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Charting a 'Northwestern' Passage: ERISA's Duty of Prudence and Requirements for Pleading a Breach After 'Hughes v. Northwestern University'

To survive a motion to dismiss after 'Northwestern', plaintiffs will have to allege facts showing the plan fiduciaries have not followed a prudent process in making decisions specific to the circumstances when the decision was made.

By Jeffrey D. Mamorsky and Jonathan L. Sulds| March 11, 2022 | The New York Journal

Under ERISA, prudence is process. As many courts have said, the prudence of a fiduciary's actions is not judged by hindsight. To the contrary, the central aim of ERISA's fiduciary prudence standard is to oversee the means by which fiduciaries of defined contribution retirement plans carry out their duties and not to scrutinize the substantive outcome of their decisions. *PBGC v. Morgan Stanley,* 712 F.3d 705, 716 (2d Cir. 2013).in

In the selection of investment vehicles and in the engagement of vendors for defined contribution plan administration, there are possibilities of conflicts of interest or insufficiently researched decisions. There are also in many instances thoroughly prudent reasons for actions taken, with fiduciaries employing robust processes to make those decisions. Therein lies the thicket the Supreme Court faced in its recent decision in *Hughes v. Northwestern University*, ____ U.S. ____, 2022 WL 199351 (Jan. 24, 2022). What cases should proceed and which should not?

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The motion to dismiss decision stage is an inflection point for plan fiduciaries and their insurers with significant risk of litigation cost and reputational harm. Courts are divided over whether participants know a great deal about the workings of their plans (*Meiners v. Wells Fargo & Co.*, 898 F.3d 820 (8th Cir. 2018)) or have scant information (*Sweda v. University of Pennsylvania*, 923 F.3d 320 (3d Cir. 2019)). That spotlights a significant challenge for courts in this area. How to harmonize litigation procedure, what needs to be said in a complaint to stay in court with due consideration of a fiduciary process (for which the touchstone is the Supreme Court's decision in *Tibble v. Edison Int'l*, 575 U.S. 523, holding that fiduciaries have ongoing duties to monitor the decisions they have made and correct them as circumstances warrant) at a point in the procedure where the particulars of fiduciary processes may not be known.

In deciding motions to dismiss in these cases, many courts have reasoned that discovery should proceed where plaintiffs have made general allegations that less expensive investment vehicles than those the plan offered were available or that the fees paid by those plans for recordkeeping and administrative services are too high, or that offered investment vehicles underperformed others available but unoffered as investment options, on the theory that plaintiffs do not need to rule out possible lawful explanations for these actions if they can infer potentially improper actions from them. *Braden v. Wal-Mart Stores*, 588 F.3d 585 (7th Cir. 2009). In so doing, some courts have explicitly declined to apply *Twombly*'s pleading standard, on the grounds that *Twombly* (*Bell Atlantic v. Twombly*, 550 U.S. 544 (2009)) was an antitrust case. *Sweda v. University of Pennsylvania*, 923 F.3d 320 (3d Cir. 2019). Others have ruled that even if a complaint contains no factual allegations referring directly to the fiduciary's process, circumstantial factual allegations, not setting forth per se violations, may suffice if a court believes it can infer from them that a fiduciary acted imprudently. *Sacerdote v. New York University*, 9 F.4th 95 (2d Cir. 2021).

The viability of those holdings may now be open to question. In its January 2022 unanimous decision in *Hughes v. Northwestern University* the Supreme Court held that complaints alleging violations of ERISA's duty of prudence, as articulated in *Tibble*, must meet the standards of *Ashcroft v. Iqbal*, 556 U.S. 662 (2009) and *Twombly*. That, the court wrote, calls for a context specific inquiry.

The Supreme Court said the Seventh Circuit did not apply *Tibble*'s guidance but instead erroneously found that the Northwestern participants' allegations failed as a matter of law based on the determination that the participants' preferred type of low-cost investments were available as plan investment options. The Supreme Court emphasized that even in a defined contribution plan where participants choose their investments, *Tibble* instructs that plan fiduciaries must conduct their own independent evaluation to determine which investments may be prudently included in the plan's menu of investment options.

This appears to impose a higher context specific fact based pleading threshold than many courts have previously required. Indeed, it may be noteworthy that Justice Sotomayor, who authored the unanimous *Northwestern* opinion, while on the Second Circuit sat on the panel which decided *Young v. GM*—one of the most cited cases in the excessive fee universe—affirming grant of a motion to dismiss under *Twombly*. That panel held: "Plaintiffs failed to allege that the fees were excessive relative to the services rendered … Plaintiffs also allege no facts concerning whether a fee is excessive under the circumstances." *Young v. General Motors*, 325 F. App'x 31, 33 (2d Cir. 2009).

To survive a motion to dismiss after *Northwestern*, plaintiffs will have to allege facts showing the plan fiduciaries have not followed a prudent process in making decisions specific to the circumstances when the decision was made.

There has been a category of "excessive fee" cases in which plaintiffs allege that the duty to monitor has been breached because proprietary investment vehicles create a conflict of interest and taint the fiduciary process. *In re M&T Bank*, 2018 WL 4334807 (W.D.N.Y., Sept. 11, 2018); *Bouvy v. Analog Devices*, 2020

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WL 3448385 S.D. Cal., June 23, 2020); *Falberg v. Goldman Sachs*, 2020 WL3893285 (S.D. N.Y., July 9, 2020). There are also cases in which plaintiffs assert that fiduciaries could have used their bargaining power with billions of dollars under management to reduce fees charged to the plan. *Vellali v. Yale* University, 308 F. Supp. 2d 673 (D. Conn. 2018). The courts considering such allegations have generally denied motions to dismiss. Those type of allegations must now be supported by specific facts sufficient to meet *Twombly*/*Iqbal* standards to survive a motion to dismiss.

But to focus only on the *Twombly*/*Iqbal* pleading aspects of the Northwestern decision would be to miss the importance of the court's unanimous restatement of the applicability of *Tibble*. As the court reminded us in a different context in *Thole v. U.S. Bank*, 140 S.Ct. 1615 (2020), the point of ERISA is not to create fees for attorneys. To the contrary, ERISA is about retirement income security. Process is crucial. Under *Tibble* there must be critical self-examination of choices made on an ongoing basis. But in many instances, whether that has taken place and what the process has involved is not transparent. It is to these type of situations which many of the pre-*Northwestern* cases denying motions to dismiss speak. The logic of *Northwestern* is thus one of transparency. Not only should fiduciaries be following a process, they should be sharing that with participants. The naysayers will object that to do so would create a litigation roadmap for plaintiff lawyers. But that is exactly the point. If plaintiffs are to be held to fact based pleading standards which are context specific, fiduciaries at minimum may be well advised to set forth what that context is, not simply to have a robust monitoring process but to routinely notify the participants to whom they owe fiduciary duties what they have done.

Take for example the recent decision, after extensive discovery, in *Alas v. AT&T*, C.D. Cal, No 2:17-cv-08106, 9/28/2021 a class action involving more than 245,000 members in a 401(k) plan where the complaint accused AT&T of failing to evaluate and monitor the recordkeeping fees it paid to its third-party administrator (TPA).

At the pleading stage, allegations that the AT&T fiduciaries failed to implement a process to control administrative expenses were deemed sufficient. Importantly, what the fiduciaries had done was not in front of the court at that point in the litigation.

Ultimately, the AT&T fiduciaries showed that they reviewed ERISA required disclosures and TPA invoices and hired outside experts to ensure that compensation was reasonable.

Granting summary judgment, the California district court held that the monitoring that the AT&T fiduciaries engaged in sufficed to show "care, skill, prudence, and diligence" in negotiating the Plan's recordkeeping fees.

AT&T provides a roadmap for how the prudent fiduciary can meet its *Tibble* duty to monitor responsibility. There was an extensive and robust process which was fully documented. Consider, however, the resources which could have been saved had that process also been documented to participants in a real time basis such that a district court would necessarily have had to consider it in deciding whether a lawsuit should proceed.

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