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Sixth Circuit Upholds Dismissal of Some Investment Fee and Performance Claims But Allows Mutual Fund Share Class Claim to Proceed to Discovery

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The Sixth Circuit recently issued a mixed opinion in a 401(k) plan investment litigation. The Court upheld the dismissal of the plaintiffs' fiduciary-breach claims relating to the investment management fees and performance of several of the plan's investment options, but reinstated a claim for breach of fiduciary duty based solely on the plan fiduciaries' alleged failure to offer less expensive "institutional" share classes of mutual funds.

Plaintiffs were former TriHealth, Inc. employees who sued the company in the U.S. District Court for the Southern District of Ohio, alleging that the TriHealth 401(k) plan fiduciaries breached their duties of prudence and loyalty in connection with plan management. In particular, plaintiffs claimed that the fiduciaries violated the duty of loyalty in choosing investments that benefited third-party investment managers, and the duty of prudence by allowing the plan to pay excessive fees, selecting and retaining investment options that were expensive and underperformed relative to alleged alternatives, and offering "retail" shares of seventeen mutual funds despite the availability of less expensive "institutional" shares of the same funds.

Last year, TriHealth successfully moved to dismiss the complaint. The district court held that plaintiffs failed to plausibly allege that TriHealth acted imprudently with respect to any of their claims.

The Sixth Circuit affirmed the dismissal of most of the claims consistent with its recent decision in *Smith v. CommonSpirit Health*, No. 21-5964, 2022 WL 2207557 (6th Cir. June 21, 2022), which we discussed in a recent post. First, as to plaintiffs' claims that the plan's "average plan expenses" were excessive, the Court held that the claims failed because plaintiffs failed to plead that these fees were high relative to the services provided or that the fees could not be justified by the plan's strategic goals. Second, the Court rejected plaintiffs' identification of alleged "available alternatives in the same investment style" as insufficient to plausibly plead imprudence; the plaintiffs were required to show that these cheaper and better performing alternatives were otherwise equivalent to the challenged funds in order to justify the inference that plan fiduciaries used an imprudent process in selecting and retaining them. Third, with respect to their disloyalty claim, plaintiffs failed to allege the "fiduciary's operative motive was to further its own interests."

But the Sixth Circuit reversed as to the share class claim, holding that plaintiffs stated a plausible claim of imprudence related to TriHealth's failure to offer the cheapest share class for certain mutual funds. The plaintiffs showed that many of the plan's mutual funds offered a cheaper, but otherwise identical share class to larger investors, for which the plan—with nearly half a billion dollars in assets—was large enough to qualify. The Court held that "these allegations permit the reasonable inference that TriHealth failed to exploit the advantages of being a large retirement plan that could use scale to provide substantial benefits to its participants." The Sixth Circuit noted that facts learned in discovery—such as the existence of revenue sharing arrangements lowering the retail shares' fees, or facts showing the plan was ineligible for the institutional shares—could disprove these claims, but that "at the pleading stage, it is too early to make these judgment calls." The Court also held that, in this context, plaintiffs need not specifically allege facts showing the institutional share class is in fact a meaningful benchmark, because "this claim has a comparator embedded in it," and that any explanations for retail shares' underperformance fail because the higher fees of otherwise identical funds "guarantee[] worse returns."

Proskauer's Perspective

In reversing the dismissal of the share class claim, the Sixth Circuit joined the Second, Third, Eighth, and Ninth Circuits in allowing imprudence claims based on share class differentials to overcome motions to dismiss. The decision serves as notice to plan fiduciaries that, at least in these circuits, offering anything but the lowest share class of a mutual fund in a 401(k) plan—even if defendants can provide a reasonable explanation for doing so—all but guarantees that in litigation this claim will proceed to discovery. If fiduciaries find themselves facing this claim in one of these circuits, they should consider the prospects of staging discovery in a fashion that will facilitate an early motion for summary judgment following targeted narrow discovery on the rationale for offering the more expensive share class.

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