401(k) Forfeiture Litigation: Implications for Plan Sponsors

Background

In a wave of class-action litigation beginning around 2023, plaintiffs have alleged violations of fiduciary duties under the Employee Retirement Income Security Act (ERISA) and prohibited transaction rules in connection with plans' handling of 401(k) forfeitures.

Many 401(k) plans feature vesting schedules for contributions made by employers on behalf of employees. When an employee leaves employment before vesting fully in employer contributions per a vesting schedule, the employee forfeits the portion not vested. (Contrast with employee contributions deducted from employee paychecks, which always vest immediately.)

What happens to the forfeited funds—which can be significant—depends on plan terms. Plans might require the money to be used to pay administrative costs which can otherwise be charged against participants' accounts. Other plans might use forfeitures to reduce contributions that would otherwise be paid by the employer. Still other plans, and crucial to plaintiffs' theory, allow the plan administrator or plan sponsor to decide how the money is used.

Plaintiffs allege that those deciding how to use the money owe a fiduciary duty to participants that remain in the plan. They argue that when plan terms give a choice on how to use the money, ERISA's fiduciary duties of loyalty and prudence require that the choice be made in the interest of participants, to defray administrative expenses.

In 2023, the IRS proposed a rule that would explicitly allow plans to use forfeitures to reduce employer contributions and administrative expenses when authorized by the terms of a plan. Even if the rule had been finalized, it would have been unlikely to resolve the disputes in these cases because plaintiffs' fiduciary duty claims lie within the regulatory authority of the Employee Benefit Security Administration ("EBSA") and not that of the IRS and the IRS proposed rule would have maintained the choice of forfeiture use at the center of these cases. Also, the most recent IRS regulatory agenda strongly implies that a final rule, unlike the proposed rule, would not address acceptable use of forfeitures and only provide guidance on the timing of their use.

Mixed results

Plaintiffs have seen some limited success in defeating motions to dismiss. Take these representative examples.

For the most successful in this line, look to *Rodriguez v. Intuit* (Aug. 2024), in which plaintiffs defeated a motion to dismiss in California district court. There, plaintiffs argued for breaches of fiduciary duties of loyalty and prudence, as well as prohibited transactions and anti-inurement violations. In denying Intuit's motion to dismiss, the court first determined that plaintiffs had adequately pleaded that Intuit acted as a fiduciary when deciding how to use forfeitures. In doing so, the court rejected Intuit's contention that the decision on how to use forfeitures was a settlor function not subject to fiduciary duties. Further, the court agreed that plaintiffs pleaded plausible breaches of the fiduciary duties of loyalty and prudence. This case settled earlier this year.

A similar result was reached in *Perez-Cruet v. Qualcomm*, in which plaintiffs made almost identical arguments. In denying Qualcomm's motion to dismiss (May 2024), the court agreed that use of forfeitures to reduce contributions in lieu of reducing administrative expenses was a plausible fiduciary violation. The court reasoned that had the plan used forfeitures "toward paying Plan administrative expenses, all Plan participants would have benefited by incurring no administrative expense charge to their accounts. Instead, all Plan participants had to pay for administrative expenses that could have been reduced to zero had the Defendants chosen to use forfeited contributions in that way."

Similarly, in *McManus v. Clorox* (March 2025) a California district court declined to dismiss an amended complaint after determining that defendants plausibly acted as fiduciaries in deciding how to use the forfeitures at issue. The court determined that the pleaded facts were sufficient "to infer that defendants are liable for the misconduct alleged because courts look to motivation for loyalty claims and the thoroughness of an investigation for prudence claims." Here, the court focused on pleadings showing that Clorox had a conflict of interest with respect to its fiduciary decision and always decided in its own favor rather than in that of plan participants.

These results stand in contrast to the decision in *Hutchins v. HP*, in which a California district court twice dismissed (June 2024 and Feb. 2025) complaints of this type. The court gave great weight to the implausible breadth of the plaintiff's theory—that ERISA's fiduciary provisions would always require use of forfeitures to pay administrative costs otherwise borne by participants. Following such a theory to its conclusion, the court reasoned, would in essence create a benefit not promised by the plan. And crucially, the court pointed to plan language that gave total discretion on how to pay plan expenses to the plan sponsor (which the court characterized as a settlor function not subject to fiduciary standards). In other words, under the terms of the plan, the plan administrator was only permitted to use forfeitures to pay plan expenses when the plan sponsor, acting as a settlor, chose to allow it.

Hutchins v. HP has been appealed to the 9th Circuit, and the U.S. Department of Labor ("DOL") filed an amicus brief in support of HP. The brief states that "deciding how to allocate Plan forfeitures in accordance with the Plan terms [is] a fiduciary function." But in this case, the brief argues, the plan sponsor, acting as the settlor, tightly constrained the fiduciary decision by using plan document language to reserve total control over funding decisions like how expenses are paid. Thus, the DOL concluded, that "a fiduciary's use of forfeited employer contributions in the manner alleged in this case, without more, would not violate ERISA." While a DOL brief in support of the plan sponsor may seem like good news for employers, the reality is mixed. On the positive side, the DOL believes that plaintiffs would need to plead more in order to establish a breach of fiduciary duty. On the negative side, the brief clearly states that the allocation of expenses is a fiduciary decision and its support relied heavily on the particular facts of this case, including plan terms and how the plan sponsor determined contribution levels. At any rate, the brief is not binding on courts.

In *Sievert v. Knight-Swift Transportation* (April 2025), closely tracking the Hutchins v. HP reasoning, an Arizona district court held that "plan sponsor's decision to allocate forfeitures toward reducing its own employer contributions, without more, is not sufficient to state a claim for a breach of fiduciary duty of loyalty or prudence under ERISA." The court was persuaded that plaintiffs' theory was impermissibly broad because accepting it would result in all forfeitures being required to be used to defray plan expenses, a result the court found to be unlikely.

Finally, in *Wright v. JPMorgan Chase* (June 2025), the Central District of California rejected breach of fiduciary duty claims with respect to 401(k) forfeitures. Most significantly, the court noted that, by the terms of the plan, even if forfeitures were used to pay administrative expenses, they were only permitted to "reduce future contributions of the Bank or the Bank's share of Plan expenses not paid directly by the Plan." The court also noted that accepting plaintiffs' theory would require the court to turn its back on decades of common practice and settled law.

Strategies to Limit Litigation Risk

Fortunately, if you sponsor a plan that allows discretion in how to use forfeitures, there are several options to reduce litigation risk with respect to their use.

The safest option is to limit discretion. A plan could be amended to prescribe the order priority of forfeiture use rather than allowing the plan administrator to decide. For example, the plan document could require use of forfeitures first to restore participant accounts following reemployment, second to reduce employer contributions, and third and finally towards administrative expenses. In this way, there would be no fiduciary decision on how to use forfeitures.

Another option that maintains some discretion in how forfeitures are used is to amend the plan to unambiguously vest discretion in the plan sponsor (not the administrator) as a plan funding decision and settlor function. This strategy, while not as safe as simply eliminating discretion, keys off the reasoning in the *HP* case.

Finally, a plan sponsor could amend the plan to require that, when forfeitures are used to pay administrative expenses, they may only be used to pay administrative expenses that would have otherwise been borne by the employer (similar to the plan language the court relied on in dismissing the JPMorgan complaint). With this type of rule in place, participants are not worse off when the plan administrator declines to use forfeitures for defraying plan administrative expenses.

If you have questions about your litigation exposure with respect to your plan's forfeiture terms, contact Gregory M. Katz, any attorney in our employee benefits and executive compensation practice or the attorney at the firm with whom you are regularly in contact.

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