Employee Benefits Newsletter
December 2023

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The Aftermath of *Hughes v. Northwestern University*

In early 2022 the Supreme Court released its opinion in *Hughes v. Northwestern University* (*Hughes I*), a case involving excessive fees and underperforming investments in retirement plans. In *Hughes I*, the Supreme Court did not identify a concrete test for these lawsuits to be dismissed or move forward. Instead, the Supreme Court reiterated its position from *Tibble v. Edison International* that plans have an ongoing duty to monitor their plans' investments. Additionally, the Court held that offering participants prudent options in a plan will not excuse offering them imprudent ones, reversing the Seventh Circuit's holding in *Divane v. Northwestern University*.

Since the ruling in *Hughes I*, courts have issued new opinions regarding excessive fee/underperforming investment suits, including *Smith v. CommonSpirit Health* from the Sixth Circuit, *Albert v. Oshkosh Corp.* from the Seventh Circuit, *Matousek v. MidAmerican Energy Co.* from the Eighth Circuit, and *Hughes v. Northwestern University* (*Hughes II*), which the Seventh Circuit revisited in light of the Supreme Court's *Hughes I* decision.

Mixed Rulings on Motions to Dismiss

Unfortunately for plan sponsors, excessive fee litigation has not slowed down and courts are still allowing cases to move forward. However, at the appellate level, with the exception of the Seventh Circuit's Hughes II decision, the major decisions in this area have been trending toward dismissal. In *Smith*, *Matousek*, and *Albert*, the courts dismissed a familiar set of fiduciary breach allegations that had been brought by plaintiffs, as well as more unique allegations that were made in *Albert*.

It appears *Hughes I* did little to upend the status quo; *Hughes II* underscores just how much of the courts' current precedent was left intact. Revenue sharing arrangements and actively managed funds still do not constitute a *per se* fiduciary breach, plans cannot commit a fiduciary breach by offering too many funds for investment, and fiduciaries are not required to "scour the market to find and offer the cheapest possible fund." The only notable change as a result of *Hughes I* is that defendants cannot excuse imprudent investments by simply offering funds with a wide variety of fee structures.

Hughes II May Be Somewhat Unique

The Seventh Circuit in *Hughes II* allowed the case against Northwestern to move forward into discovery, but there are reasons to believe that the eventual opinion will not have far-reaching consequences, especially if plans regularly benchmark their fees and conduct periodic requests for proposal. For one, the imprudence claims brought against Northwestern are partly based on an uncapped revenue sharing model that is not used by most plans today. The complaint also pointed to five comparable university plans that had taken specific measures to reduce plan fees in ways that Northwestern had not, making the case against Northwestern stronger than most other excessive fee cases.

"All Large Plans Buy the Same Recordkeeping Services"

A major point of contention in excessive fee litigation since *Hughes I* has been allegations that recordkeeping services provided to large plans are fungible. In other words, it does not matter whether a large plan uses Fidelity, Vanguard, etc.—the recordkeeping services offered will be largely identical, with price being the only distinguishing factor. In an excessive recordkeeping fee case, a plaintiff must compare a defendant's imprudent actions to the actions of a benchmark plan that was acting prudently. Such distinctions involve significant research and a thorough analysis of the two plans. The shortcut alternative is to allege that all large plans pay for the same services and are thus comparable. By doing this, plaintiffs can file cases more quickly and more cheaply.

Courts' reactions to this allegation have been mixed. District courts in *Singh v. Deloitte LLP* and *Laabs v. Faith Techs., Inc.* both held that these types of allegations are conclusory and therefore cannot proceed. On the other hand, in *Hughes II*, the Seventh Circuit allowed the excessive recordkeeping claim to proceed based partly on this allegation. Although the Seventh Circuit considered several other factors, plaintiffs likely will continue to use this pleading tactic to progress litigation until courts consistently rule against the claim.

Missing Out on Good Deals Is Still a Fiduciary Breach

The court in *Hughes II* held that plans with access to cheaper institutional-class shares of an investment that offer retail-class share options may be committing a fiduciary breach. Plaintiffs have had success in the past with this claim, and continue to find success with it today.

Like all litigation, ERISA litigation is unpredictable, but plan sponsors can mitigate the risk of a lawsuit (or win an early dismissal of the claims) by doing the following:

- Regularly review and benchmark investment fees and investment performance. Document the review process and the reasoning, especially in scenarios where there was a cheaper option that was not selected.
- Regularly review and benchmark compensation and fees paid to service providers and understand what services are being provided to the plan.
- Regularly review the plan's investment policy statement and determine whether funds offered by the plan align with it.
- Regularly review the investment menu to ensure that participants have a diverse range of investment options.

Contacts

John E. Schembari
Omaha
402.231.8886
john.schembari@kutakrock.com

Michelle M. Ueding
Omaha
402.661.8613
michelle.ueding@kutakrock.com

William C. McCartney
Omaha
949.852.5052
william.mccartney@kutakrock.com

P. Brian Bartels
Omaha
402.231.8897
brian.bartels@kutakrock.com

Ruth Marcott
Minneapolis
612.334.5044
ruth.marcott@kutakrock.com

Sevawn Foster Holt
Little Rock
501.975.3120
sevawn.holt@kutakrock.com

John J. Westerhaus
Omaha
402.231.8830
john.westerhaus@kutakrock.com

Robert J. Hannah
Omaha
402.661.8667
robert.hannah@kutakrock.com

Emma L. Franklin
Omaha
402.231.8842
emma.franklin@kutakrock.com

Aaron D. Schuster
Kansas City
816.960.0090
aaron.schuster@kutakrock.com

Jacob S. Gray
Minneapolis
612.334.5053
jacob.gray@kutakrock.com

Although this area of litigation is traditionally associated with retirement plans, group health plans should also follow some of these steps, as plaintiffs' firms are using new required disclosures from group health plans to generate excessive fee complaints.

If you have questions about specific actions you can take to mitigate the risk of excessive fee litigation, please contact the Kutak Rock Employee Benefits and Executive Compensation Practice Group.

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