California District Court Denies Motion to Dismiss 401(k) Excessive Fee and Underperformance Claims

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A California district court recently denied a motion to dismiss claims that the fiduciaries of a 401(k) plan breached their ERISA fiduciary duties of prudence and loyalty by selecting underperforming, high-cost investments and causing the plan to pay excessive fees for services. The decision is notable for illustrating how pleading standards in investment performance and excessive fee litigation vary depending on jurisdiction. The case is *Coppel v. Seaworld*, No. 21-cv-1430 (S.D. Cal. Jan. 31, 2024).

Background

Participants in the 401(k) plan at issue commenced a putative class action against the plan's investment committee, as well as the plan sponsor, board of directors and certain officers, alleging that defendants breached their fiduciary duties by selecting and maintaining as plan investment options: higher-cost mutual fund share classes, certain underperforming mutual funds, and stable value funds that charged excessive fees and/or underperformed. Plaintiffs also complained about defendants' retention of the plan's financial advisor, which charged allegedly excessive fees. Defendants moved to dismiss for failure to state a claim.

Share Classes

Plaintiffs challenged defendants' selection and retention of allegedly higher-cost share classes of mutual funds as plan investment options when cheaper but otherwise identical share classes were available. Defendants argued that an "obvious alternative explanation" for their selection of the allegedly higher-cost share classes was that these allocated revenue to offset other plan expenses, and moving to a "less expensive" share class without revenue sharing would require plan participants to pay for plan expenses through other means. Defendants requested judicial notice of the plan's Form 5500, which purported to show that the cost difference (compared with less expensive share classes) was due to revenue sharing. While the Court recognized that this argument could be dispositive for defendants on summary judgment, and also judicially noticed the existence and filing of the Form 5500, it declined to take judicial notice of the information contained in the Form because this was a disputed fact that was not properly resolved at the pleading stage. The Court therefore denied defendants' motion on this claim.

Mutual Fund Underperformance

Plaintiffs alleged that four underperforming mutual fund options should have been replaced. Defendants argued the claim should be dismissed because plaintiffs failed to allege material and persistent underperformance by these funds. The Court rejected this argument, holding that in the Ninth Circuit, a showing of material and persistent underperformance is not required to state a fiduciary breach claim based on underperformance; rather, a plaintiff can state a claim by alleging underperformance in addition to "some other indicia of imprudence." In holding that plaintiffs stated a claim, the Court found that plaintiffs alleged that each of the four mutual funds underperformed relative to a "meaningful benchmark," and plaintiffs coupled these allegations with other indicia of imprudence that—although seemingly unrelated to the performance of the mutual funds—supported a finding of fiduciary breach, such as allegedly excessive fees for different plan options and failure to competitively bid for service providers.

Stable Value Funds

The plaintiffs alleged that the defendants breached their fiduciary duties by offering two stable value funds when better-performing but substantially identical stable value funds should have been offered instead. The defendants argued that plaintiffs' purported comparator funds were not meaningful due to material differences in fund structure and strategy. While the Court agreed with defendants that certain comparators were not meaningful, it denied defendants' motion to dismiss this claim because some comparators were sufficiently similar to the challenged funds and plaintiffs also included allegations that, while unrelated to performance, supported an argument that defendants imprudently retained the funds.

Financial Advisory Fees

Finally, the Court upheld plaintiffs' claims that defendants permitted the plan to pay excessive fees to its financial advisor. Defendants urged dismissal because the one "benchmark" offered by plaintiffs was inadequate and based on outdated data. Although the Court had appeared to apply a "meaningful benchmark" standard in considering plaintiffs' claims based on *performance*, it declined to do so for this claim, stating that for excessive fee claims in the Ninth Circuit, "apples to apples" comparisons between challenged plan services and other plans' services are not required to state a claim. The Court therefore held that it was plausible that the plan paid excessive fees based on a comparison to fees paid by another plan, without considering whether the plan and its alleged comparator received similar services from the financial advisor.

Proskauer's Perspective

This decision reveals how defendants in plaintiff-friendly jurisdictions generally face tougher odds in dismissing complaints before entering the expensive discovery phase. In this case, defendants could not overcome the Court's consideration of seemingly unrelated allegations to support holdings that plaintiffs plausibly alleged certain claims, or the Court's refusal to apply a "meaningful benchmark" standard to plaintiffs' excessive fee claim. The decision serves as another example of how additional, clearer guidance from the Supreme Court concerning the pleading standards applicable to ERISA fiduciary breach claims would be useful.

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