What High Court Ruling Means For ERISA Class Claims

By **Nancy Ross and Jed Glickstein** (January 28, 2022)

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The Employee Retirement Income Security Act requires administrators of employer-sponsored plans to act prudently when selecting investment options and other services.

In recent years, plaintiffs lawyers have filed a torrent of cases alleging that 401(k) and 403(b) plan administrators violated this duty by incurring excessive costs or selecting improper investments. These putative class actions routinely seek tens or hundreds of millions of dollars in damages, and are expensive to litigate and insure against.

Often, courts dismiss ERISA fiduciary duty claims for relying on a mix of hindsight allegations, inapt comparisons and conjecture.

That a particular service provider charged $50 per person for a service, for instance, does not show that using a different provider that charged $60 was imprudent. Perhaps the services were different; perhaps the first provider charged less for one service but more for a bundle of services; perhaps participants had a long-standing and trusted relationship with the second provider; and so forth.

Other courts, however, give plaintiffs the benefit of the doubt at the pleading stage, concluding that it is possible that prudent fiduciaries would act differently.

Maybe some fiduciaries did decide to pay $50, for example. Who is to say that the defendants should not have done the same?

Courts in this latter camp typically emphasize that plaintiffs often lack direct knowledge of fiduciaries' decision-making process at the time a complaint is filed. Whether the fiduciaries followed an appropriate process is thus left for discovery.

Defense and plaintiffs counsel — not to mention the employers and fiduciaries that are the targets of these lawsuits — hoped that the U.S. Supreme Court's recent grant of certiorari in Hughes v. Northwestern University would bring some clarity to these issues.

In this respect, the Supreme Court's Jan. 24 disposition comes as something of a disappointment. The six-page decision in Hughes settles little of the dispute between the parties. It provides even less concrete guidance for future cases.

That said, Hughes' concluding recognition that fiduciaries face difficult tradeoffs and must have room to make "a range of reasonable judgments" underscores an important and often overlooked point.

We hope and expect that lower courts will heed this principle in assessing whether complaints state plausible claims under ERISA.

The Hughes Decision

In Hughes, participants in Northwestern University's retirement plans sued the university, its retirement investment committee and several individuals for allegedly breaching their fiduciary duty of prudence under ERISA.

Before the Supreme Court, the plaintiffs focused on three ways in which the fiduciaries supposedly breached their duty:

- Failing to monitor and control plan record-keeping costs;
- Failing to offer institutional class shares of numerous investment options that supposedly charged lower fees than the retail class shares the plan offered; and
- Failing to limit the total number of investment options, supposedly confusing participants.

The U.S. District Court for the Northern District of Illinois dismissed the complaint, and the U.S. Court of Appeals for the Seventh Circuit affirmed.

The Supreme Court reversed the Seventh Circuit on narrow grounds. The court read the Seventh Circuit's opinion as repeatedly relying on participants' "ultimate choice over their investments" in finding no plausible breach of fiduciary duty.

The duty of prudence, the court reasoned, applied to all investments, so the fact that participants had the opportunity to choose some prudent investments did not mean that the defendants had satisfied their fiduciary duties with respect to the investments and services the plaintiffs challenged.

Rather than determine itself whether the plaintiffs had alleged sufficient facts to make any of their three theories plausible, the Supreme Court vacated the judgment and ordered the Seventh Circuit to "reevaluate the allegations as a whole" to determine whether the plaintiffs had stated a claim.

Implications For Other Cases

The fact that the Supreme Court reversed a decision granting a motion to dismiss — no matter how narrow the basis for the decision — will likely energize the plaintiffs bar. At a minimum, it is unlikely to dampen their enthusiasm.

In the short term, therefore, the Hughes decision means that the steady drumbeat of cases filed against plan sponsors will probably continue.

Practically speaking, however, Hughes' impact is likely to be limited. The notion that participant choice excuses a breach of fiduciary duty has rarely formed the basis for the dismissal of prudence claims.

In fact, it is debatable whether the court was correct to characterize the Seventh Circuit's opinion as having an exclusive focus on investor choice in the first place.[1]

Besides clarifying that the participant's ultimate choice over investments cannot excuse a breach of fiduciary duty, Hughes said very little about how to evaluate complaints for breach of fiduciary duty on a motion to dismiss.

The court made clear that its 2015 decision in Tibble v. Edison International, which recognized a continuing duty to monitor investments and remove imprudent ones, applied in these circumstances. But that was never really in doubt.

Tibble expressly left it to the lower courts to address "the scope of that responsibility."[2] Hughes does not elaborate further.

The court also mentioned its 2014 decision in Fifth Third Bancorp v. Dudenhoeffer, which reversed the dismissal of prudence claims based on employee stock ownership plans — not at issue in Hughes or the majority of recent cases.

In Dudenhoeffer, however, the court balanced its reversal by articulating several considerations to guide lower courts in assessing ESOP claims, including holding that fiduciaries were not required to risk a violation of securities laws in order to satisfy their ERISA fiduciary duties.

These considerations helped to structure the ESOP pleading analysis and quickly resulted in a material reduction of cases challenging 401(k) plan company stock funds.

The Supreme Court offered no such considerations for lower courts to take into account here. It merely reaffirmed that, per Dudenhoeffer, the duty of prudence "will necessarily be context specific."[3]

The most reassuring aspect of the Hughes decision is the court's concluding observation, which stressed the crucial — if commonsense — point that fiduciaries are expected to exercise discretion and judgment:

> At times, the circumstances facing an ERISA fiduciary will implicate difficult tradeoffs, and courts must give due regard to the range of reasonable judgments a fiduciary may make based on her experience and expertise.

It remains to be seen whether this principle will have bite in the lower courts, particularly at the pleading stage. But if taken seriously, this principle should make it more difficult for plaintiffs to allege a breach of fiduciary duty by relying on nothing more than their own preference for a different approach to selecting plan service providers or investments.

Conclusion

Even though Hughes does not provide much immediate clarity, those interested in these questions have no shortage of cases to look forward to. In just the seven weeks between the date Hughes was argued and the date the opinion was issued, a host of new ERISA class actions were filed in district courts around the country.

A number of cases that had been temporarily stayed while Hughes was pending will now move forward; many others have been proceeding apace in the meantime. And with the Supreme Court's remand, the Seventh Circuit will now have another chance to weigh in on the specific allegations against Northwestern University.

In short, there will be many opportunities for lower courts to address pleading requirements and similar issues in this developing area of the law. Employers and practitioners should therefore stay tuned.

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Disclosure: Ross and Glickstein submitted an amicus brief on behalf of 18 higher education organizations in support of Northwestern University in Hughes v. Northwestern.

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[1] The Seventh Circuit offered independent grounds for dismissing both the recordkeeping claim and the share-class claim. Divane v. Northwestern University, 953 F.3d 980, 989-91 (7th Cir. 2020). Even as to the theory that it was imprudent to offer "too many investment options" to participants—a theory the Solicitor General notably did not endorse before the Supreme Court—the Seventh Circuit mentioned investor choice not to "excuse" a breach of duty, but to explain why a wide range of investments is not a breach of fiduciary duty in the first place. Id. at 991-92.

[2] Tibble v. Edison International, 575 U.S. 523, 530-31 (2015).

[3] Fifth Third Bancorp v. Dudenhoeffer, 573 U.S. 409, 425 (2014).