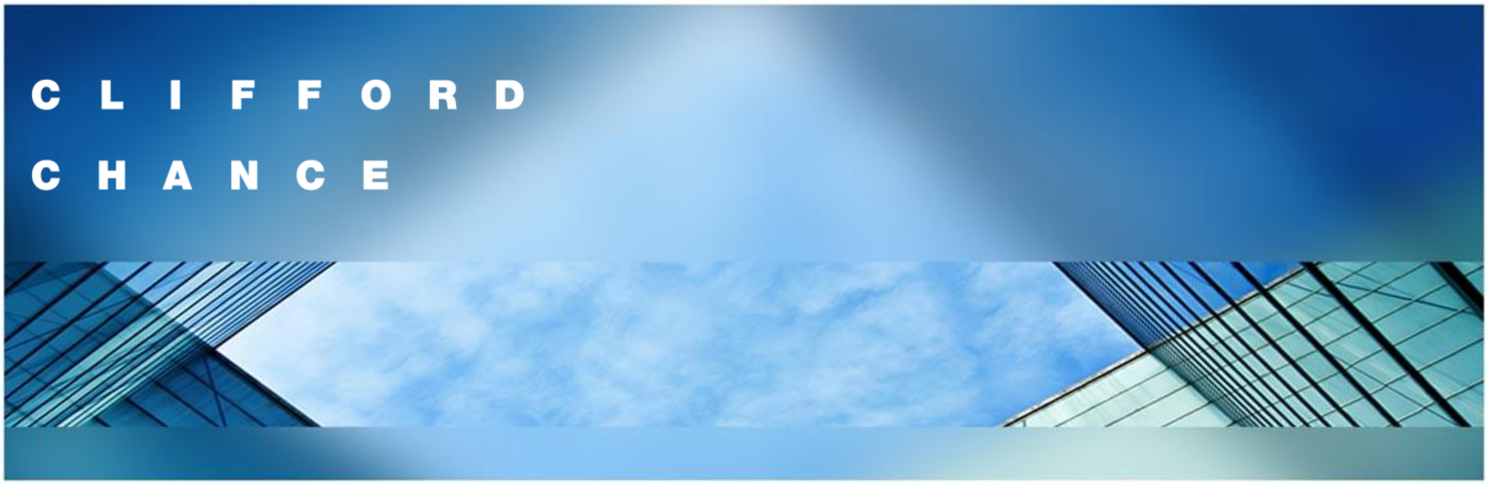

INVESTOR CHOICE IS NOT ENOUGH: SUPREME COURT EXPANDS RISKS FOR ERISA FIDUCIARIES

In January 2022, the Supreme Court in *Hughes v. Northwestern University, et al.*, unanimously held that an ERISA plan fiduciary does not satisfy the ERISA prudence requirements by just including *some* prudent investment options in an employee retirement plan.[1] That holding rejects investor choice as a "categorical" defense to claims of imprudence. For that reason, the *Hughes* decision may make it harder to dismiss private litigation by classes of plan participants.

WARNING: A recent U.S. Supreme Court decision underscores that ERISA plan fiduciaries must actively monitor the investment options and associated fees of the employee retirement plans that they manage. Merely providing a diverse array of options and allowing plan participants to choose their investments will no longer suffice to defend the actions of statutory fiduciaries.

BACKGROUND

The U.S. Employee Retirement Income Security Act of 1974 (ERISA) imposes comprehensive standards governing the conduct of fiduciaries who are responsible for administering employee benefit plans in the U.S. and managing the money in those plans. These plans include defined-contribution plans, such as the 401(k) retirement accounts that are the backbone of most U.S. private employer retirement savings. These duties include "care, skill, prudence, and diligence."[2] One "component" of a fiduciary's duty of prudence requires the fiduciary to offer and maintain a diverse menu of investment options and to give plan participants information to assist participants when they make investment choices. In 2015, the Supreme Court drew upon the common law of trusts and estates to identify another aspect of the ERISA duty of prudence: the "continuing duty . . . to monitor investments and remove imprudent ones."[3] The Court's most recent decision, *Hughes v. Northwestern*, touches upon the interplay between those aspects of the ERISA duty of prudence.

Hughes v. Northwestern

In 2016, employees of Northwestern University sued administrators of defined-benefit contribution plans for University employees. Plaintiffs alleged that defendants violated their ERISA duty of prudence by: (1) offering "too many

---

1. *Hughes v. Northwestern*, No. 19-1401, 2022 WL 199351 (U.S. Jan. 24, 2022).
2. 29 U.S.C. §1104(a)(1)(B).
3. *Tibble v. Edison Int'l*, 575 U.S. 523, 530 (2015).

investment options"—more than 400—causing participant confusion and poor investment decisions; (2) failing to "monitor and control the fees they paid for recordkeeping"; and (3) offering higher-priced "retail-class" mutual funds and annuities as plan investments, rather than otherwise-identical "institutional" share classes available to "large investors" such as university pensions.[4]

The district court dismissed the case for failure to state a claim. The Court of Appeals for the Seventh Circuit affirmed dismissal. The Seventh Circuit focused on the defendants' fiduciary obligation to assemble a diverse menu of investment options. Because the Northwestern plan's "array of choices" included the low-cost index funds preferred by plaintiffs, the offering "eliminated any claim that plan participants were forced to stomach an unappetizing menu" of imprudent investments.

The Supreme Court reversed the appeals court. Writing for a unanimous Court, Justice Sonia Sotomayor held the lower court erred by "relying on the participants' ultimate choice over their investments to excuse allegedly imprudent decisions by respondents." The Court explained that the Seventh Circuit's "exclusive focus on investor choice" had failed to take into account another "aspect" of the ERISA duty of prudence: the "continuing obligation" to "properly monitor investments and remove imprudent ones." The Court explained that each alleged breach of duty amounted to an allegation that defendants "failed to remove imprudent investments" from the plans.

On that basis, the Supreme Court vacated dismissal, and ordered the appeals court to reassess plaintiffs' allegations "as a whole" in order to discern whether they plausibly established a breach of defendants' ERISA duty of prudence. The Court reaffirmed that the question is necessarily a "context-specific inquiry" dependent upon the "circumstances prevailing at the time the fiduciary acts." The Court acknowledged those circumstances "implicate difficult tradeoffs" on the part of an ERISA fiduciary, and instructed lower courts to give "due regard" to the "range of reasonable judgments" a fiduciary may make in a given setting.

Implications of the *Hughes* Decision

The *Hughes* decision is the latest in a rising tide of class action litigation landing in harbors on ships piloted by ERISA plan participants against statutory fiduciaries.

In practical terms, the *Hughes* decision underscores that ERISA plan fiduciaries must actively monitor the investment options and associated fees of the plans that they manage. Fiduciaries can no longer defend themselves by providing a diverse array of options and allowing plan participants to choose their investments.

In addition, *Hughes* could expand the growing trend in ERISA litigation against plan administrators by making it more challenging to dismiss prudence claims at the threshold pleadings stage of litigation. At that early stage, courts must accept as true plaintiffs' well-pleaded factual allegations, and test only the legal sufficiency of their claims. By rejecting a "categorial" defense premised on investor choice, in favor of a deeply "context-specific inquiry" into a fiduciary's activities, the *Hughes* Court identified a standard that courts may find challenging to apply in favor of defendants, without resort to factual discovery. It remains to

---

4 *Hughes*, 2022 WL 199351, at *1.

be seen how the Seventh Circuit assesses the *Hughes* plaintiffs' claims on remand.

In the meantime, if you are an ERISA plan fiduciary and have not thoroughly examined your plan recently, contact us for a litigation risk analysis.

CONTACTS

John Friel
Partner

T +1 212 878 3386
E john.friel
@cliffordchance.com

Paul Koppel
Partner

T +1 212 878 8269
E paul.koppel
@cliffordchance.com

Robert Houck
Partner

T +1 212 878 3224
E robert.houck
@cliffordchance.com

Steven Gatti
Partner

T +1 202 912 5095
E steven.gatti
@cliffordchance.com

Michelle Williams
Partner

T +1 202 912 5011
E michelle.williams
@cliffordchance.com

Benjamin Berringer
Associate

T +1 212 878 3372
E benjamin.berringer
@cliffordchance.com

Minji Reem
Associate

T +1 212 878 8027
E minji.reem
@cliffordchance.com

Meredith George
Associate

T +1 212 878 8163
E meredith.george
@cliffordchance.com

Alexandra Coyle
Associate

T +1 212 880 5719
E alexandra.coyle
@cliffordchance.com

www.cliffordchance.com

Clifford Chance, 31 West 52nd Street, New York, NY 10019-6131, USA

Clifford Chance US LLP

Abu Dhabi • Amsterdam • Barcelona • Beijing • Brussels • Bucharest • Casablanca • Delhi • Dubai • Düsseldorf • Frankfurt • Hong Kong • Istanbul • London • Luxembourg • Madrid • Milan • Moscow • Munich • Newcastle • New York • Paris • Perth • Prague • Rome • São Paulo • Shanghai • Singapore • Sydney • Tokyo • Warsaw • Washington, D.C.

Clifford Chance has a co-operation agreement with Abuhimed Alsheikh Alhagbani Law Firm in Riyadh.

Clifford Chance has a best friends relationship with Redcliffe Partners in Ukraine.