

Recent Plan Forfeitures Litigation Update

June 5, 2024

PRACTICES Employee Benefits and Executive Compensation

A California federal district court recently issued a decision in *Perez-Cruet v. Qualcomm Incorporated* requiring that a 401(k) plan sponsor and its retirement plan committee defend their practice of using participant forfeitures to offset future plan employer contributions, when the terms of the plan offered the option to instead use participant forfeitures to reduce plan expenses. Similar to other recent plan-forfeiture cases, all filed by the same California law firm against large retirement plan sponsors, the participants allege that the plan committee breached its fiduciary duties of loyalty and prudence and that the plan sponsor engaged in prohibited transactions under ERISA by choosing to use participant forfeitures to reduce the plan sponsor's future employer contribution obligation under the plan. The *Qualcomm* case is the first decision issued in response to these forfeiture lawsuits.

As background, forfeitures generally result when a participant terminates employment prior to completing the plan's vesting service requirement for employer contributions. As we reported [here](#) and [here](#), the IRS permits defined contribution retirement plan sponsors to use forfeitures to pay reasonable plan administrative expenses and/or reduce future employer contributions, if permitted by the plan and timely applied.

Because participant forfeitures are plan assets, the choice of how to apply participant forfeitures is a fiduciary decision limited by the constraints of what is permitted under the plan and under applicable law. Although both the current and proposed regulations issued by the IRS expressly permit the use of forfeitures to offset future employer contributions, the crux of the complaint in the lawsuit is that because the plan provided the plan committee with the discretion to apply forfeitures in a way that is more favorable to participants, the plan committee violated its duty of loyalty to participants when it chose to apply forfeitures to offset employer contributions.

It will be interesting to see how this case and similar lawsuits progress, and we will continue to monitor any further developments. In the meantime, and as a reminder, plan sponsors, with assistance from the plan's counsel, should continue to follow the same process in connection with using plan forfeitures. This involves reviewing their plan documents to determine if the plan authorizes the use of forfeitures for employer contributions and ensuring that any ordering rules set forth in the plan document are followed (for example, some plans require plan expenses be paid prior to using forfeitures to offset employer contributions). An employer can minimize the risk of a similar lawsuit by incorporating ordering rules that clearly define the circumstances in which forfeitures are used to offset future employer contributions and those in which forfeitures are used to reduce plan expenses—so that it is no longer a discretionary decision of the employer or committee administering the plan.

The court's order denying the motion to dismiss is available [here](#).