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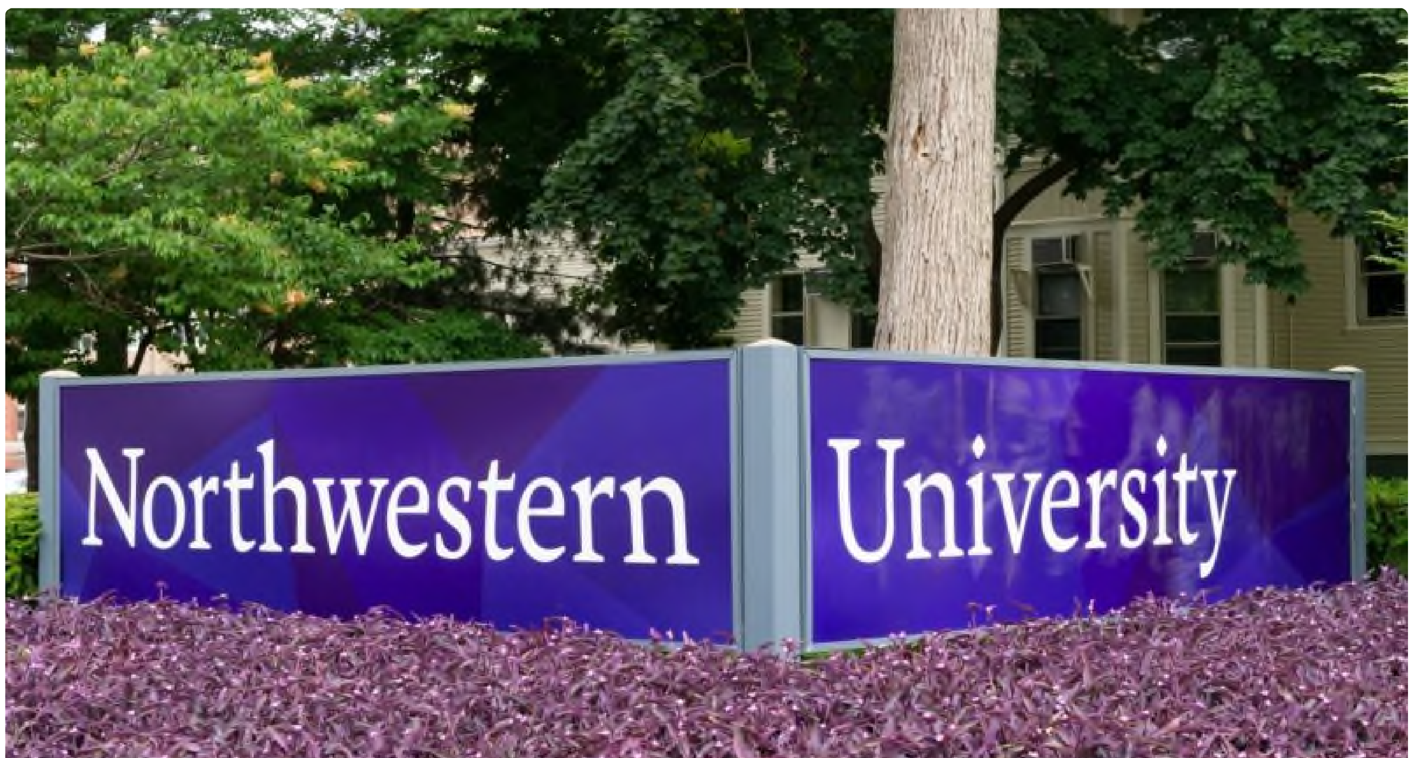
Hughes v. Northwestern Bottom Line: Harder to Dismiss Cases

Recent Supreme Court opinion means steady flow of 401k and 403b excessive fee cases expected to continue, with motions to dismiss less likely to be granted

by **Brian Anderson** · February 1, 2022 · 5 minute read



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Lawyers can't seem to stop writing about the Supreme Court's Jan. 24 opinion in Hughes v. Northwestern University, and what it means for the future of retirement plan fiduciary breach lawsuits.

Name a law firm with an employee benefits focus and chances are they've written a brief or a blog post in the past week analyzing the opinion's implications for retirement plan sponsors.

A theme that emerges in reading through them? In reversing the decision of the Seventh Circuit, the Supreme Court's ruling likely ensures a continuing flow of 401k and 403b excessive fee cases, and it will be harder for plan sponsor fiduciaries to win motions to dismiss in excessive fee lawsuits from lower courts moving forward.

In the rare unanimous 8-0 ruling, the Supreme Court held that the U.S. Court of Appeals for the Seventh Circuit "erred in relying on the participants' ultimate choice over their investments to excuse allegedly imprudent decisions by respondents," citing previous precedent set in Tibble v. Edison.

The fiduciary breach case against plan fiduciaries for the elite Evanston, Ill.-based university had been appealed after the lower courts had granted Northwestern's motion to dismiss, which the Seventh Circuit then affirmed. With the Supreme Court's opinion, the case was remanded back to the Seventh Circuit for reconsideration.

"Determining whether petitioners state plausible claims against plan fiduciaries

for violations of ERISA's duty of prudence requires a context-specific inquiry of the fiduciaries' continuing duty to monitor investments and to remove imprudent ones as articulated in Tibble v. Edison," the opinion stated.

Noted ERISA attorney Marcia Wagner of The Wagner Law Group told FiduciaryNews.com, "Since the pleading standard for breaches of fiduciary duty are context-specific, as the Supreme Court unanimously determined, it will be more difficult to have such claims dismissed at the motion-to-dismiss stage."

One new decision already

In the first case since the Supreme Court's Hughes opinion—Goodman v. Columbus Reg'l Healthcare Sys.—indeed a Georgia federal district court held in favor of plaintiffs and declined to dismiss allegations that defendant's 401k plan included costly and underperforming funds and charged excessive recordkeeping fees, reports a Jan. 28 blog from Proskauer.

In declining to dismiss plaintiffs' investment management fee claims, the district court relied heavily on *Hughes*. "The court expressed its view that *Hughes* 'suggested' that a defined contribution plan participant may state a prudence claim by merely alleging that the plan offered higher priced retail class mutual funds instead of available identical lower-cost institutional class funds. The district court also rejected defendant's argument that plaintiffs' claims should be dismissed in part because the plan offered a variety of investment options that participants could select, including lower-cost passive investment options," *the Proskauer blog states*. "The district court explained that *Hughes* rejected this exact argument in holding that a fiduciary's decisions are not insulated merely by giving participants choice over their investments and that fiduciaries have a continuing duty to monitor plan investments."

Yet in offering the "Proskauer Perspective" on the case, the law firm says the decision does not indicate that this will (or should be) the trend.

Harder road for plaintiffs?

Groom Law Group also wrote about the Hughes case, saying that while the decision might appear to be a win for the plaintiffs, the Supreme Court didn't go nearly as far as plaintiffs had hoped—and that the decision could ultimately signal a harder hill to climb for plaintiffs' claims in the world of 401k fee lawsuits.

Groom listed three takeaways to consider (listed verbatim):

- *First, the Northwestern decision is a short, narrow opinion that offers very little in the way of clear cut guidance for 401k plan fiduciaries. Indeed, the only guidance provided is the fact that a plan offering a variety of investment options, including low-cost options, does not provide, by itself, a sufficient basis to dismiss claims for (1) failing to include the lowest-cost share class of a fund; (2) including too many investment options in a plan thereby causing participant confusion; or (3) allowing plan recordkeepers to charge excessive fees.*

- *Second, there is positive language for plan sponsors and fiduciaries in the unanimous decision that recognizes that fiduciary conduct must be judged in a context specific fashion at the time the challenged conduct occurred and with recognition of what are often competing considerations faced by fiduciaries. However, because the Court remanded to the Seventh Circuit for further consideration of those issues, the Court's ruling is not likely to have an immediate impact on the ongoing wave of new filings challenging the prudence of fiduciary oversight of defined contribution plans.*

- *Third, the Northwestern decision may make plan-wide class certification more difficult. Here, the Supreme Court focused on specific investment options as being imprudent rather than the lineup as a whole. Under recent standing decisions, courts have focused on whether each individual seeking relief suffered personal harm. The combination of these two trends could make it tougher for plaintiffs to bring claims on behalf of plan participants who did not invest in the specific investment alternatives being challenged.*

Making plans ‘unattractive’ for lawsuits

In light of the Supreme Court decision, what’s the bottom line for plan sponsor fiduciaries? Plan investment monitoring for every investment in the plan (from both a performance and cost perspective) must be ongoing—and be well documented. Plan fiduciaries have a duty of prudence to independently evaluate investments and remove any imprudent ones.

“Merely offering a wide range of investment choices with varying associated costs will not insulate the fiduciaries from potential personal liability,” said Kevin O’Connor of Kohrman Jackson & Krantz LLP. “Equally important is adequate documentation of this investigation. Without such written documentation, the fiduciaries may be hard pressed to prove their exercise of the required prudence.”

O’Connor said fiduciaries should, every few years, entertain proposals from several different service providers and investment managers to (if nothing else) document the exercise of their fiduciary responsibility.

Will the decision result in plan fiduciaries reducing the number of investments offered in a plan’s menu so there is less to monitor? Perhaps, and plan sponsors may lean toward offering more index funds and self-directed brokerage accounts to reduce fiduciary risk instead of offering riskier actively managed funds that might make them more vulnerable to a lawsuit.

Taking steps like these in addition to actively and continually reviewing and benchmarking investment options and removing imprudent investments can make plans unattractive for ERISA lawsuits.

SEE ALSO:

- Plaintiffs Score Win in Excessive Fee Case Vs. Northwestern

- How Fiduciaries Can Help Protect Themselves from Excessive Fee Litigation

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AUTHOR

Brian Anderson

Veteran financial services industry journalist Brian Anderson joined 401(k) Specialist as Managing Editor in January 2019. He has led editorial content for a variety of well-known properties including Insurance Forums, Life Insurance Selling, National Underwriter Life & Health, and Senior Market Advisor. He has always maintained a focus on providing readers with timely, useful information intended to help them build their business.

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