

The Supreme Court Holds Process Determines Prudence in 401(k) and 403(b) Fee Litigation

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The last several years have seen numerous claims against 401(k) plan and 403(b) plan fiduciaries alleging breaches of the duty of prudence under the Employee Retirement Income Security Act of 1974 (“ERISA”) in connection with purported “excessive fees,” including high recordkeeping or other administrative fees, the selection of inappropriate investment options with higher fees than comparable options and a failure to monitor these recordkeeping, administrative and investment costs over time. This week, the Supreme Court reminded fiduciaries that, while deference to their decisions may be warranted, ERISA’s duty of prudence will be satisfied by a fiduciary exercising its judgment after a thoughtful process relative to the issue presented.

On January 24, 2022, in *Hughes et al. v. Northwestern University et al.*, the United States Supreme Court vacated and remanded the Seventh Circuit’s dismissal of claims by Northwestern University employees that the fiduciaries of Northwestern’s defined contribution plans violated ERISA’s duty of prudence by, among other things, failing to monitor and control unreasonably high recordkeeping fees in the plans, offering investments that carried higher fees than those of otherwise identical alternatives and offering investment options that were likely to confuse investors. The District Court had granted Northwestern’s motion to dismiss, which the Seventh Circuit affirmed, basing its decision in part on its determinations that (a) the plan provided an adequate array of choices for investors and (b) the amount of fees payable was ultimately within the participants’ control because the plan included investment options with low expense ratios and recordkeeping costs.

The Supreme Court found that the employees’ claims could not be defeated by the provision of a diverse assortment of investment options, including low-cost alternatives. Citing its 2015 decision in *Tibble v. Edison International*, 575 U. S. 523, the Supreme Court explained that even in the defined contribution context where participants choose investments, “plan fiduciaries are required to conduct their own independent evaluation to determine which investments may be prudently included in the plan’s menu of options.” Further, “[i]f the fiduciaries fail to remove an imprudent investment from the plan within a reasonable time, they breach their duty.” Accordingly, the Supreme Court remanded the case to the Seventh Circuit to reevaluate the plaintiffs’ allegations,

specifically considering whether the plaintiffs have plausibly alleged that the plan fiduciaries violated their duty of prudence to monitor investments and remove any imprudent investments as contemplated by *Tibble*.

The *Northwestern* case reaffirms that ERISA requires 401(k) plan fiduciaries to monitor and evaluate which investments may prudently be offered and to remove any imprudent investment options within a reasonable time. The decision reinforces that there are no hard and fast rules on the appropriateness of fees in 401(k) and 403(b) plans; the determination of whether an ERISA fiduciary has acted prudently in offering investment choices and approving the fees associated therewith is fact- and context-specific. The Court acknowledged that “[a]t times, the circumstances facing an ERISA fiduciary will implicate difficult tradeoffs, and courts must give due regard to the range of reasonable judgments a fiduciary may make based on her experience and expertise.” Thus, whether the plan fiduciaries satisfy their duty of prudence under ERISA in regard to the fees payable in the operation of, and with regard to the investment under, a defined contribution plan will turn on the processes engaged in by these fiduciaries in connection with evaluating service providers, investment options and fees. Whether such fiduciaries succeed in any litigation brought on such issues will largely depend on whether the fiduciaries have sufficiently documented such processes to prove that they have appropriately exercised their reasonable judgment.

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Please do not hesitate to contact us with any questions.



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