No. 19-1401

In The
Supreme Court of the United States

APRIL HUGHES, *et al.*,

Petitioners,

v.

NORTHWESTERN UNIVERSITY, *et al.*,

Respondents.

On Writ Of Certiorari To The United States Court Of Appeals For The Seventh Circuit

BRIEF FOR EUCLID FIDUCIARY AS AMICUS CURIAE SUPPORTING RESPONDENTS

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INTEREST OF AMICUS CURIAE

Amicus Curiae Euclid Fiduciary (Euclid)[1] has an interest in describing how the current ERISA caselaw permits implausible claims to proceed against prudent plans and fiduciaries. As a leading provider of fiduciary liability insurance for America's employee benefit plans, including many of the nation's largest and most sophisticated plans, Euclid has underwritten fiduciary liability insurance for thousands of plans and fiduciaries across the country. Euclid has considerable expertise analyzing issues of prudence using the same information that is frequently available to courts at the motion to dismiss stage. Its singular focus on fiduciary liability has cultivated a deep understanding of the industry best practices that allow plans and fiduciaries to provide quality investment options and services to participants without imprudent risks and costs.

Euclid's expertise is applying fiduciary liability standards to insure prudently managed plans. When underwriting defined contribution plans, Euclid underwriters analyze each plan's disclosures required by the Department of Labor (DOL). These include the Form 5500, the financials attached to the Form 5500, the participant Rule 404a5 fee disclosure, and the recordkeeper's Rule 408b2 fee disclosure. Using these

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[1] Pursuant to Supreme Court Rule 37(6), amicus states that no one other than amicus and its counsel authored this brief in whole or part or contributed money intended to fund the preparation or submission of this brief. All parties have consented to the filing of this brief in blanket consents on file.

disclosures, Euclid underwriters analyze various factors regarding whether the plan and its fiduciaries follow prudent processes. Based on this review, Euclid quotes insurance for plans and plan sponsors that comply with fiduciary best practices. Despite its best fiduciary underwriting, however, Euclid has seen purported excessive fee cases being filed against plans with quality fiduciary processes, and it believes that further guidance to the lower courts is necessary to ensure that such cases are resolved under a uniform and predictable pleading standard.

INTRODUCTION AND SUMMARY OF THE ARGUMENT

The pleading standard for excessive fee lawsuits ought to "readily divide the plausible sheep from the meritless goats." *Fifth Third Bancorp v. Dudenhoeffer*, 573 U.S. 409, 425 (2014). Instead, industry data and Euclid's own experience demonstrate that, all too often, the lower courts fail to distinguish the two, improperly permitting meritless goats to proceed in expensive and burdensome litigation against prudent plans and fiduciaries. The chance for a windfall recovery has spawned hundreds of excessive fee lawsuits over the past five years, already resulting in dozens of meritless claims avoiding dismissal and extracting large settlements. The pleading standard should be clarified and further guidance should be given to better equip the lower courts to weed out these claims.

Plaintiffs employ two primary tactics to avoid dismissal of excessive fee claims: improper benchmarking and incomplete or inaccurate descriptions of the fees at issue. They improperly allege benchmarks with different sizes, investment strategies, levels of activity, target dates, asset allocations, and levels of services (among other factors) to create the façade of a reliable benchmark with lower fees. They also allege inaccurate or immaterial fee differentials by cherry-picking data from fee disclosures and public financials to exaggerate the plan's fees and by claiming that even minor fee differences—in one example, only .0003 higher—suffice to allege a plausible claim.

Applying the familiar standards of *Twombly* and *Iqbal*, *Dudenhoeffer* confirmed the importance of a "context specific" inquiry and "careful judicial consideration of whether the complaint states a claim that the defendant has acted imprudently." *Dudenhoeffer*, 573 U.S. at 425. But the complexities of modern plans and investment strategies, and the associated services and fees, require more guidance than to be "careful" when analyzing claims. The lower courts need direction regarding what factors to consider when determining whether a plaintiff has plausibly alleged excessive fees.

The pleading standard and the factors that inform it should focus on three elements: (i) that no prudent fiduciary would have agreed to the allegedly excessive fees based on (ii) a comparison of a reliable benchmark of materially identical investments and services with

(iii) disproportionately lower fees during the relevant time period.

The first element focuses on what a prudent fiduciary would *not* have done, rather than trying to discern whether the plan should have been more prudent than it was. Claims should be dismissed unless plaintiffs plausibly allege that the challenged fees are too high to be the result of a fiduciary's prudent decisions.

The second and third elements acknowledge that any allegation of "excessive" fees begs the question of compared to what. Rather than permitting plaintiffs to cherry-pick lower-cost benchmarks, courts ought to apply a uniform set of factors to ensure that plaintiffs allege appropriate benchmarks with sufficient information from which the courts can ascertain whether the challenged fees are excessive, rather than merely different. Allegations omitting material facts about the benchmark or the fees are not plausible.

Courts can and should make use of the relevant plan disclosures, including the DOL-required fee disclosures and public financial information, when analyzing excessive fee claims. This information is available to plaintiffs and is often incorporated into complaints to establish their own preferred benchmarks and to support allegations about the fees at issue. Likewise, Euclid's own underwriting uses this information to determine whether to insure plans and fiduciaries. In Euclid's experience, it is useful to distinguish the sheep from the goats through the underwriting process, during which time Euclid, like most

district courts, does not have access to the additional facts that would be provided in discovery.

The alternative proposed by Petitioners and DOL is unworkable. Merely requiring a benchmark that is substantially similar (not materially identical) to the challenged plan improperly overlooks material dissimilarities. Because plans have a wide variety of prudent investment options and services available, lower courts must do more than compare "apples to apples"; they must compare McIntosh to McIntosh and Red Delicious to Red Delicious. Moreover, the plan's entire mix of investments should be considered, even if plaintiffs challenge only a few of the investment options as imprudent, lest ERISA become a *de facto* requirement to chase short-term returns, to the detriment of the plan's long-term investment strategy. Lastly, assuming a proper benchmark is alleged, another problem arises from the overly simplistic approach permitting claims to proceed simply because the benchmark's investment options and services are available at "a lower cost." U.S. Br. 12. This ignores that some differences in fees among materially identical plans are likely to exist in a free market, which means that plaintiffs often will be able to point to lower-cost options elsewhere. ERISA does not require plans and fiduciaries to continually chase the lowest costs.

ARGUMENT

I. Implausible ERISA claims are unfairly allowed to proceed against prudent plans and fiduciaries.

"The aim of ERISA is to make the plaintiffs whole, but not to give them a windfall." *Henry v. Champlain Enterprises, Inc.*, 445 F.3d 610, 624 (2d Cir. 2006). Over the past five years, however, excessive fee claims have proliferated, taking advantage of under-developed pleading standards to avoid dismissal and extract windfall settlements. Industry data and Euclid's own experience confirm that many of these claims are based on implausible allegations.

A. Industry data demonstrates that excessive fee lawsuits have become excessive.

Over 300 excessive fee lawsuits have been filed in the last five years, with well over one billion in settlements and several hundred million in payouts to plaintiffs' counsel.[2] Last year alone, nearly 100 excessive fee suits were filed, marking a 500 percent increase from the year before.[3] And an estimated 70 percent of those

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[2] *See* Daniel Aronowitz, *Pleading Standard for Excessive Fee Lawsuits* 3, Euclid Specialty Managers (Aug. 2021), https://bit.ly/3jpXti4; Robert Rachal, Myron D. Rumeld & Tulio D. Chirinos, *Fee Litigation 2019 Round-Up: Recent Developments and Best Practices to Mitigate Risk*, Benefits Law Journal, Spring 2020, Vol. 33, Issue 1.

[3] *See* Jacklyn Wille, *Spike in 401(k) Lawsuits Scrambles Fiduciary Insurance Market*, Bloomberg Law (Oct. 18, 2021),

cases proceed into discovery.[4] It is now routine "in numerous other lawsuits" for "a plaintiff's attorney, seeking a large fee," to "target a plan that holds abundant assets," in the hope of a large settlement. *Sweda v. Univ. of Pennsylvania*, 923 F.3d 320, 341 (3d Cir. 2019) (Roth, J., concurring in part and dissenting in part). Furthermore, plaintiffs have increasingly attacked smaller plans with less than $100 million in assets and fewer than 1,000 participants,[5] and have also shifted their focus to universities, filing a dozen copycat lawsuits against large universities.[6] This, in turn, has made it harder for plans and fiduciaries to obtain the insurance coverage necessary to operate in today's litigious environment, threatening the availability of retirement benefits and services to employees.[7]

Petitioners contend that skyrocketing litigation serves ERISA's remedial purposes. Pet. Br. 47. But they ignore the *in terrorem* effects of the low and

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https://bit.ly/3CjnTK5 (reporting approximately 140 cases filed in 2020 and 2021, as compared to only 20 in 2019).

[4] *See* Proskauer Rose, *ERISA Fest* 6 (Oct. 7, 2021), https://bit.ly/3m1O2af.

[5] *See* Lars Golumbic, et al., *2020 ERISA Litigation Trends Hint At What's Ahead This Year*, Law360 (Jan. 3, 2021), https://bit.ly/2TeiodS ("The biggest driver of the explosion of ERISA class actions in 2020 was a dramatic increase in the number of smaller plans facing these lawsuits. . . .").

[6] *See* Resp. Br. 11; *see also* Golumbic, *supra* n.5; Heather Salko, *ERISA Litigation Targets Higher Education Retirement Plans*, United Educators, https://bit.ly/3yWhjYm.

[7] *See* Lee Barney, *Excessive Fee Lawsuits Expected to Continue to Rain Down on Plans*, PLANADVISER (June 11, 2021), https://bit.ly/3vzkLam.

undeveloped pleading standard applied to such suits, which forces even successful plans (and the employees who volunteer to serve as fiduciaries) to incur the burdens and costs of protracted litigation. Plaintiffs' strategy "has substantial consequences for fiduciaries of these plans, particularly at universities," by putting them in an untenable position, forcing them to pay the ransom demanded by plaintiffs. *Sweda*, 923 F.3d at 341 (Roth, J., concurring in part and dissenting in part). "This reality demands that cases such as this one be carefully scrutinized in order not to permit implausible allegations to result in a large settlement, under which a substantial portion of the funds that are to be reimbursed to retirement plans are instead diverted to attorneys' fees." *Id.*

B. Euclid's experience demonstrates that significant numbers of excessive fee lawsuits are based on implausible allegations.

For years, lower courts have permitted significant numbers of implausible excessive fee lawsuits to proceed, inflicting "probing and costly inquiries and document requests" on prudent plans and fiduciaries. *Pension Ben. Guar. Corp. v. Morgan Stanley Inv. Mgmt. Inc.*, 712 F.3d 705, 719 (2d Cir. 2013); *see also* Lockton Financial Services Claims Practice, *Fiduciary Liability Claim Trends* 1 (Feb. 2017), https://bit.ly/3viCsd2 (reporting estimated $2.5 to $5 million in discovery costs).

1. Implausible claims are allowed to proceed based on allegations that are not material to the actual fiduciary process or the investments at issue.

When it comes to ERISA plans, "[c]omparing apples and oranges is not a way to show that one is better or worse than the other." *Davis v. Washington Univ. in St. Louis*, 960 F.3d 478, 485 (8th Cir. 2020). This is especially true given that plan participants have different financial goals, requiring options with "different aims, different risks, and different potential rewards that cater to different investors." *Id.*; *see also Loomis v. Exelon Corp.*, 658 F.3d 667, 673-74 (7th Cir. 2011) (noting "the absence from ERISA of any rule that forbids plan sponsors to allow participants to make their own choices"). Unfortunately, the lower courts sometimes permit excessive fee lawsuits to rely on contrived benchmarks to accuse an "apple" plan of imprudently paying more fees than an "orange" plan.

a. Improperly comparing large plans to small plans

One strategy employed by Plaintiffs is to use small plans as benchmarks for large plans, relying on publications like the 401k Averages Book even though it does not analyze fees for large plans.[8] *See Davis v.*

[8] The 401k Averages Book provides average cost information for 401k plans, beginning at the level of 10 participants / $100,000 in assets and ending at 2,000 participants / $200,000,000 in assets. *See 401k Averages Book* 1 (21st ed. 2021); *see also* https://www.401ksource.com/.

Magna Int'l of Am., Inc., No. 20-cv-11060, 2021 WL 1212579, at *9 (E.D. Mich. Mar. 31, 2021) (alleging a benchmark of a 2,000 participant / $200 million asset plan against a 26,000 participant / $1.6 billion asset plan); *In re Omnicom ERISA Litig.*, No. 20-cv-4141, 2021 WL 3292487, at *15 (S.D.N.Y. Aug. 2, 2021) (noting that the Averages Book "evaluated recordkeeping fees for plans much smaller than" the challenged plan).

Defendants' arguments about the impropriety of using small-plan statistics to judge large-plan fees tend to fall on deaf ears. In *Omnicom*, the court found that plaintiffs' alleged average recordkeeping fees for small plans were sufficient for benchmarking, reasoning that the larger plan should have used its greater bargaining power to negotiate even lower fees—in other words that the Averages Book set the ceiling for fees that a large plan should pay. *See In re Omnicom ERISA Litig.*, 2021 WL 3292487, at *15. Plaintiffs' amended complaint focused exclusively on comparing the plan's alleged $46 per-participant fee with the alleged benchmark of $14-21. *Id.* ECF 17 ¶¶50-51. Plaintiffs did not allege—and the court did not analyze—whether the plan's recordkeeping services were comparable to the services that allegedly could have been obtained at the lower rate. *Id.* 2021 WL 3292487, at *15. More importantly, plaintiffs obscured the actual costs at issue by using the $35 average recordkeeping cost for small plans with 100 participants and $5 million in assets (Amd. Compl., ECF 17 ¶50), even though the Averages Book indicates that total participant cost

(TPC) for these plans is $604.[9] Based on plaintiff's own allegations, the plan's TPC was approximately $418, over 30% lower than the purported benchmark.[10] This distortion of small-plan data is a recurring feature of ERISA complaints. *See*, *e.g.*, *Allison v. Brands, Inc.*, No. 2:20-cv-6018, 2021 WL 4224729, at *8 (S.D. Ohio Sept. 16, 2021) (following *Omnicom* despite fact that the plan was "much larger than the ones evaluated in the Averages Book"); *Parmer v. Land O'Lakes, Inc.*, 518 F. Supp. 3d 1293, 1299 (D. Minn. 2021) (using Averages Book and similar sources to benchmark large plan with "over $1.4 billion" in assets).

By contrast, in *Johnson v. PNC Financial Services Group, Inc.*, the district court rejected plaintiffs' bald assertion that a large plan's fees must be lower than the "average" fees for small plans, concluding that imprudence cannot "be inferred from the comparison between the direct recordkeeping and administrative costs of smaller plans with the record keeping and administrative fees Plan participants pay." No. 2:20-cv-01493, 2021 WL 3417843, at *4 (W.D. Pa. Aug. 3, 2021). Other factors, including revenue sharing, showed that "smaller plans pay much more." *Id.* Additionally, the court rejected another common plaintiffs' tactic—*i.e.*,

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[9] *See 401k Averages Book* 56 (21st ed. 2021) ("Total Plan Cost per participant is $604."). The lower recordkeeping fees for smaller plans are more than offset by their higher asset-based fees.

[10] Plaintiffs alleged the plan had 36,807 participants, $2.8 billion in assets, and TPC from 0.53% to 0.55% of its total assets. Amd. Compl., ECF 17 ¶¶4, 55. Simple math ($2.8 billion x 0.55% ÷ 36,807) yields a TPC of $418 per participant.

citing inconclusive and incomplete data from other plans' Form 5500 filings, without accurately comparing the services provided by those plans. *Id.* (noting that alleged benchmark was "premised on unspecified recordkeeping services provided by Fidelity to other plans . . . without any comparison to the services provided to the Plan").

Undeterred, the *PNC* plaintiffs amended their complaint to rely on the purported lower recordkeeping fees of other large plans. But this, too, was defective because plaintiffs used the Form 5500 direct compensation data in lieu of the DOL-mandated Rule 408b2 disclosure, which provides the accurate recordkeeping total. No. 2:20-CV-01493, ECF 42 at 15 ¶46; 29 C.F.R. § 2550.408b-2. Nor did plaintiffs allege any facts to support their assumption that the other plans and services were sufficiently comparable to be proper benchmarks. *See PNC*, No. 20-CV-01493, ECF 42 at 15-17 ¶¶46-49.

b. Improperly comparing active funds to passive funds

Another issue is the use of a passive fund to benchmark active funds, alleging that the higher fees associated with active investment strategies are "excessive" simply because they exceed the passive fund's fees. Petitioners themselves used a *passive* Vanguard index fund as a benchmark for *active* funds in Respondents' plans. *Divane v. Nw. Univ.*, No. 16-cv-8157, 2018 WL 2388118, at *4 (N.D. Ill. May 25, 2018).

They offered no materially identical benchmark to properly assess the fee differential—just an inapposite passive index fund that failed to account for the different strategies and associated fees of active funds. *See Loomis*, 658 F.3d at 669-70; *Davis*, 960 F.3d at 485 (rejecting use of "index funds as a potential benchmark" for actively managed funds).

In the same vein, plaintiffs challenge isolated active investments for which fiduciary prudence can only be evaluated in the context of the entire investment portfolio. In *Miller v. Autozone, Inc.*, the court declined "to rule on the reasonableness of comparing actively-managed funds to passively-managed index funds" and denied the motion to dismiss even though plaintiffs alleged no actively managed funds to benchmark the allegedly excessive fees. No. 2:19-cv-2779, 2020 WL 6479564, at *4 (W.D. Tenn. Sept. 18, 2020). Likewise, the plaintiffs in *Reichert v. Juniper Networks* challenged two active investments but ignored the fact that the plan offered 44 low-cost index options. No. 4:21-cv-6213, ECF 1 (N.D. Cal.).[11]

Appellate courts have given conflicting guidance on this issue. The Third Circuit recognized that "a fiduciary breach claim must be examined against the backdrop of the mix and range of available investment options," but in the next breath, opined that even "a meaningful mix and range of investment options" does

[11] The case is described by Euclid in its whitepaper *Analyzing the BrightScope Defined Contribution Plan Data in the Context of Excessive Fee Lawsuits* (Sept. 14, 2021), https://bit.ly/2ZdX37I.

not "insulate[] plan fiduciaries from liability for breach of fiduciary duty," (*Sweda*, 923 F.3d at 330), leaving unresolved the question of what other factors should inform the analysis of the mix of options. The mix may not be dispositive, but if it matters at all, then the lower courts should be told how to account for it in the Rule 12 analysis.

c. Improperly comparing funds with different target dates or asset allocations

A third strategy employed by plaintiffs is to challenge target-date funds by comparing benchmarks with different target dates, ignoring the funds' asset allocations, which change as the target date draws closer. *Divane v. Nw. Univ.*, 953 F.3d 980, 984 (7th Cir. 2020). In *Brown-Davis v. Walgreen Co.*, the court denied a motion to dismiss claims alleging poor performance of funds by benchmarking them against two indexes and three target-date funds with low 6 bps fees. No. 1:19-cv-05392, 2020 WL 8921399, at *1 (N.D. Ill. Mar. 16, 2020). Plaintiffs were dissatisfied with the return of 7.96% compared to the returns of Fidelity (9.30%), TRP (9.93%), and the S&P 500 (8.42%). *Id.* ECF 1 at 15 ¶54. But the challenged funds had materially different allocations. The 2025 funds held 46% equities compared to 61-65% in the alleged benchmark, and the 2045 funds held 82% equities compared to 89-93% in the alleged benchmarks. *Id.* Mot. to Dismiss, ECF 38 at 10. The district court refused to take judicial notice of the available performance and asset

allocation information published by the benchmark funds themselves (even though plaintiffs presumably used that same information to identify returns). *See Walgreen Co.*, 2020 WL 8921399, at *2.

A related problem arises when plaintiffs attack quality investments because they lag a purported benchmark in the short-term (*i.e.*, over the span of a few years). The *Walgreens* plaintiffs filed their complaint six years after the challenged funds were added to the plan in 2013. *Id.* Mot. to Dismiss, ECF 38 at 3. But it is not imprudent "to select conservative funds with long-term growth potential and to stay with those mutual funds even during years of lower performance." *Jenkins v. Yager*, 444 F.3d 916, 926 (7th Cir. 2006). Nor does the duty of prudence "compel ERISA fiduciaries to reflexively jettison investment options in favor of the prior year's top performers." *Patterson v. Morgan Stanley*, No. 16-cv-6568, 2019 WL 4934834, at *11 (S.D.N.Y. Oct. 7, 2019). Such shortsightedness only encourages frequent adjustments to an investment portfolio, which runs counter to prudent investment management principles including those based on modern portfolio theory. *See Laborers Nat. Pension Fund v. Northern Trust*, 173 F.3d 313, 322 (5th Cir. 1999) (applying modern portfolio principles consistent with "ERISA policy as expressed by the Secretary's regulations."). Prudent investment management prioritizes long-term diversification across asset classes, with returns achieved by disciplined rebalancing rather than chasing short-term returns at the expense of the

portfolio's long-term return and ultimate benefit to participants.[12]

A prudent fiduciary should consider several factors regarding the plan's investment options, including diversification by asset class, an appropriate time horizon based on the proximity of participants to retirement, the plan's liquidity needs, and legacy investments that may pose material penalties to liquidate, to name a few. *See Northern Trust*, 173 F.3d at 317.

2. Implausible claims are allowed to proceed based on allegations of inaccurate or immaterial fee or performance differences.

In addition to improper benchmarking, Euclid has found that most excessive fee complaints include inaccurate or incomplete data. These claims must rely on plan disclosures and public financial information to compare plans to purported benchmarks. Complaints cannot plausibly allege that plans' fees are "excessive" in a vacuum; rather, they must identify at least one benchmark with lower fees, which necessarily requires reliance on information outside the complaint. Too often, complaints assert incomplete or distorted information.

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[12] Kate Stalter, *Chasing Performance Is a Quick Way to Disaster*, U.S. News & World Report (Feb. 8, 2017), https://bit.ly/3hEs1Lk; Vanguard, *Quantifying the Impact of Chasing Fund Performance* (2014), https://bit.ly/3mjGZu5.

Petitioners, for example, relied on direct and indirect compensation numbers from the plan's Form 5500. *Divane*, No. 16-cv-8157, ECF 1, Compl. ¶¶66-67. But those numbers do not represent an accurate recordkeeping fee because they include transaction fees that are not plan administration costs.[13] Petitioners also failed to allege any benchmark for their claim that $35 per participant is plausible or even available in the market. They included examples of five universities that allegedly negotiated lower fees, without identifying the actual fees of those plans for comparison to the Northwestern plan. *Id.* Amd. Compl. ECF 38 ¶¶93-101 (discussing Loyola Marymount, Pepperdine, Purdue, CalTech, and Notre Dame). The lower courts properly rejected Petitioners' inflationary tactics, but many other courts have allowed distorted allegations to proceed.

The examples are abundant. In the excessive fee litigation against AT&T's retirement plan, plaintiffs alleged a false $61 recordkeeping fee, which was exposed at summary judgment when the undisputed facts showed a market-low recordkeeping fee. *See Alas v. AT&T Servs., Inc.*, No. 2:17-cv-8106, ECF 215, Order at 19-20 (C.D. Cal. Sept. 28, 2021) (finding "no factual dispute exists as to whether [defendants] breached their duty of prudence in evaluating and monitoring the recordkeeping fees paid to Fidelity. . . ."); *id.* ECF

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[13] *See* DOL, *Frequently Asked Questions about the 2009 Form 5500 Schedule C* at Q4 (July 2008), https://bit.ly/3nrB1Gr (identifying "fees relating to administration" as one of multiple reportable categories of compensation).

81, 3d Amd. Compl. ¶60. The court found that the plan had a diligent process to monitor recordkeeping and administrative expenses, including hiring outside experts to benchmark fees, negotiating lower fees with Fidelity, obtaining fee reductions, and even negotiating a "most favored customer" provision to ensure the lowest fee. *Id.* ECF 215 at 19-20. That the Plaintiffs did not dispute these facts suggests the suit should have been dismissed earlier. Instead, plaintiffs avoided dismissal by repeatedly claiming an "excessive" recordkeeping fee of $61 compared to an alleged $30 benchmark. *Id.* ECF 81 ¶61. Plaintiffs buttressed their claim with public financial information showing fees charged by the Home Depot plan ($28) the FedEx plan ($23-30), the HCA plan ($24-30), the Costco plan ($35-38), and the Bank of America plan ($14-30). *Id.* ¶62. The fact that AT&T's fees were comparable could have been verified from the Rule 404a5 disclosure form provided to every plan participant including the plaintiffs. Instead, AT&T undoubtedly expended significant resources to exonerate its diligent fiduciary process through discovery and summary judgment briefing, all because the district court permitted the case to proceed based on inaccurate fee allegations.

Other cases have followed the same pattern. In *Klawonn v. Board of Directors for the Motion Picture Industry Pension Plans*, Plaintiffs alleged "astronomical" fees "averaging 1.18% per year, four to five times higher than the average plan of similar size," allegedly making the plan "one of the five most expensive plans in the country." No. 20-cv-9194, ECF 56, 2d Amd.

Compl. ¶10 (C.D. Cal.). Plaintiffs' allegation of $46 million in excess fees, however, contradicted the Form 5500, showing a total of $14,901,268 in fees paid for investment advisory and management services, well short of the $46 million allegation.[14] The alleged 1.18% investment expense was contrived from whole cloth to avoid dismissal and exaggerate damages to leverage a settlement.

Also in *Khan v. Board of Directors of Pentegra Defined Contribution Plan*, Defendants moved to dismiss, arguing the plan's fee disclosure confirmed that plaintiffs "have wildly overstated the Plan's investment fees" and seeking judicial notice of the disclosures. Case 7:20-cv-07561, ECF 93-1 at 18 (S.D.N.Y.). Among other problems, the disclosures confirmed that plaintiffs had improperly compared the plan's *total* fees to the *partial* fees of other plans, based on a chart in the complaint alleging that the plan's fees were "9,233% more expensive than the identical lower-cost alternatives," without disclosing the sources of the purported alternatives. *Id.* at 15, 18. These allegations were exposed by public data, which showed, for example, that one of the challenged funds had an annual operating expense ratio of .02%—exactly what plaintiffs claimed it should be. *Id.* at 18.

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[14] The expense information appears at page 4 of Schedule H to the plan's Form 5500 (attached in the appendix to this brief). For 2019, the plan reported total administrative expenses of $30,529,413, which is still significantly less than what plaintiffs alleged. The full Form 5500 is available on DOL's website at https://www.efast.dol.gov/5500search/.

Finally, Plaintiffs often sue over immaterial fee or performance differences that do not justify litigation and inappropriately second-guess the fiduciary process. In *Lauderdale v. NFP Retirement, Inc.*, No. 8:21-cv-301 (C.D. Cal.), plaintiffs made a series of such allegations, comparing challenged funds against purported benchmark funds with slightly lower costs (ECF 1, Compl. ¶¶70, 82-83, 93-94), including alleging that a difference of only 3 bps (5 vs 2) was imprudent. *Id.* ¶111. (Plaintiffs also ignored the plan's Rule 408b2 disclosure showing that for each listed active investment option the plan offered a low-cost index fund option.) The fact that plaintiffs felt they could state a claim based, in part, on a mere .0003 difference in fees confirms that guidance is needed to weed out lawsuits alleging immaterial differences.

II. The pleading standard for ERISA claims should weed out the implausible claims by requiring lower courts to account for the factors that demonstrate plausible claims of imprudence.

ERISA judges fiduciaries on their "process rather than results." *Sweda*, 923 F.3d at 329; *see also DeBruyne v. Equitable Life Assurance Soc'y*, 920 F.2d 457, 465 (7th Cir. 1990) (ERISA "requires prudence, not prescience."). "A prudently made decision is not actionable . . . even if it leads to a bad outcome." *Davis*, 960 F.3d 478, 482 (8th Cir. 2020); *see also Northern Trust*, 173 F.3d at 317 ("ERISA's test of prudence . . . is one of conduct and not a test of the result of performance

of the investment." (citation omitted)). Courts recognize that "the prospect of discovery in a suit claiming breach of fiduciary duty is ominous" and causes "an *in terrorem* increment of the settlement value." *Pension Ben. Guar. Corp.*, 712 F.3d at 719. But these principles are often accompanied only by the less-than-helpful proposition to take "particular care" in analyzing allegations of imprudence. *Id.* at 718.

There is little definitive guidance regarding how to take "particular care" in the context of an excessive fee case. Plaintiffs' claims frequently assert some version of the following: the plan should have negotiated lower fees because (in hindsight) the allegedly comparable plan(s) paid lower fees. This line of attack requires plausible allegations about the comparator plans and fees, so plaintiffs rely on plan disclosures and public financial data to contend that the comparator plans really are comparable and that the differential in fees really is excessive. But the lack of a well-developed pleading standard unfairly tips the Rule 12 scale by bestowing inferences of truth on plaintiffs' allegations about the data, no matter how one-sided or inaccurate, and by failing to articulate the factors that lower courts should use to evaluate allegations regarding what is a proper benchmark and whether an alleged fee is excessive. The already difficult task of "weeding out meritless [ERISA] claims," *Dudenhoeffer*, 573 U.S. at 425, becomes harder still when plaintiffs are permitted to stack the deck with incomplete or distorted information.

A. The pleading standard should focus on comparing the plan at issue with a reliable benchmark of materially identical investments and services.

With hundreds of excessive fee lawsuits pending, this is an opportune time to clarify the pleading standard. As explained below, the Court may find it useful to account for the following factors as it considers the proper articulation:

> *To properly allege whether a plan's fees are excessive, plaintiffs must plausibly allege that (i) no prudent fiduciary would have agreed to those fees based on (ii) a comparison of a reliable benchmark of materially identical investments and services*[15] *with (iii) disproportionately lower fees during the relevant time period.*

This standard builds upon *Dudenhoeffer*, where the Court considered, *inter alia*, whether there were alternatives available that "a prudent fiduciary in the same circumstances would not have viewed as more likely to harm the fund than to help it." 573 U.S. at 410. *Dudenhoeffer* does not prevent a fiduciary from exercising judgment about the range of available prudent investment options and services that suit the plan's needs and objectives, notwithstanding differences in the available options and the associated fees. The

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[15] There are two types of fees to consider: management fees expressed as an expense ratio and administrative fees, including recordkeeping fees, paid on a per-participant basis or included in the expense ratio. Resp. Br. 8-9.

question is not, as plaintiffs would have it, whether a prudent fiduciary could have found a lower-fee option, but whether the fees were so high that no prudent fiduciary would have agreed to them. *See Renfro v. Unisys Corp*., 671 F.3d 314, 322 (3d Cir. 2011) (no hypothetical prudent fiduciary would have made the same objective choice).

This approach aligns with the rule that allegations that are "merely consistent with" unlawful behavior—but are also "just as much in line with" lawful behavior—fail to state a claim. *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 554, 557 (2007). It cannot be sufficient to allege that some of the plan's investment options charged excessive fees or performed inadequately. Rather, the appropriate inquiry is whether plaintiff's allegations show that a prudent fiduciary in like circumstances would not have selected those options and paid those fees. Allegations that are consistent with a course of action a prudent fiduciary would have taken fail to state a claim. *See White v. Chevron Corp.*, 752 F. App'x 453, 455 (9th Cir. 2018) (insufficient to allege only that "Chevron could have chosen different vehicles for investment that performed better . . . or sought lower fees for administration of the fund").

B. The pleading standard should be informed by factors that tend to indicate whether a reliable benchmark plan charges disproportionately lower fees compared to the fees charged by the plan at issue.

It is one thing to agree that fiduciaries may consider all options on the menu of prudent investments and services, notwithstanding cost differentials. The harder task is identifying factors for analyzing whether a plaintiff has plausibly alleged that a fiduciary's choice was not on that menu. In many ways, a lower court's task is akin to the process that Euclid follows when it underwrites plans. Euclid is not involved in the plan's investment selection process or ongoing monitoring. It makes underwriting decisions based on the same DOL-mandated disclosures and public financial information that plaintiffs rely on in their complaints, which it uses to assess two categories: benchmarking factors regarding the material features of the plan and its proper comparators, and disproportionality factors regarding the degree of difference between the fees of the plan and those of its comparators.

1. A reliable benchmark must include materially identical investments and services.

Courts agree that plaintiffs "must provide a sound basis for comparison—a meaningful benchmark." *Davis*, 960 F.3d at 484. But investment options exist to serve all manner of participant preferences and goals;

simply being "meaningful" is arguably insufficient. The better question is whether the proposed benchmark is materially identical in terms of its investments and services. Apples-to-oranges comparisons won't do (*Davis*, 960 F.3d at 485), but even apples-to-apples comparisons allow material dissimilarities, suggesting that more granularity is necessary to account for the wide variety of prudent investment options and services available to plans and the many factors that inform the fiduciary's decision-making, including the plan's size, overall investment objectives, risk tolerance, financial circumstances, liquidity needs, and participants' expected retirement timeline. Plan participants have different tastes and different needs; some may require or prefer McIntosh, others Red Delicious, and others Honeycrisp. Thus, the lower courts should compare McIntosh to McIntosh, not McIntosh to Red Delicious. Treating all apples the same at the pleadings stage will encourage more litigation, thereby chilling the plan's ability to cater to participants' preferences.

a. Plan's size and number of participants

This factor considers whether the plan's fees are prudent relative to its size and number of participants. It is important to consider *all* the fees, including per-participant fees, as well as revenue-sharing and other asset-based fees. No participant would be better off paying total fees of $604 instead of $418, regardless of which plan has higher recordkeeping fees (*e.g.*, *Omnicom*). Conversely, if only one type of fee is at issue, then

only that fee should be analyzed across the plan and its comparator(s), but still in the context of the plan's total fees.

Courts err when they assume that small plan fees can benchmark large plan fees (*e.g.*, *Omnicom* and *Allison*), ignoring that smaller plans pay fees differently and may have more asset-based fees that are overlooked when comparing fees per participant. Additionally, larger plans may require more investment options and services, like enhanced participant education, because of their size and number of participants. By analogy, a large corporation may be able to negotiate favorable business travel rates for its employees, but those rates may still exceed those offered to small businesses or individuals because of the different requirements and expectations of corporate travelers.

b. Plan's mix of investment options

This factor considers whether the plan offers a prudent mix of investment options across both active and passive funds, which typically have "different aims, different risks, and different potential rewards that cater to different investors." *Davis*, 960 F.3d at 485. At a minimum, complaints should include allegations regarding the benchmark funds' holdings, asset allocations, investment strategies, and risk profiles. *See Patterson*, 2019 WL 4934834, at *11 (dismissing claim that lacked "detail as to the extent of the investment's shortcomings or why the [alleged comparator] is a comparable investment"); *Parmer*, 518 F. Supp. 3d

at 1306 (finding comparators with "different strategies, aims, risks, and potential rewards do not provide meaningful benchmarks").

A frequent dispute is whether a plan imprudently includes active funds. If the entire mix of investments is at issue, complaints should identify a benchmark plan with a materially identical mix, rather than asserting *ipse dixit* that the active funds were imprudent because passive funds were available. *See Davis v. Salesforce.com, Inc.*, 20-cv-01753, 2020 WL 5893405, at *3 (N.D. Cal. Oct. 5, 2020) ("[A]llegations that passively managed funds are available as alternatives to actively managed funds . . . do not suffice to demonstrate imprudence."); *Kong v. Trader Joe's Co.*, No. 20-cv-05790, 2020 WL 7062395, at *4 (C.D. Cal. Nov. 30, 2020) (same). Plans may offer a "concentration of actively managed funds," particularly if they also "offer[] a variety of investment options that include[] low-cost options. . . ." *Rosen v. Prudential Ret. Ins. & Annuity Co.*, No. 15-cv-1839, 2016 WL 7494320, at *15 (D. Conn. Dec. 30, 2016); *see also White v. Chevron Corp.*, No. 16-cv-0793, 2016 WL 4502808, at *9 (N.D. Cal. Aug. 29, 2016) (dismissing imprudence claim despite the presence of five actively managed funds).

Plaintiffs may not "dodge the requirement for a meaningful benchmark by merely finding a less expensive alternative fund or two with some similarity." *Meiners v. Wells Fargo & Co.*, 898 F.3d 820, 823 (8th Cir. 2018). Instead, the focus should be on the asset allocation of the challenged plan's funds and those of the benchmark plan(s). It is not sensible to compare funds

with different weights of asset classes (*i.e.*, weighted more heavily towards equities vs. weighted towards investment-grade bonds). *See supra* 14-16; *Davis*, 960 F.3d at 485 (funds with lower percentages of international securities were not proper benchmarks for fund with higher percentage). A plan that provides an appropriate mix of low-cost options, as well as actively managed options, has fulfilled its fiduciary obligations. *See Davis*, 960 F.3d at 485 ("[I]t is not imprudent to provide options with differing features from which to choose. . . .").[16]

This principle applies even when complaints target only some of the plan's investments, rather than the overall mix. In *Juniper Networks*, plaintiffs challenged two active investments, ignoring the plan's 44 low-cost index options (*supra* 13 & n.11), but an isolated inquisition into a few funds invites hindsight bias and discourages beneficial long-term investment strategies. It incentivizes fiduciaries to eliminate the plan's worst performers each year—since they will be the most likely targets of lawsuits—even though most funds do have years where they underperform their peers. The better approach is to consider the challenged funds in the context of a comparator plan with a materially identical mix of investment options. In all likelihood, that plan too will have some

[16] Lower courts can analyze investment mixes on a case-by-case basis. They are in the best position to determine, based on proper benchmarks, whether there are plausible allegations of imprudence because, for example, a plan offered too many higher cost funds and/or not enough lower cost funds.

underperformers, underscoring the need to avoid an isolated analysis of individual funds.

Petitioners and DOL, on the other hand, favor an isolated analysis, arguing that even "a *single* imprudent investment" could be the basis for a viable claim. *See* Pet. Br. 28; U.S. Br. 23-24 (contending that "ERISA does not permit respondents to offer any *imprudent* investments in the mix" (emphasis in original)). This position is based on *Sacerdote's* unfortunate statement that "[i]f the prudence of a particular investment offering will become clear only in the context of the portfolio as a whole, that argument cannot resolve a motion on the pleadings." *Sacerdote v. NYU*, 9 F. 4th 95, 109 (2d Cir. 2021). But this is a standardless standard. Plaintiffs can easily attack fewer than all of a plan's investment options and then argue that the imprudence thereof "will become clear only in the context of the portfolio as a whole," which conveniently circumvents dismissal and increases the opportunity for a large settlement. So much for weeding out meritless claims.[17]

c. Type of services provided to the Plan

This factor considers whether the plan pays for only basic recordkeeping or additional services too. It is impossible to know whether a plan's fees were

[17] This approach also elevates results over process. If plaintiffs feel they can only state an imprudence claim by challenging a few underperforming funds, rather than the overall mix, this suggests the plan has a prudent process in place.

excessive without knowing what services the plan received for those fees. *See Hecker v. Deere & Co.*, 569 F.3d 708, 711 (7th Cir. 2009) (denying rehearing where complaint was "silent about the services Deere participants received from the company sponsored plans"); *see also* DOL, *A Look at 401(k) Plan Fees* 1 (Sept. 2019), https://bit.ly/3fP8vuH (fees should be only "one of several factors" in fiduciary decision making). For example, recordkeeping fees may include additional administrative services such as investment planning and education for participants.[18] Similarly, a plan may have to pay more to obtain the most reputable service providers for its participants.

2. The plan's fees must be disproportionate to the fees of the reliable benchmark.

Having identified the proper benchmark, the task shifts to analyzing the difference in fees. Service providers are not monolithic, and neither are their fees. A standard that allows *any* difference in fees, no matter how small, to sustain a claim will permit manipulation by immaterial differentials, such as the .0003 fee difference alleged to be "excessive" in *NFP Retirement*. The better approach is to require a disproportionate difference in fees between the plan and its benchmark.

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[18] *See* Sarah Holden, *The Economics of Providing 401(k) Plans: Services, Fees, and Expenses, 2020*, at 4, ICI Research Perspective (June 2021), https://bit.ly/3juJhVa.

a. Total plan fees

This factor is self-evident: Unless only part of the plan's fees is alleged to be excessive, the total fees—recordkeeping fees, fund expense ratios, and all other service fees—should be ascertained, and complaints should be dismissed if they fail to allege sufficient facts from which to do so. This is clearly the case when plaintiffs allege "no factual support at all for their assertion that the Plans should pay" lower fees (*Kong*, 2020 WL 7062395, at *5), or where plaintiffs distort fees through misleading allegations, as they have in multiple cases involving AT&T, Walgreens, the Motion Picture Industry, and Pentegra, to name a few.

Allegations also must show "that the fees were excessive relative 'to the services rendered.'" *Young v. Gen. Motors Inv. Mgmt. Corp.*, 325 F. App'x 31, 33 (2d Cir. 2009) (quotation omitted). This scenario may arise where the benchmark plan offers different—or fewer—services than the plan at issue, in which case some difference in fees is normal. *See* Daniel Aronowitz, *Exposing Excessive Fee Litigation Against America's Defined Contribution Plans*, Euclid Specialty Managers (Dec. 2020), https://bit.ly/3hNXJaW ("Even plans that have an identical number of participants and the same total plan assets may have very different service models."). Extra services will result in fees that "exceed those charged by a simple administrative services provider." *Brown v. Daikin Am., Inc.*, No. 18-cv-11091, 2021 WL 1758898, at *8 (S.D.N.Y. May 4, 2021).

Sometimes, plaintiffs also challenge the plan's share classes, claiming that the identical funds could have been obtained at a lower price, but without alleging sufficient supporting facts. This was the problem in *Davis*, where the Eighth Circuit agreed that defendants had "identified one plausible inference" of prudence in their selection of share classes because of the availability of larger revenue sharing payments and their efforts to shift into institutional shares in proportion to the plan's overall growth. 960 F.3d at 483. Nevertheless, the court reasoned that "mismanagement is another plausible inference" and refused to dismiss the share-class claim (*id.*), disregarding the fundamental tenet that claims should be dismissed if the underlying allegations "are as consistent with lawful conduct as they are with unlawful conduct." *Divane*, 2018 WL 2388118, at *4 (citing *Twombly*, 550 U.S. at 570). Instead of inferring mismanagement, courts should consider the context and associated trade-offs. *See Kong*, 2020 WL 7062395, at *5 ("fiduciaries have latitude to value investment features other than price (and indeed are required to do so)" (citation omitted)).

b. Fee negotiation process

This factor considers whether the challenged fees are the result of arm's-length negotiations. A claim cannot rest on allegations that the plan "could have obtained substantially the same investment opportunities or services at a lower cost," (U.S. Br. 12), because some difference in fees among materially identical plans will exist in a free market and, consequently, a

lower cost will frequently be available elsewhere. But "nothing in ERISA requires every fiduciary to scour the market to find and offer the cheapest possible fund" (*Hecker v. Deere & Co.*, 556 F.3d 575, 586 (7th Cir. 2009)), or to engage in constant negotiations with its service providers. *See Chevron*, 2016 WL 4502808, at *14 ("nothing in ERISA compels periodic bidding"); *Ferguson v. Ruane Cunniff & Goldfarb Inc.*, No. 17-cv-6685, 2019 WL 4466714, at *8 (S.D.N.Y. Sept. 18, 2019) ("ERISA does not require plan fiduciaries to obtain competitive bids from plan service providers."). Requiring disproportionality of fees honors these principles by reducing the prospect of an excessive fee lawsuit simply because the plan might have obtained a better price with more scouring or harder negotiating.

Courts recognize that "[fiduciaries] are [not] required to pick the *lowest*-cost fund, particularly when the expense-ratio differences are small. . . ." (*Davis*, 960 F.3d at 486), but they tend to improperly infer that defendants either "did not negotiate aggressively enough"—which ERISA does not require—or were "asleep at the wheel" and "failed to pay close enough attention to available lower-cost alternatives." *Id.* at 483. Equally plausible inferences of prudent management must be considered—namely that fiduciaries considered the funds' fee structure relative to the services obtained, the funds' diversification and liquidity requirements, the degree of the fee differences compared to other options, and the range of prudent expenses in light of these factors.

C. Courts should consider plan disclosures and public financial information when analyzing excessive fee lawsuits.

Plaintiffs already use this data for their complaints,[19] and it is integral to excessive fee claims. The "excessive" element requires comparison to a benchmark, which means plaintiffs must obtain fee and performance data from the challenged plan's disclosures and then obtain the same information for their chosen benchmark(s). Nothing in *Twombly* or *Iqbal* permits plaintiffs to cherry-pick or distort the material features, performance, and fees of the plan or the benchmark(s). Thus, in *Motion Picture Industry*, a short review of the plan's Form 5500 would have confirmed that plaintiffs exaggerated the alleged fees by 300 percent ($46 million vs. $14 million). *Supra* 18-19. A similar approach in *AT&T* would have prevented the case from proceeding through expensive discovery and summary judgment based on a fabricated recordkeeping fee that could have been corrected by reviewing the plan's disclosures to plaintiffs and the other participants. *Supra* 17-18. And in *NFP Retirement*, reviewing the plan's disclosures (including its Rule 408b2 disclosure) would have demonstrated the plan's low total fees and recordkeeping fee, as well as the plan's investment mix, which included a low-fee alternative

[19] *AT&T Servs., Inc.*, No. 2:17-cv-8106, ECF 81 ¶¶62, 78, 102 (Form 5500s); *Juniper Networks*, No. 4:21-cv-6213, ECF 1 ¶¶121, 208 (Form 5000s, financial statements, plan description, fee disclosures); *NFP Retirement*, No. 8:21-cv-301, ECF 1 ¶¶58, 113 (Form 5500s, financial statements); *Parmer*, 518 F. Supp. 3d at 1302 (considering public prospectuses and the Form 5500).

juxtaposed with each active investment option. *Supra* 20.

Allegations of imprudence should be assessed based on all the material features of the challenged plan and its fees and services. DOL-mandated disclosures and public financials are the consistent and reliable source for this data. The Court should make clear that allegations regarding "excessive" fees and purported benchmarks are implausible if they materially omit or contradict the data.

CONCLUSION

The Court should uphold the Seventh Circuit's decision, clarify the pleading standard for excessive fee lawsuits, and identify the factors that lower courts should use to weed out meritless suits.

Respectfully submitted,

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