Miller & Chevalier

Dog Days of Summer Pave the Way for Continuing Rise in ERISA Litigation: Summer 2021 ERISA Litigation Update

ERISA Litigation Alert
08.31.2021

Three important Employee Retirement Income Security Act of 1974 (ERISA) breach of fiduciary decisions came down this summer. In *Sacerdote v. New York University* (*Sacerdote III*), the Second Circuit affirmed the trial result in favor of the fiduciaries but reversed on the district court's earlier dismissal at the pleadings stage of a prudence claim, sending it back for further proceedings.[1] The Seventh Circuit's *Halperin v. Richards* decided whether ERISA preempts state corporate law/breach of fiduciary claims against company officers and directors who also serve in an ERISA fiduciary capacity, as permitted by ERISA's "two-hat" principles.[2] Both *Sacerdote* and *Halperin* are plaintiff-friendly, and *Sacerdote* in particular is likely to pave the way for an influx of breach of fiduciary litigation in the future, including class actions. In *Jackson v. AT&T Retirement Savings Plan* (*Jackson II*), the Fifth Circuit provided fiduciaries and plan sponsors some comfort by confirming again that a plan sponsor's authority to amend its plan does not implicate fiduciary duties.[3]

Update on University § 403(b) Excessive Fee Cases

***Sacerdote v. New York University* (*Sacerdote III*)**

On August 16, 2021, in a 2-1 decision, [4] the Second Circuit issued its highly anticipated decision in *Sacerdote III*, affirming the district court's judgment in favor of the fiduciaries after a 10-day bench trial, including, notably, that the fiduciaries did not breach their ERISA duties by failing to consolidate recordkeepers more quickly and by retaining two allegedly underperforming investment funds. The case reverts to the district court, however, as the Second Circuit reinstated a claim that the fiduciaries breached their ERISA duty of prudence by offering retail shares, rather than lower-cost institutional shares of mutual funds, which the district court had dismissed at the motion to dismiss stage. Writing for the panel, Circuit Judge John M. Walker, Jr. ruled that this dismissal was in error as Plaintiffs raised a plausible inference of imprudence and the error was not rendered moot by the trial, because the district court's findings addressed different questions. While the Plaintiffs are entitled to litigate the claim on the merits, the Second Circuit did allow that the "[d]iscovery ... may turn out to be minimal [ ] before the claim is dispensed with."[5]

Sacerdote III represents a significant win for the fiduciaries. Its approach to the standard of review in this type of university fees case regarding the plausibility of breach of fiduciary duty allegations at the motion to dismiss stage breaks with the Seventh Circuit, which affirmed dismissal of similar claims,[6] and aligns with the Third and Eighth Circuits, which permitted such claims to proceed. [7]

Background

Plaintiffs are a class of participants and beneficiaries of one of two defined contribution plans, tax qualified under 26 U.S.C. § 403(b), sponsored by New York University (NYU).[8] Both of these plans offered investment options administered by two different recordkeepers, Teachers Insurance and Annuity Association of America and College Retirement Equities Fund (TIAA-CREF) and the Vanguard Group.[9] The Faculty Plan offered 103 investment options and the Medical Plan offered 84 options to plan participants at issue in the litigation.[10] The NYU Retirement Plan Committee, comprised of nine members, was both plan fiduciary and plan administrator.[11]

Plaintiffs brought claims under ERISA § 502(a)(2), alleging that NYU breached its fiduciary duties of loyalty and prudence and engaged in prohibited transactions. Counts I and II alleged a breach of fiduciary duty based on TIAA-CREF's requirement that it be the recordkeeper for certain funds, resulting in increased fees from multiple plan recordkeepers; Counts III and IV alleged a breach of fiduciary duty based on unreasonable recordkeeping fees, which included failing to monitor excessive recordkeeping costs, employing a revenue-sharing method to pay recordkeepers, and employing multiple recordkeepers for each plan; Counts V and VI alleged a breach of fiduciary duty based on unreasonable investment fees, unnecessary marketing and distribution fees, and mortality and expense risk fees (causing unreasonable performance losses); and Count VII alleged NYU's failure to monitor the investments.[12]

The district court granted in part and denied in part NYU's motion to dismiss, retaining only Counts III and V in part. [13] The part of Count V that was dismissed alleged that Defendants breached their fiduciary duty by offering retail class shares rather than more affordable institutional class shares of the same mutual funds.[14] In dismissing this claim, the district court reasoned that "prudent fiduciaries may very well choose to offer retail class shares over institutional class shares ... because retail class shares necessarily offer higher liquidity than institutional investment vehicles."[15] The district court also found the fees associated with the retail funds to be lower than what was permitted by the Third, Seventh, and Ninth Circuits.[16]

The case proceeded to trial on the prudence claims relating to the retention of multiple recordkeepers and the associated costs and the continued offering of two underperforming investment options. Granting NYU's motion to strike the Plaintiff's jury demand, the district court held an eight-day bench trial.[17] The district court found that Plaintiffs had failed to prove a breach of fiduciary duty by the use of a revenue-sharing method to pay recordkeepers or the retention of the underperforming funds and that Plaintiffs had failed to prove loss resulting from any of its claims.[18]

Second Circuit Decision

The Second Circuit found that the district court had erred by dismissing Plaintiffs' claim that NYU breached its ERISA fiduciary duty by offering retail-class shares of mutual funds instead of lower-priced institutional class shares and failing to monitor the investments in the retirement portfolio.[19] It also found that the district court had erred by denying Plaintiffs' leave to amend to include retirement plan committee members as Defendants.[20] The Court rejected four other arguments raised by Appellants, including that they should have received a jury rather than a bench trial.[21]

The Second Circuit reasoned that Plaintiffs' claim for breach of the duty of prudence based on the retail class funds should have survived the motion to dismiss because "the court, based on circumstantial factual allegations, may reasonably infer from what is alleged that the process was flawed" or "that an adequate investigation would have revealed to a reasonable fiduciary that the investment at issue was improvident."[22] The Court specifically took issue with the district court's reasoning that offering retail class shares over institutional class shares is a prudent choice because retail class shares offer greater liquidity. Such an argument goes to the merits and "provides no basis to dismiss pleadings that otherwise generate plausible inferences of the claimed misconduct."[23] The Court also warned about an "overreliance on cost ranges from other ERISA cases as benchmarks," citing the fact-specific nature of the imprudent fiduciary inquiry.[24]

The Second Circuit also took issue with the district court's reason for rejecting the retail class claims at the motion for reconsideration stage. There, the district court suggested that Plaintiffs erred by not alleging that "the mixes of options in the Plans were imprudent" or that the plans were tainted as a whole because the retail shares were included.[25] The Second Circuit explained that the district court's articulation of a possible ERISA breach of fiduciary claim concerning the "mix" of funds is best reserved for claims of imprudence based on the riskiness of funds or a portfolio as a whole rather than in situations like this case where Defendants had a choice to either include higher or lower-cost shares in the same fund. It stated: "Fiduciaries cannot shield themselves from liability — much less discovery — simply because the alleged imprudence inheres in fewer than all of the fund options."[26] The Second Circuit was not as critical of the theory that the plans were tainted in the entirety, but thought that Plaintiffs didn't need this theory to survive a motion to dismiss.[27]

The Second Circuit, though, did uphold the district court's entry of judgment on the claims that went to a bench trial: Count III, the claim that the record-keepers should have been consolidated immediately; and Count V, the claim that fiduciaries were imprudent by retaining two specific funds. The Court upheld the district court's factual findings as to Count III, namely that immediate consolidation would have required lengthy and time-intensive changes to systems already in place for payroll, finance, student records, and human resources and that consolidation occurred once the university updated its global information technology (IT) systems. Therefore "NYU did not breach its fiduciary duty of prudence by failing to consolidate recordkeepers any faster than it did."[28] As to Count V, the Second Circuit also reasoned that there was no clear error in the district court's factual findings that the funds' "unique and complex characteristics" made them appropriate and that their retention was necessary to diversify the plans, concluding that "a hypothetical prudent fiduciary would have made similar choices if presented with these circumstances."[29]

Dissenting Opinion

Circuit Judge Steven J. Menashi authored a dissenting opinion, disagreeing that the share-class claims should be heard and that the district court should grant leave to amend the complaint to add additional individual Defendants. He reasoned that the district court's conclusion (which was not appealed) that the revenue-sharing model was prudent forecloses a conclusion that including retail class funds is imprudent "[b]ecause retail shares enable revenue sharing ...."[30] He also rejected the theory that NYU erred by adopting too many retail class funds because NYU followed a deliberate process and so "NYU acted prudently even if the plaintiffs or the court could imagine a better ultimate decision."[31] He pointed out that NYU "made a considered decision to offer retail shares rather than institutional shares" because "the excess cost of the retail shares paid for the recordkeeping fees under NYU's revenue-sharing model."[32] According to the dissent, the district court decision should have been affirmed in its entirety.

Divane v. Northwestern University, cert. granted sub nom. Hughes v. Northwestern University

On July 2, 2021, the U.S. Supreme Court granted a petition for a writ of certiorari in a similar case but with a different outcome: *Hughes v. Northwestern University*.[33] In this case, participants in Northwestern University's § 403(b) plan claimed that the plan fiduciaries (the University, the plan's retirement investment committee, and nine individuals) breached their fiduciary duty of prudence by causing the participants to pay inflated investment management fees (when there were lower-cost share classes available to plans) and inflated recordkeeping fees, among other things. Like in *Sacerdote III*, Plaintiffs in *Hughes* took issue with the plan's inclusion of retail class funds as investment options instead of using its bargaining power to offer institutional class shares at lower prices. The Seventh Circuit affirmed the district court's decision granting Northwestern's motion to dismiss.

The Plaintiffs/Petitioners argued that the Seventh Circuit's decision conflicts with *Sweda* and *Davis*,[34] which allowed similar complaints to proceed to discovery.[35] They also argued that the Seventh Circuit's reasoning that Northwestern did not breach its fiduciary duty because it offered lower-cost investment options alongside the ones with excessive fees conflicted with the duty to monitor trust investments articulated in the Supreme Court's *Tibble* decision, which they contended would require the fiduciaries to monitor and exclude investment options with high fees.[36] Briefing is scheduled to begin on September 3, 2021.

ERISA Preemption

Halperin v. Richards

On July 28, 2021, in *Halperin v. Richards*, a unanimous panel of the Seventh Circuit found that ERISA does not preempt state corporate law claims brought against a company's officers and directors, who also served as ERISA fiduciaries.[37] The case involved an employee stock ownership plan (ESOP) sponsored by Appvion, Inc.[38] When Appvion experienced a financial freefall and filed for bankruptcy protection, the company's bankruptcy trustees sued the officers and directors, as well as the ESOP's trustee and appraiser, under state corporation law for inflating Appvion's stock value to benefit corporate insiders.[39]

The director and officer Defendants argued that the state law claims were preempted by ERISA because despite their "dual-hat" functions as ERISA fiduciary and corporate officer/director, they acted solely as an ERISA fiduciary as it concerned the stock valuation allegations.[40] The ESOP trustee and appraiser also argued that these claims are preempted because they were based on ERISA duties rather than any corporate duties.[41]

Acknowledging "little circuit-level precedent assessing whether and to what extent ERISA preempts corporation-law claims against dual-hat directors and officers," the Seventh Circuit found that ERISA did not preempt the state law claims against the officer and director Defendants.[42] After reviewing ERISA's preemption principles, the Court turned to ERISA § 408(c)(3), which "explicitly allows corporate insiders to serve as ERISA fiduciaries."[43] From there, the panel concluded that the state law claims "are not preempted because ERISA contemplates parallel state-law liability against directors and officers serving dual roles as both corporate and ERISA fiduciaries."[44] Under the Court's reasoning, because "dual-hat" fiduciaries serve as both an ERISA fiduciary and a settlor and thus carry "dual corporate and ERISA obligations," they are liable under both state corporate law and ERISA, highlighting "that ERISA is written to invite, and certainly to tolerate, *these specific parallel and independent duties* — the directors' and officers' fiduciary duties to the corporation."[45]

Notably, the Court recognized that the company's bankruptcy trustees would have no standing to bring ERISA claims against the officers and directors. Thus, there was no concern that the Plaintiffs were pleading state law claims as an end-run around ERISA's built-in limitations on state causes of action because they had no rights as a participant, beneficiary, or fiduciary to sue under ERISA. Pointing to § 408(c)(3), which provides that ERISA "shall not 'be construed to prohibit any fiduciary from ... serving as a fiduciary in addition to being an officer, employee, agent, or other representative of a party in interest,'" the Court determined that disallowing parallel state law liability would contravene this mandate and "thwart ERISA's purpose to protect plan assets from misuse," leaving the Plaintiffs without a remedy.[46]

The Court also reasoned that ERISA preemption principles did not require preemption because the state claims did not "'govern[] ... a central matter of plan administration' or 'interfere[] with nationally uniform plan administration'" and allowing the claims would not "disrupt national uniformity in plan administration" because the state law claims run parallel to, rather than conflict with, ERISA's fiduciary duties.[47]

Conversely, the Court found that ERISA did preempt state law claims against "single-hat" ERISA fiduciaries, like the ESOP trustee, because assigning liability under both ERISA and state law runs contrary to the ERISA exclusive benefit rule, for which there is no exception for "single-hat" fiduciaries. In the Court's words, "ERISA does not contemplate single-hat fiduciaries owing any parallel duties to the corporation — even a limited duty not to aid and abet breaches against the corporation."[48] This is because it would "create[] too great a risk that single-hat ERISA fiduciaries ... would be forced to worry about whether directors and officers were complying with separate corporation-law duties" and interfere with the singular focus of ERISA's exclusive benefit rule.[49] The Court applied similar reasoning to the claims against the ESOP valuation expert, who, while not a fiduciary to the corporation or to the ERISA plan, and not subject to the exclusive benefit rule under ERISA § 404(a)(1), was still caught up in a conflict of avoiding state corporate law liability or serving ERISA beneficiaries. Additionally, state law liability "would arguably conflict with ERISA's remedial limits on claims against non-fiduciaries."[50] In both instances, although the bankruptcy trustees would not be able to bring claims under ERISA against the trustee or its valuation expert, the Court emphasized that allowing state claims to proceed "would in fact impose on single-hat fiduciaries new state-law duties to the corporate employer" and that "[s]uch liability is fundamentally at odds with [ERISA's] text and purpose."[51]

Plan Transfer is Settlor Activity

***Jackson v. AT&T Retirement Savings Plan* (*Jackson II*)**

In a short *per curiam* decision issued on August 16, 2021, the Fifth Circuit affirmed the dismissal of a fourth amended complaint filed by a participant in the AT&T Retirement Savings Plan, a 401(k) plan.[52] The lawsuit involved the merger of Cingular Wireless into AT&T Mobility.[53] After the merger, AT&T terminated the Cingular plan and transferred the participants and their plan accounts to the AT&T plan.[54] The Plaintiff, who had been a participant in the Cingular plan, alleged that the plan termination and transfer resulted in a decrease of company contributions to the plan in breach of AT&T's fiduciary responsibilities.[55] The district court disagreed and the Fifth Circuit affirmed, stating that "an employer that decides to terminate, amend, or renegotiate a plan does not act as a fiduciary, *and thus cannot violate its fiduciary duty*, provided that the benefits reduced or eliminated are not accrued or vested at the time, and that the amendment does not otherwise violate ERISA or the express terms of the plan."[56]

Considerations Going Forward

- *Sacerdote III* joins the Third and Eighth Circuits on articulating a more lenient pleading standard for § 403(b) excessive fee cases, paving the way for more of these types of suits, or at least influencing an increase of cases that proceed to discovery.

- We will be closely watching how the Supreme Court weighs in on the pleading standard in the *Hughes* case. The Court will hopefully offer some guidelines as to what plaintiffs must assert at the pleadings stage to plausibly allege that defendants were objectively imprudent in failing to bid for, adequately research, or offer investment options carrying lower recordkeeping and/or investment management fees. For example, must plaintiffs allege that defendants failed to issue a competitive request for proposal (RFP) or failed to do adequate market research for service providers? Additionally, the Court may also address whether courts should be crediting defendants' reasons for its decision-making at this stage of the case rather than granting all inferences in favor of plaintiffs.
- A question embedded in these excessive fees/university cases is how paternalistic or protective toward ERISA beneficiaries the law should be in this area. In other words, how much should a beneficiary's ability to choose how their retirement funds are invested factor into whether an ERISA fiduciary breached its duty? This raises questions similar to those discussed in *Intel Corporation Investment Policy Committee v. Sulyma*, 140 S. Ct. 768 (2020). In that case, the Court found that information given to beneficiaries posted online about plan investments did not constitute "actual knowledge" for the purpose of ERISA's three-year statute of limitations. In both *Sulyma* and now in *Sacerdote*, federal courts have chosen to shield participants from large amounts of information, instead putting the responsibility onto more sophisticated ERISA fiduciaries. Of course, in the mutual fund context, ERISA fiduciaries face a bit of a catch-22: Offering an investment plan with many choices (including low-fee options) does not automatically guard against breach of fiduciary duty claims, but offering an investment plan with too few investment options could lend itself to a claim of breach of fiduciary duty. *See, e.g., Braden v. Wal-Mart Stores, Inc* ., 588 F.3d 585 (8th Cir. 2009).
- As mentioned in our alert about the Third Circuit *Sweda v. University of Pennsylvania* case, a prudent fiduciary process is key and plan fiduciaries need to be diligent about reviewing and monitoring investments and recordkeepers, including an affirmative determination that fees and expenses are reasonable. A prudent process could provide a strong defense on the merits.
- While the *Halperin* court's analysis is fairly novel with respect to corporate officers and directors who also occupy fiduciary positions under ERISA, these individuals should be mindful that they could be facing increased legal exposure, particularly with respect to ESOPs, under both state law and ERISA, and take steps to further insulate themselves.
- *Jackson II* relied on settled law to dismiss the Plaintiff's fourth amended complaint. The Plaintiff's persistence reflects the very active litigation environment for ERISA plans. In a plan termination, merger, or transfer context, fiduciaries and plan sponsors should continue to review plan documents to ensure that the settlor activity is consistent with the terms of both the old and new plans.

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[1] *Sacerdote III*, No. 18-2707-CV, 2021 WL 3610355 (2d Cir. Aug. 16, 2021).

[2] *Halperin v. Richards*, No. 20-2793, 2021 WL 3184305 (7th Cir. July 28, 2021).

[3] *Jackson II*, No. 20-30255, 2021 WL 3624751 (5th Cir. Aug. 16, 2021), *petition for cert. filed*, No. 20-8153 (U.S. May 21, 2021).

[4] *Sacerdote III*, 2021 WL 3610355. The panel majority consisted of Circuit Judges John M. Walker, Jr. and Jon O. Newman, replacing Circuit Judge Ralph K. Winter, who died on December 8, 2020. Circuit Judge Steven J. Menashi wrote the dissenting opinion.

[5] *Id.* at *9. The Second Circuit also concluded that the district court improperly denied the Plaintiffs' motion to amend the complaint to add individual fiduciary committee members as Defendants. *Id.* at *11.

[6] *Divane v. Northwestern Univ.*, 953 F.3d 980 (7th Cir. 2020), *cert. granted sub nom. Hughes v. Northwestern Univ.*, No. 19-1401 (U.S. July 2, 2021) (affirming dismissal of claims that fiduciaries breached their ERISA duties, including by permitting multiple recordkeepers, offering expensive, underperforming investment options, and retaining retail-class shares of mutual funds when institutional shares were available).

[7] *Sweda v. Univ. of Pennsylvania*, 923 F.3d 320 (3d Cir. 2019), *cert. denied*, 140 S. Ct. 2565 (2020) (limiting Twombly pleading standard applicability to ERISA claims, reversing dismissal of prudence claims relating to recordkeeper services and fees and retaining high-cost retail class shares, despite availability of low-cost institutional shares, but affirming dismissal of prohibited transaction claims); *Davis v. Washington Univ. in St. Louis*, 960 F.3d 478 (8th Cir. 2020) (affirming dismissal of claim related to poorly performing investment but reversing and permitting to proceed claim that fiduciaries should have replaced retail share classes with institutional shares).

[8] *Sacerdote III*, 2021 WL 3610355, at *1.

[9] *Id.* at *2.

[10] *Id.*

[11] *Id.* at *1-3.

[12] *Id.* at *2.

[13] *Sacerdote v. New York Univ.* (*Sacerdote I*), No. 16-CV-6284, 2017 WL 3701482 (S.D.N.Y. Aug. 25, 2017).

[14] *Id.* at *8-9.

[15] *Id.* at *11.

[16] *Id.*

[17] *Sacerdote v. New York Univ.* (*Sacerdote II*), 328 F. Supp. 3d 273, 281 (S.D.N.Y. 2018).

[18] *Id.* at 316.

[19] *Sacerdote III*, 2021 WL 3610355, at *4, *5-11.

[20] *Id.* at *11-14.

[21] *Id.* at *3-4.

[22] *Id.* at *6 (internal quotation marks omitted).

[23] *Id.*

[24] *Id.* at *7.

[25] *Id.* (internal quotation marks omitted).

[26] *Id.*

[27] *Id.*

[28] *Id.* at *16.

[29] *Id.* at *16-17.

[30] *Id.* at *18-24 (Menashi, J., dissenting).

[31] *Id.* at *19.

[32] *Id.*

[33] *Divane v. Northwestern Univ.*, 953 F.3d 980 (7th Cir. 2020), *cert. granted sub nom. Hughes v. Northwestern Univ.*, No. 19-1401 (U.S. July 2, 2021).

[34] *Sweda v. Univ. of Pennsylvania*, 923 F.3d 320 (3d Cir. 2019); *Davis v. Washington Univ. in St. Louis*, 960 F.3d 478 (8th Cir. 2020).

[35] *See* Petition for Writ of Certiorari at 1-2, *Hughes v. Northwestern Univ.*, No. 19-1401 (U.S. July 2, 2021). The Eighth Circuit similarly reversed the dismissal of ERISA claims for imprudent management in *Braden v. Wal-Mart Stores, Inc.*, 588 F.3d 585, 595 (8th Cir. 2009) and *Tussey v. ABB, Inc.*, 746 F.3d 327 (8th Cir. 2014).

[36] *Tibble v. Edison Int'l*, 575 U.S. 523, 528-29 (2015).

[37] *Halperin v. Richards*, No. 20-2793, 2021 WL 3184305 (7th Cir. July 28, 2021). The panel consisted of Circuit Judges Michael S. Kanne, Ilana Diamond Rovner, and David F. Hamilton, with the latter authoring the opinion.

[38] *Id*. at *1.

[39] *Id.*

[40] *Id*. at *2.

[41] *Id.*

[42] *Id.* at *3.

[43] *Id*. (citing 29 U.S.C. § 1108(c)(3)).

[44] *Id.*

[45] *Id*. at *3, *5.

[46] *Id.* at *7 (quoting 29 U.S.C. § 1108(c)(3)), *9.

[47] *Id*. at *6 (quoting Gobeille v. Liberty Mut. Ins. Co., 577 U.S. 312, 320 (2016)), *10.

[48] *Id.* at *11.

[49] *Id.*

[50] *Id*. at *12; *see also id*. at *13-14 (noting that ESOP valuation expert could be sued for knowingly aiding an ERISA fiduciary's breach of fiduciary duty and citing to ERISA § 502(a)(3) and (a)(5)).

[51] *Id*. at *12.

[52] *Jackson II*, No. 20-30255, 2021 WL 3624751 (5th Cir. Aug. 16, 2021), *aff'g, Jackson v. AT&T Ret. Sav. Plan* (*Jackson I*), No. 19-CV-00116, 2020 WL 149282 (W.D. La. Feb. 18, 2020). The *per curiam* panel consisted of Circuit Judges Leslie H. Southwick, Andrew S. Oldham, and Cory T. Wilson.

[53] *Jackson II*, 2021 WL 3624751, at *1.

[54] *Id.*

[55] *Id.*

[56] *Id*. at *2 (internal quotation marks removed).
