Employee Benefits Newsletter
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Services

Employee Benefits and Executive Compensation

Fiduciary Duties and Governance

Qualified Retirement Plans

Taft-Hartley Plans

Health and Welfare Plans

Government Plans

Higher Education

Employee Stock Ownership Programs (ESOPs)

Executive Compensation and Nonqualified Plans

ERISA and Benefits Litigation

College Savings and ABLE Plans

Mandatory Paid and Unpaid Leave

Audits and Investigations

Mixed Feelings About *Hughes v. Northwestern*

Almost one year has passed since the Supreme Court issued a decision in favor of participants in *Hughes v. Northwestern*; as expected, excessive fee lawsuits brought against plan sponsors under the Employee Retirement Income Security Act of 1974 ("ERISA") have not slowed down. In fact, we are on track for over 100 ERISA class action lawsuits in 2022! While the Supreme Court affirmed that offering some prudent investments within a menu of other investments does not, by itself, satisfy the duty of prudence, it clarified little else and instead emphasized application of a context-specific inquiry. In light of this guidance, results at the lower courts have been mixed. This article outlines several recent case results and their common themes.

Summary of *Hughes v. Northwestern*

Northwestern involved a class of participants in Northwestern University's 403(b) plan who alleged that plan fiduciaries breached their fiduciary duties by:

- causing the plan to pay excessive recordkeeping fees;
- providing too many investment options; and
- including expensive investment options where identical but cheaper options were available.

The lower courts dismissed the case, concluding that the participants failed to allege plausible ERISA violations. However, the Supreme Court reversed and remanded, stating that courts must use a context-specific inquiry to determine whether sufficient facts have been presented to support a breach of fiduciary duty claim. The Supreme Court also emphasized that there is not a single reasonable fiduciary decision in a given situation, but rather a *range* of reasonable decisions that depend on the circumstances.

No Time for Plan Sponsor Defenses

One month after the Northwestern decision, in *Lauderdale et al. v. NFP Retirement Inc. et al.*, the Central District of California denied NFP's motion to dismiss participants' fiduciary breach claims. Citing *Northwestern*, the court concluded that participants need only *plausibly* allege a fiduciary breach to advance their case. Whether the claims will hold up after both parties have presented their evidence is immaterial when deciding an initial motion to dismiss. Similarly,

the Ninth Circuit reversed the dismissals of participant claims in *Davis v. Salesforce* and *Kong v. Trader Joe's* after the *Northwestern* decision. In *Trader Joe's*, the Ninth Circuit explained that "taking the allegations as true, ***as we must at this stage,***" Trader Joe's rationale for its fiduciary decisions is immaterial at the pleading stage. The Ninth Circuit was similarly dismissive of employer fiduciary explanations in *Salesforce*, concluding it was inappropriate to consider Salesforce's explanation for utilizing more expensive class shares at the pleading stage.

Participant Allegations Must Still Be Supported by the Appropriate Context

Not every court is willing to accept participant allegations at face value. A three-judge panel in the Sixth Circuit held, in *Smith v. CommonSpirit Health*, that whether an ERISA excess fee claim is plausible depends on many factors, including "common sense and the strength of competing explanations for a defendant's conduct." Dismissing the participants' claims, the Sixth Circuit panel noted that allegations of fiduciary breach require "evidence" of actual imprudence, including meaningful benchmarks and "context" enough to move the allegations from "possibility to plausibility."

In *Albert v. Oshkosh Corporation*, participants alleged that allowing some of the plan's investment options and service providers to charge excessive fees was a breach of the plan sponsor's fiduciary duties. Affirming the lower court's dismissal, the Seventh Circuit concluded that Northwestern did not require fiduciaries to regularly solicit bids from service providers and that a mere allegation that the plan paid higher service provider fees without more context (e.g., a comparison of fees charged by similar service providers) is not enough to plausibly allege a breach of fiduciary duty. Citing *Oshkosh*, an Illinois district court granted a plan sponsor's motion to dismiss in *Baumeister v. Exelon Corp.* because the participant did not support the allegations of fiduciary breach with context-specific facts showing a breach occurred, like a comparison of services offered by the lower-cost service providers, or demonstrating that investment benchmarks are appropriate comparators for challenging higher-priced investments.

Mixed Feelings on Higher-Priced Funds

Goodman v. Columbus Regional Hospital System was another excessive fee suit decided shortly after the *Northwestern* decision. The Georgia District Court explicitly cited *Northwestern* in its denial of the motion to dismiss, noting the Supreme Court's "suggestion" that fiduciary breach allegations based on the offering of higher-priced funds instead of identical but cheaper funds is plausible enough to defeat a motion to dismiss. However, in *Oshkosh*, the Seventh Circuit confirmed that ERISA does not require a fiduciary to choose the cheapest possible fund, so the mere availability of a cheaper fund is, without more, insufficient to sustain a fiduciary breach allegation. And, citing *Smith*, the Seventh Circuit reiterated that there are many reasons a plan sponsor may elect to offer a more expensive, actively-managed fund over a less expensive, passively-managed fund.

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Next Steps

While decisions at the courts are still mixed, there are steps plan sponsors can take to mitigate their litigation risk. For instance:

- Regularly review and benchmark investment fund performance, investment expenses and service provider services and fees. In situations where the plan does not utilize the cheapest investment or service provider, document the rationale for the decision. Be very careful in documenting the decision as it will be discoverable in litigation.

- Regularly review and follow the plan's investment policy statement and act with respect to funds that fail to meet its criteria.

- Regularly review the plan's investment menu and adjust as needed. Plan sponsors have an obligation to offer a diverse menu of investment options but, as *Northwestern* affirmed, plan sponsors cannot simply offer prudent investment options alongside imprudent options and satisfy their fiduciary duties. Likewise, plan sponsors cannot rely on a brokerage window alone to satisfy their duties.

- Regularly reviewing service provider compensation and understanding what services are being included in fees and regular benchmarking, can confirm that the fees for services provided are competitive.

If you have questions about actions you can take to mitigate fiduciary risk in the wake of the *Northwestern* decision and its progeny, do not hesitate to reach out to the Kutak Rock Employee Benefits and Executive Compensation Practice Group.

Hughes v. Northwestern, 595 U.S. ____ (2022)

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