GT GreenbergTraurig

Alert | ERISA & Employee Benefits Litigation

August 2022

Get with the *Spirit*: 6th Circuit Tutorial on Context-Specific Pleading in ERISA Fee-And-Expense Cases After *Northwestern v. Hughes*

Go-To Guide:

- First court of appeals decisions applying Supreme Court opinion in *Northwestern v. Hughes* that provide a tutorial-like analysis of *Hughes'* requirement of "context-specific inquiry" pleading in deciding motions to dismiss in ERISA fee-and-expense cases.
- Both Sixth Circuit decisions conclude that market-based outcome comparison allegations that employer acted imprudently in offering actively managed funds inadequate without context-specific pleading.
- Nine new lawsuits against well-known national employers with multibillion-dollar plans for allegedly poor-performing target date funds based only on market outcomes and not process-driven based on context-specific pleading as required by *Hughes* and Sixth Circuit decisions.

"[T]he Employee Retirement Income Security Act, ERISA for short, does not give the federal courts a broad license to second-guess the investment decisions of retirement plans." So ruled the Sixth Circuit Court of Appeals in affirming a district court's dismissal of an excessive fee case alleging ERISA fiduciary duty breaches based on market based outcome comparison allegations of plan fiduciaries paying excessive

© 2022 Greenberg Traurig, LLP

recordkeeping and management fees offering actively managed investment options instead of allegedly lower-cost, better-performing options in a 401k plan investment menu.[1]

This decision is the first court of appeals opinion applying the Supreme Court's *Hughes v. Northwestern* decision,[2] which held that courts deciding motions to dismiss in ERISA fee-and-expense cases must engage in a "context-specific inquiry" that gives due regard to the range of reasonable judgments a fiduciary may make based on their experience and expertise.

Three weeks later the Sixth Circuit reaffirmed its *CommonSpirit* analysis in *Forman v. TriHealth, Inc.*,[3] where the court dismissed claims concerning the duty of prudence as applied to the investment options a company offers its employees for their retirement plans. The court found plaintiffs' pleading inadequate in that it was not context-specific but contained only market-based outcome allegations that an employer plan sponsor acted imprudently by offering participants actively managed, higher-fee mutual funds with lower returns compared to passively managed ones.

These decisions effectively rebut the arguments of fiduciary imprudence asserted in most excessive fee lawsuits, where plaintiffs ask the court to infer fiduciary malpractice based on circumstantial evidence of what participants consider an undesirable outcome. In so doing, the Sixth Circuit's analysis is instructive on *Hughes*.

But just as the Sixth Circuit seemed to bring clarity on these cases post-*Hughes*, nine new lawsuits were filed against[4] well-known national employers with multibillion-dollar plans for including allegedly poor-performing target date funds in their plan lineups based only on market outcome comparison allegations and not context-specific pleading as required by the *Hughes*, *CommonSpirit*, and *Forman* decisions. It remains to be seen if these suits will survive a motion to dismiss.

Smith v. CommonSpirit Health Background

Starting in 2016, Plaintiff Yosaun Smith participated in her then-employer CommonSpirit Health's[5] defined contribution 401(k) plan. With more than 105,000 participants and more than $3 billion in assets, the plan offers 28 different funds in which participants may invest their contributions. These include several index funds with management fees as low as 0.02% and several actively managed funds with management fees as high as 0.82%. An administrative committee CommonSpirit appointed oversees the plan.

Plaintiff sued CommonSpirit and the plan's administrative committee for breach of fiduciary duty, claiming CommonSpirit breached its duty of prudence by offering several actively managed investment funds when index funds available on the market offered higher returns and lower fees. In addition, she separately alleged the plan's recordkeeping and management fees were excessive.[6]

CommonSpirit moved to dismiss, and the district court granted the motion, concluding that the plaintiff failed to allege facts from which it could plausibly infer CommonSpirit acted imprudently in violation of ERISA.[7]

[1] *Smith v. CommonSpirit Health*, No. 21-5964, 6th Cir., June 21, 2022.
[2] *Hughes v. Northwestern University*, U.S.S. Ct., No. 19-1401, Jan. 24, 2022.
[3] *Forman v. TriHealth, Inc.*, No 21-3977, 6th Cir., July 13, 2022.
[4] See, e.g., *Antoine v. Marsh & McLennan Companies*, USDC, SDNY, Case No. 1:22-CV-6637, Aug. 4, 2022.
[5] Formerly known as Catholic Health Initiatives.
[6] *Smith v. CommonSpirit Health*, No. 21-5964, 6th Cir., June 21, 2022.
[7] *Smith v. CommonSpirit Health*, Civil action No. 20-95-DLB-EBA, United States District Court, E.D. Kentucky, Sept. 8, 2021.

© 2022 Greenberg Traurig, LLP

Sixth Circuit's Decision in *CommonSpirit*

The Sixth Circuit affirmed the district court's dismissal, emphasizing that ERISA § 404 (a)(1)(B) protects participants in retirement plans by establishing standards of conduct for plan fiduciaries that require that a plan administrator discharge his duties "with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims." The obligation, according to the Supreme Court, includes "a continuing duty to monitor trust investments and remove imprudent ones."[8] Bedrock trust principles establish that "[w]hether the trustee is prudent in the doing of an act depends upon the circumstances as they reasonably appear to him at the time when he does the act and not at some subsequent time when his conduct is called in question."[9]

According to the Sixth Circuit, all of this requires "careful, context-sensitive scrutiny of a complaint's allegations" in order to "divide the plausible sheep from the meritless goats."[10] "Because the content of the duty of prudence turns on 'the circumstances . . . prevailing' at the time the fiduciary acts, the appropriate inquiry will necessarily be context specific." In the last analysis, the Sixth Circuit said, "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."[11]

In gauging the sufficiency of a complaint, the Sixth Circuit said that the plaintiff must provide sufficient "facts to state a claim to relief that is plausible on its face.[12] Plausibility requires the plaintiff to plead sufficient facts and law to allow "the court to draw the reasonable inference that the defendant is liable for the misconduct alleged."[13]

According to the Sixth Circuit, the participant has not plausibly pleaded that the plan acted imprudently merely by offering actively managed funds in its mix of investment options. Plaintiff Smith alleged that investors should be very skeptical of an actively managed fund's ability to consistently outperform its index and take levels of risk that render them unsuitable for the average retirement investor. But such investments represent a common fixture of retirement plans, the court said, and there is nothing wrong with permitting employees to choose them in hopes of realizing above-average returns over the course of the long lifespan of a retirement account. It is possible indeed, the Sixth Circuit said, that denying employees the option of actively managed funds would itself be imprudent. Also, the court said, Smith could still choose an index fund investment for her 401(k), as CommonSpirit offered many such options. The court emphasized that it knows of no case that says a plan fiduciary violates its duty of prudence by offering actively managed funds to its employees as opposed to offering only passively managed funds. Several cases suggest the opposite.

However, the Sixth Circuit noted that even if CommonSpirit did not violate a fiduciary duty by offering actively managed plans in general, the company still could violate ERISA by imprudently offering specific actively managed funds. ERISA does not allow fiduciaries merely to offer a broad range of options and call it a day, the court said. While plan participants retain the right to choose which fund is appropriate for them, the plan must ensure all fund options remain prudent options.

---

[8] *Tibble v. Edison Int'l*, 575 U.S. 523, 529 (2015).
[9] *Pfeil v. State St. Bank & Tr. Co.*, 806 F.3d 377, 384-85 (6th Cir. 2015).
[10] *Fifth Third Bancorp v. Dudenhoeffer*, 573 U.S. 409, 425 (2014).
[11] *Hughes v. NW Univ.*, 142 S. Ct. 737, 742 (2022).
[12] *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 570 (2007).
[13] *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009).

© 2022 Greenberg Traurig, LLP

But according to the Sixth Circuit, the participant had not plausibly pleaded that the company violated this obligation either. Smith mainly compared the actively managed funds' performance to the index funds' performance for a five-year period, noting the actively managed funds trailed the index funds by as much as 0.63 percentage points per year. A showing of imprudence does not come from pointing to a fund with better performance, the court explained. Rather, pointing to an alternative course of action, say another fund the plan might have invested in, will often be necessary to show a fund acted imprudently (and to prove damages). In addition, the Sixth Circuit said, these claims require evidence that an investment was imprudent from the moment the administrator selected it, that the investment became imprudent over time, or that the investment was otherwise clearly unsuitable for the goals of the fund based on ongoing performance.

The Sixth Circuit said its reasoning aligns with how other circuits have evaluated similar claims. For example, the Eighth Circuit rejected an employee's claim that plan administrators breached a fiduciary duty by offering actively managed funds in addition to passively managed ones, concluding it was "not imprudent for a fiduciary to provide both investment options."[14] The Eighth Circuit explained that the two general investment options "have different aims, different risks, and different potential rewards that cater to different investors. Comparing apples and oranges is not a way to show that one is better or worse than the other."[15]

Finally, the Sixth Circuit pointed out that Smith worried that the imperatives of pleading a process-based defect "put her in a deep hole" given the difficulty of gaining information about how her plan chose each investment. The Sixth Circuit felt this a fair point, but noted it is Congress, not the courts, that established a cause of action premised on a duty of prudence, and the difficulties are not insurmountable. ERISA's extensive disclosure requirements ease the burdens, the Sixth Circuit said. Under ERISA, a retirement plan must disclose a range of information about costs and performance, including the administrative expenses it charges to participants and investment-related information explaining the characteristics of the plan's investment options.

As to the recordkeeping fees, the Sixth Circuit said Smith failed to give the kind of context that could "move this claim from possibility to plausibility." She had not pleaded that the services CommonSpirit's fee covered were equivalent to those provided by the plans comprising the average in the industry publication that she cites. Smith compared CommonSpirit's fees, for example, to some of the smallest plans on the market, which might offer fewer services and tools to plan participants. Smith failed to allege the fees were excessive relative to the services rendered. She also alleged no facts concerning other factors relevant to determining whether a fee is excessive under the circumstances. Such pleaded facts did not suffice to create an inference that CommonSpirit was imprudent to choose recordkeeping fees of this amount, the Sixth Circuit said.

Forman v. TriHealth, Inc. Background

Danielle Forman and two other employees ("plaintiffs") participated in TriHealth's 401(k) plan since 2013. They alleged that for every year between 2013 and 2017, the administrative fees charged to TriHealth plan participants were greater than 90% of those charged to comparable plans, and that the TriHealth plan cost 86 basis points (bps) in 2017, compared with an alleged peer mean of 41 bps. The plaintiffs also claimed that the TriHealth plan's investment fees were excessive when viewed against other

[14] *Davis v. Washington University*, 960 F. 3d 478 at 485 (8th Cir. 2020).
[15] Id., see also *Meiners v. Wells Fargo & Co.*, 898 F. 3d 820, 823 (8th Cir. 2018).

© 2022 Greenberg Traurig, LLP

comparable mutual funds not offered by the plan. TriHealth argued the plaintiffs failed to adequately plead breach of the duty of prudence and loyalty claims such that dismissal was required.

Sixth Circuit's Decision in *TriHealth*

The Sixth Circuit agreed that their decision in *CommonSpirit* required a dismissal of the plaintiffs' claims that TriHealth should not have offered the option of investing in actively managed funds based only on market-based outcome comparisons and not context-specific pleading. The court emphasized that they held in *TriHealth* that "disappointing performance in the near term and higher costs do not by themselves show deficient decision making, especially when we account for competing explanations and other common-sense aspects of long-term investments." "Different services, investment strategies and investor preferences invariably lead to a spectrum of options—and in turn a spectrum of reasonable fee structures and performance outcomes. As a result, side-by-side comparisons of how two funds performed in a narrow window of time, with no consideration of their distinct objectives, will not tell a fiduciary which is the more prudent long-term investment option."

However, the Sixth Circuit held that the plaintiffs stated a plausible claim that TriHealth acted imprudently in offering them more expensive retail mutual fund shares when institutional shares with the same investment strategy, same management team, and same investments were available to their retirement plan at lower costs. Only an imprudent financier would offer a more expensive share when he could offer a functionally identical share for less, the Sixth Circuit said. Therefore, the Sixth Circuit reversed and remanded in part the district court's dismissal of this claim, since competing inferences could be drawn requiring factual development though discovery.

With respect to the remanded claim, the plaintiffs complained that TriHealth violated the duty of prudence by offering them pricier retail shares of mutual funds when those same investment management companies offered less expensive institutional shares of the same funds to other retirement plans. They argued that TriHealth could have taken advantage of lower-priced institutional mutual fund shares for the same investment team and same investment strategy since the TriHealth plan had nearly half a billion dollars in assets.

Taken in their most flattering light, the Sixth Circuit said, these allegations permit the reasonable inference that TriHealth failed to exploit the advantages of being a large retirement plan that could use scale to provide substantial benefits to its participants and "under the common law of trusts, which supplied the backdrop to ERISA when Congress enacted it in 1974, that would state a claim of imprudence."

On the other hand, the Sixth Circuit pointed out that "equally reasonable inferences in the other direction . . . could indeed exonerate TriHealth once all of the facts come in. Perhaps the plan has revenue sharing arrangements in place that make the retail shares less expensive or that benefit plan participants on the whole. But at the pleading stage it is too early to make these judgment calls. 'In the absence of further development of the facts, we have no basis for crediting one set of reasonable inferences over the other. Because either assessment is plausible, the Rules of Civil Procedure entitle [the three employees] to pursue [their imprudence] claim (at least with respect to this theory) to the next stage.' Other courts of appeals have reached similar conclusions at this juncture and in this setting."

© 2022 Greenberg Traurig, LLP

Conclusion

Plan sponsors and fiduciaries who offer retail and not institutional share class investments – as the *TriHealth* court suggested might be the case – may be able to negate competing potential inferences drawn from offering retail shares by demonstrating that revenue sharing is available to defray other costs, or because they have sought but been unable to negotiate for institutional share availability, thereby enhancing the possibility of success at the motion to dismiss stage, by being transparent about and communicating to participants the reasons for offering retail shares. With such a record, arguably a plaintiff's attempt to draw a different explanation by inference should fail under the logic of *CommonSpirit*.

Click here to read related GT Alerts.

Authors

This GT Alert was prepared by:

- Jeffrey D. Mamorsky | +1 212.801.9336 | mamorskyj@gtlaw.com
- Jonathan L. Sulds | +1 212.801.6882 | suldsj@gtlaw.com

Albany. Amsterdam. Atlanta. Austin. Boston. Chicago. Dallas. Delaware. Denver. Fort Lauderdale. Germany.¬ Houston. Las Vegas. London.* Long Island. Los Angeles. Mexico City.+ Miami. Milan.» Minneapolis. New Jersey. New York. Northern Virginia. Orange County. Orlando. Philadelphia. Phoenix. Portland. Sacramento. Salt Lake City. San Francisco. Seoul.∞ Shanghai. Silicon Valley. Tallahassee. Tampa. Tel Aviv.^ Tokyo.¤ Warsaw.~ Washington, D.C.. West Palm Beach. Westchester County.

*This Greenberg Traurig Alert is issued for informational purposes only and is not intended to be construed or used as general legal advice nor as a solicitation of any type. Please contact the author(s) or your Greenberg Traurig contact if you have questions regarding the currency of this information. The hiring of a lawyer is an important decision. Before you decide, ask for written information about the lawyer's legal qualifications and experience. Greenberg Traurig is a service mark and trade name of Greenberg Traurig, LLP and Greenberg Traurig, P.A. ¬Greenberg Traurig's Berlin office is operated by Greenberg Traurig Germany, an affiliate of Greenberg Traurig, P.A. and Greenberg Traurig, LLP. *Operates as a separate UK registered legal entity. +Greenberg Traurig's Mexico City office is operated by Greenberg Traurig, S.C., an affiliate of Greenberg Traurig, P.A. and Greenberg Traurig, LLP. »Greenberg Traurig's Milan office is operated by Greenberg Traurig Santa Maria, an affiliate of Greenberg Traurig, P.A. and Greenberg Traurig, LLP. ∞Operates as Greenberg Traurig LLP Foreign Legal Consultant Office. ^Greenberg Traurig's Tel Aviv office is a branch of Greenberg Traurig, P.A., Florida, USA. ¤Greenberg Traurig's Tokyo Office is operated by GT Tokyo Horitsu Jimusho and Greenberg Traurig Gaikokuhojimubengoshi Jimusho, affiliates of Greenberg Traurig, P.A. and Greenberg Traurig, LLP. ~Greenberg Traurig's Warsaw office is operated by GREENBERG TRAURIG Nowakowska-Zimoch Wysokiński sp.k., an affiliate of Greenberg Traurig, P.A. and Greenberg Traurig, LLP. Certain partners in GREENBERG TRAURIG Nowakowska-Zimoch Wysokiński sp.k. are also shareholders in Greenberg Traurig, P.A. Images in this advertisement do not depict Greenberg Traurig attorneys, clients, staff or facilities. No aspect of this advertisement has been approved by the Supreme Court of New Jersey. ©2022 Greenberg Traurig, LLP. All rights reserved.*