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[Podcast]: Key ERISA Fee and Investment Litigation Developments and the Impact of Hughes v. Northwestern University

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In this episode of The Proskauer Benefits Brief, Myron D. Rumeld, partner and co-chair of Proskauer's ERISA Litigation group and senior associate Tulio D. Chirinos, review the current state of affairs with respect to the litigation challenging the fees charged and investments offered in defined contribution plans; and The Supreme Court's recent decision in Hughes v. Northwestern University where the court reversed and remanded the Seventh Circuit's decision affirming dismissal of a 403(b) plan excessive fee litigation.

Myron D. Rumeld: Welcome to The Proskauer Benefits Brief: Legal Insight on Employee Benefits and Executive Compensation. My name is Myron D. Rumeld. I'm a partner and co-chair of Proskauer's ERISA Litigation Group. I'm joined today by Tulio Chirinos, senior associate in Proskauer's Boca Raton office. Today we're going to review the current state of affairs with respect to lawsuits challenging the fees charged and investments offered in defined contribution plans. We're also going to discuss, in particular, the Supreme Court's recent decision in the Hughes v. Northwestern University. The Court reversed and remanded the Second Circuit's decision that had affirmed the dismissal of a 403(b) excessive fee litigation claim. Tulio, can you tell us generally what has been going on with the defined contribution plan litigation in the last year or two?

Tulio D. Chirinos: Thank you, Myron. When we in the ERISA community look back at 2020 and 2021, we will remember it as a historic period for fee and investment litigation. During just this two-year period, plaintiffs filed over 140 class action complaints involving plans of all sizes and nearly all industries. Just for a little bit of context: that's more cases filed in a two-year period than all other years combined since the surge of these cases began in 2015. District Courts issued over 80 motions to dismiss decisions. With nearly 60 of those decisions being handed down and 2021. Which easily accounts for the most decisions at the pleading stage in any year since 2015. Appellate courts address numerous procedural and substantive issues during this period, including the enforceability of arbitration agreements with class action waivers, the proper pleading standard to survive a 12(b)(6) motion to dismiss, and the appropriateness of several trial decisions. The Supreme Court issued two rulings in fee and investment cases, including the Hughes case that we'll discuss a little later.

Myron D. Rumeld: So, have there been changes you're noticing in the types of claims asserted in all these cases?

Tulio D. Chirinos: Although there have been some novel claims since 2015, the vast majority of the recent cases stick to the same fairly straightforward claims of breach of fiduciary duty, which include, for example, allowing the plan to pay excessive record-keeping and administrative fees. This claim is usually supported with allegations that the fiduciaries did not investigate through periodic R.F.Ps. Whether the fees paid were excessive compared to the market and that fiduciaries entered into unchecked asset base arrangements where the record keepers revenue increased over time as the plan assets increased without an increase in services. The other typical claim that we see is selecting and retaining investment options for the plan menu that are allegedly more expensive and/or that underperformed other comparable investments in the marketplace. In many of these cases, we find that these claims are asserted in virtually identical fashion. Now, that's not surprising, given that six law firms account for the overwhelming majority of those 140 new complaints from 2020 and 2021.

Myron D. Rumeld: How has the defense bar responded to all these cases?

Tulio D. Chirinos: Well, the answer to this question is in the eye of the beholder, as plaintiffs and defendants can point to victories. If we only look at cases filed motion to dismiss decisions, class certification, and settlements, it will look favorable for the plaintiffs' bar. Those are important things to look at. As I briefly explained, plaintiffs have filed over 140 cases in just the last two years. They've survived over 60 out of the over 80 motions to dismiss, often moving these cases into expensive and time-consuming class discovery. Last but of course, not least in this space, plaintiffs have acquired over 300 million in settlements and over 100 million in attorneys' fees. If we go back to 2015, those numbers rise to one billion in settlements and over 300 million in attorneys' fees. But if we look at decisions on the merits, it begins to look a little bit more favorable for defendants. Since 2015, only seven of the hundreds of cases that have been filed have reached trials. In those cases, plaintiffs have only won on two discrete claims and have lost in several large class actions at the summary judgment stage. Just by way of example, in 2021, the plaintiff lost all claims in both cases to reach trial and lost that summary judgment and a case with a certified class of over 250,000 plan participants.

Myron D. Rumeld: So let's focus on the motion to dismiss experiences for the moment since, from a defense standpoint, that's the key area where we want to try to make the case go away. It sounds like the majority of the motions have been denied in the last couple of years, but there have been quite a few successful outcomes. Are you finding Tulio any meaningful way to distinguish the outcomes that are favorable at the motion to dismiss stage from the ones that have been favorable for the plaintiffs?

Tulio D. Chirinos: That's right, defendants are not completely shut out. They have been winning about 30% of the motion to dismiss decisions in the last two years. Some of the victories for defendants are their unique issues that make it clear that plaintiffs asserted bad facts that completely undermine their claims. For instance, in one case, plaintiffs got the performance figures wrong. And in other cases, they clearly lacked standing because plaintiffs are not invested in any of the challenge funds, which in those cases, it makes it easy for the Court to grant dismissal. But when we look at the rest of that 30%, we're seeing courts dismiss claims that do not appear to be any less well-pled than in any other cases where motion to dismiss have been denied. Remember, these are cases brought primarily by six law firms and assert substantially similar claims and move them into class discovery.

Myron D. Rumeld: Let's switch the discussion to the Supreme Court decision on *Hughes v. Northwestern*. I know, on our side, everybody was hoping that the Supreme Court would deliver some clarity when it first granted **cert in *Hughes v. Northwestern*.** Can you tell us how Hughes reached the Supreme Court and what the Court ended up doing?

Tulio D. Chirinos: You're correct. The ERISA community, especially the defense bar, was eagerly awaiting the huge decision with the hope that the Supreme Court would issue a ruling that would resolve the core pleading issues that have persisted for many years in the space, some of which I just described. This noticeable inconsistency at the pleading stage came to a head in a series of lawsuits, including the Hughes case, which commenced in 2016 against university-sponsored 403(b) plans by the same firm, asserting virtually identical claims. These lawsuits targeted the offering of retail share classes for certain mutual funds when allegedly less expensive institutional share classes for identical funds were available that could have been offered instead. The selection and retention of investment funds that allegedly overcharge for underperformance benchmarks or other funds available in the market and administrative record keeping fees charged. Which allegedly exceeded the average per-participant fees charged by funds of comparable sizes. The Seventh Circuit affirmed the dismissal of all claims in Hughes, including those I just described. But the Third Circuit earlier had allowed the same claims brought by the same law firm to survive a motion to dismiss. This created a circuit split. For its part, the Seventh Circuit provided various legal reasons why the plaintiffs' claims failed like there's no requirement in ERISA to offer the cheapest fund and also gave weight to valid reasons offered by defendants for making the challenge decisions. Crucially, the Seventh Circuit also stated throughout its ruling that plaintiffs' claims were insufficient because the plans included a wide range of options.

Therefore, plaintiffs could choose not to invest in the more expensive funds they challenged and complaint. At the Supreme Court, the Court reversed the Seventh Circuit's decision affirming the dismissal, and unfortunately, did so on the narrowest possible grounds. In a unanimous decision authored by Justice Sotomayor with Justice Barrett, recusing herself, the Court vacated and remanded the Seventh Circuit's ruling because of what it characterized as the seventh circuit's quote, "exclusive focus on investor choice" and for failing to apply the guidance set forth in its 2015 decision *Tibble v. Edison*, which held that plan fiduciaries have an ongoing duty to monitor investments and remove imprudent investments within a reasonable time. The Court remanded The Seventh Circuit to reevaluate its decision and apply the Supreme Court's guidance in *Tibble* and general pleading standards set forth in the Supreme Court's decisions in *Ashcroft v. Iqbal* and *Bell Atlantic v. Twombly*. The Court then concluded its decision with what is likely the most interesting statements of the entire order. First, the Court cited its prior decision in *Fifth Third Bancorp v. Dudenhoeffer,* which set forth pleading standards for employer stock drop claims. It stated that because the content of the duty of prudence turns on the circumstances prevailing at the time the fiduciary acts, the appropriate inquiry will necessarily be context-specific. This is the first time the Supreme Court has directly said *Dudenhoeffer* applies in a fee and investment litigation.

The Court then concluded the order by stating the circumstances facing an ERISA fiduciary will implicate difficult trade-offs. And courts must give due regard to the range of reasonable judgments a fiduciary may make based on her experience and expertise. Now, Myron, as someone who has studied and defended against this surge of fee and investment litigation over the last couple of years, what are your key takeaways from the Hughes decision?

Myron D. Rumeld: Well, Tulio, from the perspective of the defense bar, I don't think there's any question that we view this as a missed opportunity for the Court to help stem the tide of all these inconsistent rulings on motions to dismiss by putting some clarity and some teeth into the pleading standards for these types of cases. For whatever reason, the Court was just not prepared to do that. But it also didn't say anything that was particularly troublesome to the defense. The ruling, when read properly, stands merely for the proposition that a court cannot dismiss the complaint simply because the plan offered a mix and range of investment options. Doing so allowed the participant to avoid costly investments. The Court said that each investment still has to be evaluated on its own standing. I don't know, that's a particularly troublesome statement. In remanding the case, the Court left open the possibility that there could be dismissal of the same claims for other reasons, including some of the reasons that you just alluded to that the Supreme Court didn't address in its ruling.

Tulio D. Chirinos: Well, over the last two weeks, we've seen a lot of discussion from the defense bar about the end of the Court's decision. What do you make of that part of the decision where the Court references the *Igbal* and *Twombly* pleading standards and to the Supreme Court's prior decision in *Dudenhoeffer*?

Myron D. Rumeld: Well, like some of our colleagues, I think the references to these other cases on pleading standards are encouraging, and they could create an opening for other courts to develop pleading standards that could put some restraints on these lawsuits. That's particularly true for the *Dudenhoeffer* decision that the Court specifically referenced. Now *Dudenhoeffer* dealt with an employer stop lawsuit, which is a different ball of wax. Still, the requirement in *Dudenhoeffer* that the plaintiff pleads facts that make it more likely than not that a prudent fiduciary would have engaged in the same conduct, that standard could readily be applied here. For example, a court could conclude that a bare-boned share class claims, a claim that the plan wrongfully used more expensive share classes than were otherwise available. A court could conclude a claim like that is insufficiently pled because the prudent fiduciary could very well have decided to use the highest share classes as a means to generate revenue sharing that was used to pay for record-keeping fees. Or a court could reject a bare-boned record-keeping fee claim, a claim that says nothing more than the fees charged are more than what others in the industry are charging by concluding that a prudent fiduciary would have paid the higher fees in return for some additional services. Or the Court could conclude that a proven fiduciary could have used an asset-based fee arrangement notwithstanding the plaintiff's challenges because doing so would protect the participants with small accounts who would suffer from a fixed fee per participant instead of the asset-based fee arrangement.

The Court could also reject the claim of improving the selection of managed funds by ruling that a prudent fiduciary could have very well opted to pay the higher fees associated with these managed funds in return for the greater protection that they offer relative to index funds from downside movement of the market, there are reasons to have managed funds, even though they cost more money. Even on a motion to dismiss if implying they do not offer standard, a court could conclude that it's not more likely than not that a prudent fiduciary couldn't have reached the same result. In each of those examples I've given, which go to some of the typical claims that have frequently been surviving a motion to dismiss, a court could be acting consistently with the spirit of *Dudenhoeffer* by considering these obvious explanations for the challenged conduct before allowing these claims to proceed to discovery. If that were to happen, we could be looking back at the Hughes decision as creating the opportunity for other courts to develop the kind of standards that would put some restraints on these types of claims.

Tulio D. Chirinos: So I take it then, while Hughes may be a missed opportunity to straighten out the pleading standards and fee and investment litigation. You think the ruling may, in the future, pave the way for one that does?

Myron D. Rumeld: That's right. That's the hope. Unfortunately, until that time, it is unlikely that we're going to see any let-up in the pace of these lawsuits.

Tulio D. Chirinos: Thank you, Myron, and thank you all for joining us today on The Proskauer Benefits Brief. Stay tuned for more insights on employee benefits and executive compensation and be sure to follow us on Apple Podcasts, Google Podcasts, and Spotify.

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