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Client Alert

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JANUARY 6, 2022

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Supreme Court Poised To Decide What Allegations Make The Grade In University Fee Case, With Broader Implications For ERISA Retirement Plan Fiduciaries

Last month, the U.S. Supreme Court heard argument in an ERISA case that could have sweeping ramifications for retirement plan fiduciaries. The case—*Hughes v. Northwestern University*—tees up a threshold question that has vexed courts for the past decade: What must an ERISA plaintiff allege to state a viable claim that the fees and expenses charged by their retirement plan are too high? The Supreme Court's answer to that question could curtail—or encourage—the growing wave of ERISA fee class actions filed in recent years. While oral argument did not provide any clear sign about how the Court will answer the central question posed in *Hughes*, it did highlight the Justices' shared concern with striking the right balance between protecting plan participants from imprudent conduct and shielding plan fiduciaries from meritless claims.

Background: *Hughes v. Northwestern University* and the Growing Docket of ERISA Excessive Fee Cases

In the last decade, there has been a proliferation of ERISA class actions alleging that 401(k) and other defined contribution retirement plans charge participants excessive fees and expenses. According to an amicus brief submitted by the U.S. Chamber of Commerce, ERISA class actions increased five-fold from just 2019 to 2020.

Hughes v. Northwestern University is a ready example of this trend. Filed in 2016, *Hughes* was one of many cases targeting large universities over the management of their 403(b) plans (essentially the educational equivalent of a 401(k) plan). *Hughes* takes aim at Northwestern University, and, similar to complaints filed against other universities, alleges that the fiduciaries of Northwestern's retirement plans breached their ERISA duties by allowing participants to pay (1) fees for more

expensive “retail” share classes of investment funds when cheaper institutional class shares were available and (2) a fee for the plan’s two recordkeepers that was higher than the fee paid by similar plans that used only one recordkeeper. The complaint in *Hughes* alleged that these excessive fees were caused, at least in part, by an investment menu with a needlessly large number of investment options and the use of multiple recordkeepers.

The district court dismissed the complaint. The Seventh Circuit affirmed, holding that the complaint in *Hughes* failed to state a viable claim because Northwestern’s plans included low-cost funds that plaintiffs could have selected. It also rejected the recordkeeping claim, concluding that the plaintiffs in *Hughes* had failed to plausibly allege that participants would have paid less if a single recordkeeper, or different fee structure, had been used. Plaintiffs petitioned for Supreme Court review, contending that the Seventh Circuit’s decision conflicted with decisions from the Third, Eighth, and Ninth Circuits that allowed similar allegations to proceed to discovery. The Supreme Court granted review in July 2021.

Oral Argument: Supreme Court grapples with the standard for pleading imprudent conduct under ERISA

Hughes presents a basic—and unsettled—question: What must a plaintiff allege to state a viable claim that ERISA fiduciaries have failed to prudently manage retirement plan expenses? This is not the first time that the Supreme Court has considered the intersection between ERISA’s fiduciary duties and federal pleading standards. In 2014, the Court handed down *Fifth Third Bancorp v. Dudenhoeffer*, 573 U.S. 409, a 9-0 decision that set a high bar for pleading claims that fiduciaries breach their ERISA duties by offering company stock in a retirement plan. At oral argument in *Hughes*, the Justices grappled with several interrelated issues that will shape whether, and how high, they set the bar for excessive fee claims:

- ***What’s the standard for prudent fiduciary conduct*?** The bulk of oral argument focused on the big picture question presented in *Hughes*: What is the correct standard for pleading a viable claim that ERISA fiduciaries failed to prudently monitor retirement plan expenses? Different groups of Justices appeared to view the question through different lenses. At least five Justices (the Chief Justice, Thomas, Alito, Gorsuch, and Kavanaugh) expressed concerns about a pleading standard that is too lax (and thus allows participants to sue no matter what fiduciaries might do). Justices Sotomayor and Kagan (and at times Justice Breyer), meanwhile, voiced reservations about articulating a standard that is too demanding (and thus allows fiduciaries to escape liability for wrongdoing). Plaintiffs contended that the relevant standard was “objective reasonableness,” but Chief Justice Roberts and Justices Gorsuch and Kavanaugh seemed unsatisfied with that answer and probed what it might mean in practical terms. How much must an investment underperform others, for example, before it is “objectively” unreasonable? And how much more expensive must an investment or service be compared to others before it is “objectively” unreasonable?
- ***Excessive fees versus excessive options*.** The Court also tried to untangle the excessive fee claims from the allegations that Northwestern supposedly offered too many investments and used too many recordkeepers. In general, the Court was less receptive to the too many investments/recordkeeper (or “consolidation”) theory. Indeed, even the Justices who appeared inclined to side with the plaintiffs in *Hughes* were skeptical of their “consolidation” argument as a stand-alone theory of imprudence. Justice Sotomayor suggested that the investment fee allegations were stronger, and added that Northwestern’s use of two different recordkeepers was “likely reasonable” on its face. And Justice Kagan sought (and obtained) confirmation from counsel that plaintiffs’ claim that the Northwestern plans’ fees were too high did not depend on their allegation that the plans offered too many investments and recordkeepers.
- ***What is an appropriate comparator*?** The Court also pondered another common issue in ERISA fee cases: Have the plaintiffs identified alternative investments or recordkeepers that were both cheaper *and*

available? Northwestern argued that the *Hughes* plaintiffs had not alleged that the cheaper share classes they identified were actually available to Northwestern. Plaintiffs maintained that this was a merits defense for trial, not grounds for a motion to dismiss. But the Court appeared to assume that ERISA plaintiffs must allege real-world comparators to state a claim, and both Justices Breyer and Alito focused their questions on exactly how much detail is needed to meet the plausibility standard of *Twombly and Iqbal*.

- ***Are subsequent plan changes fair game*?** While less of a focus at argument, Chief Justice Roberts seemed keenly interested in whether the *Hughes* plaintiffs could rely on allegations that Northwestern subsequently consolidated its plan investment lineup to plead a plausible claim. Both plaintiffs and the United States argued that allegations about changes to the Northwestern plans were proper (and perhaps even sufficient) support for a claim that the prior investment menu was imprudent. But the Chief Justice expressed concern that this might discourage ERISA fiduciaries from taking prudent steps to improve plans.

Overall, oral argument illustrated that there is no clear consensus among the Justices and several avenues for deciding (or avoiding) the bedrock question presented in *Hughes*. A broader opinion could follow *Dudenhoeffer*'s approach by providing generally applicable guidance on the standard for pleading that an ERISA fiduciary failed to prudently manage retirement plan expenses. Indeed, if oral argument is any guide, there may be a majority of votes to establish a pleading standard that, like the standard in *Dudenhoeffer*, proves fatal in fact for excessive fee cases going forward. But a narrower ruling, for example affirming the dismissal of the "consolidation" claims while vacating the Seventh Circuit's decision on the ground that the presence of cheaper funds in Northwestern's plans did not relieve fiduciaries of their obligation to ensure that the fees charged by other funds were also reasonable, is also possible. A narrow path may be the only way to achieve a broader consensus given the diversity of views expressed by the Justices during oral argument.

Justice Barrett, a former Seventh Circuit judge, has recused herself from the case. This creates the possibility of a split 4-4 decision, which would leave the Seventh Circuit's decision intact. Although that outcome is certainly possible, it may not be probable—the last time the Court considered ERISA's pleading standards in *Dudenhoeffer*, its decision was unanimous.

The Court is expected to issue a written opinion in *Hughes* by June 2022.

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