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# 2 ERISA Rulings Highlight Need for Different Defense Tactics

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Albert Einstein is famously credited with saying, "Insanity is doing the same thing over and over and expecting different results." This adage comes to mind as defense counsel continue to resort to the same strategies for seeking dismissal of 401(k) and 403(b) plan investment complaints, notwithstanding increasingly discouraging results.

The discouraging trend is encapsulated by the U.S. Court of Appeals for the Ninth Circuit's recent back-to-back decisions allowing a commonly asserted breach of fiduciary duty claim — that the plan should have been invested in a cheaper share class of a mutual fund — to survive dismissal

In so ruling, the Ninth Circuit joined the U.S. Courts of Appeals for the Second, Third and Eighth Circuits in refusing to consider at the pleadings stage arguments that the factual allegations supporting these claims were demonstrably false, and/or that there was an obvious, industry-accepted reason for the alleged misconduct.[1]

It also comes on the heels of the U.S. Supreme Court's Jan. 24 ruling in Hughes v. Northwestern University,[2] which reversed and remanded the dismissal of similar claims, albeit on different grounds.

Pending an opportunity for renewed consideration by the Supreme Court, the defense bar should consider whether, in appropriate circumstances, there are other potential strategies available to prevent these lawsuits from consuming their clients' — and their insurance carriers' — resources, and ultimately coercing them into class action settlement payments that are disproportionate to the merits of the underlying claims.

**The Defense Strategy Rejected by the Ninth Circuit**

The Ninth Circuit's decisions earlier this month in Davis v. Salesforce.com Inc.[3] and Kong v. Trader Joe's Co.[4] are the latest examples of courts rejecting the common strategy for seeking dismissal of excessive fee claims at the pleadings stage by presenting alternative explanations for the alleged misconduct.

This strategy has most frequently been deployed in response to claims that allege, without more, that the plans imprudently offered share classes of mutual funds that have higher published fees — commonly referred to as expense ratios — when identical lower fee share classes of the same funds were available.

In support of their motions to dismiss, defendants frequently explain that the complaints are deficient because they fail to contain allegations that would disprove the common and well- accepted explanation that the higher fee share class funds generate revenue share.

Revenue share is a payment made by the mutual fund company to the plan record-keeper in exchange for the record-keeper providing services that would otherwise be the responsibility of the mutual fund company.

Such services might include keeping track of participants' shares of the fund and conveying legally required information about the mutual funds to the plan participants.

In many cases, the plan and the record-keeper agree that all, or a portion of, the revenue share paid by the mutual fund will be used to defray the record-keeper's fees for administrating the plan.

This may effectively reduce the net fees borne by participants to an amount below the fees associated with share classes that do not have a revenue share component.

Similarly, defendants have contended that bare-boned claims of paying excessive fees for actively managed funds, or excessive record-keeping fees, are unsustainable because they fail to allege a basis for disproving that the managers and record-keepers perform services that justify the higher fees.

For example, actively managed funds tend to have higher published fees because of the additional work required to create and implement investment strategies that are designed to outperform the market.

In many of these cases, defendants have also challenged at the motion to dismiss stage alleged factual premises for the claims that are demonstrably inconsistent with known, documented facts.

These arguments are supported by the Supreme Court's recognition in its 2009 Ashcroft v. Iqbal decision[5] and 2007 Bell Atlantic Corp. v. Twombly decision[6] that a complaint cannot withstand a motion to dismiss if the alleged unlawful conduct is just as much in line with a defendant's lawful alternative explanation for the conduct.

In fact, in Hughes, the Supreme Court instructed the lower courts to apply Iqbal and Twombly's pleading standard to Employee Retirement Income Security Act breach of fiduciary duty cases.

Both before and after Hughes, however, many courts have ruled that, to state a viable claim under ERISA, plaintiffs are not required to rule out every possible alternative explanation a fiduciary defendant may assert, and that discovery is required to determine whether the fiduciary defendant's alternative explanation has merit.

On the strength of this rationale, courts more often than not have been refusing to consider at the pleadings stage even the most obvious explanations for the challenged conduct.

The results in Davis highlight the plaintiff-friendly trajectory that appears to have emerged.

Before the Ninth Circuit's ruling, the U.S. District Court for the Northern District of California ruled twice that the plaintiffs' share-class claim did not meet the plausibility standard.

In so ruling, the court:

- Accepted the defendants' judicially noticeable documents that showed the plaintiffs' complaint contained factual errors, including the assertions that there were multiple cheaper share classes available, and that the plan never invested in the cheapest share class during the class period; and
- Gave weight to the "obvious alternative explanation" that more expensive share classes were selected when they paid revenue sharing that was in turn used to offset record-keeping and administrative

In reversing the district court ruling, the Ninth Circuit held that it was inappropriate to consider, on a motion to dismiss, the judicially noticed documents that unequivocally disproved some of the plaintiffs' allegations.

The Ninth Circuit also refused to consider the defendants' alternative explanations at the pleadings stage, quoting its 2011 ruling in Starr v. Baca to explain that when "there are two alternative explanations, one advanced by defendant and the other advanced by plaintiff, both of which are plausible, plaintiff's complaint survives a motion to dismiss under Rule 12(b)(6)."

The Ninth Circuit reached the same result one week later in Kong.

**The Ominous Consequences of an Unsuccessful Defense Strategy**

The Ninth Circuit rulings are just the latest in a disturbing trend in favor of lax scrutiny of even the most bare-boned ERISA fiduciary breach claims.

From the perspective of plan sponsors and fiduciaries, the adverse implications of this trend cannot be overstated. Since 2015, hundreds of complaints have been filed against them.

Many of these complaints, often copycats of prior filings by the same plaintiffs firm, contain egregious factual errors and fail to address the obvious reasons for the alleged misconduct.

Defendants have filed motions to dismiss in nearly every one of these cases, with the overwhelming majority of the complaints withstanding dismissal in whole or in part.

Unfortunately, as a practical matter, even a partial dismissal will leave the plan defendants with the equally poor choice of expending millions of dollars to defend the case through discovery, and possibly through trial if they cannot prevail on summary judgment, or to settle for a sum that may be less than the anticipated defense cost, but still substantial. In most cases, they have chosen the latter course.

The cumulative results are staggering. By surviving motions to dismiss, plaintiffs have generated over $1 billion in recoveries through settlement, with over $350 million of the proceeds earmarked for attorney fees.[7]

Thus far, the cost of litigation and settlement has been borne primarily by fiduciary liability insurance carriers, but, looking into the future, one must wonder whether plan sponsors and fiduciaries will be able to procure adequate insurance if these trends continue.

**The Need for a Fresh Look at Alternative Defense Strategies**

Motions to dismiss ERISA defined contribution plan investment litigations have generally been viewed as a given. The motions are prompted by the understandable concern over mounting defense costs once the case proceeds to discovery.

In some jurisdictions, where there are still meaningful prospects of prevailing, the motion to dismiss may still be the best alternative. But in many jurisdictions, prior adverse precedents may now militate in favor of alternative approaches.

For starters, it is not necessarily a forgone conclusion that passing on a motion to dismiss will open the floodgates to expensive discovery.

Federal Rule of Civil Procedure 56 allows a summary judgment motion to be filed at any time until 30 days after discovery ends, and there is no prohibition in Rule 56 on filing a subsequent motion for summary judgment at the conclusion of all discovery if the prior motion does not succeed — although local rules should be reviewed on the filing of multiple summary judgment motions.

There are limited, but helpful, examples of courts authorizing and considering early summary judgments in ERISA defined contribution plan investment cases, following limited discovery, when the motions are directed at discrete issues that could resolve key portions of the case — such as standing or statute of limitations defenses.

Significantly, unlike on a motion to dismiss, a court adjudicating a motion for summary judgment should be more willing to consider documentary or testimony evidence that is not genuinely disputed.

Defense counsel should look more expansively for opportunities to proceed with an early motion for summary judgment following limited, targeted discovery. These opportunities can be pursued at an initial scheduling conference.

Alternatively, defense counsel could consider filing a motion for summary judgment in response to the complaint, in lieu of a motion to dismiss.

Pursuant to Rule 56(d), a plaintiff may be afforded an opportunity to take discovery before responding to the motion, but that discovery should be narrowly tailored to the issues presented in the motion.

Whether an early summary judgment strategy is warranted will depend on the facts and circumstances of the particular case. But in appropriate cases, it could prove to be a more effective means to dismiss the lawsuit — in whole or substantial part — before defendants face the pressures to settle at an excessive price.

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[1] See Kong v. Trader Joe's Co., 20-56415, 2022 WL 1125667 (9th Cir. Apr. 15, 2022); Davis v. Salesforce.com, Inc., No. 21-15867, 2022 WL 1055557 (9th Cir. Apr. 8, 2022); Sacerdote v. N.Y. Univ., 9 F.4th 95, 107-11 (2nd Cir. 2021); Davis v. Wash. Univ. in St. Louis, 960 F.3d 478, 483-84 (8th Cir. 2020); Sweda v. Univ. of Pa., 923 F.3d 320, 331-333 (3d. Cir. 2019).

[2] Hughes v. Northwestern University, 142 S. Ct. 737 (2022).

[3] Davis, No. 21-15867, 2022 WL 1055557 (9th Cir. Apr. 8, 2022).

[4] Kong, No. 20-56415, 2022 WL 1125667 (9th Cir. Apr. 15, 2022).

[5] Ashcroft v. Iqbal, 556 U.S. 662 (2009).

[6] Bell Atlantic Corp. v. Twombly, 550 U.S. 544 (2007).

[7] Tulio D. Chirinos, Robert Rachal, Myron Rumeld, & Kyle Hansen, ERISA Fee and Investment Litigation – 2021 Developments and Best Practices to Mitigate Risk Risks – Vol. 35 No. 1 Ben. L.J. 21, notes 15-16 (Spring 2022); Tulio D. Chirinos, Robert Rachal, Myron Rumeld, & Kyle Hansen, Fee and Investment Litigation 2015-2020: Five Year Review of Developments and Best Practices to Mitigate Risks – Part 1, Vol. 34 No. 1 Ben. L.J. 21, note 7 (Spring 2021).

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