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Clues from the oral argument in *Hughes v. Northwestern University*

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In recent years, there have been a flood of lawsuits filed challenging the administration of retirement savings plans. Initially, these cases targeted large corporate 401(k) plans. But over a short period in 2016, plaintiffs filed more than a dozen complaints against large private university 403(b) plans as well, raising a number of similar theories.

Over 100 retirement cases were filed in 2020 and over 40 more in 2021.

Broadly speaking, in these cases, plaintiffs claim that plan participants paid too much for administrative services and were not offered the investment choices that they say, in retrospect, they would have preferred. By targeting large plans and suing on behalf of tens of thousands of putative class members, plaintiffs can bring enormous settlement pressure to bear on defendants.

The lower courts have struggled to impose order on this litigation — and nowhere is that struggle more evident than in the university cases. Even though the factual allegations in these cases were very similar, in the federal district courts, the cases took very different paths from the start.

In the D.C. Circuit, for example, the initial complaints against Georgetown and George Washington University were dismissed in their entirety for failure to state a claim, among other reasons. In the Second Circuit, cases against New York University, Yale, Columbia, and Cornell survived motions to dismiss to varying degrees. In the Third Circuit, the case against the University of Pennsylvania was dismissed in its entirety but revived on appeal by a divided court. In the Seventh Circuit, the case against Northwestern was dismissed in its entirety and the dismissal upheld in a forceful opinion on appeal. The Eighth Circuit split the difference, affirming dismissal of the investment option claims but not the administrative fee claims against Washington University. That the same law, applied to the same basic factual allegations, could yield such different results vividly illustrates the problems that defendants face in assessing and mitigating exposure in these lawsuits.

In *Hughes v. Northwestern University*, the Supreme Court granted certiorari to address the applicable pleading standard in these cases. The case was argued in December 2021. In some respects, it is ironic that this issue only reached the Supreme Court now, five years after the wave of 403(b) litigation crested. Besides Northwestern, most of the other university cases have either settled or been resolved on the merits.

In other respects, however, the decision to hear the case could not be more timely. Over 100 retirement cases were filed in 2020 and over 40 more in 2021. Yet the Supreme Court has not weighed in on the applicable pleading standard in an ERISA case since *Fifth Third Bancorp v. Dudenhoeffer*, 573 U.S. 409 (2014), which addressed a distinct category of employee stock ownership plan claims largely not at issue in the more recent spate of litigation.

Hughes thus represents a long-awaited opportunity for the Supreme Court to determine the ground rules that will apply in cases alleging that plan fiduciaries failed to act prudently in administering retirement plans.

Reading the tea leaves

By the time the case reached the Supreme Court, the petitioners in *Hughes* had limited their case to three claims.

First, they argued that Northwestern's plan paid too much in recordkeeping fees and should have reduced those fees in various ways, including soliciting competitive bids for recordkeeping services, consolidating recordkeepers, or simply negotiating harder.

Second, the petitioners argued that Northwestern's plan offered participants too many investment options.

Finally, they argued that Northwestern's plan ought to have offered many of its investments in "institutional" share classes as a way to lower overall fees.

Making predictions about Supreme Court arguments, like making predictions about plan investments, is difficult. But several aspects of the oral argument in the Northwestern case provide important clues about where the Court may be headed.

Consolidation

A basic tenet in fiduciary duty cases is that courts must compare apples to apples. It is not, for example, imprudent to pay different fee amounts for different services. At the oral argument in *Hughes*, the petitioners focused heavily on their claim that fiduciaries could have saved money by consolidating from multiple recordkeepers to one recordkeeper.

Several justices expressed skepticism at the notion that it was plausible to infer a breach of fiduciary duty when the petitioners' examples of possible cost savings all relied on consolidating several recordkeepers and making significant changes to investment lineups instead of comparing apples to apples.

This issue is particularly important in university cases because of the unique history of university retirement plans. University plans typically have significant assets invested in annuity options from the Teachers Insurance and Annuity Association ("TIAA"), which only TIAA had record kept. Thus, the few examples the petitioners provided of universities that consolidated to a single recordkeeper did so either by consolidating to TIAA or by freezing TIAA or other core offerings in their plans.

At the oral argument in Hughes, the petitioners focused heavily on their claim that fiduciaries could have saved money by consolidating from multiple recordkeepers to one recordkeeper.

The justices did not seem inclined to find these comparisons suggestive of imprudence. For example, Justice Sotomayor noted, "That's so hard because consolidating … I don't know how you ever could allege that having one as opposed to two is imprudent."[1] Justice Sotomayor explained that she assumed "there is value to having two because you don't want to get rid of TIAA because of its institutional situation."[2]

Justice Kagan agreed: "[F]or me, that's the one that seems a little bit more, I don't know, I have to think about that."[3] As Justice Kavanaugh indicated, identifying three or four fiduciaries that took a different path is hardly evidence that every other fiduciary was violating its fiduciary duty. "You've named three universities or maybe four that changed. Is that enough to say the industry norm has changed?"[4]

'Too much choice'

The petitioners also alleged that Northwestern was imprudent because it offered too many investment options to plan participants. Respondents countered that participant-directed plans like 403(b) plans are fundamentally about maximizing choice and giving participants options so that they can decide for themselves how best to invest their retirement savings.

Several justices expressed concern about the claim that ERISA fiduciaries must winnow investment options for its own sake. For example, Justice Kagan asked, "isn't the consolidation claim a harder one for you? … I mean, there is … at some point a downside to having a non-diverse set of funds, right?"[5]

Both Justice Kagan and Justice Gorsuch indicated concern about how courts might administer a hard rule. Justice Gorsuch observed, "I don't think you'd … want courts to say 40 is a magic number and … that choice is bad. I mean, all things equal, choice is usually a good thing."[6] And Justice Kagan asked, "isn't that much harder for courts to figure out? … [A]t what point is … nobody's going to want that plan, it only has three funds in it?"[7]

The Solicitor General, who filed an amicus brief in support of the petitioners, notably did not take a position on whether offering too many investment options to participants could itself represent a breach of fiduciary duty. At the oral argument, Justice Gorsuch confirmed with the government's advocate that the government had not changed its position.[8]

'Just ask'

Although the justices spent more time on the petitioners' share class claim, they appeared to resolve less. Absent an obligation to winnow the number of investment options, counsel for the petitioners asserted that another way respondents could have lowered overall fees was to request a special fee waiver: "all they [fiduciaries] had to do was ask for it and get it."[9]

Typically, investors must meet minimum investment thresholds to qualify for institutional share classes, but the petitioners argued in their brief (at 31 n.13) that Northwestern's plans "are among the largest 0.2% defined-contribution plans in the country" and that "such large investors are able to obtain lower-cost institutional share classes, even if they do not meet minimum investment thresholds."

Thus, at the oral argument, their counsel stated that Northwestern could have lowered fees by requesting a special fee waiver from its recordkeepers: "minimum thresholds are waived," he argued, and institutional share classes are "available if the [r]espondents would have asked."[10]

This "just ask" approach drew some supportive questioning from several justices.[11]

But other justices were skeptical that respondents should be held to a special standard. Chief Justice Roberts suggested an analogy: if you ask somebody "to go out and fill this car with gas, you know, if he came to the intersection and one company, A, was however many, you know, dollars a gallon and somebody else was a lot less, you'd expect him to go to the one that's a lot less." But, "I don't know if you'd expect him to drive … another 10 miles and go to the Acme gas company."[12]

Justice Breyer used his own analogy, stating that "a fiduciary shouldn't be able to go into the grocery store, to take an example, and pay a thousand dollars for an apple. Even if they're charging a thousand, he should say something. Okay? On the other hand, you can't expect a person to go into the Giant grocery and get the best deal on each item."[13]

'All our competitors'

Under ERISA, fiduciaries owe duties to retirement plan participants to act "with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims." 29 U.S.C. § 1104(a)(1)(B).

ERISA thus sets a relative standard that requires fiduciaries to heed the practices of their peers. Many of the exchanges between justices and counsel in the *Hughes* oral argument ultimately concerned how to define the respondents' peer group at the pleading stage.

One of the most interesting things highlighted in the argument was that the petitioners seek to define Northwestern's peer group differently from claim to claim. For example, with respect to recordkeeper consolidation, the petitioners' counsel pointed the Court to the 403(b) market *generally*.

What is plausible in the 403(b) context might look different than plausibility in the 401(k) context — particularly if the Supreme Court takes an interest in the relevant "peer group."

He explained that by "January 1, 2009, some 57 percent of the 403(b) plans had conformed to bring their practices in line, and by 2013, depending on which survey, and we cited both of them in the complaint, between 80 and 90 percent of the plans, the 403(b) plans, had consolidated to a single recordkeeper."[14] Thus, he argued, Northwestern, and the other universities sued, were "bad outliers … way behind industry standards in conforming their plans."[15]

Yet for the special waiver claim, petitioners' counsel pointed the Court to the smaller subset of "jumbo" plans within the 403(b) and 401(k) plan markets. He explained that the petitioners pled that "minimum thresholds are waived" for the largest retirement plans and "*jumbo plans* get the best deals."[16]

At one point, Justice Kagan asked, "why can't you go into federal court saying all our competitors are paying … far lower fees than you are for the exact same service?"[17] In light of the petitioners' arguments, the Court will have to grapple with what an ERISA plaintiff must plead with respect to a fiduciary's peer group. In Justice Kagan's example, who exactly are Northwestern's "competitors"? And, can that shift from claim to claim?

If so, that raises important questions for fiduciaries. If plans like Northwestern's must heed their peer jumbo plans for purposes of securing special fee waivers, why should they not also follow those same peers on questions of recordkeeper consolidation, or on offering TIAA annuities? What should be their benchmark for recordkeeping fees? Or more complicated still, for investment offerings?

The path forward

In our view, the Court's questions at oral argument show skepticism about the merits of many of the petitioners' theories in the 403(b) cases, even if some justices are inclined to give plaintiffs more leeway at the pleading stage. However these questions are resolved in *Hughes*, the decision is likely to be merely the end of the beginning of the conversation.

In part, this is because the claims before the Court in *Hughes* are merely a subset of the administrative and investment option claims brought in ERISA excessive fee cases.

For example, the petitioners in *Hughes* did not ask the Court to consider their challenges to TIAA's traditional and variable annuities; or their claims that respondents imprudently allowed TIAA to "cross-sell" its commercial products to plan participants.

The petitioners had tried unsuccessfully to assert both of these claims in the lower courts. The former claim is typical of challenges to certain investment offerings in retirement plans; the latter, distinct theory has started to arise in other ERISA litigation as well.

More fundamentally, however, *Hughes* is unlikely to be the final word because the argument focused heavily on the particulars of the university 403(b) market. Although many 401(k) cases involve recordkeeping and share-class claims, 401(k) plans tend to offer many fewer investment options than university plans, and the recordkeeping marketplace for 401(k) plans is meaningfully different.

401(k) lawsuits are also increasingly targeting smaller plans, which raise distinct considerations, and bringing claims for breach of the duty of loyalty. What is plausible in the 403(b) context might look different than plausibility in the 401(k) context — particularly if the Supreme Court takes an interest in the relevant "peer group," as discussed above.

In any event, based on their questioning at oral argument, the justices seem likely follow the approach taken in cases like *Dudenhoeffer* and *Tibble v. Edison International*, 575 U.S. 523 (2015), by articulating general principles but leaving the details to be worked out by the lower courts.

This means that, while Hughes undoubtedly will serve as a polestar for future cases, difficult questions about the showings that must be made to advance beyond the motion to dismiss stage are likely to arise as plaintiffs shift their theories and factual allegations in response to the Supreme Court's ruling.

Notes

[1] Tr. 31

[2] *Id.*

[3] Tr. 49-50

[4] Tr. 21

[5] Tr. 18

[6] Tr. 19

[7] Tr. 18

[8] Tr. 52-53

[9] Tr. 17

[10] Tr. 15-16

[11] *See, e.g.*, Tr. 17–18 (Justice Kagan: "All they had to say was we want the institutional rate and they would have gotten it. That just sounds like negligence."); Tr. 19 (Justice Gorsuch: "I can certainly see that argument."); Tr. 30 (Justice Sotomayor: "I think that your strongest argument is with respect to the institutional shares because, … you say others have offered institutional shares without the minimum, and they could have done this. You have to prove it, but assuming that's plausible.").

[12] Tr. 25

[13] Tr. 13

[14] Tr. 21

[15] Tr. 22-23

[16] Tr. at 15

[17] Tr. 64

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