EMPLOYEE BENEFITS AND EXECUTIVE COMPENSATION

SUPREME COURT REAFFIRMS NEED FOR INDIVIDUALIZED ANALYSIS OF BREACH OF FIDUCIARY DUTY CLAIMS

Since 2008, plaintiffs' firms have filed numerous lawsuits challenging various aspects of 401(k) and 403(b) plan investment management and administration. 2020 and 2021 saw a further surge in these cases. As a result, ERISA practitioners, plan sponsors, and fiduciaries were closely watching the Supreme Court's review of the Seventh Circuit's dismissal of a case alleging that Northwestern University's retirement plans included overpriced investment options and charged excessive recordkeeping fees. It was hoped that the case would provide better clarity on the level of detail necessary for plaintiffs' claims to survive an initial motion to dismiss. On a motion to dismiss, the court reviews whether the defendants' conduct constituted an actionable violation of their fiduciary duties, if in fact the defendants acted as the plaintiffs have described. If the claim survives a motion to dismiss, plaintiffs can then engage in discovery, and the matter (in the absence of a settlement) will eventually proceed to the court for findings as to whether, in fact, the plaintiffs have proven that the alleged problematic conduct occurred.

Accordingly, prevailing on a motion to dismiss can spare defendants significant expense and effort. In order for a complaint to survive a motion to dismiss, the Supreme Court's *Bell Atlantic Corp. v. Twombley* decision states that the complaint must "'give the defendant fair notice of what ... the claim is and the grounds upon which it rests'" and must be "plausible." The Court ruled that while detailed factual allegations are not necessary, the plaintiff cannot simply state "conclusions" and explained that a "formulaic recitation of the elements of a cause of action" is not sufficient. Over the years, plaintiffs and defendants have argued about how to apply this standard in the context of claims alleging that a plan's fees were excessive or that its investment options underperformed. For example, is it sufficient for a plaintiff to allege that a plan's fees as reported on Form 5500 were higher than average fees, or must a plaintiff provide evidence that specific comparator plans had lower fees? If the latter, how similar to the plan at the center of the complaint do those comparator plans need to be? How many years of data must be supplied?

Unfortunately, the Supreme Court's decision in *Hughes v. Northwestern University* seems unlikely to definitively settle the matter. The Court emphasized that the decision to dismiss a breach of fiduciary claim or allow it to proceed will turn on a context-specific analysis. In the *Hughes* case itself, the Court concluded that the Seventh Circuit had erroneously relied on the availability of investment options that did not involve the fees to which plaintiffs had objected as grounds to dismiss the case, and remanded the case for reconsideration. The Court did not determine that the plaintiffs' allegations were in fact adequate to pass muster, leaving that analysis for the lower court to conduct.

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The Supreme Court's rejection of the argument that the availability of acceptable options should obviate the presence of (allegedly) problematic options was not surprising. While there had been some precedent along those lines in the Seventh Circuit, that viewpoint had never gained widespread acceptance. In most courts, fiduciaries have been expected to remove problematic investment options from a plan's designated investment line-up, no matter what other investment options were also available.[1]

Lower courts will need to decide how to interpret the Court's comments on the context-specific nature of fiduciary decisions. For example, defendants will likely argue that a plaintiff asserting that recordkeeping fees are excessive must provide comparison data for similar plans, not just plans in general or plans of a similar size but lacking other comparable characteristics, or else the plaintiff will be asking the court to review the allegations without the requisite context. Similarly, defendants will likely argue that plaintiffs challenging investment options need to provide comparative performance data for funds with a high degree of similarity, not just funds in the same asset class. However, plaintiffs will no doubt argue that the proper time for presenting data of this sort is after discovery, when the plaintiffs will have been able to obtain details about the plan not available from public filings. It remains to be seen how the courts will opine on these types of arguments.

The Supreme Court reiterated the potential complexity of ERISA fiduciary decision-making, noting that, "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." In other words, simply showing that Recordkeeper X was cheaper than Recordkeeper Y, or that Fund X performed better than Fund Y over a given period, will not necessarily be enough for a plaintiff to prevail. However, it remains to be seen what the lower courts will expect plaintiffs to demonstrate in order for their claims to survive a motion to dismiss.

Ultimately, plan fiduciaries should continue to follow well-established best practices. Fiduciaries should periodically review the cost and performance of their funds and vendors, and should work with professional advisors as appropriate to be sure they have the information and expertise necessary to make prudent decisions. Fiduciaries also need to be careful to document their decisions and the reasons for those decisions. For example, a fiduciary committee that determines that a more expensive recordkeeper will offer more valuable services than a cheaper alternative, and represents a better choice for the plan's needs, should be sure to record its analysis in the materials documenting its decision to hire the more expensive provider. A good process coupled with clear and contemporaneous documentation represents the best line of defense should a dispute arise. A good process also enables the fiduciaries to make prudent decisions in the first place and to identify and respond to problems promptly.

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[1] Self-directed brokerage accounts, which offer access to hundreds or thousands of investments, present different issues, since this type of monitoring is not feasible for these accounts.

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