ERISA Litigation Roundup: Seventh Circuit Sets Forth Pleading Standard in ERISA Duty of Prudence Claims in Hughes v. Northwestern University

A Practical Guidance® Article by
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On March 23, 2023, the Seventh Circuit issued a long-awaited decision in *Hughes v. Northwestern University*, the case remanded from the Supreme Court's 2022 decision of the same name. See Hughes v. Northwestern University, 142 S. Ct. 737 (2022). Following the remand, the Seventh Circuit was called on to consider the appropriate pleading standard that applies to ERISA fiduciary-duty breach claims, specifically as to the duty of prudence. In its order, the court did so and concluded that two of the plaintiffs' three remaining claims could continue.

The case involves a putative class of current and former employees of Northwestern University who sued the school and alleged fiduciaries of two retirement plans. The claims, which were narrowed by the time the case reached the Supreme Court, alleged that the fiduciaries of the 403(b) defined-contribution plans violated ERISA fiduciary duties by offering investment options and recordkeeping services with excessive fees. Specifically, the plaintiffs challenged: (1) the number of recordkeepers and the total amount of recordkeeping fees; (2) offering "retail" share classes with higher fees than allegedly "identical" "institutional" share classes; and (3) offering too many options, which allegedly confused participants. The district court dismissed the complaint and the Seventh Circuit affirmed, primarily because the less-expensive options the plaintiffs preferred were offered by the plan. The Seventh Circuit's reasoning was based on precedent holding that a plaintiff does not state a claim of imprudence if the plan offers a diverse menu of options that included the lower-cost options the plaintiffs preferred.

The Supreme Court disagreed and directed the Seventh Circuit to reconsider the plausibility of the plaintiff's complaint, but without relying solely on the principle that fiduciaries meet their ERISA obligations by offering a diverse menu. Instead, each option must be prudent, in the context of the plan's overall menu of options. The Supreme Court advised that the inquiry into the duty of prudence should be "context specific."

The Seventh Circuit began its renewed analysis by first opining on the pleading standard for an ERISA breach of duty of prudence. The court rejected Northwestern University's argument for applying the heightened pleading standard found in Fifth Third Bancorp v. Dudenhoeffer, 573 U.S. 409 (2014), which involved an employee stock ownership plan (ESOP) in which fiduciaries had inside information about the company stock. In *Dudenhoeffer*, the Supreme Court set a pleading standard that required plaintiffs to demonstrate imprudence by plausibly alleging that reasonable alternative actions were available that would not do more harm than good to the plan. According to the Seventh Circuit, the Supreme Court intended for *Dudenhoeffer's* heightened pleading standard to apply only to breach of duty of prudence claims alleged against fiduciaries who manage ESOPs. Instead, the court concluded that the standard plausibility pleading standard set forth in *Twombly/Iqbal* applies. Under that standard, defendants can still present alternative explanations for the conduct at issue. However, the Seventh Circuit concluded that the law does not require a plaintiff to conclusively rule out every possible alternative explanation of a defendant's conduct; only obvious alternative explanations must be overcome at the pleadings stage, and only by a plausible showing that such alternative

explanations may not account for the defendant's conduct. The court did note, however, that "sometimes an alternative explanation for an ERISA fiduciary's conduct may be patently more reasonable and better supported by the facts than any theory of fiduciary duty violation pleaded by a plaintiff" and "in such a scenario, courts should not hesitate to dismiss an ERISA claim for breach of the duty of prudence." But where the alternative inferences are in "equipoise", the plaintiff will prevail on a motion to dismiss.

Applying those principles, the court applied the following standard of review: "A plaintiff must plausibly allege fiduciary decisions outside a range of reasonableness. How wide that range of reasonableness is will depend on 'the circumstances … prevailing' at the time the fiduciary acts. The discretion accorded to an ERISA fiduciary 'will necessarily be context specific.'" (citations omitted).

The court then applied the standard to the remaining claims. As to the recordkeeping fees claims, the court concluded that under its newly articulated pleading standard, the plaintiffs sufficiently alleged that recordkeeper consolidation and soliciting an equally capable but lower-cost recordkeeper were plausibly alleged available options, especially given the plaintiffs' comparison to other university plans. The court also noted that to require plaintiffs to prove that another recordkeeper would have offered a lower fee or that consolidation was actually available would apply *Dudenhoeffer's* heightened pleading standard, rather than the less stringent *Twombly/Iqbal* standard. The court further concluded that other alternative explanations offered by Northwestern University did not defeat the plaintiffs' claims.

As to the share-class claims, the court considered and rejected Northwestern University's alternative explanation for its conduct that the plaintiffs had not plausibly alleged that institutional class shares were actually available to the plan. The court concluded that the plaintiffs plausibly alleged that waivers of investment minimums were possible and that Northwestern University could have negotiated for institutional class shares. Plaintiffs substantiated their claims with statements by industry experts and references to other large plans and case law.

Finally, as to the duplicative fund's claims, the court concluded that the Supreme Court's decision did not alter prior precedent that claims that a fiduciary provided too many fund choices, without more, does not state a claim for breach of the duty of prudence.

Faegre Drinker Perspective

It's clear that the appellate court attempted to provide greater clarity into the pleading standard applicable to ERISA fiduciary breach claims in the Seventh Circuit. But its focus on "plausibly alleging fiduciary decisions outside a range of reasonableness" and conducting a context-specific inquiry into that range of reasonableness will likely result in more questions — and most certainly more litigation. Plan fiduciaries may find it particularly troubling that the Seventh Circuit's new standard does not even require plaintiffs to allege actual alternatives to the action taken by the fiduciary — merely alleging that alternatives are possible is sufficient. The standard does not affect how plan fiduciaries review, choose, and monitor investment choices and recordkeeping fees, but makes it easier to second-guess those decisions without fully understanding the "circumstances prevailing" at the time the fiduciary acts.

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Cases

- Hughes v. Nw. Univ., 63 F.4th 615 (7th Cir. 2023)
- Hughes v. Northwestern University, 142 S. Ct. 737 (2022)
- Fifth Third Bancorp v. Dudenhoeffer, 573 U.S. 409 (2014)

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