Professional Perspective

SCOTUS Opens ERISA Litigation Floodgates

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In a straightforward, unanimous decision involving eight justices (since Justice Amy Coney Barrett did not take part in the decision) and relying squarely on recent precedent, the U.S. Supreme Court held that plaintiffs can elude a motion to dismiss by alleging that ERISA retirement plan fiduciaries didn't ensure that all investments in a plan were prudent. The decision likely guarantees that a busy line of litigation will continue for years to come.

The case, Hughes v. Northwestern Univ., was on appeal from the Seventh Circuit, which affirmed the district court's granting of defendants' motion to dismiss. The lower courts concluded that the plaintiffs-petitioners had failed to state a claim because, among other reasons, Northwestern University's plans offered a "diverse menu" of investment options that featured the exact lower-cost options that plaintiffs sought in their complaint. The Seventh Circuit found that although the plan menus included higher-priced options plaintiffs-respondents complained about, the inclusion of lower-cost offerings "eliminat[ed] any claim that the plan participants were forced to stomach an unappetizing menu."

The Supreme Court vacated the judgment. Writing for the Court, Justice Sonia Sotomayor said the Seventh Circuit had "erred in relying on the participants' ultimate choice over their investments to excuse allegedly imprudent decisions" by the Northwestern University plan fiduciaries.

The Court relied principally on its decision in Tibble v. Edison Int'l, 575 U.S. 523 (2015), which held that a fiduciary breaches its duty of prudence "by failing to properly monitor investments and remov[ing] imprudent ones." The Seventh Circuit, Justice Sotomayor wrote, did not correctly apply *Tibble*, because plaintiff-petitioners had adequately alleged that Northwestern failed to monitor plan investments by: (1) retaining recordkeepers' excessive fees; (2) offering too many options that confused participants; and (3) failing to provide cheaper but otherwise identical investment alternatives.

Citing *Tibble*, Justice Sotomayor wrote that "[i]f the fiduciaries fail to remove an imprudent investment from the plan within a reasonable time, they breach their duty." The Seventh Circuit's focus on the ability of participants to choose, she found, "elided this aspect of the duty of prudence."

The opinion was short but nevertheless includes guidance that is highly instructive for practitioners. Here are few salient points:

• These cases will likely continue to be difficult to defeat on motions to dismiss.

The ERISA excessive fee cases, for the most part, have been difficult to dismiss at early stages of litigation. The decision will likely make it even more difficult.

Justice Sotomayor wrote that the Seventh Circuit's decision was "flawed": Its "categorical rule" that some investment options were prudent "was inconsistent with the *context-specific* inquiry that ERISA requires and fails to take into account [Northwestern's] duty to monitor *all* plan investments and remove any imprudent ones." (Emphasis added.)

The Court's reference to "context-specific" inquiry are the words that could launch many more litigation ships. The opinion suggests plaintiffs can survive a motion to dismiss by alleging that even if fiduciaries provided only *one* imprudent fund, deciding whether it was imprudent will require discovery.

• The case presents a clash of fiduciary duties.

The Supreme Court refers often to the lower courts' reliance on ERISA's duty to diversify. But the *Northwestern* decision suggests that diversification might be imprudent-- specifically, that *too much* diversification might be imprudent. Navigating and complying with these two conflicting duties will be a difficult balancing act for fiduciaries and could create an even wider opening for plaintiffs firms. .

• The onus for investment menus will be on plan fiduciaries.

The Supreme Court held that, at least at the pleading stage, plan fiduciaries, not participants, will ultimately bear the responsibility for decisions in retirement plans. Citing *Tibble*, the Court wrote that "plan fiduciaries are required to conduct their own independent evaluation to determine which investments may be prudently included in the plan's menu of options." The lower court's statement that "plaintiffs claims are paternalistic, but ERISA is not" may be tested for years to come.

Despite being only six pages, the Supreme Court's *Northwestern* decision will probably be evaluated and cited for years, only propelling a line of litigation that has been active for more than a decade.