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7th Circ. Northwestern Ruling Eases ERISA Pleading Standard

By **Kellie Mejdrich**

Law360 (March 24, 2023, 8:03 PM EDT) -- The Seventh Circuit has laid out a "newly formulated" standard for assessing claims that a retirement plan manager breached a duty to make prudent investment decisions, reviving claims against Northwestern University and embracing a plan participant-friendly analysis that will likely help certain federal benefits lawsuits survive motions to dismiss.

In a **35-page published opinion,** the panel found that when defending claims that the university violated the Employee Retirement Income Security Act, ex-workers did not have to prove that an alternative action, such as selecting a cheaper record keeper, was available — but merely that such an action was plausible.

The case is on remand after the U.S. Supreme Court vacated the panel's previous ruling to uphold dismissal in its **January 2022 decision**, Hughes v. Northwestern University. The high court based its ruling on a rejection of the appellate court's **earlier finding** that the existence of better options in the university's two defined-contribution 403(b) retirement plans precluded claims over lower-quality ones.

In a key portion of the panel's **Thursday ruling** explaining the new standard, the panel said that when considering motions to dismiss, courts had to consider alternative explanations for an ERISA fiduciary's conduct when presented by the defense. But the existence of a prudent alternative didn't have to be "overcome conclusively" by plan participants to survive dismissal, the panel said.

"At the pleadings stage, a plaintiff must provide enough facts to show that a prudent alternative action was plausibly available, rather than actually available," the panel said, before reviving claims of excessive record-keeping fees. The panel also revived allegations that Northwestern offered retirees higher-cost "retail" share-class investments, despite having access lower-cost "institutional" alternatives of the same funds, such as mutual funds or annuities.

Plaintiff-side benefits partners said in interviews with Law360 Friday that the decision would help some workers' claims survive.

"I think it's clearly a plaintiff-friendly decision," said Mark Boyko, a partner at Bailey & Glasser LLP.

"It's not unexpected after the Supreme Court decision for the decision to come down this way. But at the same time, certainly defendants have been arguing, especially on record-keeping claims, for what would be an impossible pleading standard," Boyko added.

On appeal, Northwestern had asked the Seventh Circuit to extend the U.S. Supreme Court's 2014 decision in Fifth Third Bancorp v. Dudenhoeffer when articulating a new standard for dismissal of workers' excessive fee claims. That case dealt with plan participants' allegations of employee stock ownership, or ESOP, mismanagement by a publicly traded company.

Under that standard, the workers would first have to plausibly allege that alternative actions to the alleged conduct by plan managers were reasonable and available. Northwestern said the plaintiffs should also have to prove that the alternative action, if taken, would not do more harm than good to the plan.

But the panel swatted down that argument in its opinion and said the high court had set the exacting pleading standard for ESOP cases involving prudence claims because inside information held by plan fiduciaries presented a "unique tradeoff" between the federal securities and benefits laws.

"Because this case does not involve an ESOP, Dudenhoeffer's standard does not apply. But the context-specific inquiry is key," the panel said.

Charles Field, partner and chair of the financial services litigation practice at plaintiffs firm Sanford Heisler Sharp LLP, said the panel rejected what would have been "an unreasonable standard" for workers' claims.

Field said defendants had tried to argue there was a "good explanation" for high fees — they were being rebated back to the plan to pay expenses.

"And the court said, 'Well, that's not so obvious to us. We need to dig in and look at it,'" Field said.

The panel's rejection of Dudenhoeffer was criticized by Lynn Dudley, senior vice president of global retirement and compensation policy for the American Benefits Council, an industry group representing large companies that sponsor or administer health and retirement plans.

"We think it's eroding the Supreme Court's clear position. So for us, it's a step backwards in this regard," Dudley said. She added that just as the panel said Dudenhoeffer didn't apply to the case at hand, "their new standard shouldn't necessarily apply in other cases, either."

Management-side attorneys, meanwhile, said the circuit panel's emphasis on a "context-specific" inquiry required from courts in retirement plan lawsuits, which the high court described in Northwestern, could blunt impacts from the Seventh Circuit's Thursday decision.

"It's clear that the courts and the Seventh Circuit are trying to articulate a concrete pleading standard, and that's what the Seventh Circuit says it's setting out to do. But it really doesn't add, in my view, a huge amount of specificity beyond what has already emerged in the wake of the Supreme Court decision," said Jed Glickstein, litigation and dispute resolution counsel at Mayer Brown LLP.

"And I think you see the Seventh Circuit continually reminding courts that this is all context-specific. So, you know, it's very tricky to determine how these things will apply in different contexts," Glickstein said.

Glickstein added that in his view, cases dealing with university 403(b) plans, particularly with regard to record-keeping allegations, have "a really unique set of considerations and contexts."

"You see the court discussing a lot of those things" in the opinion, Glickstein said, including surrender charges incurred by participants for some distributions, consolidating multiple record keepers and other issues like education workers' desire for access to certain Teachers Insurance and Annuity Association of America annuities.

Glickstein also pointed out that the Seventh Circuit panel referenced the circuit's decision from **August 2022** in Albert v. Ohskosh , which upheld dismissal of similar claims against a 401(k) plan.

"There's even a footnote in the Seventh Circuit opinion, where they note that in the Oshkosh case, where they dismissed a similar claim, you know, consolidation wasn't an issue," Glickstein said. "It sort of remains to be seen how this will play out."

For Northwestern workers, however, the appellate panel's decision could brighten prospects for a settlement that has so far eluded the parties since the lawsuit began in 2016. The case has now gone through two different lead plaintiffs, traveled all the way up to the Supreme Court, and now heads back to Illinois district court on remand with two claims revived.

"There are still real significant claims that have now survived, but not all of them, and it remains to be seen if this is going to be that proverbial open road to settlement now that the defendants have not successfully gotten this case dismissed on the pleadings," said Andrew Oringer, partner and

general counsel at Wagner Law Group.

Oringer said the decision was "certainly a win" for the plaintiffs in this case, but that the broader impact wasn't yet clear.

"While the case is favorable to the plaintiffs here, the court goes out of its way to emphasize that its rationale is context-specific. And so in future cases, where it may be challenging to convince a court that there are plausible claims of imprudence, this case will not help those plaintiffs," Oringer said.

Still, the decision was clearly an unwelcome development for many management-side advocates. For example, the ERISA Industry Committee, or ERIC, another group representing large employers that administer ERISA-regulated benefit plans, was critical of the decision in a statement to Law360 on Friday.

Andy Banducci, senior vice president of retirement and compensation policy at ERIC, said, "Plan sponsors have seen an explosion in fiduciary litigation, and many of these cases are brought based on hindsight or vague allegations. If routinely permitted to proceed beyond motions to dismiss, these suits will make providing retirement benefits more costly for employers and ultimately plan beneficiaries."

"Our goal in all these cases is to protect the ability of employers to efficiently design and administer retirement plans for tens of millions of American workers," Banducci said.

The development also raised concerns from Daniel Aronowitz, managing principal and owner of Euclid Fiduciary, a fiduciary liability insurance underwriting company for employee benefit plans.

"We risked that bad facts would lead to bad law. In the end, we ended up with a reasonable opinion that provides guidance for all plan sponsors, although there are a few concerning elements of this decision," Aronowitz said.

One of those concerns, Aronowitz said, had to do with how "the court used Northwestern's plan changes against them as contextual proof of excess fees."

"By trying to argue that their fee structure prior to the changes was prudent, they risked this opinion that the fee changes were used against them as proof of potential imprudence," Aronowitz said. "We are disappointed that plan remedial changes could be used as proof of imprudence, as this is a recurring fact pattern in cases in which plaintiff law firms allege that 'changes are too little, too late.'"

The U.S. Department of Labor on Friday declined a request to comment on the opinion.

--Editing by Philip Shea and Jill Coffey.
