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Tenth Circuit Affirms Damages Based on Revenue Credit, and Makes Clear That Arms-Length Service Agreements Without Evidence of A Prior Relationship Are Not Prohibited Transactions

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On appeal following a bench trial of claims brought by a class of participants and beneficiaries of a 401(k) plan, the Tenth Circuit affirmed the decision of the District of Colorado calculating damages and prejudgment interest, denying injunctive relief, and finding the employer did not engage in a "prohibited transaction" under ERISA Section 406, 29 U.S.C. § 1106. Ramos v. Banner Health, No. 20-1231 (10th Cir. June 11, 2021).

At trial, the district court concluded the failure to monitor recordkeeping fees under an uncapped, revenue-sharing agreement with a service provider for nearly 20 years was a breach of fiduciary duty resulting in overpayment to the service provider and losses to participants. However, analyzing damages, the district court found the class expert's testimony of $19.4 million in excessive recordkeeping fees and corresponding losses was unreliable under Fed. R. Evid. 702(c) and *Daubert* because it was unquantifiable and non-replicable. The class expert relied solely on his individual prior experiences, of which he provided "scant" information, and he left it unclear as to whether the plans were on the same par with the one at issue.

Accordingly, the district court chose to rely on revenue credits the service provider gave to the fiduciary to approximate the extent of excessive recordkeeping fees because it was based on plan characteristics, asset configuration, net cash flow, fund selection and the number of participants, resulting in damages of about $1.6 million. The Tenth Circuit highlighted that calculation of damages is within the discretion of the district court, affirming the calculation. The district court also utilized the IRS underpayment rate as set forth in 26 U.S.C. § 6621 to calculate prejudgment interest finding that it reasonably approximated the lost earning investment opportunity even though it was not the highest rate among other options, including the federal post-judgment rate or Colorado's statutory rate, which were much higher. However, because prejudgment interest is discretionary, not mandatory, the Tenth Circuit deferred to the district court.

The appellate court also affirmed the denial of the request for injunctive relief to require the fiduciary to issue a request for proposals to test the market for recordkeeping services. The appellate court reasoned that once the fiduciary updated its agreement to a per-participant recordkeeping fee, the breach ended.

Finally, the Tenth Circuit agreed with the district court's finding that the services provided by the recordkeeper were not prohibited transactions under ERISA. Plaintiffs contended, "[b]ecause [the recordkeeper] is a service provider and hence a 'party in interest,' its 'furnishing of' recordkeeping and administrative services to the Plan constituted a prohibited transaction[.]" The Tenth Circuit soundly rejected that notion, noting "[t]he class's interpretation leads to an absurd result: the initial agreement with a service provider would simultaneously transform that provider into a party in interest and make that same transaction prohibited under § 1106." Instead, the appellate court clarified that a prior relationship would have to exist between the fiduciary and service provider to make it a party in interest under 29 U.S.C. § 1106 as the goal of ERISA is to prevent such transactions, which raise concerns of impropriety. Because no such evidence was provided by the class, entry of judgment was affirmed.

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