19-1401

IN THE
Supreme Court of the United States

APRIL HUGHES,
KATHERINE D. LANCASTER, AND JASMINE WALKER,
Petitioners,

v.

NORTHWESTERN UNIVERSITY, ET AL.,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

REPLY BRIEF FOR PETITIONERS

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The Seventh Circuit dismissed petitioners' ERISA claims for imprudent retirement plan management, even though the Third and Eighth Circuits have allowed lawsuits with virtually identical allegations to advance, and the Ninth Circuit has also upheld similar claims. This undeniable circuit split is not a factual disagreement about whether the specific allegations at issue clear the pleading hurdle. It is a legal disagreement about where that hurdle should be set. Most courts have properly held that, at the pleading stage, ERISA plaintiffs are entitled to the plausible inference that excessive fees result from imprudent management. But the Seventh Circuit read the complaint in respondents' favor, dismissing petitioners' claims because they could not negate respondents' explanations for their behavior at the pleading stage. ERISA fee litigation has become an increasingly common mechanism for employees and retirees to obtain compensation for losses caused by imprudent management and to spur plan fiduciaries to improve their practices. At issue here is whether such lawsuits can continue or whether they will be cut off by insurmountable pleading standards. The Court should grant review.

ARGUMENT

I. RESPONDENTS FAIL TO REFUTE THE EXISTENCE OF A CIRCUIT SPLIT WARRANTING REVIEW

1. Petitioners demonstrated the existence of a circuit split. The Third, Eighth, and Ninth Circuits have held that allegations that a defined-contribution plan paid or charged to participants excessive fees (including recordkeeping and investment management fees) suffice to support a claim for violation of ERISA's duty of prudence. The Seventh Circuit rejected a claim based on such allegations, holding instead that petitioners' claims were precluded by the potential to craft a prudent explanation for respondents' conduct from petitioners' allegations. *See* Pet. 8-14; *see also* Pet. 14-16 (demonstrating similar split in district courts).

Respondents scarcely try to deny the existence of this circuit split. The bulk of respondents' argument on the supposed lack of a circuit split is an extended defense of the decision below on the merits, *see* BIO 11-17, which, even if it were correct (it is not, *see infra* Part II), would not refute the split's existence.

Regarding the two cases that most clearly conflict with the decision below – *Sweda v. University of Pennsylvania*, 923 F.3d 320 (3d Cir. 2019), and *Davis v. Washington University in St. Louis*, 960 F.3d 478 (8th Cir. 2020) – respondents rationalize (at 20, 22-23) the diverging outcomes as the "inevitable" result of the application of the same "holistic approach" to different allegations. This argument fails for two reasons.

First, respondents point to no relevant differences in the allegations at issue in *Sweda* or *Davis* that would justify a different outcome.[1] Respondents fail to acknowledge, let alone refute, petitioners' showing

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[1] The only such distinction that respondents attempt to draw is their assertion (at 17 n.1) that the operative complaint here did not include a claim based on offering retail-class shares of mutual funds instead of institutional-class shares of the same funds. But that is wrong; the First Amended Complaint included such a claim. *See infra* n.6. Moreover, petitioners supported that claim with a table comparing retail-class funds in the plan with institutional-class funds providing the same investment at a lower expense ratio. C.A. App. 119-29 (¶ 161). Such a "table comparing options in the Plan with the readily available cheaper alternatives" is exactly the type of allegation that persuaded the Third Circuit that the plaintiffs in *Sweda* had adequately pleaded a breach of fiduciary duty. 923 F.3d at 331.

(at 12 & n.7) that the allegations in the three cases were virtually identical. Nor do they respond to petitioners' showing (at 16-17) that commentators have widely acknowledged the circuit split. The chorus of commentary recognizing the split has increased since the petition was filed. For example, defendants' counsel in *Sweda* and *Davis* acknowledged that *Sweda*, *Davis*, and the decision below involved the "[s]ame allegations" and posed the question: "Might SCOTUS Finally Weigh In?"[2]

Second, respondents fail to grapple with petitioners' showing (at 11-14) that the legal reasoning employed by the court below conflicted with the reasoning of *Sweda* and *Davis*. *Sweda* held that a plaintiff was not required "to rule out lawful explanations for [defendant]'s conduct" and concluded that "the District Court erred by 'ignor[ing] reasonable inferences supported by the facts alleged,' and by drawing 'inferences in [Defendants'] favor, faulting [Plaintiffs] for failing to plead facts tending to contradict those inferences.'" 923 F.3d at 326, 332 (quoting *Braden v. Wal-Mart Stores, Inc.*, 588 F.3d 585, 595 (8th Cir. 2009)) (alterations in original). *Davis* held that the university's identification of a "plausible inference" of prudent behavior did not support dismissal because "mismanagement is another plausible inference" from allegations of excessive fees. 960 F.3d at 483. By contrast, the

[2] Jeremy Blumenfeld & Brian Ortelere, *Managing Your 401(K) During a Pandemic* 4, 13 (July 28, 2020), https://www.morganlewis.com/zh-cn/events/-/media/eeb6c13406044ee1b48cb8bfae044724.ashx; *see also* Gibson Dunn, *2020 Mid-Year Securities Litigation Update* 26 (Aug. 10, 2020) (court below held that allegations failed to state a claim, "notwithstanding decisions of the Third and Eighth Circuits potentially suggesting otherwise"), https://www.gibsondunn.com/wp-content/uploads/2020/08/2020-mid-year-securities-litigation-update.pdf.

court below accepted respondents' "expla[nation]" for why their behavior was prudent and "disagree[d] with" the inference of imprudence that petitioners drew from their well-pleaded factual allegations. App. 16a.

It is true, as respondents point out (at 18), that the Seventh Circuit acknowledged *Sweda* and stated: "The Third Circuit's approach is sound and not inconsistent with our own." App. 20a-21a. But the Seventh Circuit's attempt to harmonize its result with *Sweda* was unconvincing. The Seventh Circuit agreed with just one limited aspect of *Sweda*: the rejection of "a 'bright-line rule that providing a range of investment options satisfies a fiduciary's duty.'" App. 20a (quoting *Sweda*, 923 F.3d at 330). But the Seventh Circuit ignored *Sweda*'s holding that plaintiffs are not required to plead facts to negate inferences in defendants' behavior. And the Seventh Circuit failed to explain how it could have reached the opposite result from *Sweda* on virtually identical allegations. As one commentator explained: "The Seventh Circuit's ruling in *Divane* appears to create a circuit split with the Third Circuit's ruling in *Sweda*. Although the Seventh Circuit purported to agree with the framework applied by the Third Circuit, the fact remains that many of the allegations in the case against the University of Pennsylvania that were allowed to proceed were nearly identical to those asserted against Northwestern and dismissed."[3]

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[3] *Seventh Circuit Upholds Dismissal of 403(b) Plan Lawsuit Against Northwestern University in Apparent Split with Third Circuit*, Nat'l Law Rev. (Apr. 7, 2020), https://www.natlawreview.com/article/seventh-circuit-upholds-dismissal-403b-plan-lawsuit-against-northwestern-university.

This case also would have come out differently in the Ninth Circuit. Although, as respondents note (at 23), *Tibble v. Edison International*, 843 F.3d 1187 (9th Cir. 2016), was not a motion to dismiss decision, it held that claims based on offering some retail-class funds with excessive fees were legally viable, notwithstanding the plan's offering of other low-expense options. *See id.* at 1198 & nn.4-5. By contrast, the court below held that the availability of low-cost funds in the plan "eliminat[ed] any claim" that offering other funds with excessive fees was imprudent. App. 19a.

2. Contrary to respondents' suggestion (at 18), petitioners seek resolution of a split on an important legal issue, not "factbound error correction." As explained above, the circuits disagree on whether a plan participant can state a claim by alleging excessive fees that plausibly suggest imprudent management or whether a plan fiduciary can defeat such a claim merely through the assertion that the plaintiff's allegations could also support an inference of prudent behavior.

This legal issue carries vital importance to the financial security of millions of employees and retirees. ERISA excessive-fee lawsuits are quite common, with dozens filed per year in recent years. *See* George S. Mellman & Geoffrey T. Sanzenbacher, Ctr. for Retirement Research, *401(k) Lawsuits: What Are The Causes And Consequences?* 4 & fig. 3 (May 2018). Often, as in this case, they involve large plans with many thousands of participants. *See*, *e.g.*, C.A. App. 57-58 (¶¶ 12, 16) (plans had 21,622 and 12,293 participants); *Sweda*, 923 F.3d at 324 (plan had 20,000 participants). The facts available to plaintiffs in complaint pleadings may plausibly allege excessive fees resulting from imprudence. However, at the pleading stage, plaintiffs typically will lack knowledge of the defendant's decisionmaking processes. *See Braden*, 588 F.3d at 598 ("No matter how clever or diligent, ERISA plaintiffs generally lack the inside information necessary to make out their claims in detail unless and until discovery commences. . . . If plaintiffs cannot state a claim without pleading facts which tend systemically to be in the sole possession of defendants, the remedial scheme of the statute will fail, and the crucial rights secured by ERISA will suffer."). Yet in direct conflict with the Eighth Circuit, the Seventh Circuit below imposed as a rule of law that plaintiffs could not advance beyond the pleading stage without negating plausible inferences of prudent behavior. *See* App. 17a (affirming dismissal because "Northwestern had 'valid reasons' for the recordkeeping arrangements they chose").

At issue in this circuit split is whether plaintiffs can continue to bring the ERISA lawsuits that have revolutionized fiduciary practices, spurring operational improvements that have sharply reduced plan expenses for millions of Americans. *See* Pet. 22-24 (citing cases and commentary recognizing impact of ERISA litigation). The Seventh Circuit's decision is already having a chilling effect on such litigation. In *Martin v. CareerBuilder, LLC*, 2020 WL 3578022 (N.D. Ill. July 1, 2020), the court held that the Seventh Circuit's decision required dismissal of an ERISA claim resting on allegations of excessive recordkeeping fees and offering of retail-class versions of funds where lower-cost institutional-class versions were available. *Id.* at *1-2, *4. As one commentator explained, *CareerBuilder* "is noteworthy in that it departs from other courts that have permitted lawsuits to survive a motion to dismiss based on similar allegations."[4]

As one commentator who represents defendants in ERISA litigation rightly acknowledged, "the debate about the appropriate pleading standard in ERISA fiduciary breach cases rages on," and this "issue . . . transcends the university cases." Catalina J. Vergara, *Back to School: Latest Developments in the University Cases*, ERISA Litig. Reporter (May 2020). "Whether in *Divane* or otherwise, the pleading question will need to be resolved at some point by the [Supreme] Court." *Id.* The Court should resolve the circuit split now.

II. THE SEVENTH CIRCUIT ERRED

The Seventh Circuit erred by dismissing the case when plaintiffs' allegations gave rise to the plausible inference that the Plans' excessive fees resulted from imprudent management. Respondents' defenses of the decision below only underscore that the decision hinged on inverting the applicable pleading standard by accepting respondents' inferences and disregarding petitioners' reasonable inferences.

For example, respondents argue (at 14, 25) that the Seventh Circuit properly held that respondents' choice of recordkeepers was justified because it allowed respondents to offer a specific annuity fund. Respondents argue (at 13-14) that, because such an inference could be derived "from [petitioners'] complaint," it was proper for the court to draw that inference in respondents' favor to dismiss the lawsuit. But petitioners alleged facts plausibly supporting the inference that

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[4] Holland & Knight, *District Court Dismisses 401(k) Excessive Fee Lawsuit* (July 22, 2020), https://www.jdsupra.com/legal-news/district-court-dismisses-401-k-34675/.

the Plans paid excessive recordkeeping fees because of their imprudent failure to pursue strategies – such as competitive bidding, consolidation to a single recordkeeper, or negotiation of fee reductions – that other university plans had successfully employed to lower fees. C.A. App. 90-95, 111, 115-16 (¶¶ 93-97, 140-141, 151-152).[5] While respondents note (at 13) that the Seventh Circuit recited the applicable pleading standard requiring the court to draw reasonable inferences in petitioners' favor, respondents applaud the Seventh Circuit for disregarding that standard.

Respondents' defense of the Seventh Circuit's dismissal of the excessive investment management fee claim likewise contravenes settled law. Respondents assert (at 26) that, because the Plans offered a fund with an expense ratio of 0.05%, any claim that other funds carried excessive expenses fails "as a matter of law." Under respondents' position, even their offering of 129 retail-class funds despite the availability of identical lower-cost institutional-class versions of the same funds cannot support a claim. *See* C.A. App. 116-30 (¶¶ 155-165).[6] That position cannot be

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[5] Accordingly, petitioners' allegation that respondents could have achieved lower recordkeeping fees is not "conclusory," as respondents claim (at 25), but supported by well-pleaded factual allegations.

[6] Respondents assert (at 17 n.1, 27) that petitioners did not assert a claim based on offering of retail-class shares. Not so. The First Amended Complaint contained 14 pages of allegations supporting this theory. C.A. App. 116-30 (¶¶ 155-165). Count V incorporated these allegations, asserted a claim for "[u]nreasonable [i]nvestment [m]anagement [f]ees," and further alleged: "The Plans' investment offerings included the use of mutual funds and variable annuities with retail expense ratios far in excess of other lower-cost options available to the Plans. These lower-cost options included lower-cost share class mutual funds with the identical investment manager and investments, lower-

squared with *Tibble v. Edison International*, 135 S. Ct. 1823 (2015), in which this Court held that a fiduciary "has a continuing duty to monitor trust investments and remove imprudent ones." *Id.* at 1828. Tellingly, respondents ignore this Court's *Tibble* opinion.

Respondents' attempt to justify the Seventh Circuit's ruling on the basis of pre-*Tibble* Seventh Circuit case law is unpersuasive. Respondents cite (at 27) two cases, *Hecker v. Deere & Co.*, 556 F.3d 575 (7th Cir. 2009), and *Loomis v. Exelon Corp.*, 658 F.3d 667 (7th Cir. 2011), as rejecting the argument that a plan "should have offered only wholesale or institutional funds, and zero retail funds." But petitioners did not argue that all retail-class funds are imprudent in all circumstances. Petitioners merely argued that, where respondents offered 129 retail-class versions of funds for which an institutional-class version was available that provided *the same investment at lower cost*, petitioners at least raised a plausible inference of imprudent behavior. To the extent *Hecker* and *Loomis* suggest otherwise, they did not survive this Court's holding in *Tibble* that a fiduciary is obligated to remove imprudent investments.

III. RESPONDENTS RAISE NO VEHICLE PROBLEMS THAT WOULD HINDER THIS COURT'S REVIEW

This case squarely presents the legal question whether excessive-fee allegations are sufficient to state an ERISA claim. Given the similarity of the allegations here to those that survived in *Sweda* and *Davis*, this case presents the ideal vehicle to resolve the circuit split. Respondents' supposed vehicle problems are nonexistent or overblown.

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cost insurance company variable annuities and insurance company pooled separate accounts." *Id.* at 181-83 (¶¶ 260, 266).

First, respondents' assertion (at 30) that lower courts are unaware of a conflict does not justify denial of certiorari. Commentators have widely acknowledged the split, *see supra* pp. 3-4 & nn.2-3, 7 & n.4; Pet. 16-18, and *CareerBuilder* specifically noted disagreement between the circuits on excessive investment management fee claims, 2020 WL 3578022, at *5 n.8.

Second, for the reasons described above, *see supra* pp. 5-7, the decision is not "painfully narrow and fact-bound." BIO 30. Moreover, because many fiduciaries engage in similar practices, the same fact patterns recur frequently in the dozens of ERISA excessive-fee lawsuits filed each year. Respondents fail to acknowledge petitioners' lengthy string-cites of other recent cases addressing excessive recordkeeping fees and imprudent offering of retail-share classes. Pet. 14-16 & nn.9-10.

Third, denial of certiorari in *Sweda* does not support denial here. Since that denial, the *Davis* decision deepened the circuit split. Moreover, because *Sweda* reversed a dismissal in relevant part, the Court would have taken the case in an interlocutory posture, a concern absent here given the Seventh Circuit's final judgment. Whatever motivated the Court's denial in *Sweda*, this case presents a far more compelling candidate for review.

Fourth, respondents' suggestion (at 31) that "petitioners tacitly acknowledged the shortcomings of the operative complaint" is baseless. The 141-page First Amended Complaint is extraordinarily thorough. It situates respondents' practices within the broader context of fiduciary management, *see* C.A. App. 66-82 (¶¶ 41-79); quantitatively measures the impact of respondents' practices, *id.* at 85-86, 113-15, 118-29 (¶¶ 84, 145-150, 161); describes specific alternative actions respondents could have taken to lower fees, *id.* at 90-95 (¶¶ 93-97); and cites numerous experts in the field to demonstrate the imprudence of respondents' behavior, *id.* at 95-100 (¶¶ 98-108). If the First Amended Complaint is insufficient, virtually no complaint ever will be sufficient. Petitioners merely noted, in passing, that the proposed Second Amended Complaint, which incorporates information learned in discovery, contains even more factual detail supporting petitioners' claims. *See* Pet. 20 n.15. That petitioners substantiated their claims in discovery only underscores that the Seventh Circuit erred in holding that petitioners' claims were implausible.

Finally, the fact that respondents made changes to their plans in October 2016 – two months after petitioners filed their initial complaint – underscores the importance of review. As respondents' conduct demonstrates, ERISA litigation spurs fiduciaries to make changes to attempt to improve plan administration. Yet by erecting procedural barriers to asserting such claims, the Seventh Circuit's decision will remove incentives for plan fiduciaries to improve their practices. In any event, petitioners allege that respondents' practices remained imprudent in many respects, even after the 2016 changes. *See*, *e.g.*, C.A. App. 129 (¶ 163).

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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