, plaintiffs did not "plausibly plead facts showing a quid pro quo." Plaintiffs' allegations in this regard "on information and belief" were not sufficient.

- We note that in *Tussey v. ABB* a similar *quid pro quo* claim was successful. In that case, the court (the United States District Court for the Western District of Missouri) found evidence (an email and a consultant's report) that the plan was being improperly over-charged in order to pay for unrelated services (including DB plan, health plan and non-qualified plan recordkeeping services).

- Obviously, Vanguard is likely to be the (or one of the) "largest shareholders" in many companies in the S&P 500. If plaintiffs had won on this issue, then it is possible that we would see a flood of fee lawsuits against S&P 500 companies that used Vanguard as recordkeeper for, or used Vanguard funds in, their 401(k) plans. So long as the *Chevron* court's analysis of this issue holds, and there are no additional facts, e.g., suggesting an actual *quid pro quo*, it appears that those claims can generally be disposed of at the pleadings stage.

- *Investment management fees*: Courts are currently considering a number of 401(k) plan fee cases in which, in effect, plaintiffs are claiming that plan fiduciaries did not get the "best deal" for plan participants. Typically, plaintiffs will (as they did in this case) allege that the plan included a mutual fund share class when there was an "identical," lower priced share class available. Defendants will (typically) argue that ERISA's prudence standard only requires that they get a "good deal," frequently citing (as the *Chevron* court does in this decision)

Key takeaways for clients (cont'd)

- language from *Hecker v. Deere* 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)."

- In this regard, plaintiffs may (as they did in this case) cite *Tibble v. Edison*, in which the United States District Court for the Central District of California found that the use of a retail share class where a lower-cost institutional share class was (or may have been) available violated ERISA prudence standards. The *Chevron* court distinguished *Tibble* because it involved a "fail[ure] to investigate the possibility of institutional-share class alternatives."

- *The motion to dismiss – a critical stage in fee litigation*: The question for a court considering these arguments is: is the mere allegation that there was a cheaper, "identical" (or in some cases, very similar) investment available enough to get plaintiffs past a motion to dismiss? If plaintiffs can survive such a motion, and get to the discovery stage, they can develop more facts and impose litigation costs on defendants – increasing plaintiffs' chances of a favorable settlement or victory in an ultimate trial on the merits. In this ongoing argument, the *Chevron* court sides with the defendants.

- *Recordkeeping fees*: In 2016 the court dismissed plaintiffs' claim that plan recordkeeping fees were imprudently high, ruling that "any claim alleging that Vanguard's recordkeeping fees were excessive failed to state a claim because plaintiffs failed to allege *what those fees were and how they were excessive*" (emphasis added). To remedy this lack, plaintiffs, in their amended complaint, attempted to estimate recordkeeping fees for 2010 and 2011 from information in the plan's Form 5500 for those years.

- The court, agreeing with defendants, found that "plaintiffs' allegations [based on 5500 information] are little more than guesses, and are either invalid or relatively incomprehensible." Moreover – given that in 2012 Chevron switched from paying for recordkeeping out of revenue sharing/assets under management to a per participant fee – plaintiffs' claim "boils down to an assertion that Chevron should have foreseen that the market would go up – and that Plan assets would increase as a result [increasing revenue sharing-based fees] – and renegotiated its asset-based fee arrangement sooner than March 2012." The question that this part of the court's decision begs is: how can a participant/plaintiff – without access to internal plan financial data – develop specific facts about how much a plan is paying for recordkeeping?

- *Money market vs. stable value*: Like several other 401(k) plan fee cases, the Chevron plaintiffs alleged that the inclusion in the plan's fund menu of a money market fund (as "the Plan's sole conservative capital preservation investment option"), rather than a stable value fund, was imprudent, because "stable value funds generally outperform money market funds." In dismissing this claim, the court held that plaintiffs alleged "no facts showing that the fiduciaries failed to consider a stable value fund, or showing that the process by which the fiduciaries chose the funds was somehow flawed or imprudent."

- We note that this claim – that the use of money market funds is imprudent – has also recently been rejected by two other courts. In light of the *Chevron* court's analysis, fiduciaries of plans using a money market fund rather than a stable value fund may want to consider their process and whether they have reviewed stable value alternatives.

What's next?

We will continue to follow these issues.