MEMO# 34008

January 25, 2022

Supreme Court Vacates Seventh Circuit's Dismissal of 403(b) Plan Fee Case

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TO: ICI Members
Pension Committee
Pension Operations Advisory Committee SUBJECTS: Pension RE: Supreme Court Vacates Seventh Circuit's Dismissal of 403(b) Plan Fee Case

On January 24, the US Supreme Court issued an opinion[1] in Hughes v. Northwestern,[2] a case regarding the investment lineup and fees in two 403(b) plans. At issue in this appeal is whether the petitioners stated a plausible claim for relief against the plan fiduciaries for breach of the duty of prudence. By a unanimous vote of 8-0, the Court vacated the Seventh Circuit's dismissal of the case and remanded the case for reconsideration.

In October, ICI filed an amicus brief in the case, urging the Court to affirm the Seventh Circuit's decision and clarify for the lower courts that its well-established and common-sense pleading standards apply to excessive fee cases.[3]

Background

The petitioners (plaintiffs in the district court case, who are participants in two 403(b) plans sponsored by Northwestern University) alleged that Northwestern University (and the Retirement Investment Committee) breached their duty of prudence under ERISA, by "paying excessive recordkeeping fees" and "offering mutual funds with excessive investment management fees." More specifically on this point, petitioners allege that the plans offered a number of mutual funds in the form of retail share classes, instead of otherwise identical institutional share classes.[4] Petitioners also complain that they had too many investment options (over 400, for part of the time period at issue) to choose from, which they allege caused participant confusion and poor investment decisions.

The district court dismissed the complaint for failure to adequately plead a breach of the fiduciary duty of prudence, noting that low-cost index funds were available under the plans and that the Seventh Circuit has held that using revenue-sharing to pay for plan expenses does not violate ERISA.

The Seventh Circuit affirmed the dismissal. The Supreme Court characterizes the Seventh Circuit's holding as follows: "petitioners' allegations fail as a matter of law, in part based on the court's determination that petitioners' preferred type of low-cost investments were available as plan options. In the court's view, this eliminated any concerns that other plan options were imprudent."

Supreme Court Opinion

In disagreeing with the Seventh Circuit, the Court points to language in its 2015 opinion in Tibble v. Edison Int'l,[5] affirming that a fiduciary has a continuing duty to monitor plan investments and remove imprudent ones. The Court explained that the Seventh Circuit's "categorical rule is inconsistent with the context-specific inquiry that ERISA requirements," that it had focused on a fiduciary's obligation to assemble a diverse menu of options and relied on the fact that participants' had the ultimate choice over their investments, and that it had avoided the fact that the duty of prudence requires that the fiduciary monitory investments and remove any imprudent investments from the plan within a reasonable time.

The Court remands the case back to the Seventh Circuit, directing it to "consider whether petitioners have plausibly alleged a violation of the duty of prudence as articulated in Tibble."[6] Helpfully, the last sentence of the opinion indicates that the Court believes some level of deference to fiduciary decision-making is warranted, by noting that "[a]t 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." This sentiment is similar to observations made in the oral argument in December, where the Justices seemed to recognize that decision-making is complex, and that fiduciaries should not be required select the lowest cost alternative.[7]

As a result of the Court's framing of the Seventh Circuit's holding, this opinion is a very narrow decision that rejects the per se defense that a plan sponsor is insulated from liability as long as it offers enough investment low-cost options that are performing well. The opinion reaffirms the principle from Tibble that the court has to look at the specific allegations and circumstances in order to determine whether the complaint plausibly alleges a breach of fiduciary standard based on keeping poorer-performing/higher-cost options on the plan lineup.

That said, the Court's reliance on Tibble, and its recitation of the plaintiffs' allegations without seeming to suggest that they are insufficient, coupled with the Court's failure to note more explicitly some of the countervailing considerations (such as those raised in oral argument), could lead lower courts to lean toward allowing more marginal complaints to survive past the pleading stage. In this respect, the decision can be seen as a missed opportunity for the Court to firm up the pleading standard and shut down some of the more abusive lawsuits in the retirement plan fee space. Instead, the Court has punted these issues back to the lower courts to consider which these types of allegations sufficiently present "plausible claims for relief."

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Endnotes

[1] The opinion is available at https://www.supremecourt.gov/opinions/21pdf/19-1401_m6io.pdf.

[2] Hughes v. Northwestern University, U.S., No. 19-1401; appealed from Hughes v. Northwestern University, 953 F.3d 980 (7th Cir. 2020).

[3] See ICI Memorandum No. 33879, dated November 2, 2021, available at https://www.ici.org/memo33879.

[4] The opinion mentions this claim in the Supreme Court's review of the facts. The opinion does not, however, mention the point raised in oral arguments and in amicus briefs that institutional class shares carry investment minimums that impact the number of options, and that retail class shares also helped to defray administrative expenses for the plan as a whole.

[5] 575 U. S. 523 (2015).

[6] The Court goes on to say that the Seventh Circuit should apply the standard articulated in Ashcroft v. Iqbal, 556 U.S. 662 (2009), and Bell Atlantic Corp. v. Twombly, 550 U. S. 544 (2007). "Because the content of the duty of prudence turns on 'the circumstances . . . prevailing' at the time the fiduciary acts, §1104(a)(1)(B), the appropriate inquiry will necessarily be context specific." Fifth Third Bancorp v. Dudenhoeffer, 573 U. S. 409, 425 (2014).

[7] The transcript of the December 6, 2021 oral arguments is available at https://www.supremecourt.gov/oral_arguments/argument_transcripts/2021/19-1401_d18f.pdf.

For example, at pages 17–18, Justice Kagan asked "Is that part of your complaint here, that—that they should have consolidated their funds in order to get the institutional rates? Or are you saying, no, forget the consolidation piece of this. Even with their—the number—their existing number of funds, they could have gotten the institutional rate and they should have? … But, on the consolidation point, I mean, there is at some—at some point a downside to having a non-diverse set of funds, right? And isn't that much harder for courts to figure out? Like, at what point is it like, no, nobody's going to want that plan, it only has three funds in it?"

At pages 24–25, Chief Just Roberts said "it seems to me that that—those [prudent man in a like capacity] are words that seem—I don't know if you want to say it's the average or that it simply is, you know, the normal standards that would apply, as opposed to, you know, slightly below average, as opposed to egregious. I mean, it's the same concern that I think Justice Breyer had. If you said—said to somebody, you know, I want you 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. I don't know if you'd expect him to drive, you know, another 10 miles and go to the Acme gas company or—or whatever."

At pages 44–45, Chief Justice Roberts, in asking whether cost should be the only factor said, "let's say—I mean, the mutual fund plans, they advertise a lot on television, and it doesn't say just we have the lowest cost. You know, they've got different characters and, you know, try—I mean, what—what if people in the fund say, you know, I really like, whatever—the gecko's not funds, right? That's just insurance? … or I like the guy for E.F. Hutton who used to be on … I want to invest in those funds. I mean, is that—are you supposed to say no, you can't?"

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