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Supreme Court issues highly anticipated ruling in defined contribution plan class-action

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Supreme Court rejects Seventh Circuit's basis for dismissing defined contribution plan lawsuit.

What's the Impact?

- Decision makes it easier for plaintiffs' lawsuits to survive motions to dismiss
- Fiduciaries are responsible for ensuring each investment option is prudent and should adopt practices to carefully monitor plan expenses and investment options

There has been a virtual explosion of class-action lawsuits aimed at participant-directed 401(k) and 403(b) defined contribution retirement plans. These lawsuits typically allege that plan fiduciaries breached their duties under ERISA (Employee Retirement Income Security Act) in overseeing the plan and designating investment options. While the specific allegations may differ from lawsuit to lawsuit, many have common themes, including allegations that the fiduciaries failed to monitor and control recordkeeping fees, failed to offer the best class of fund available for a particular investment option, and/or offered imprudent investment options. In an 8–0 ruling (*Hughes v. Northwestern University*), the U.S. Supreme Court vacated a Seventh Circuit decision that made it harder for plaintiffs to bring these cases.

Northwestern University offered eligible employees two defined contribution retirement plans. Each plan allowed participants to defer compensation into the plan and invest such deferrals, as

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well as employer contributions, in a number of designated investment options. The plaintiffs sued the University, its Retirement Investment Committee, and the individual officials who administered the plans, alleging that the plan fiduciaries breached their fiduciary duties by (i) failing to monitor and control the fees they paid for plan recordkeeping, resulting in unreasonably high costs to plan participants; (ii) offering a number of mutual funds and annuities in the form of "retail" share classes that carried higher fees than those charged by otherwise identical "institutional" share classes of the same investments; and (iii) offering too many investment options (over 400 in total) thereby causing participant confusion and poor investment decisions.

Northwestern moved to dismiss the plaintiffs' complaint for failing to state a claim for relief under ERISA. The district court and Seventh Circuit both agreed, granting dismissal principally on the basis that the plans offered participants a variety of investment options, including low-cost index funds championed by the plaintiffs, and the plaintiffs were free to choose those investment options rather than the allegedly problematic ones. In the appellate court's view, the availability of a diverse menu of investment options "eliminated[ed] any claim that plan participants were forced to stomach an unappetizing menu" and prevented the plaintiffs from asserting a fiduciary breach premised on allegedly imprudent offerings. The plaintiffs appealed to the Supreme Court.

The Supreme Court reversed, relying heavily on its prior decision in *Tibble v. Edison*, 575 U.S. 523 (2015), which held that fiduciaries had an ongoing obligation to monitor all plan investment options. Specifically, the Court concluded that the existence of non-offending investment options did not absolve the fiduciaries from potential liability for options that otherwise were allegedly imprudent, stating:

> The Seventh Circuit erred in relying on the participants' ultimate choice over their investments to excuse allegedly imprudent decisions by respondents. In [*Tibble*], this Court explained that, even in a defined-contribution plan where participants choose their investments, plan fiduciaries are required to conduct their own independent evaluation to determine which investments may be prudently included in the plan's menu of options. If the fiduciaries fail to remove an imprudent investment from the plan within a reasonable time, they breach their duty.

The Court's opinion did not suggest that it necessarily agreed with the plaintiff's allegations. Rather, the Court remanded the case, stating "[o]n remand, the Seventh Circuit should consider whether petitioners have plausibly alleged a violation of the duty of prudence as articulated in *Tibble*, applying the pleading standard discussed in [other Supreme Court precedents]." The Court also noted, "[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."

The bottom line is the Supreme Court's decision will make it easier for plaintiffs' lawsuits to survive motions to dismiss, which will encourage these types of lawsuits. In the current legal climate, it is very important that fiduciaries regularly monitor their plans and investment options,

and engage in a full and thoughtful process in making their decisions. As these cases evolve, it will be interesting to see exactly how much deference courts will give fiduciaries in reaching their decisions.

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