Pleading Standard for Excessive Fee Lawsuits

An In-Depth Analysis of the Northwestern Excessive Fee Case Before the Supreme Court

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Introduction

Over 350 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 Schlichter Bogard and Denton, Capozzi Adler and other law firms. During this entire time period, the Department of Labor has been largely silent, allowing plaintiff law firms to terrorize plan sponsors without providing clear guidance as to what ERISA fiduciary law actually expects regarding plan fees. And without a clear pleading standard to evaluate whether cases have merit, plan fiduciaries and their insurers have been forced to spend millions to defend these cases, as federal courts hash out unequal and inconsistent justice in high-stakes litigation.

It took five years, but one of the first university cases to be filed by the Schlichter law firm in 2016 has reached the Supreme Court. The Supreme Court accepted the *Hughes v. Northwestern* excessive fee case for review after the Department of Labor ("DOL") filed an amicus brief advocating that the case presented an opportunity for the Court to rule on "the question of what ERISA requires of plan fiduciaries to control expenses" — a question that DOL said "frequently recurs."

The key issue is what standard or hurdle plaintiffs must satisfy in order to withstand a motion to dismiss. The pleading standard is critical, because if the case proceeds to expensive discovery, which is more burdensome to the defense [Northwestern says it paid $4m for discovery in just 16 months before its motion to dismiss was decided], plaintiffs gain the upper-hand to drive a settlement based on a high damages model — the differential between what plaintiff lawyers say recordkeeper and investment fees should have been subtracted from what the plan actually paid. Given that most cases currently survive a motion to dismiss — only one-quarter are dismissed at the pleading stage — plaintiffs have been able to leverage substantial settlements against plan sponsors.

The stakes are high, as acknowledged by both sides. The participant class petitioning the Supreme Court aptly summarizes the case as "a legal disagreement about where that hurdle should be set." They have asserted that if the defense standard prevails from the lower court, "it would become virtually impossible for plan participants to plead an imprudence claim based on excessive fees." In their reply brief, they further contended that "[a]t issue here is whether such lawsuits can continue or whether they will be cut off by insurmountable pleading standards." According to lead lawyer Jerome Schlichter, the dean of the excessive fee bar, it is an existential issue for his business model. By contrast, an amicus brief filed by the Chamber of Commerce before the Seventh Circuit stated that "Plaintiffs here seek a diluted pleading standard that would defeat dismissal based on conclusory assertions about a fiduciary's decision-making process." This would be an "empty standard" because "[p]laintiff's proposed standard would insulate duty-of-prudence claims from dismissal, as a plan fiduciary *always* could have made *some* decision that would have proved more profitable."

The Need for a Consistent and Fair Pleading Standard

Given that most cases are allowed to proceed to expensive discovery and the inconsistent rulings by trial and appellate courts, plan sponsors need a fair and reliable pleading standard to be articulated by the Supreme Court. There must be some set of rules to regulate how and when plaintiffs can claim that retirement fees are too high: simply claiming fees are too high without substantiation should not be allowed to subject plan fiduciaries to the current litigation burdens and disruption.

The Northwestern case provides the first opportunity for clarity and judicial fairness. But with these high stakes, plan sponsors should be wary of the prospects of the Northwestern case. The reason is that the Northwestern plan's recordkeeping and investment arrangement is, at best, problematic, and bad facts often make bad law. As discussed more fully below, the plan has all of the troubling attributes that have attracted excessive fee litigation: multiple recordkeepers, alleged recordkeeping costs of $150-200+ per participant with significant asset-based and uncapped revenue sharing, hundreds of investments, and most of its investments in higher-fee share classes. This is not the set of facts that plan sponsors would select for Supreme Court review, particularly if it will control the pleading standard for 401k and other defined contributions plans — most of which are better structured and have much lower fee profiles. In fact, the Northwestern plan is so anomalous to how most large defined contribution plans are currently structured, if fairly construed, the case should have no precedential value for most 401k plans. Northwestern even argued in opposing class certification that the case was no longer relevant, because it had radically changed its plan in 2016 to streamline investment options and lower fees. But, unfortunately, DOL and the Supreme Court disagreed. Nevertheless, we believe the best strategy before the Supreme Court is for plan sponsors to be upfront that the Northwestern facts are suboptimal, yet that should not alter the need for a rigorous and predictable pleading standard for excessive fee cases.

The following is an in-depth analysis of the Northwestern recordkeeping and investment fees and how the Supreme Court should address the excessive fee pleading standard. As we demonstrate, the Supreme Court needs to provide clarity to reduce expensive and frequent litigation by articulating **two principles** supported by ERISA fiduciary law, related excessive fee law under the Investment Company Act, and even the briefs of DOL and participant counsel:

(1) that no fiduciary under ERISA fiduciary law should be held liable for breach of fiduciary duty and be forced to spend millions defending their conduct unless the fees are <u>egregious or disproportionately large</u>; and

(2) to properly allege whether fees are egregious, plaintiffs must allege a reliable benchmark of <u>materially identical investments or services</u>, demonstrating that no prudent fiduciary would have made the same decision.

As we analyze, Northwestern may not ultimately prevail under this standard, but this more rigorous test would weed out the many meritless excessive fees cases currently being filed against plan sponsors.

The Northwestern Facts

Plaintiffs in excessive fee cases allege that the recordkeeping and investment fees of defined contribution plans are too high, and/or that the investment performance is inadequate. Plaintiffs have filed hundreds of cases alleging that retirement plan sponsors have failed to control the expenses of the retirement plan vendors, who purportedly act in their own financial interests and not the interests of plan participants. Most of the cases allege that the investment options have achieved a lower return than selected index or passive investments that follow different investment strategies. We see lots of commentary debating the merits of excessive fee cases, but very little, if any, in-depth analysis as to whether the actual fees are too high. But the fee level is what matters.

ERISA is supposed to be a law of process, and not results. Stated differently, ERISA fiduciaries are not supposed to be liable for bad results if the process is diligent. Yet plaintiffs usually allege nothing about the fiduciary process, and instead rely on circumstantial evidence to imply the fiduciary process was flawed or the fiduciaries were somehow "asleep at the wheel." But other than the requirement to control expenses by acting in the best interest of plan participants, there are no absolute prescriptions in ERISA as to any required practice: no prohibition against offering active funds, revenue sharing, or even using investments from the plan recordkeeper. Fiduciaries are supposed to be afforded significant discretion to manage plans — yet another reason why no fiduciary should be held liable for fiduciary negligence unless plan fees are highly disproportionate to a reliable benchmark. But with most cases allowed to proceed to expensive discovery, the current cases working their way through the courts are not protecting fiduciaries who follow a prudent process.

For any excessive fee case, the actual plan fees matter, and that is where the Northwestern case is ominous for plan sponsors. The reason is that the Northwestern case is a poor test case for the excessive fee standard given that it contained: multiple recordkeepers; high plan fees compared to most benchmarks; significant asset-based revenue sharing to the recordkeepers; duplicative investment options; and many options in higher-cost retail share classes.

The Amended Complaint is a massive 140-page treatise of the Schlichter law firm's preferred view of ERISA law. The Schlichter firm gives its opinion on the merits of active versus passive investing [plans may consider active funds, but not without an analysis of the ability to beat "overwhelming odds" of beating index returns]; that recordkeeping is a commodity in which vendors compete on price [as opposed to defense briefs which constantly argue that plaintiffs fail to distinguish between the actual level of recordkeeping services provided]; the merits of revenue sharing [not a per se violation of ERISA, but can lead to excessive fees if not properly monitored and capped]; the need for RFPs for recordkeeping services ["[i]n multi-billion dollar plans with over 10,000 participants . . . benchmarking based on fee surveys is alone inadequate . . . the only way to determine the true market price at a given time is to obtain competitive bids"]; plan fiduciaries were required to conduct an independent assessment of every fund with revenue sharing; the risk of closed architecture plans [bundled services include proprietary investments from the recordkeeper that are not independently analyzed and reviewed]; the investment structure of plans in which TIAA is the recordkeeper [TIAA is a closed architecture plan that requires TIAA investments even if they are imprudent]; and multiple recordkeepers [a "multi-recordkeeping platform is inefficient" because it squanders leverage of bargaining power of large plans]. But even if you ignore these legal opinions, which a court must, the Amended Complaint lays out a worrisome fact pattern that is hard to defend.

When reviewing the facts, we must first remember that the entire case below was dismissed on threshold motion, so the only facts in the case are what have been alleged in an Amended Complaint, with no defense factual record of the fiduciary process of the plan committee to defend most of the allegations. The facts are selectively slanted towards plaintiffs' claims of imprudence. For example, plaintiffs claim that the TIAA recordkeeping fees are inflated with both a per-participant fee [which is not disclosed] and supplemented with substantial revenue sharing on an asset basis, but never mention the Fidelity recordkeeping fee, which we can only assume was a reasonable amount given that it was not disclosed. We further note that, based on our analysis of cases filed by the Schlichter law firm, the fees and other crucial facts are often misrepresented. But when the defense moves for a dismissal on the pleading, we are stuck with the facts alleged in the complaint, even if they are false.

Based on the Amended Complaint, Northwestern sponsored two retirement plans: (1) the Northwestern Retirement Plan had $2.34B in assets and 21,622 participants as of 12/31/2015; and (2) the Voluntary Savings Plan had $530M in assets and 12,293 participants as of the same date. These are large plans in the upper top 1% of all defined contributions in 2015. The Amended Complaint states the following alleged problems with both large plans:

Multiple Recordkeepers

The first claim is that the plan squandered its leverage of bargaining power by maintaining both TIAA and Fidelity as recordkeepers for the plan. By contrast, the Amended Complaint cites five universities who engaged in a comprehensive fiduciary process to reduce recordkeeper fees: (1) Loyola Marymount hired Aon Hewitt to conduct a RFP and hired Diversified as the sole recordkeeper for the plan to replace the prior recordkeepers; (2) Pepperdine also consolidated from four recordkeepers to one with Diversified; (3) Purdue hired a consultant and reduced the number of investment options from 381 to 19 and reduced administrative fees by an estimated $3-4 million per year; (4) CalTech eliminated over 100 Fidelity mutual fund options and consolidated to TIAA as sole recordkeeper with $15m in revenue sharing rebates; and (5) Notre Dame hired AON Hewitt and improved its plan by changing to a single recordkeeper and unbundling investment and administrative services to switch away from revenue sharing to "explicit, hard dollar administrative fees."

Excessive Recordkeeping Fees:

Plaintiffs allege that a reasonable recordkeeping fee would be $1.05m or $35 per participant, compared to $3.3 and $4.1 million paid by the Retirement Plan [between $153 and $213 per participant from 2010 to 2015 — over 500% higher than a reasonable fee for these services]. The smaller plan paid between $54 to $87 per participant during the same time period. The TIAA-CREF investments also contained high "revenue sharing kicked back" to TIAA [15 to 24 bps for TIAA investments].

> Euclid Note: It is noticeable that plaintiffs cite no benchmark to justify their claim that $35 per participant is reliable or even available in the market. Plaintiffs only cite five universities who engaged in a RFP process to lower fees, but do not cite the actual fees of these plans in order to compare those plans fees to the Northwestern plan. This is a significant omission that was not addressed by the DOL in its amicus brief.

Failure to conduct a competitive bidding process for the Plan's recordkeeping services.

With a RFP for recordkeeping services, the plans could have demanded "plan pricing" rebates from TIAA based on the Plans' economies of scale.

Hundreds of investment options, many of which are duplicative:

Whereas the average plan purportedly has fifteen total investment options, the main Retirement Plan has 242 investment options [39 TIFAA ($1.8B) and 203 Fidelity ($548m)]; and the Voluntary Savings Plan has 187 options [39 TIAA ($360m) and 148 Fidelity ($160m)]. The plans also had a "dizzying array of duplicative funds." The plans had duplicative investment options in every major asset class, placing a "monumental" burden on plan participants that leads to "decision paralysis." For example, the plan had 32 fixed income investments; 48 large cap domestic equity investments; and 15 mid cap domestic equity investments. As another example, the plan offered the CREF Stock Account for 46 bps and the CREF Equity Index Account for 37 bps, when the Vanguard Index Fund was available for 2 bps.

> Euclid Note: Participants are using a Vanguard index fund to benchmark against active funds — plans with different strategies and thus different expense structures. There is no materially identical benchmark offered to properly assess the fee differential — just an inapposite passive index fund.

Improperly allowed TIAA to include its proprietary investments and to require it to provide recordkeeping for proprietary options.

The Plan allowed TIAA to bundle products and services, which promoted TIAA financial interests and drove excessive and uncapped revenue to TIAA's recordkeeping arm for years. The plans were thus locked into funds that Northwestern fiduciaries allegedly did not analyze. For example, the CREF Variable Annuity Funds and CREF Stock account had multiple level of fees totaling 38 to 46.5 bps, including administrative, distribution, mortality and expense risk and investment advisory expenses.

The Plans used higher cost share classes:

The plans offered 129 retail-class mutual funds in a higher fee class even though lower-cost share classes of the exact same mutual funds were available. Plaintiffs allege that the institutional-class funds differed only in their lower management fees. The Amended Complaint contains a nine-page chart showing the plan fees for dozens of options compared to the alleged "identical lower-cost mutual fund" and corresponding fees. Here are the first few entries of the chart of the share class fee differential to give the gist of what is alleged:

Plan Mutual Fund	Plan Fees	Identical Lower-Cost Mutual Fund	Identical Lower-Cost Mutual Fund Fee	Plan's Excess Cost
Calvert New Vision Small Cap (A) CNVAX)	189 bps	Calvert New Vision Small Cap (I) (CVSMX)	92 bps	105.43%
Fidelity Large Cap Growth (FSLGX)	80 bps	Fidelity Advisor Large Cap Growth (Inst) (FLNOX)	68 bps	17.65%
Fidelity Mid Cap Growth (FSMGX)	67 bps	Fidelity Advisor Mid Cap Growth (Inst) (FGCOX)	59 bps	13.56%
Fidelity Spartan 500 Index (Inv) (FSMKX)	10 pbs	Fidelity Spartan 500 Index (Adv) (FSMAX)	7 bps	42.86%
Fidelity Stock Selector Small Cap (FDSCX)	75 bps	Fidelity Advisor Stock Selector Small Cap (I) (FCDIX)	62 bps	20.97%
TIAA-CREF Lifecycle 2010 (Retire) (TCLEX)	47 bps	TIAA-CREF Lifecycle 2010 (Inst) (TCTIX)	22 bps	113.64%
TIAA-CREF Lifecycle 2015 (Retire) (TCLIX)	46 bps	TIAA-CREF Lifecycle 2015 (Instl) (TCNIX)	42 bps	9.52%

The differential range for investments in plan, according to the Amended Complaint, ranges from as low as 22 bps to as high as 92 bps. The average spread between share class on the chart is 19-20+ bps [E.g. Vanguard Mid Cap Index (Inv) (VIMSX) 27 bps versus Vanguard Mid Cap Index (Inst) (VMCIX) 8 bps].

In 2016, the plans eliminated hundreds of mutual funds and moved to 32 investment options, including Blackrock target-date mutual funds. The Amended Complaint uses these plan changes against Northwestern, alleging that this demonstrates how poorly the plan was designed before this significant change.

Under-performing Plan Investments

The plan had 119 allegedly underperforming funds. For example, the CREF Stock Account had $528m in plan assets with 46 bps overall (compared to Vanguard index of 2 bps), including 24 bps of revenue sharing to TIAA. It is an active fund [**Euclid Note:** from the TIAA website: "The **CREF Stock Account** is an actively-managed variable annuity that seeks favorable long-term returns through capital appreciation and investment income], but even allegedly underperformed active stocks funds, but was still more expensive compared to the Vanguard Primecap (.35) and Vanguard Capital Opportunity Advantage fund (.40). The TIAA Real Estate Account is 87 bps — allegedly 10 times more expensive than the Vanguard REIT Index at 8 bps.

The Decisions in the Lower Courts

The district court granted Northwestern's motion to dismiss the Amended Complaint for failure to state a claim on which relief could be granted, and denied leave to file an amended complaint. The court of appeals for the Seventh Circuit affirmed. The court of appeals held that the claim for excessive recordkeeping fees failed as a matter of law because ERISA does not require a flat-fee structure as opposed to revenue sharing; "does not require a sole recordkeeper"; and did not require the plans "to search for a recordkeeper willing to take $35 per year per participant" — the amount that plaintiffs alleged would have been reasonable recordkeeping fees. The court noted the allegations that using multiple recordkeepers and failing to solicit competitive bids imposed higher costs on participants, but the court concluded that the plan had "explained it was prudent to have this arrangement so [the Plans] could continue offering" the TIAA Traditional Annuity, given that TIAA had required the Plans to use TIAA as the recordkeeper for all TIAA funds in the plan. The court also found that the plans had not identified an "alternative recordkeeper that would have accepted" a lower fee than the one paid by the Plans while still providing the same level of service. And "[a]t any rate," the court reasoned, "plan participants had options to keep the expense ratios (and, therefore, recordkeeping expenses) low," by choosing to "invest in various low-cost index funds." As to the claim that the plans offered imprudent investment funds with unnecessary management fees and inferior investment performance, the court of appeals stated that it understood the participants "clear preference for low-cost index funds," but there was no breach of fiduciary duty because index funds "*were and are* available" in the plans. The court also declined to endorse "a blanket prohibition on retail share classes," and it stated that "plans may generally offer a wide range of investment options and fees without breaching any fiduciary duty." The court specifically rejected the argument that, based on similar allegations and facts, the Third Circuit Court of Appeals in *Sweda v. University of Pennsylvania*, 923 F.3d 320 (3d Cir. 2019), cert. denied, 140 S. Ct. 2565 (2020), had ruled that a "meaningful mix and range of investment options [does not] insulate[] plan fiduciaries from liability for breach of fiduciary duty."

The Schlichter law firm filed a petition of certiorari. They argued that the Third and Eighth Circuits have held that a plan participant can adequately plead a breach of fiduciary duty by claiming that the retirement plan charged excessive fees when lower-cost alternatives existed. But the Seventh Circuit in the Northwestern case held that "virtually identical pleading" are insufficient to state a claim, because it is necessary to credit the defendant's explanation for not offering lower cost options for the retirement plan before allowing a well-pleaded complaint to proceeded. The petition characterized the question presented as: "Whether allegations that a defined-contribution retirement plan paid or charged its participant fees **that substantially exceeded fees for alternative available investment products or services** are sufficient to state a claim against plan fiduciaries for breach of the duty of prudence under ERISA." [emphasis added by Euclid]. As discussed more fully below, even the most prominent excessive fee law firm appears to concede that no fiduciary challenge should be allowed unless the fees are demonstrably egregious — a challenge to small fee differentials should not be tolerated by federal courts.

What ERISA Requires to Control Plan Expenses

The Department of Labor Excessive Fee Standard

Given this factual record, it is no surprise that the Department of Labor and Department of Justice filed an amicus brief at the request of the Supreme Court, and strongly advocated that the case presented at least two plausible claims for breach of fiduciary duty and "presented an opportunity for this Court to clarify that ERISA requires fiduciaries to work actively to limit a plan's expenses and remove imprudent investments." This is in contrast to the November 2019 amicus brief of DOL in the *Putnam Investments, LLC v. Brotherston* excessive fee appeal before the Supreme Court in which the Trump Administration DOL advised the Court not to accept the case. Ultimately, the Supreme Court will issue an opinion in the 2021-22 term and likely will give guidance as to the pleading standard for an excessive fee case. As noted, the stakes are high, because the cost of defense is asymmetrical and more burdensome for plan sponsors, which increases the risk of unwarranted high-value settlements if the motion to dismiss is not granted.

But while we wait for the Supreme Court, the DOL/DOJ amicus brief should be analyzed by plan sponsors to better understand what the current DOL believes as to the merits of excessive fee cases. After five years of relative silence while courts have rendered unequal and inconsistent rulings, allowing excessive fee cases to thrive mostly uninhibited except some resistance in California and the Seventh Circuit, the DOL has finally given specific guidance as to what it believes constitutes a meritorious excessive fee case. DOL has clearly taken the position that excessive fee cases serve a useful purpose, but it has stated some guidelines that deserve careful scrutiny. Importantly, DOL is not advocating a no-holds-barred pleading standard. It has outlined some useful guidelines that both help and potentially hurt plan sponsors.

To begin, DOL restated the question presented in the case with a meaningful difference than proposed by the participant-petitioners: "Whether participants in a defined-contribution ERISA plan stated a plausible claim for relief against plan fiduciaries for breach of the duty of prudence by alleging that the fiduciaries caused the participants to pay investment-management or administrative fees higher than those available for other **materially identical** investment products or services." [emphasis added by Euclid].

DOL stated in its brief that the Amended Complaint stated at least "two plausible" claims for breach of ERISA's duty of prudence. First, assuming the factual allegations are true, the plans caused participants to pay excessive investment-management and administrative fees when the plan could have obtained the same investment opportunities at a lower cost. Specifically, the plans selected retail-class investment funds "even though identical institutional-class investment funds with lower management fees were available to Plans based on their size." Second, the plans failed to use any of the several available methods to monitor and reduce the plans' cost of recordkeeping services. DOL asserted the Seventh Circuit's decision conflicted with the Third Circuit in the University of Pennsylvania case and the Eighth Circuit in the Washington University case. DOL further contended that the "frequently recur[ring]" question of "what ERISA requires of plan fiduciaries to control expenses is important to millions of employees throughout the Nation whose retirement assets are invested in ERISA-governed plans."

We see two defining principles for excessive fee cases articulated by the Department of Labor:

1. The first principle articulated by DOL is that fiduciaries are liable for breach of fiduciary duty if lower investment fees are available for materially identical investments.

The key factor in DOL's opinion was that the only difference alleged for the Northwestern plans was their share class: the plans could have offered "the same investment opportunities at a lower cost." DOL said that the inquiry is context specific, and fiduciaries can justify cost differences. But here there was no difference between retail and lower-cost institutional shares: the investments were identical except for cost [i.e., same manager and same investment strategy].

The test is not a free-for-all. First, DOL states that the fee must be judged against a benchmark of "materially identical investments." In addition, DOL specifically stated that merely alleging an alternative available investment with lower management fees is not enough: "bare allegation that cheaper alternative investments exist in the marketplace," on its own, likely does not state a claim (citing *Braden v. Wal-Mart Stores*). Citing long-standing fiduciary case law, fiduciaries "should not consider costs *alone* when establishing an investment menu for plan participants"; "rather, prudent fiduciaries must consider all relevant factors when selecting the plan's investments. For example, a fiduciary can have many justifications for paying higher fees, including the "potential for higher return, lower financial risk, more services offered, or greater management flexibility." The Northwestern case, by contrast, was different because the failure to offer "identical lower-cost institutional-class investments" was "different *only* in their lower costs." DOL asserted that "there is no apparent justification for [the plans] failure" to offer the lower-cost share classes. We note that the plans had stated that the higher fees were justified by revenue sharing, but DOL ignores that purported justification, likely because the revenue sharing is so high — over 20 bps in most options — that it could not be justified as reducing recordkeeping fees.

2. The second defining principle articulated by DOL is that each investment must be prudent.

Fiduciaries cannot rely on a mix of low and high-cost investments in the plan, and shift the burden to participants to find the best investments. DOL opined that under "the law of trust, which informs ERISA's fiduciary standards, fiduciaries are not excused from their obligations not to offer imprudent investments <u>with unreasonably high fees</u> on the ground that they offered other prudent investments" (emphasis added by Euclid to demonstrate that even the DOL requires the fees to be egregiously higher). The duty "applies to *each* of the trust's investments" to ensure that they are appropriate. For added emphasis, DOL stated a second time later in the brief that "ERISA fiduciaries may not shift onto plan participants the burden of identifying and rejecting investments with imprudent fees."

With respect to recordkeeping, DOL opined that the plans had failed to use several methods like other plans to reduce recordkeeping fees. But DOL expressly stated that it is not per se imprudent to have multiple recordkeepers or revenue sharing. Here plaintiffs substantiated its excessive recordkeeping fees with strategies from CalTech and other similar plans that negotiated revenue sharing rebates. DOL rejected the rationale that TIAA recordkeeping was necessary in order to gain access to the popular TIAA guaranteed annuity, the primary defense offered by university plans in excessive fee litigation, including in the New York University case that went to trial.

The Euclid Perspective

Preliminary Thoughts

The Northwestern case presents problematic facts that are obsolete in hindsight, particularly given that the plan made substantial changes in 2016. The fact pattern is further challenging because it is based on the narrow fact pattern of a motion to dismiss, which is limited to the biased facts alleged by plaintiffs.

PROBLEMATIC FACT PATTERN

Despite numerous blog posts about the Northwestern case, we have not seen any representative of the plan sponsor community admit publicly that the Northwestern facts are problematic. As noted previously, the Northwestern plan presents a difficult fact pattern to defend: multiple recordkeepers; hundreds of duplicative investments; proprietary investments from the recordkeepers; high recordkeeping fees with high, uncapped revenue sharing; no recent RFP for lower fees; expensive retail share classes; and high investment fees. Any lawyer will tell you that bad facts make bad law, and that is the risk here.

OBSOLETE FACT PATTERN

Part of the problem is that five years have passed, and the recordkeeping and investment fees look even higher than the current climate, given the significant fee compression and plan changes in the interim. For example, the Fidelity 500 Index Fund is alleged in the complaint at 10 instead of 7 bps in a lower share class, when it is now available for 1 or 2 bps, or sometimes even lower. It is hard to measure whether fees constitute a fiduciary breach when a fast-changing world has made a 2015 plan look obsolete.

To this point, it is important to note that the vast majority of large 401k plans — even plans with $100m or more assets — are different than the Northwestern 403b plan facts. Most plans have one recordkeeper, and even 80%+ of 403b plans have one recordkeeper. And as measured by the most recent Brightscope survey of 2018 plans, most plans have 20-40 investment options, not hundreds [we note that the Amended Complaint alleges that the average plan has 15 investment options on average, but that is incorrect]. In fact, if you count target-date funds as one investment option, the median plan has 21 investment options [29 investment options with all target date funds included]. This reduces any alleged participant confusion and fully leverages the size of the plan for lower fees.

NORTHWESTERN PLAN CHANGES

Finally, even the Northwestern plan made substantial plan changes in 2016 to reduce fees, as the Amended Complaint summarizes to demonstrate how allegedly imprudent the plan was in the 2010-2015 class period. Northwestern eliminated hundreds of investments, negotiated a revenue sharing credit, and added Blackrock target-date funds, which are presumably at a low cost [because, if the costs had been high, plaintiff's counsel would have pointed it out — again, we are limited to an incomplete and biased factual record on a motion to dismiss]. No plan should be held liable for subsequent remedial changes, and there are supposed to be evidence rules to protect against admissions of guilt based on making changes. But the Supreme Court is being presented with one of the worst possible fact scenarios in which to assess the pleading standard for excessive fee cases. Credit to defense counsel for prevailing in the district and appellate courts, but most $100m or larger plans in America have better recordkeeping and investment fees than the Northwestern plan.

THE LIMITATIONS OF THE MOTION TO DISMISS

Defense law firms file motions to dismiss in nearly every excessive fee case. But the motion to dismiss is limited to the stilted factual record presented by the plaintiffs. There is no ability for defendants to compare their fees against other plans or to even correct the factual record when plaintiffs make incorrect assertions. Most universities in 2016 had similar TIAA fees and mandatory bundled TIAA investments, and many still do today. But plaintiffs showed that at least five universities had made significant changes by 2016, including one plan that negotiated lower fees from TIAA itself. That does not change the fact that Northwestern's plan was like dozens, if not hundreds of other 403b university plans — indeed, nearly every 403b plan was doing the same thing at the time. The Schlichter law firm claims that this was not the standard of care, but defendants have never argued that every plan was doing the same thing, which should represent the actual standard of care in the industry. We further believe that if the fiduciary standard has changed, every plan needs time and notice to make changes before liability should be imposed. But again, this argument has never been raised in the limited tool of the motion to dismiss.

DIFFERENCE BETWEEN 403B AND 401K PLANS

Another important factor is that most large 401k plans have better recordkeeping and investment fees, and a better investment lineup than the Northwestern plan. For example, most 401k plans have a single recordkeeper. Some pay their recordkeeper on a flat, per participant fee; others pay on an asset basis; and some pay with revenue sharing, including some with a flat fee plus additional revenue sharing. Most plans — well over 80% - offer target-date funds, either an actively managed or index basis; and 90%+ offer at least one low-cost index option as index options have become nearly universal in large plans. The universality of index options is a key factor, because nearly every plan participant in a large plan now has the ability to reduce investment expense to one to four basis points by putting their money in a S&P 500 Index Fund. This is why the DOL's position that plans cannot rely on the overall mix of investments is a harsh and unfair standard if not put into context.

Three Key Categories of Excessive Fee Challenges

With these preliminary caveats in mind, we believe that there are three key categories of excessive fee challenges raised in nearly every excessive fee lawsuit that should be re-evaluated with DOL's excessive fee standards: (1) challenges to higher-cost retail share classes and asset-based revenue sharing; (2) challenges to a single allegedly imprudent investment when the overall mix of investments includes low-cost index funds; and (3) challenges to active funds against a passive fund benchmark.

1. CHALLENGING HIGHER-COST RETAIL SHARE CLASSES AND ASSET-BASED REVENUE SHARING

The question has been raised in dozens of cases [and nearly every case filed by the Capozzi Adler law firm] whether it is a breach of fiduciary duty to use higher cost retail share classes. DOL thinks it is a breach of fiduciary duty, at least when it involves materially identical investments with no other substantive difference. It should be a legitimate defense that the higher share class is justified if the revenue sharing differential lowers overall recordkeeping and administrative fees. But in the Northwestern case, the revenue sharing is very high for most of the 130 retail-class options. For example, it is alleged to be 24 bps for the CREF Stock Account in which $528B was invested. Most rational decisionmakers would assume that this is high and prejudicial to plan participants in large plans. Indeed, it is higher than the total fees for many of the investments offered by Vanguard and Fidelity today. If you do the math, a $100,000 participant account at 24 basis points would yield a $240 recordkeeping fee if invested in the CREF Stock Account. Any honest observer would agree that 24 basis points for recordkeeping a large plan is too high. Asset-based recordkeeping is already problematic for high-asset participant accounts, but 24 basis points is likely egregious. Again, bad facts make bad law if not put into proper context, which must be encouraged in the Northwestern case to avoid bad law.

There does not appear to be any justification for the higher cost retail share classes used by the Northwestern plan to the extent that the revenue sharing is not capped, but these facts should not be allowed to permit excessive fee litigation plans against plans with reasonable fees. Very few large plans today over $100m in assets, and certainly over $250m or $500m in assets have asset-based recordkeeping fees at 20+ bps like the Northwestern plan in 2016. Plaintiffs should not prevail on an unsupported assertion that all plans should have a $35 or lower flat fee recordkeeping fee, as that is a fictional fee with no support or justification, notwithstanding how many times plaintiffs have alleged this number in excessive fee filings. But the Northwestern's asset-based arrangement should also not be allowed to set precedent on the proper pleading standard for alleging that recordkeeping fees are too high. The Supreme Court needs to articulate a pleading standard that requires the fees alleged to be egregious — not just higher than some aspirational and unsupported benchmark. To the extent that the Supreme Court overturns the Seventh Circuit (or sends it back to the district court for reconsideration), it needs to be based on the factual issue of whether the Northwestern recordkeeping fees are egregious, which are alleged to be $200+ for participants. By contrast, this means that a $50-75 recordkeeping fee for a $500m-$1B+ plan should be off limits for excessive fee litigation, because the differential is not egregious. Courts should not allow high-stakes litigation over $10-25 per participant because the difference is not material and is usually based on proper arms-length negotiation.

Euclid will be authoring additional articles that give advice to plan sponsors based on the case law, but we offer one point of advice here. The DOL makes clear that the number one priority for all plan fiduciaries and their consultants is to ensure that every plan investment is in the lowest fee share class. Often a plan will grow during a year, and should be in a lower fee share class when it reaches a higher asset level. For example, Fidelity offers institutional K Shares, a lower share K6 class, and even lower-fee share classes with collective investment trusts [for mutual funds, but not for the Fidelity Freedom Target-Date funds in which the K6 share class is the cheapest available]. Many excessive fee cases have been brought challenging plans with Fidelity K shares when lower cost shares are available. *See, e.g., Smith v. CommonSpirit Health*, E.D. Ky., No. 2:20-cv-00095, 7/6/20; *Jones v. Coca-Cola Consol. Inc.*, W.D.N.C., No. 3:20-cv-00654, 11/24/20. Given that the damages model in excessive fee cases is the alleged overpayment to the plan recordkeeper and investment manager, plan sponsors need to hold their recordkeepers and investment managers accountable. **Investment contracts need to certify that plans have been offered the lowest share class available, and require investment managers and recordkeepers to agree to reimburse and indemnify plans if they are alleged to have been overpaying for plan fees.** Plan sponsors should not bear this burden — **investment providers need to be accountable for ensuring that plans have the lowest possible fees offered by the advisor.** Stated differently, if the case alleges that Fidelity, T. Rowe Price, or any investment manager or recordkeeper took too much compensation, plan sponsors need to turn the tables and require their plan provider to reimburse the plan for any alleged overpayment.

2. CHALLENGING A SINGLE INVESTMENT AS IMPRUDENT WHEN THE MIX OF PLAN INVESTMENTS INCLUDES LOW-COST INDEX FUND

The second key issue raised in most excessive fee litigation is whether plan sponsors can offer a wide range of investments — active and passive — and be absolved from liability by allowing participants to choose what they want. The DOL has taken the position that every single investment must be prudent, even if the plan offers many high-quality, low-cost investments. This is the most problematic and potentially damaging tenant of DOL's amicus brief.

Without the context of the Northwestern case-specific facts, this could be read to allow plan participants to file an excessive fee case if even one plan investment was allegedly imprudent. But again, that is where context is necessary. Northwestern had 129 investments in retail share classes with 20+ bps of revenue sharing. The DOL standard should not be a license to sue on any active investment option. It must be read in context with the key issue in the case that the Northwestern plan was filled with dozens of higher cost retail share classes that the DOL said had no justification. Northwestern argued that the differential represented revenue sharing, but when recordkeeping fees are $150 to $200+ per participant with asset-based and uncapped revenue sharing, it is difficult to argue that revenue sharing benefited plan participants. Revenue sharing is more likely to be justified when there is no participant recordkeeping fee and revenue sharing is modest [i.e., 5 to 10 bps, or lower]. In addition, DOL qualified its definition of imprudence by reference to "unreasonably high fees." Their focus was not on the investment strategy — active or passive — but on the fact that they viewed the fees as unreasonably high — i.e., egregious, which is a high standard to prove.

From what we can tell, the only redeeming aspect of the Northwestern plan was that it did offer some index funds that even the participants' law firms think are prudent. Defendants argued, and the lower courts agreed, that participants had access to low-cost index funds and thus the fiduciaries were prudent. This is a critical issue. Plaintiff law firms have been arguing that they have the right to sue if even one investment is allegedly imprudent, and DOL appeared to agree. But plan sponsors under ERISA 502c are supposed to have protection from liability in a defined contribution plan if the investments are participant directed. The entire excessive fees case genre is based on the different premise that they have the right to sue if even one investment is allegedly underperforming and/or containing excessive fees. Here DOL has articulated a very problematic standard that every investment can be judged in isolation and alleged imprudent. This invites an open season against every plan in America, because nearly every plan has at least one active fund with an over 50 bps investment fee.

Consequently, there has to be some limitation to DOL's position that you cannot argue that the overall mix of investments is reasonable. According to the most recent Brightscope survey, 93.8 of all plans offer at least one index option in 2018 and over 80 percent of plans over $500m offer target-date funds. Index funds are nearly universal in large plans. If there is no requirement that all large plans need to offer an all-index fund lineup, then class actions should not be allowed to challenge one or two higher cost active funds in a plan that also has a low-cost index alternative. Again, this is why the Northwestern case is so dangerous. It was filled with so many high-cost options that its participants were able to allege that they were confused and could not easily choose low-cost alternatives. By contrast, the modern plan with 20-30 focused investment options should not be subject to any finding that the Northwestern plan constituted a breach of fiduciary duty. Moreover, we believe that the DOL' s position needs to be taken into context that the Northwestern investment options were imprudent because they were retail share classes that were identical to lower fee share classes. This is a crucial distinction. As noted below, DOL's position that all investments need to be prudent does not appear to allow a challenge against an active fund just because it is actively managed and more expensive than an index fund. In a plan with low-cost index alternatives, it should be prudent to offer alternative options that are actively managed to provide a contrasting, different strategy — again, as long as it is the lowest fee for the investment options to which the plan is eligible.

3. CHALLENGES TO ACTIVE FUNDS BASED ON A PASSIVE-FEE BENCHMARK

The third key challenge in excessive fee litigation is whether courts should allow plaintiffs to file excessive fee cases against plans with active investment options just because active plans do not perform as well as index funds in overall return. Many large plans today have reasonable recordkeeping fees on a flat, per-participant basis with limited or no revenue sharing, but have target date suites in active funds like T. Rowe Price Retirement (starting at .52%) or the Fidelity Advisor Freedom Funds (starting at .50%). These actively managed funds are higher priced than most index series like Vanguard Index Target Date Funds at .09% or lower. Because the Brightscope average investment fee of .32 for large plans includes both active and passive plans, any large plan over $100m that offers active target date plans will have an all-in fee over the .32% average for large plans.

Plaintiff firms take the position that they can challenge any active fund on the premise that it cannot beat an index fund. And for the last ten to fifteen years, statistics prove them mostly correct. But it should not be a breach of fiduciary duty to offer active funds without an express law from Congress or fair regulatory notice from DOL that it is a breach of fiduciary duty. Many competent plan advisors continue to recommend active funds based on legitimate investment theories that: (1) active plans will beat the market in down or sideways markets, like from 2000-2008; and (2) while it may be difficult, if not impossible, to beat index funds for large-cap stocks with high daily trading volumes, active management should be able to beat the benchmark for smaller stocks that require research not readily available for large plans. An additional reason is that quality advisors will tell clients that you cannot judge an investment based on a short-term track record, as it takes at least a decade or more to fairly judge investment performance. Underperformance claims are unfair and particularly insidious, because chasing investments with higher, temporary performance is often a fool's errand. Moreover, a five-year benchmark of under-performance is not long enough to award damages, as every value investor has lagged the market in which growth stocks with high price-to-earnings multiples have dominated returns for a decade now — as even Warren Buffett's company with a value focus has lagged the S&P 500 in the recent decade in which the S&P 500 index has dominated.

Importantly, we do not read DOL's position in the Northwestern case to support any claim of breach of fiduciary duty for investing in active funds. DOL specifically stated that the prudence of any plan investments is context specific and should be prudent if based on rationale justifications, such as seeking to outperform the market. This is exactly what active funds try to accomplish: outperform the market. DOL also casted the question presented in the Northwestern case as whether it is a breach of fiduciary duty to pay higher for "**materially identical**" investment options. An index fund like Vanguard target-date funds is not materially identical to a fund with an active strategy. That should end most excessive fee cases. In addition, the reason DOL thinks the Northwestern fiduciaries acted imprudently is that there was no difference between the retail and lower-cost institutional share class — not because it somehow didn't perform like an index funds. The key issue from DOL's position is whether your plan is in the lowest-possible share class. There is nothing in the DOL's position prohibiting a plan from investing in active target-date or other active funds if the plan is in the lowest available share class. Given that nearly every plan now offers a cut-rate .01-.02 index fund for large cap or S&P 500 stocks, this should be a defense to the second issue of whether a plan can prudently rely on a mix of index and active funds. Again, as long as the share class is the lowest-cost institutional fees structure available, no excessive fee allegations should be permitted. This is where the problematic facts of the Northwestern case need to be distinguished.

The Proper Pleading Standard for an Excessive Fee Case

No fiduciary under ERISA fiduciary law should be held liable for breach of fiduciary and forced to spend millions defending their conduct unless (1) the fees are egregious; and (2) to properly allege whether the fees are egregious, plaintiffs must allege a reliable benchmark of materially identical investments.

THE PROPER PLEADING STANDARD

The best way the Supreme Court can be helpful is to establish a rigorous and predictable pleading standard to weed out illegitimate excessive fee cases. ERISA's promise of uniform standards of fiduciary responsibility cannot be fulfilled when courts treat identical allegations differently under inconsistent pleading standards. But this is what has happened with the Northwestern case dismissed in the Seventh Circuit, but the appellate courts in the Washington University (Eighth Circuit) and University of Pennsylvania (Third Circuit) cases allowing the cases to proceed.

As the Supreme Court has said, motions to dismiss are "important mechanisms for weeding our meritless claims." *Fifth Third Bancorp v. Dudenhoeffer*, 573 U.S. 409, 425 (2014). This bedrock principle is supposed to apply in ERISA cases, but it is not working out that way. In *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 554, 557 (2007), the Supreme Court held that allegations that are "merely consistent with" antitrust violations — but "just as much in line with" lawful behavior — fail to state a claim for relief. The Court reaffirmed that principle in *Ashcroft v. Iqbal*, 566 U.S. 662, 678, 684 (2009), stressing that *Twombly* provides "the pleading standard for 'all civil actions.'" In *Fifth Third Bancorp v. Dudenhoeffer*, 573 U.S. 409, 426 (2014), it held that "the pleading standard as discussed in *Twombly* and *Iqbal* governs breach of fiduciary duty claims under the ERISA. Under the *Twombly* standard, merely alleging some of the plan's investment options charged excessive fees or performed inadequately is insufficient. Unless the allegations "show that a prudent fiduciary in like circumstances would have acted differently," they do not clear the *Twombly* threshold. Stated differently, the *Twombly* standard requires an excessive fee case to be dismissed if the conduct alleged to be negligent is equally consistent with competitive business strategy as they are with a fiduciary breach.

Where there is a <u>concrete, obvious alternative explanation</u> for the defendants' conduct, a plaintiff must be required to plead additional facts tending to rule out the alternative. If the complaint's allegations are merely consistent with liable acts, the complaint stops short of the line between possibility and plausibility. When both lawful and unlawful conduct would have resulted in the same decision, a plaintiff should not survive a motion to dismiss by baldly asserting that unlawful conduct occurred. For example, the recent Ninth Circuit ERISA ruling in *White v. Chevron* grounded its statement of the pleading standard for fiduciary breach claims in one of the court's application of *Twombly* to securities claims: "[w]here there are two *possible* explanations, only one of which can be true and only one of which results in liability, plaintiff cannot offer allegations that are merely consistent with it favored explanation but are also consistent with the alternative explanation."[1] "Something more is needed, such as facts tending to exclude the possibility that the alternative explanation is true, in order to render plaintiff's allegations plausible within the meaning of *Iqbal* and *Twombly*."[2]

Under the proper *Twombly* standard, under-performance allegations can be little more than a "hindsight critique of returns" which cannot show that a fiduciary acted imprudently at the time the fiduciary made the challenged decision. Plaintiffs must show that a reasonable fiduciary "would have acted differently" — for example by not offering the investment because it was so plainly risky or by offering a superior alternative instead. Most excessive fees cases would be dismissed under this heightened standard from the Supreme Court, but it is not being used uniformly.

In its appeal to the Supreme Court, participant counsel correctly pointed out that the Northwestern case was dismissed because the appellate court credited the explanations of the plans as to their conduct. The investment fee allegations were thrown out because the plans argued that participants were not prejudiced because there were low-cost index funds available if they wanted low fees, in addition to the investment options challenged by participants. In other words, participants could avoid all of the offending investments. Second, the high recordkeeping fees claims were thrown out because the plans had recordkeeping based on revenue sharing and participants could avoid those fees by choosing the low-cost index funds. Also, to the extent that the TIAA recordkeeping was high, it was necessary to pay the TIAA fees in order to maintain the popular TIAA guaranteed annuity option.

The Seventh Circuit appears to have been applying the proper motion to dismiss standard by crediting the explanations of plan fiduciaries for the challenged conduct. Plaintiffs have made potentially legitimate arguments that the fiduciary conduct was negligent, and that the rationales from the plan were not worthy. But that does not mean that the pleading standard was incorrect. In other words, there may be a legitimate argument that the plan's rationale for their conduct were insufficient as a matter of law, but the high pleading standard is correct.

THE PROPER EXCESSIVE FEE PLEADING TEST

Euclid believes that the briefing in the Northwestern case, taken in total, has articulated a fair standard for excessive fee case.

<u>First</u>, no fiduciary under ERISA fiduciary law should be held liable for breach of fiduciary duty and forced to spend millions defending their conduct unless the fees are egregious. Given the high cost of excessive litigation, including the asymmetrical discovery burden, plaintiffs should not be allowed to sue over small recordkeeping or investment fee differences. Even the petitioner's brief seeking review by the Supreme Court articulated that the breach of fiduciary duty is for "substantial excess" fees. The Schlichter law firm casts the Northwestern case as one in which the fees were "substantially" higher than available alternatives. To their credit, they are not proposing that the fees of any plan can be challenged, but only if the fee differential is substantial — a standard that we would characterize as egregious. This is often lost in the high volume of copy-cat excessive fee lawsuits being filed by new plaintiff firms trying to enter this lucrative business.

There is substantial body of case law that supports the requirement that fees must be egregious in order to be challenged. In *Young v. General Motors Inv. Mgmt. Corp.*, the Second Circuit held that the challenged fund must "charge a fee that is so disproportionately large that it bears no reasonable relationship to the services rendered."[3] This disproportionate standard was echoed in *Genentech* and *Kong v. Trader Joe's Co.* recent cases.

This is similar to the standard that is required under the Investment Company Act for challenges to fees charged by mutual funds or investment advisors. Ten years ago, the Supreme issued its seminal opinion in *Jones v. Harris Associates L.P.*, establishing the standard of liability for claims under Section 36(b) of the Investment Company Act, which establishes a fiduciary duty on the part of fund advisers with respect to their receipt of fees, and grants fund shareholders the express right to bring lawsuits in federal court for breaches of this duty. The Supreme Court held that to establish liability under Section 36(b), a plaintiff must ultimately show a fee "<u>so disproportionately large</u> that it bears no reasonable relationship to the services rendered and could not have been the product of arm's length bargaining."[4] While *Jones* is best known for having set "the beyond arms-length" standard of liability for Section 36(b) claims, in its ruling the Supreme Court also provided guidance regarding how courts should assess certain allegations and evidence in applying that standard. In this regard, the Court noted that "[w]e do not think that there can be any categorical rule regarding the comparisons of the fees charged different types of clients. Instead, courts may give such comparisons the weight that they merit in light of the similarities and differences between the services that the clients in question require, <u>but courts must be wary of inapt comparison</u>."[5] This standard requires two elements: (1) that the fees are egregious within context and (2) the comparison or benchmark must be appropriate. Just as the Supreme Court restored order in Section 36(b) excessive fee litigation against investment advisors, the Court needs to set a similar rigorous standard for excessive fee cases now ravaging plan fiduciaries.

A recent case demonstrates how this standard should work. In one of the most recent lawsuits filed by the Schlichter law firm in *Lauderdale v. NFP Retirement, Inc.*, Case No. 8-21-cv-301-JVS-KES (C.D. Calif.), they seek to impose liability when the plan allegedly paid 7 bps for Vanguard index fund when 5 bps were allegedly available for the same plan, and a prior target-date strategy at 26 bps for one year before it was lowered within one year to 12 bps. The contrast in fees to the Northwestern case is remarkable when most plan fees ranged between 40 and 100 basis points. Surely a 2 bps differential does not meet the Schlichter standard requiring "substantial" excess that the firm has articulated before the Supreme Court. This illustrates our point that the bad facts of the Northwestern case should not be allowed to influence the many illegitimate "excessive" fee cases that should be weeded out in the pleading stage, before plan sponsors have to spend millions of dollars to defend their conduct or be forced into settlements to protect against high liability. ERISA is a law of process that gives discretion to fiduciaries, and they should not be terrorized by excessive fee litigation unless the fees are seriously egregious.

Second, to properly allege whether fees are egregious, plaintiffs must allege a reliable benchmark of materially identical investments. Plaintiffs cannot speculate on fees and sue without substantiating their case based on a reliable benchmark. The typical case tries to compare every plan fee against the lowest available Vanguard target date fund. But needless to say, all active funds fail this invalid comparison. An index fund with a passive strategy is not a meaningful benchmark for any active fund. Such comparisons must be rejected to weed out the many meritless claims. Most target-date funds have different strategies, and are not conducive to superficial comparisons. A reliable benchmark is an apples-to-apples comparison of materially identical recordkeeping services and investment options. Most excessive fee cases fail this basic standard. For example, in the Northwestern case, plaintiffs claim a reasonable recordkeeping fee should be $35 per participant, but provide no evidence to substantiate their case. In other words, they may have met the first standard that $150-200+ is potentially egregious, but they make no effort to demonstrate how this compares to other similarly situated plans.

DOL's brief in the Northwestern cases supports this benchmark requirement, stating that an excessive fee case is proper only if a plan is paying higher fees than a **materially identical** alternative investment or service. "Materially identical" is an important test that requires a context-specific benchmark in order for a complaint to proceed — just alleging that plan fees are too high should not meet this test, because plaintiffs must allege that their benchmark or alternative is materially identical. This should rule out a significant majority of complaints that allege that investment returns of an actively managed plan lag an index fund, because an active fund is not materially identical to a passive index plan. This is a critical distinction for all plan sponsors facing this new paradigm of excessive fee risk.

In sum, if you combine the Schlichter standard of "substantial excess" with DOL's requirement of proof by comparison to a "materially identical" alternative, you arrive at a credible pleading standard for excessive fee cases: **that an excessive fee complaint meets the pleading standard only if (1) the fees alleged are egregious (2) judged against a reliable benchmark of materially identical alternative investments or services that no prudent fiduciary would have selected.**

Conclusion

Finally, Northwestern may not ultimately prevail under the more rigorous pleading standard that we espouse, but the goal for plan sponsors should be to win the war on excessive fees. Plan sponsors deserve a rigorous standard that requires plaintiffs to prove that fees are egregious based on a reliable benchmark of materially identical investments. We would not have chosen the Northwestern case to set the pleading standard for all excessive fee cases, but we hope the Supreme Court looks beyond the specific facts to articulate a rigorous and responsible standard to weed out meritless cases.

About the Author

Daniel Aronowitz is the Managing Principal and owner of Euclid Specialty, a leading fiduciary liability insurance underwriting company for America's employee benefit plans. Dan has nearly thirty years of experience in the professional liability industry as a coverage lawyer and underwriter, and is a widely recognized fiduciary liability expert and thought leader. He is the author of Euclid's Fiduciary Liability Insurance Handbook and the fiduciary liability insurance chapter of the Trustee Handbook published by the International Foundation of Employee Benefit Plans. He is a graduate of The Ohio State University and Vanderbilt University School of Law and has achieved the RPLU+ designation from the Professional Liability Underwriting Society

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ENDNOTES

1 *White v. Chevron Corp.*, 752 Fed Appx. 453, 454 (9th Cir. 2018) (quoting *In re Century Aluminum Co. Sec. Litig.* 729 F.3d 1104 108 (9th Cir. 2013).

2 *Id.* At 454-455.

3 325 F. App'x 31, 33 (2d Cir. 2009)

4 559 U.S. 335 (2010) at 346.

5 *Jones*, 559 U.S. at 349-350.

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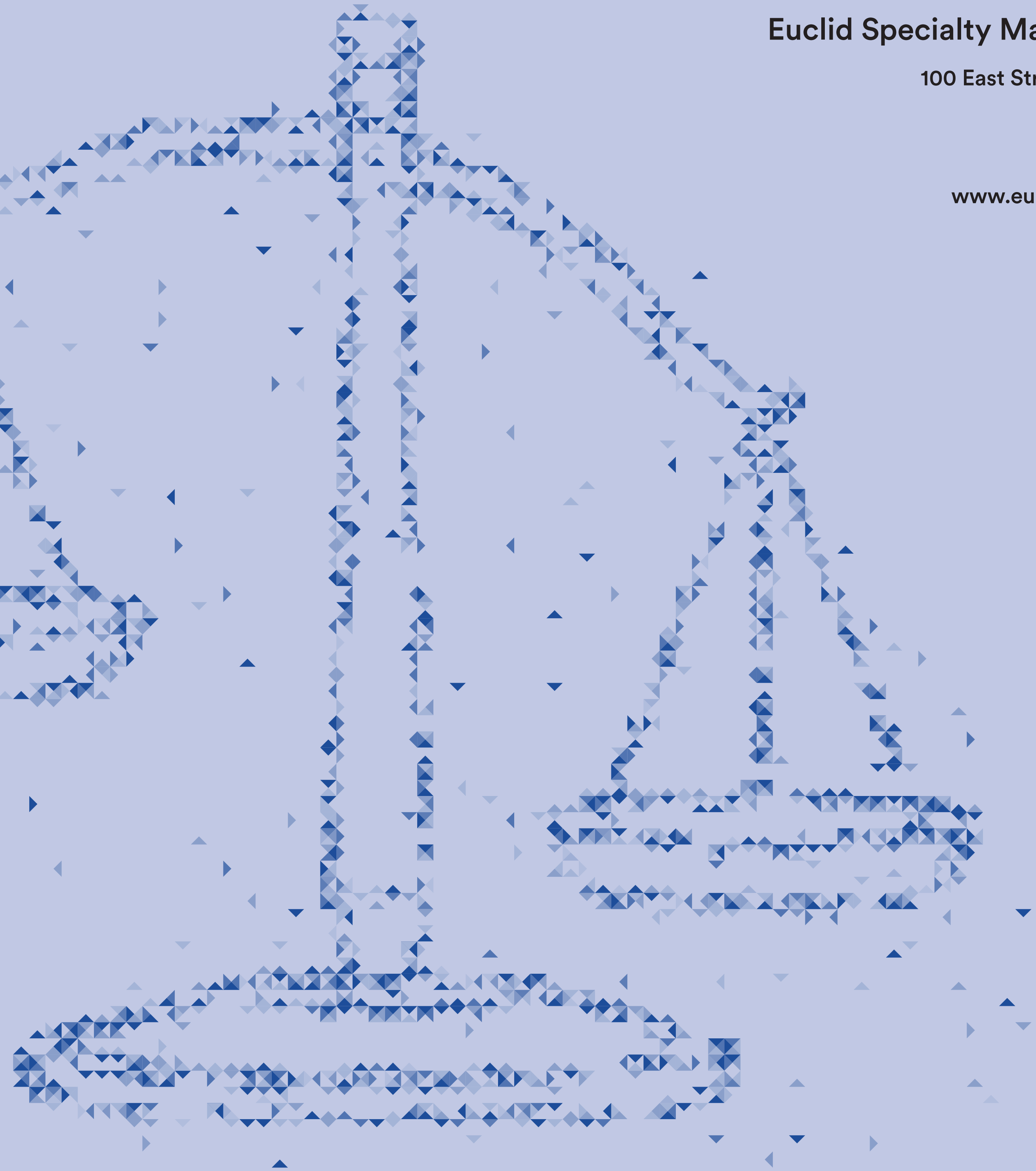

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