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Employee Benefit Plan Review

U.S. District Court for the Northern District of California Dismisses 401(k) Forfeiture Suit With Prejudice

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There has been a recent uptick in ERISA class actions challenging the use of 401(k) plan forfeitures. Plaintiffs in these cases generally allege that the use of 401(k) forfeitures to offset future employer contributions violates several ERISA provisions, including the fiduciary duties of loyalty and prudence and ERISA's anti-inurement provision. Plaintiffs have also alleged that this practice constitutes a prohibited transaction under ERISA. These cases are still in their early stages, with only a handful of mixed decisions on motions to dismiss.

In a recent decision – *Hutchins v. HP Inc.*[1] – the U.S. District Court for the Northern District of California dismissed the plaintiff's claims in their entirety for a second time, this time with prejudice.[2] Focusing on the language in HP's (the Company's) plan document, the court concluded that the plaintiff's theory was overly broad and implausible because it would require that the Company, as fiduciary, choose to pay administrative costs with forfeited funds every time it was "given the option between using forfeited funds to pay administrative costs or reduce employer contributions."[3]

The court emphasized that this result was contrary to the plan language and ERISA and would impermissibly "stretch the fiduciary duties of loyalty and prudence beyond the law and to create benefits beyond what was promised in the Plan itself."[4] The court thus dismissed the plaintiff's claims for breach of the fiduciary duties of loyalty and prudence.[5]

The court also dismissed the plaintiff's prohibited transaction claim because the plaintiff had failed to identify a "transaction" as that term is used in ERISA Section 406(a).[6]

The Parties' Arguments

The plaintiff alleged that the Company breached its fiduciary duties and engaged in self-dealing in violation of ERISA when it decided to use 401(k) plan forfeitures to reduce employer contributions rather than to pay administrative costs.

In its motion to dismiss the amended complaint, the Company presented two "overarching arguments": (1) the plaintiff was seeking a "categorical increase in benefits provided under the Plan," and (2) the plaintiff's arguments "ignore 'decades of settled law' allowing defined contribution plans to use forfeitures exactly as [the Company] did."[7]

The plaintiff responded to the motion to dismiss by arguing that he is not seeking greater benefits than the plan provides but is "merely seek[ing] to hold the administrator to its fiduciary obligations" in making its decisions with respect to whether to use plan assets to pay administrative expenses or to reduce employer contributions.[8] The plaintiff also argued that the Company's "'asserted compliance with the Plan and 'settled law' does not establish' that [the Company] fulfilled its fiduciary obligations."[9]

The Court's Decision

The court agreed with the Company on both of its "overarching" points.

First, the court noted "[w]here [the p]laintiff goes awry is in his implicit suggestion that 'actin[g] in the best interests of the plan participants and beneficiaries,' . . . requires 'maximiz[ing] pecuniary benefits' to individual plan participants or 'resolv[ing] every issue of interpretation in favor of plan beneficiaries.'"[10] Rather, "an ERISA fiduciary's duty is to ensure that all participants have received the full benefit guaranteed to them by the plan documents."[11]

The court noted that the plaintiff's theory was flawed because it "intended to create an additional benefit: that in any year in which there were forfeitures, those forfeitures would first be used to reduce administrative expenses for individual Plan participants."[12] The court concluded that this proposition is at odds with controlling case law and the Company's plan documents, "which state that the company retains discretion over whether to pay Plan expenses out of the Plan trust."[13]

The court then clarified its earlier ruling on the Company's first motion to dismiss regarding whether the Company's decision on the allocation of forfeited funds was a settlor or fiduciary function. The court explained that although the Company acted as a fiduciary in determining how to use forfeitures under the terms of the plan – i.e., whether to use forfeitures to "reduce employer contributions, to restore benefits previously forfeited, to pay Plan expenses, or for any other permitted use" – that fiduciary decision was restricted by the terms of the plan that state:

> The Company shall have complete and unfettered discretion whether an expense of the Plan or Trust shall be paid by the Participating Companies or out of the Trust Fund, and this Section shall not be construed to require the Participating Companies to pay any portion of the expense of the Plan.[14]

The court noted that this plan term "indicates that [the Company] acting as settlor determines whether, in a given year, Plan expenses will be paid by [the Company] or charged to Plan participants' accounts."[15] Then, the Company "acting as fiduciary implements the allocation of the forfeitures."[16] Thus, the Company "(as fiduciary) will only use those forfeitures to pay Plan expenses if [the Company] (as settlor) decided that year that the Plan administrator should use at least some forfeitures to pay Plan expenses."[17]

The court rejected the plaintiff's theory that would essentially require the court to find that the language of the plan's provision with respect to forfeiture allocation "in combination with ERISA's general fiduciary duty provisions," overrides the language of the plan provision that gives the Company, as settlor, the choice of whether, in a given year, at least some forfeitures will be used to pay plan expenses.[18]

Next, the court agreed with the Company's argument that the plaintiff's theory "seems to ignore 'decades of settled law'" including, the U.S. Department of the Treasury's proposed regulations that "seek to 'clarify that forfeitures arising in any defined contribution plan . . . may be used for one or more of the following purposes, as specified in the plan: (1) to pay plan administrative expenses, (2) to reduce employer contributions under the plan, or (3) to increase benefits in other participants' accounts in accordance with plan terms.'"[19]

In addition, the plaintiff's theory is inconsistent with the Conference Report accompanying the Tax Reform Act of 1986, which "indicates that the use of forfeitures in defined contribution plans to 'reduce future employer contributions' predated enactment of that law."[20]

With the benefit of this detailed discussion on the Company's "overarching" arguments, the court then turned to its rulings specific to the plaintiff's three causes of action.

First, the court dismissed the plaintiff's breach of fiduciary duty of loyalty claim because:

(1) Allegations of a possible conflict of interest do not amount to a breach of fiduciary duty;
(2) The plan administrator was not obligated to provide more benefits than the plan document sets out; and
(3) The Company's allocation of forfeitures did not amount to a "cutback" of benefits.[21]

Second, the court dismissed the plaintiff's breach of fiduciary duty of prudence claim because the "facts as alleged do not invite a plausible inference of wrongdoing on [the Company's] part" and "all Plan participants received all of their promised benefits."[22]

Finally, the court dismissed the plaintiff's self-dealing claim because the plaintiff failed to identity a "transaction" as that term is used in ERISA Section 406(a).[23]

In summary

- In *Hutchins v. HP Inc.*, a federal district court in California dismissed – with prejudice – the plaintiff's claims challenging the use of forfeited employer 401(k) contributions. This is the latest decision impacting the new wave of class action lawsuits alleging that the use of 401(k) forfeitures to offset future employer contributions violates the Employee Retirement Income Security Act (ERISA).
- The court's decision highlights the importance of thoughtfully drafted plan provisions that detail the permitted or mandated uses of forfeitures.
- The court's decision also serves as an important reminder that employers and plan fiduciaries should continue to proactively review their plan language to ensure that the use of forfeitures is consistent with plan terms and applicable laws.

Conclusions and considerations

The *Hutchins* decision reinforces the importance of plan provisions that detail the permitted or mandated uses of forfeitures and serves as an important reminder that employers and plan fiduciaries should continue to proactively review their plan language in order to present a strong defense in case of potential or future litigation.

Notes

1. Hutchins v. HP Inc., No. 5:23-cv-05875-BLF (N.D. Cal. Feb. 5, 2025).
2. Plaintiff's complaint was previously dismissed with leave to amend. Hutchins v. HP Inc., 737 F. Supp. 3d 851, 869 (N.D. Cal. 2024).
3. No. 5:23-cv-05875-BLF, at 9.
4. Id.
5. Id. at 12-15.
6. Id. at 16.
7. Id. at 5-6.
8. Id. at 6.
9. Id.
10. Id. (citations omitted).
11. Id. at 7.
12. Id.
13. Id.
14. Id. at 7-8.
15. Id. at 8 (emphasis in original).
16. Id. (emphasis in original).
17. Id.
18. Id.
19. Id. (citing Use of Forfeitures in Qualified Retirement Plans, 88 Fed. Reg. 12282-01, 12283 (proposed Feb. 27, 2023)).
20. Id. (citing H.R. Rep. No. 99-841, at II-442 (1986)).
21. Id. at 9-12.
22. Id. at 12-15.
23. Id. at 15-16.

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