Defendants Secure Motion to Dismiss Victories in Three Post-Hughes Decisions

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In April, we wrote here about the discouraging trend of opinions allowing commonly asserted breach of fiduciary duty claims in 401(k) and 403(b) plan investment litigation to survive motions to dismiss. While it may be too soon to declare a reversal of that trend, three recent decisions dismissing these types of claims present some hope for plan sponsors and fiduciaries that in appropriate cases they may be able to avoid the costs and burdens of class action discovery. In particular, the Sixth Circuit became the first Court of Appeals to affirm the dismissal of a 401(k) fee litigation since the Supreme Court’s decision in Hughes v. Northwestern University, 142 S. Ct. 737 (2022), and two district courts dismissed similar claims.
The Sixth Circuit’s Decision

In Smith v. CommonSpirit Health, a 401(k) plan participant claimed that defendants breached their fiduciary duty of prudence by offering actively managed investments despite the availability of lower-cost and better-performing index funds. Smith v. CommonSpirit Health, No. 21-5964, 2022 WL 2207557 (6th Cir. June 21, 2022). The participant alleged that not only were actively managed funds more costly in general, but that specific funds in the plan underperformed relative to similar index funds over three- and five-year periods. She also alleged that the plan’s recordkeeping and management fees were excessive as compared to industry average costs published in surveys by NEPC and Brightscope/ICI.

We previously blogged here on the Eastern District of Kentucky’s September 2021 opinion dismissing the complaint. The district court rejected plaintiff’s investment-specific allegations insofar as they relied on comparisons to passively managed funds—which the court held were not “ideal comparators”—over a “relatively short” five-year period. Plaintiff’s challenge to the plan’s recordkeeping fees similarly was rejected for failure to identify other providers that would have provided the same services at a lower cost.

In its recent decision, the Sixth Circuit affirmed the dismissal of the case. First, the Court held that the participant’s allegation that defendants acted imprudently by offering actively managed funds in the plan’s investment lineup did not give rise to an inference of a breach. In so ruling, the Court emphasized the important role that actively managed funds can play in a plan’s investment lineup despite their comparatively higher fees, particularly for employees hoping to realize above-average returns in the long-term through a mix of high-growth and defensive investment strategies. The Court went so far as to suggest that the failure to offer any actively managed options might be imprudent.

Second, while the Court acknowledged that the selection of specific actively managed funds could be found imprudent under ERISA, it rejected the participant’s claim here because, as other circuit courts have held, a plaintiff cannot challenge a fund’s prudence based on alleged underperformance by merely “pointing to a fund with better performance.” Here, the participant's claims centered on the plan’s default investment option—the actively managed suite of Fidelity Freedom Funds—and compared its performance to that of a Fidelity-managed index fund over a five-year period. While the Fidelity Freedom Funds’ returns trailed those of the index fund in each of the five years, the Court found that this did not, without more, violate the duty of prudence. The Court reasoned that a “five-year snapshot” of performance was insufficient to show a violation of the process-based duty of prudence because “[a] side-by-side comparison of how two funds performed in a narrow window of time, with no consideration of their distinct objectives, will not tell a fiduciary which is the more prudent long-term investment option.” Moreover, according to the Court, allowing short periods of underperformance to dictate an investment’s prudence would “lead to the disappearance” of actively managed funds—which may well-serve the objectives of some investors—from 401(k) plans entirely. As the Court put it, “[a] retirement plan acts wisely, not imprudently, when it offers distinct funds to deal with different objectives for different investors.”
Third, the Court rejected the participant’s claim that the plan paid excessive recordkeeping fees because she failed to provide the necessary context for her allegations. While the participant compared the plan’s fees to industry averages, she did not allege that the services provided to the plan were equivalent to those provided to the plans comprising those averages, nor that the surveyed plans were sufficiently similar to this one.

Lastly, the participant’s similar allegations regarding the plan’s average investment management fees, without more, failed because they were devoid of context and merely reflected the fact that the plan offered several actively managed funds.

**District Court Decisions**


Like Smith, both cases involved claims by plan participants that defendants breached their fiduciary duties by allowing the plans to incur excessive investment management and recordkeeping fees.

In Riley, the court rejected both of the participants’ fee-related claims. The court rejected the participants’ excessive recordkeeping fee claim, which was based primarily on metrics from an NEPC survey of over 100 other plans, and materials, such as expert opinions, submitted in other cases regarding the average amount plans should pay in recordkeeping fees. The court explained that the NEPC survey was not an appropriate comparator because it did not detail the specific services provided to the surveyed plans, and the materials submitted in other cases were not “meaningful benchmark[s]” because the fees charged by “different and entirely unrelated plans said nothing about the reasonableness of the [plan’s] recordkeeping fees here.”

The court also rejected the participants’ reliance on the Brightscope/ICI survey (mentioned above) to compare mutual fund fees to those charged by cheaper collective trust versions because the ICI survey was not a “meaningful benchmark” insofar as it only considered plan size and high-level investment style and provided no information about fund holdings, investment style, or strategy. As for fees charged by individual funds, the court noted that courts “routinely” find collective trusts not to be meaningful comparators for mutual funds, and that the participants alleged only that the mutual funds were more expensive, with no comparisons of their underlying asset allocations.

In Matney, the court denied the participants’ motion for reconsideration of a prior ruling dismissing their complaint. In its previous dismissal, the court rejected the plan participants’ use of cherry-picked funds as a basis for challenging the plan’s investment management fees, and held that averages from a “401(k) Average Book” were not “meaningful benchmark[s]” against which to evaluate the plan’s recordkeeping fees. The plaintiffs moved for reconsideration based in part on their view that the Supreme Court’s decision in Hughes constituted an intervening change in controlling law. The court declined to revisit its original order, agreeing with
defendants that Hughes (which was decided prior to the court’s previous dismissal) did not justify reconsideration here.

**Proskauer’s Perspective**

The decisions in Smith, Riley, and Matney are a breath of fresh air for plan sponsors and fiduciaries, particularly given that most courts have denied motions to dismiss very similar claims since the Supreme Court’s ruling in Hughes. While we continue to believe that the overall track record of motions to dismiss warrants consideration of an early motion for summary judgment as an alternative, these decisions reinforce the fact that a motion to dismiss may still be a proper strategy in appropriate cases.

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