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MEMORANDUM

TO: Defined Contribution Plan Clients
CC: Investment Consultant
FROM: Saltzman & Johnson Law Corporation
DATE: December 13, 2022
RE: Duty of Prudence and Monitoring Investments and Fees following *Hughes v. Northwestern Univ*.

This memorandum follows our February 16, 2022 memorandum which reported on the Supreme Court ruling in *Hughes v. Northwestern University*, 2022 U.S. Lexis 622, 142 S.Ct. 737 (Jan. 24, 2022) ("*Hughes*"). In *Hughes*, the plaintiffs, plan participants, alleged that the Trustees violated their duty of prudence[1] by offering needlessly expensive investment options and paying excessive recordkeeping fees. The Seventh Circuit dismissed plaintiffs' claims, finding that the claims failed because the types of funds that plaintiffs wanted – low-cost index funds – were among the over 400 different options available. Given the hundreds of pending cases involving similar claims with defined contribution retirement plans, the hope was that the Supreme Court would affirm a heightened pleading standard, or at the very least provide clarity on what the applicable pleading standard should be for bringing a claim of fiduciary imprudence in these circumstances. Instead, the Supreme Court held that the Seventh Circuit's reasoning was too narrow, finding that just because some funds were appropriate did not mean that "[plaintiffs] could not complain about the flaws in other options." The Court vacated the Seventh Circuit's decision and remanded for further proceedings so that the plaintiffs' allegations could be reevaluated.

The following reported cases[2] cited the *Hughes* case in the orders on dispositive motions:

Cases Where Dispositive Motions Granted/Affirmed

Gonzalez v. Northwell Health, Inc., 2022 U.S. Dist. LEXIS 180110 (E.D.N.Y. Sept. 30, 2022) – District court granted defendants' motion to dismiss as to imprudent retention and excessive fee claims. Plaintiffs alleged that defendants allowed the plan to be charged excessive recordkeeping fees and imprudently retained investment options in plan's investment menu. The court found that plaintiffs pled relatively modest underperformance by

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[1] ERISA requires plan fiduciaries to act "solely in the interest of [plan] participants … for the exclusive purpose of (i) providing benefits to participants … and (ii) defraying reasonable expenses of administering the plan[.]" ERISA §404(a)(1)(A); 29 U.S.C. §1104(a)(1)(A). ERISA also requires plan fiduciaries to discharge their duties "with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of like character and with like aims." ERISA §404(a)(1)(B); 29 U.S.C. §1104(a)(1)(B). To evaluate whether a plan fiduciary has breached their fiduciary duty of prudence, courts focus "not only on the merits of the transaction, but also on the thoroughness of the investigation into the merits of the transaction." *Howard v. Shay*, 100 F.3d 1484 (9th Cir. 1996).

[2] There are many other pending cases that are proceeding in different courts but do not yet have any reported decisions. *See e.g., Justin Beldock, et al. v. Microsoft Corp*. (W.D. Wash); *Andre Hall, et al. v. Capital One Financial Corp*. (E.D. Va.); *Peter Trauernicht, et al. v. Genworth Financial* (E.D. Va.); *Michael Tullgren, et al. v. Booz Allen Hamilton Inc*. (E.D. Va.)

actively managed funds, compared only to index funds, over a relatively short period of time, and without putting forth any other indicia of imprudence. As for the excessive fees claims, the court found that the general allegations that a large plan should only be paying $30 to $35 per participant was not sufficient.

Perrone v. Johnson & Johnson, 48 F.4th 166 (3rd Cir. Sept. 7, 2022) – Third Circuit affirmed district court's grant of motion to dismiss. Plaintiffs, J&J employees who participated in Employee Stock Ownership Plan that invested solely in J&J stock, alleged that J&J plan administrators violated their duty of prudence. Plaintiffs alleged that J&J corporate insiders should have known that a stock price drop would occur once a baby powder controversy went public, and should have taken action to lessen that drop in stock price. The court found that the allegations failed the *Dudenhoeffer* test.

Mator v. Wesco Distrib., 2022 U.S. Dist. LEXIS 147802 (W.D. Pa. Aug. 18, 2022) – District court granted defendants' motion to dismiss. Plaintiffs alleged that defendants failed their duty of prudence as they did not evaluate fees or monitor costs assessed to the plan. The court found that plaintiffs presented only conclusory allegations regarding services with no particularity as to the quality of the services.

Smith v. CommonSpirit Health, 37 F.4th 1160 (6th Cir. June 21, 2022) – Sixth Circuit affirmed district court's grant of motion to dismiss. The court found that defendants' offering of actively managed funds in mix of investment options was reasonable, and that plaintiffs failed to offer any evidence that offered investments were imprudent. The court also found that plaintiffs' claim of excess fees failed because they did not allege that fees were excessive relative to services rendered.

Albert v. Oshkosh Corp., 47 F.4th 570 (7th Cir. Aug. 29, 2022) – Seventh Circuit upheld district court's grant of motion to dismiss. The court found that plaintiffs failed to state a claim of breach of prudence and loyalty as to plan's payment to investment advisor because there was no comparison between fees paid to advisor and fees paid to other service providers. The court noted that plaintiffs failed to identify any comparator investment advisors or allege that advisor charged unreasonable fees in light of available alternatives.

Evans v. Associated Banc-Corp., 2022 U.S. Dist. LEXIS 178430 (E.D. Wi. Sept. 30, 2022) – District court granted defendants' motion to dismiss. Plaintiffs, participants to company's 401k and ESOP plans, claimed defendants breached fiduciary duties of prudence, loyalty and monitoring. The court found that plaintiffs' allegations that defendants failed to employ a prudent and loyal process for selecting, monitoring and reviewing the plan's investment options, by improperly prioritizing proprietary investments over superior available options, were insufficient as the allegations were only based on short-term performance, the proprietary funds only numbered 8 out of 34 funds offered, and there were not enough facts to show that the purported comparator funds were truly comparable.

Baumeister v. Exelon Corp., 2022 U.S. Dist. LEXIS 176711 (N.D. Ill. Sept. 22, 2022) – District court granted defendants' motion to dismiss with leave to amend. Plaintiffs alleged a single count of breach of fiduciary duty based on excessive fees. The court found that plaintiffs fail to allege facts to plausibly state a claim for breach based upon selected comparator data similar to the *Albert* case above.

O'Driscoll v. Plexus Corp., 2022 U.S. Dist. LEXIS 150844 (E.D. Wi. Aug. 23, 2022) - District court granted defendants' motion to dismiss. Plaintiffs alleged plan's fees were excessive in comparison with other comparable 401k plans, and that defendants breached their duty to monitor those fees. The court did not address

the excessive fees claims under the pleading standard because it found that the name plaintiff did not have standing to asset those claims given her actual investments in the plan. The court then found that defendants were not required to disclose fees to charged to the plan investments with the level of detail sought by plaintiffs.

Matousek v. MidAmerican Energy Co., 2022 U.S. App. LEXIS 28271 (8th Cir. Oct. 12, 2022) – Eighth Circuit affirmed district court's grant of defendants' motion to dismiss. Plaintiffs alleged that defendants violated duty of prudence by saddling participants with unreasonably high costs and low-quality investments. The court found that these claims were properly dismissed because plaintiffs failed to identify better alternatives or plead meaningful benchmarks for assessing the performance of the challenged funds.

Riley v. Olin Corp., 2022 U.S. Dist. LEXIS 109423 (E.D. Mo. June 21, 2022) – District court granted defendants' motion to dismiss. Plaintiffs alleged breaches of the duties of prudence, loyalty and monitoring because defendants failed to adequately monitor recordkeeping expenses, failed to prudently select investment options because of excessive investment fees, and retained at least one underperforming fund in the plan. The court found that revenue sharing as the basis for fees is not imprudent per se, and that plaintiffs failed to put forth meaningful benchmark against which to compare expenses or fees.

Matney v. Barrick Gold of N. Am., Inc., 2022 U.S. Dist. LEXIS 73479 (D. Utah April 21, 2022) - District court granted defendants' motion to dismiss. Plaintiffs alleged breaches of fiduciary duties of loyalty, prudence and monitoring relating to costs of investment options and administrative recordkeeping fees. The court found that plaintiffs did not state a plausible claim as allegations focused on handful of funds and small window of time, and relied on comparisons of dissimilar investment options.

Cases Where Dispositive Motions Granted In Part and Denied In Part

Lauderdale v. NFP Ret., Inc., 2022 U.S. Dist. LEXIS 26397 (C.D. Cal. Feb. 8, 2022) - District court granted in part and denied in part motions to dismiss. The case concerns the management of the Wood 401k plan. Wood Group Management was the plan sponsor and administrator until June 2016, Wood Group U.S. was the plan sponsor and administrator since June 2016. Wood Committee was responsible for selection, monitoring and removal or plan investments and service providers, including the investment consultant. NFP was the investment consultant, and flexPath Strategies was the plan's discretionary investment manager. Plaintiffs alleged claims for breach of fiduciary duties related to selection of target date funds, the use of higher-cost versions of plan investments, and the failure to monitor fiduciaries. The Wood Defendants, NFP and flexPath Strategies filed separate motions to dismiss. The court found that plaintiffs have sufficiently alleged claims against the Wood Defendants as to the selection and retention of target date funds as well as certain higher cost investments. The court also found that the claims against the Wood Defendants regarding the imprudence in investing in higher costs products, and failing to monitor other fiduciaries, were sufficient. With NFP's motion to dismiss, the court found the claims for NFP's direct responsibility for the selection of investment fund was insufficient, but that the claims for breach of prudence regarding selection/retention of target date funds were sufficient. FlexPath's motion to dismiss was denied as the court found that plaintiffs sufficiently pled the claim for breach of prudence as to the selection and retention of target date funds.

Smith v. Shoe Show, Inc. 2022 U.S. Dist. LEXIS 33823 (M.D. N.C. Feb. 25, 2022) – District court granted in part and denied in part defendants' motion to dismiss. The court found that plaintiffs sufficiently alleged a claim for failure to reduce recordkeeping fees and that the allegations showed that the fees were excessive in

comparison to the services provided. The court also found that plaintiffs sufficiently alleged that defendants breached their duty of prudence by offering funds featuring overly expensive retail share classes. The court then found that plaintiffs failed to identify a meaningful benchmark and therefore did not sufficiently plead the claim that defendants should have offered passive funds. The court held that plaintiffs sufficiently pled their claim of failure to monitor and control investment and administrative costs on an ongoing basis.

Forman v. TriHealth, Inc., 40 F.4th 443 (6th Cir. July 13, 2022) – Sixth Circuit affirmed in part and reversed in part district court's grant of motion to dismiss. The court found that plaintiffs' claim that the plan's average plan expenses were almost twice as high as other comparable plans was insufficient because plaintiffs failed to allege that the fees were high in relation to the services provided. The court also held that plaintiffs' claims regarding alternative investment products that charged lower fees were insufficient because plaintiffs did not allege alternatives were otherwise equivalent to selected funds. The court held that plaintiffs had sufficiently pled that the plan violated its duty of prudence by offering pricier retail shares of mutual funds when those same investment management companies offered less expensive institutional shares of the same funds to other plans.

Coyer v. Univar Sols. USA Inc., 2022 U.S. Dist. LEXIS 175972 (N.D. Ill. Sept. 28, 2022) – District court granted in part and denied in part motion to dismiss. Plaintiffs alleged that defendants failed to fully disclose plan expenses and risks, allowed unreasonable expenses to be charged to participants, and selected, retained and ratified high-cost and poorly performing investments. Plaintiffs further alleged that defendants failed to adequately monitor committee members as they conducted their fiduciary duties. The court found that plaintiffs sufficiently alleged their claims as to excessive fees, but that their allegations as to the selection and retention of investment products were not sufficient.

Nohara v. Prevea Clinic Inc., 2022 U.S. Dist. LEXIS 150838 (E.D. Wi. Aug. 23, 2022) - District court granted in part and denied in part motion to dismiss. Plaintiffs alleged that the plan's fees were excessive when compared to other comparable 401k plans, that defendants failed to regularly monitor fees, failed to engage in an objectively reasonable process in selecting funds, and failed to fully disclose fees charged to plan investments in quarterly statements and disclosure documents. The court found that plaintiffs had sufficient alleged claims as to the unreasonable fees and high cost investment products. The court granted the motion to dismiss as to the disclosure claims as it found that defendant were not required to disclose fees charged to plan investments with the level of detail sought by plaintiffs.

Laabs v. Faith Techs., Inc., 2022 U.S. Dist. LEXIS 150836 (E.D. Wi. Aug. 23, 2022) - District court granted in part and denied in part motion to dismiss. The court dismissed plaintiffs' claims of breaches of the duty of loyalty and prudence based on defendants' alleged failure to disclose revenue-sharing arrangement, but kept in place plaintiffs' claims for breach of duty of prudence and monitoring based on defendants' failure to shop for or negotiate recordkeeping fees, or to follow a prudent process in selecting recordkeeper and offering higher-cost actively managed investments.

Walter v. Kerry Inc., 2022 U.S. Dist. LEXIS 95367 (E.D. Wi. May 27, 2022) - District court granted in part and denied in part motion to dismiss. The court found that plaintiffs had sufficiently pled breach of fiduciary duty of prudence as evidence established damages, and therefore claim of breach of duty to monitor other fiduciaries also survived. The court held that the claim for breach of the duty of loyalty failed because it contained no allegations of self-dealing.

Woznicki v. Aurora Health Care, Inc., 2022 U.S. Dist. LEXIS 95368 (E.D. Wil. May 27, 2022) - District court granted in part and denied in part motion to dismiss. Plaintiffs alleged that defendant breached their fiduciary duties to participants when they allowed participants to suffer exorbitant recordkeeping fees. The court found that plaintiffs plausibly alleged breaches of the duty of prudence and monitoring other fiduciaries, but failed to sufficiently pled the claims for breaches of the duty of loyalty and disclosure.

Rodriguez v. Hy-Vee, Inc., 2022 U.S. Dist. LEXIS 200906 (S.D. Iowa Oct. 21, 2022) - District court granted in part and denied in part motion to dismiss. Plaintiffs alleged that participants paid too much in recordkeeping fees and that plan included investment options with excessive investment management fees. The court found that plaintiffs provided meaningful benchmark against which the recordkeeping fees could be compared and thus those claims were sufficiently pled. However, the court then held that plaintiffs did not provide a meaningful benchmark for the allegedly excessive investment management fees so those claims were dismissed.

Anderson v. Coca-Cola Bottlers' Assn., 2022 U.S. Dist. LEXIS 589 LEXIS 58942 (D. Kan. Mar. 30, 2022) - District court granted in part and denied in part motions to dismiss. Plaintiffs alleged that defendants breached their fiduciary duty of prudence under ERISA by allowing the Plan to offer investment options that charged excessively high costs as a percentage of the amount invested in that product. Plaintiff also alleged that defendants breached their duty of prudence by allowing the plan to pay excessive direct fees to the plan's recordkeeper. Plaintiff also claimed that defendants breached their duty of loyalty by allowing the plan to include investment options offered by Wells Fargo, the recordkeeper. The court found that plaintiffs had alleged more than the mere availability of better investment options, and provided a meaningful benchmark. The court then held that plaintiffs failed to plead sufficient facts to state the claim relating to excessive fees as plaintiffs did not provide any details on the services provided or what a reasonable payment would have been or identified another company that would have performed the same services for less.

<u>Cases Where Dispositive Motions Denied</u>

Vellali v. Yale University, 2022 U.S. Dist. LEXIS 192235 (D. Conn. Oct. 21, 2022) – District court denied defendants' summary judgment motion. Plaintiffs plan participants claimed that defendants breached their duty of prudence by failing to employer strategies and procedures that would lower recordkeeping fees. Plaintiffs further alleged that defendants breached their duty to monitor the plan's investments and remove imprudent investments. The court found that there were genuine issues of material fact as to whether defendants breached their fiduciary duty to monitor and avoid unreasonable recordkeeping fees with respect contentions that defendants imprudently: (i) delayed consolidating to a single recordkeeper, (ii) failed to obtain competitive bids, (iii) used asset-based pricing, and (iv) failed to prohibit TIAA for cross-selling. The court also stated that there were genuine issues as to whether the plan sustained damages due to these alleged actions. The court also denied summary judgment as to the failure to monitor claims, finding that there were genuine issues of material facts given that plaintiffs alleged: (i) the plan initially only had one individual responsible for monitoring over 100 funds; (ii) defendants' investment review process consisted of annually revising reports from its recordkeepers about their products with no written criteria for those investments; (iii) defendant should have offered lower-cost share classes of investments earlier, and (iv) defendant failed to follow a prudent process to evaluate and remove underperforming investments.

Kohari v. MetLife Group, Inc., 2022 U.S. Dist. LEXIS 136505 (S.D.N.Y. Aug. 1, 2022) – District court denied defendants' motion to dismiss. Plaintiffs alleged that defendants breached their fiduciary duty by applying

an imprudent and disloyal preference for selecting and retaining MetLife proprietary index fund products to offer to plan participants despite their poor performance and high costs in comparison to similar investment products in the marketplace. Plaintiffs further alleged that defendants failed to monitor and evaluate the performance of the investment committee or have a system in place to do so.

Garthwait v. Eversource Energy Co., 2022 U.S. Dist. LEXIS 134892 (D. Conn. July 29, 2022) – District court denied defendants' summary judgment motion. The court also denied both parties' motions to preclude expert witnesses. Plaintiffs alleged that defendants' monitoring processes were not reasonable, and defendants' breached their duty of loyalty. The court noted that there were genuine issues of material fact as to those claims.

Carrigan v. Xerox Corp., 2022 U.S. Dist. LEXIS 70428 (D. Conn. April 18, 2022) – District court denied defendants' motion to dismiss. Plaintiffs alleged that defendant breached their duty of loyalty and prudence by causing the plan to pay excessive recordkeeping fees to recordkeepers affiliated with the plan sponsor, and breached their duty to monitor the committee's administration of the plan. The court found that plaintiffs had sufficiently pled those claims.

Berkelhammer v. Automatic Data Processing, Inc., 2022 U.S. Dist. LEXIS 150967 (D.N.J. Aug. 23, 2022) – District court denied defendants' motion to dismiss. Plaintiffs in multi-employer pension plan sufficiently alleged breach of duty of prudence claims related to excessive recordkeeping fees and management fees, and offering of poor performing investment options over unreasonable period of time without consideration of better performing alternatives.

Moler v. Univ. of Md. Medical System, 2022 U.S. Dist. LEXIS 124804 (D. Md. July 13, 2022) – District court denied defendants' motion to dismiss, finding that plaintiffs had alleged sufficient facts to support claim of imprudence. The court noted that plaintiffs alleged well pled facts regarding performance of chosen funds in comparison to less expensive funds, and superior performance of less expensive choice. The court further stated that plaintiffs alleged comparable benchmark upon which to analyze performance of stable value fund.

Turpin v. Duke Energy Corp., 2022 U.S. Dist. LEXIS 17160 (W.D. N.C. Jan. 31, 2022) – District court denied defendants' motion to dismiss. The court held that plaintiffs sufficiently alleged that defendants failed to prevent excessive recordkeeping and account management fees, and failed to adequately monitor expenses charged to participants.

Parker v. GKN N. Am. Servs., 2022 U.S. Dist. LEXIS 154358 (E.D. Mich. Aug. 26, 2022) – District court denied motion to dismiss. Plaintiffs alleged that retirement plan provided by Prudential Insurance Company violated duty of prudence, loyalty and monitoring. The court found that plaintiffs had sufficiently alleged that defendants had breached duty by failing to investigate and select lower cost alternative funds and by retaining imprudent plan investments.

Bangalore v. Froedtert Health, 2022 U.S. Dist. LEXIS 13864 (E.D. Wi. Jan. 26, 2022) – District court denied motion to dismiss without prejudice. Plaintiffs alleged that defendants had violated the duties of loyalty and prudence by, among other things, failing to monitor fees and ensure that they were reasonable, failing to monitor investments to ensure that they were prudent, failing to monitor the committee in charge of the plan and engaging in prohibited transactions. Defendants' motion to dismiss relied primarily on *Divane v. Northwestern University*, 953 F.3d 980 (7th Cir. 2020) which was overruled by the *Hughes* ruling.

Shaw v. Quad/Graphics, Inc., 2022 U.S. Dist. LEXIS 13861 (E.D. Wi. Jan. 26, 2022) - District court denied motion to dismiss without prejudice in similar circumstances as *Bangalore* case cited above.

Kong v. Trader Joe's Co., 2022 U.S. App. LEXIS 10323 (9th Cir. April 15, 2022) – Ninth Circuit reversed district court's grant of defendants' motion to dismiss. The court found that plaintiffs plausibly alleged a failure to provide cost-effective investments with reasonable fees. Taking the allegations as true at the early stage of litigation, the court found that plaintiffs sufficiently pled that defendants failed to monitor and control offering of a number of mutual funds in the form of retail share classes that carried higher fees than those charged by otherwise identical institutional share classes of the same investments.

Reichert v. Juniper Networks, Inc., 2022 U.S. Dist. LEXIS 76599 (N.D. Cal. April 27, 2022) – District court denied defendants' motion to dismiss. Plaintiffs alleged that defendants breached their duty of prudence by paying unreasonably high fees for plan services, choosing high-priced investments over options with lower costs and better returns, not monitoring the plan adequately, and not disclosing plan information to participants. The court found that plaintiffs plausibly alleged the claims as they provided a wealth of factual allegations about the management of the plan, including data that compares service fees and investment choices to other options.

Goodman v. Columbus Reg'l Healthcare Sys., 2022 U.S. Dist. LEXIS 13489 (M.D. Ga. Jan. 25, 2022) - District court denied defendants' motion to dismiss. Plaintiffs alleged that defendants violated their duty of prudence by not providing participants with a menu of prudently monitored investment options, and failing to monitor administrative expenses resulting in the payment of excessive recordkeeping fees. The court found that plaintiffs adequately alleged that defendants' investment decisions were imprudent.

<u>New Low Cost Index Funds Lawsuits</u>

We are also monitoring new lawsuits filed this year in which plaintiffs allege that plan sponsors breached their fiduciary duty of prudence by selecting Blackrock's low cost Target-Date Funds (TDFs)[3]. Despite the fact that the TDFs at issue had high Morningstar ratings, plaintiffs allege that plan fiduciaries failed to consider the TDFs' return potential and instead only chased low fees charged by the funds. Plaintiffs claim underperformance by comparing the TDFs' returns with the returns of TDFs offered by other companies such as T. Rowe Price and American Funds. Defendants contend these claims are insufficient because the comparator TDFs have different glide paths, i.e., "to retirement" versus "through retirement" strategies, in addition to the fact that the comparator TDFs are actively managed while the BlackRock TDFs are passively managed. These cases show the apparent movement of plaintiffs' counsel beyond issues of excessive investment and recordkeeping fees and into the realm of risk assessment and performance.

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[3] A TDF is an investment option that automatically shifts its asset allocation from higher to lower risk as the investor nears his or her anticipated retirement year. The asset allocation glide path of a TDF begins with the majority of the fund being invested in equities, and as the retirement date approaches, that equity allocation decreases and the allocation in fixed-income investments increases. TDFs are generally viewed as safe investments, and they are often used by 401(k) plans as their default investment option. A "to retirement" TDF reaches its lowest risk asset allocation at the investor's year of retirement, and a "through retirement" TDF continues to lower its risk after reaching the year of retirement.