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Seventh Circuit Upholds Dismissal of 403(b) Plan Lawsuit Against Northwestern University in Apparent Split with Third Circuit

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Since the beginning of 2016, the ERISA plaintiffs' bar has filed nearly two dozen complaints targeting university-sponsored 403(b) plans. The majority of these lawsuits assert that plan fiduciaries breached their duties and engaged in prohibited transactions by (1) "packing" a plan with too many investment options that underperformed and were more expensive relative to other investment options, and/or (2) retaining too many record-keepers and paying record-keepers unreasonable fees. To date, these cases have had mixed results: some have been dismissed at the initial pleading stage, others have settled after the denial of motions to dismiss, and one was dismissed after trial. In a significant development, the Seventh Circuit recently issued its decision in the case against Northwestern University and, in doing so, became the first court of appeals to uphold the dismissal of such claims in their entirety. *Divane v. N.W.U.*, No. 18-2569, 2020 WL 1444966 (7th Cir. Mar. 25, 2020).

Participants in Northwestern University's 403(b) plans had alleged that the plan fiduciaries breached their fiduciary duties by: (1) entering a bundled service agreement with one of the plans' record-keepers that mandated the inclusion of a suite of the record-keepers' investment options, including some allegedly imprudent investment options; (2) maintaining multiple record-keepers and paying record-keeping fees through an asset-based arrangement instead of a flat per-participant fee; and (3) offering too many investment options where many underperformed readily available and cheaper alternatives. The complaint also had alleged that each of these fiduciary decisions violated ERISA's prohibited transaction rules.

On appeal, the Seventh Circuit affirmed the district court's dismissal of all claims and concluded that plaintiffs' claims did not assert plausible ERISA violations, but rather merely amounted to plaintiffs' "preference" for certain investment options and record-keeping arrangements. Before turning to the specific claims, the Seventh Circuit characterized plaintiffs' 287 paragraph complaint as "massive" and observed that the majority of the allegations complained about common plan practices not specific to the defendants or the plans, including paying record-keeping fees through revenue sharing and the offering of a wide range of investment options.

Turning first to the "bundled service agreement" claim, the Court concluded that the complaint itself undermined plaintiffs' claim that the plan fiduciaries breached their duties by entering into this agreement because the complaint acknowledged that one of the plans' best investment options, a traditional annuity, would not have been available absent the bundled service agreement. The Court also explained that nothing in the plans required participants to invest in the purportedly underperforming products and, moreover, plaintiffs failed to evaluate the decision to enter into a bundled service agreement against a relevant standard. Rather than allege what a "hypothetical prudent fiduciary" would have done differently, the complaint merely criticized Northwestern for making a rational business decision. The challenge to specific options included under the agreement also failed because, according to the Court, "it would be beyond the court's role to seize ERISA" as a means to eliminate those options disfavored by individual litigants where the plans also included the lower-cost, conservative options they preferred.

Turning next to plaintiffs' record-keeping fees claim, the Court explained that ERISA does not require (i) a plan to negotiate a record-keeping agreement that charges a fixed per-participant fee (as opposed to the asset-based agreement negotiated by Northwestern), or (ii) a plan to have one record-keeper or mandate a specific record-keeping arrangement. Furthermore, plaintiffs did not explain how it was better to have a fixed per participant fee and conceded that the plans had "valid reasons" for maintaining multiple record-keepers, including that doing so allowed the plans to include the various options preferred by participants.

The Court then addressed plaintiffs’ claim that plan fiduciaries breached their duties by offering an investment lineup that contained an excessive number of expensive, underperforming options. The Court concluded that, even if plaintiffs were correct that the plans offered retail share class options with “layers of fees,” this was not in and of itself sufficient to sustain a claim because plaintiffs failed to allege that the plans omitted their preferred low-cost index fund alternatives. The Court also held that “the ultimate outcome of an investment is not proof of imprudence” and plan fiduciaries “may generally offer a wide range of investment options and fees without breaching any fiduciary duty.”

In reaching these conclusions, the Court briefly commented on plaintiffs’ reliance on the Third Circuit’s decision in *Sweda v. Univ. of Penn.*, No. 17-3244, 2019 WL 1941310 (3d Cir. May 2, 2019) and, in particular, plaintiffs’ argument that the Third Circuit held that plan fiduciaries cannot satisfy their obligations by simply offering a wide range of investment options. The Seventh Circuit observed that the Third Circuit’s ruling merely held that offering a wide range of investment options in and of itself did not insulate fiduciaries from misconduct and that, in addition to evaluating the plan as a whole, courts must also consider the prudence of the challenged actions. Without assessing the specific allegations at issue in *Sweda*, the Seventh Circuit stated that the Third Circuit’s approach was “sound.”

Lastly, the Court held that plaintiffs’ prohibited transaction claims were properly dismissed because they were simply repackaged imprudence claims, and agreed with the district court that a jury trial would not be permissible for the claims asserted even if the case had proceeded.

Proskauer’s Perspective

The Seventh Circuit's ruling in *Divane* appears to create a circuit split with the Third Circuit's ruling in *Sweda*. Although the Seventh Circuit purported to agree with the framework applied by the Third Circuit, the fact remains that many of the allegations in the case against the University of Pennsylvania that were allowed to proceed were nearly identical to those asserted against Northwestern and dismissed. For instance, in both cases, plaintiffs claimed that the plans entered into a bundled service arrangement with the same record-keeper; paid unreasonable administrative fees by using two record-keepers; paid fees through an asset-based arrangement; offered numerous duplicative investment options; and retained expensive, underperforming funds, with many of the funds at issue being identical. Not surprisingly, the University of Pennsylvania contended that the Seventh Circuit's opinion opened a split in the Circuits, and filed a supplemental brief in support of its petition for certiorari with the Supreme Court. The Supreme Court, however, declined to accept the case for review.

If the rationale applied by the Seventh Circuit becomes the prevailing view, it will create good opportunities for Plan sponsors and fiduciaries to prevent or defend future lawsuits challenging the administration of 401(k) and 403(b) plans. To begin with, the case recognizes that the decision to offer a particular investment alternative is less likely to be assailable when other investment alternatives are offered with comparable investment strategies. Secondly, the decision presents the opportunity for eliminating lawsuits of this type in the early stages, and thereby preventing discovery into the prudence of the decision-making process, based on the complaint's failure to plead with plausibility that the challenged practices were different from what a "hypothetical prudent fiduciary" would have chosen.

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