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Courts Weigh ERISA Fiduciary Duty Pleading Standards and Limit Arbitration Clauses

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Takeaways

- The Supreme Court heard arguments in December 2021 in a case that could raise the bar for pleading ERISA fiduciary claims.
- A split developed in the circuits in 2021 on the arbitrability of ERISA claims, with two courts diverging from what had been a consensus view.
- To gain evidence that retirement plan fiduciaries paid excessive fees, plaintiffs in a California case successfully sought discovery from a third-party plan about the fees it paid, raising the prospect that other plan administrators may face subpoenas in cases to which they are not parties.

Putative class actions brought under the Employee Retirement Income Security Act (ERISA) alleging breaches of fiduciary duties continued to proliferate in the past two years. More than 200 such cases were filed in 2020, an 80% increase from 2019 and double the number in 2018. This trend continued in 2021, with hundreds of new ERISA suits cast as class actions. Plaintiffs are testing new legal theories, and parties are battling over discovery tactics and arbitrability. Meanwhile, a case now before the U.S. Supreme Court is being closely watched.

The Supreme Court Reviews Pleading Standards

The upcoming ruling in the Supreme Court case *Hughes v. Northwestern University* could change the ERISA fiduciary litigation landscape for years to come. The complaint, a putative class action, alleges that fiduciaries of two retirement plans breached their duties in connection with the plans' recordkeeping and investment fees by (1) allowing participants to pay excessive recordkeeping fees to multiple service providers and (2) offering expensive and duplicative investment options when alternative lower-cost options were available.

The suit, originally captioned *Divane v. Northwestern University*, was dismissed in the Northern District of Illinois, and the Seventh Circuit affirmed, holding that there was nothing wrong with paying recordkeeping fees as a component of a fund's expense ratio, and that the plaintiffs failed to identify an alternative entity that would have accepted a lower fee while providing high-quality services. The Seventh Circuit also observed that Northwestern's plans "offered hundreds of options," including low-cost options, "making a claim of imprudence less plausible."

The Supreme Court granted a writ of *certiorari* in July 2021 to address the pleading standards for ERISA breach of fiduciary duty actions. Before the high court, the plaintiffs argued that affirming the dismissal would make it "extremely difficult for ERISA participants to bring a lawsuit for imprudence in incurring excessive fees."

Northwestern countered that the plaintiffs' position "would expose nearly all fiduciaries to the threat of damages litigation" because "[a]llegations that a fiduciary breached its duty because of marginal cost differences in isolated investments are easy to make and costly to litigate." Reversing the dismissal would "thrust the federal courts into the role of rate-setters and investment pickers," the university contended.

Oral arguments were heard on December 6, 2021, and the Court is expected to issue a ruling by June 2022. Affirming the dismissal would indeed make it more difficult for plaintiffs to successfully pursue ERISA claims and would likely curb nuisance suits, at least in the short term.

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Circuit Court Rulings Cast New Doubt on Arbitrability of ERISA Claims

Prior to 2021, the prevailing view — most recently articulated by the Ninth Circuit in *Dorman v. Charles Schwab Corp.*, and currently being tested by the Sixth Circuit in *Hawkins v. Cintas Corps.* — was that defendants could compel arbitration of ERISA fiduciary breach claims where plan documents contained arbitration provisions, but not where such clauses were contained only in plaintiffs' individual employment agreements. However, two recent appellate decisions have chipped away at this rule.

In *Cooper v. Ruane Cunniff & Goldfarb Inc.*, a retirement plan's investment adviser moved to compel arbitration of a plan participant's federal claim based on his agreement to arbitrate claims "relating to employment." The Second Circuit held that the arbitration provision did not "encompass the claims for breach of fiduciary duty" and determined that the plaintiff's ERISA claims did not "relate to" his employment because they did not "involve facts particular to an individual plaintiff's own employment."

While the outcome was consistent with the Ninth Circuit rule — the arbitration clause in an employment agreement would not be enforced where ERISA fiduciary breach claims were involved — *Cooper* broke new ground in finding that ERISA fiduciary breach claims were not employment-related.

The Seventh Circuit further undermined ERISA fiduciary breach arbitration in *Smith v. Board of Dir. of Triad Manufacturing, Inc.* There, retirement plan documents contained a provision requiring participants to arbitrate ERISA claims and precluding the award of non-individualized, plan-wide relief. The Seventh Circuit held that, while the clause was part of the plan documentation, it was unenforceable because a prohibition of plan-wide relief was incompatible with ERISA's broad statutory remedies.

Cooper potentially precludes defendants from utilizing individual employment contracts to compel arbitration of plan-wide claims, and *Smith* casts doubt on plan-wide arbitration provisions mandating individualized relief. Both rulings may curb the arbitration of ERISA class actions.

With these two rulings departing from the Ninth Circuit view, and the Sixth Circuit also poised to rule on the issue, the viability of arbitration clauses may soon find its way to the Supreme Court. For now, retirement plan administrators and fiduciaries should be alert to the diverging rulings when evaluating whether and how to draft and enforce arbitration provisions.

ERISA Plaintiffs Allowed Discovery From Unrelated Third Parties

Recently, in *Munro v. University of Southern California,* the U.S. District Court for the Central District of California allowed the plaintiffs in an ERISA fiduciary case to obtain discovery from an unrelated third party concerning the recordkeeping fees it paid.

The plaintiffs alleged that fiduciaries of two University of Southern California retirement plans breached their duties by, among other things, allowing participants to pay excessive recordkeeping fees. To help prove their case, the plaintiffs subpoenaed records from a plan at the California Institute of Technology (Caltech) that the plaintiffs asserted was similar. Caltech objected, noting that the size of the two universities' plans was quite different. It also charged that plaintiffs' counsel was actually gathering information that could be used to initiate an ERISA suit against Caltech.

The plaintiffs' counsel denied those assertions, and the court held that the discovery was relevant and proportional to the needs of the case. In response to "Caltech's suspicions" about the counsel's motives, the court imposed an additional protective order prohibiting counsel from using the discovery "for any purpose other than the litigation of this action."

Following the success of the plaintiffs' strategy, it is likely that other plan administrators will become involuntary fact witnesses in cases against their peers or competitors.