The Oral Arguments—a Summary

The Arguments

Kicking things off on behalf of the participant-plaintiffs was David C. Frederick, a partner at Kellogg Hansen Todd Figel & Frederick PLLC (later in the proceedings, the justices would also hear from Michael R. Huston of the U.S. Department of Justice, which had supported the participants in their claims), who started by noting that, "Wasting beneficiaries' money is imprudent," continuing on to acknowledge that comment by Judge Friendly that is frequently cited—that ERISA's fiduciary duty is "the highest known to the law," that the terms of that fiduciary duty means that you "…must act with prudence, solely in the interest of beneficiaries, incur only reasonable expenses, and act with care, skill, and diligence"—and that "the Seventh Circuit erred by announcing a new rule that immunizes ERISA fiduciaries from suit for including imprudent options so long as some of the plan options are prudent."

He had just built up a little steam—and in the middle of a comment that Northwestern had failed to leverage its size to command a better deal for participants—when Justice Clarence Thomas interrupted to question if this wasn't just a challenge of strategy. To which Frederick cited a standard of "objective reasonableness," which he said was a "band," one in which "the industry under the statutory words, the circumstances then prevailing, is going to recognize a wider band."

By way of conjuring up a more relatable reference, he said: "It would be like if I offered a bottle of water to you, Justice Thomas, and I said would you like to pay $2 for it or would you like to pay $1 for it? In this case, the Northwestern fiduciary was charging the beneficiaries $2 even though the $1 bottle of water was available." If that would be considered imprudent, he noted, that if that was asserted in the initial suit, and if the plaintiffs were "entitled to the truth of our averments" at that stage, that would constitute a "cause of action for a breach of fiduciary duty."

'Band of Reasonableness'

He further posited that this "band of reasonableness" was tied to a breakdown in prudent process—and that since Northwestern "never bid out its recordkeeping services, it didn't use its bargaining leverage to try to lower fees, it included proprietary funds that were bundled to the recordkeeper"—they alleged that that led to a lower return for participants, and "that is a claim for procedural imprudence, as well as a result of imprudence"—and *that*, he argued was "enough to meet "the plausibility threshold of Iqbal and *Twombly* to survive a motion to dismiss."

He also commented that "It is not in the sole and exclusive interest of participants to have to sift through imprudent funds in order to determine which ones are the prudent ones."

Justice Breyer then took the discussion into an attempt to understand the implications of a comparative fee table in the complaint—apparently puzzled that the complaint didn't specifically state that the plan didn't offer the ostensibly cheaper funds offered for comparison—a point that Justice Alito jumped on as well.

Justice Kagan then entered the "fray," asking if the argument was that Northwestern should have used its bargaining power to leverage a better deal, or was it that they should have combined funds to create a bigger pool with which to leverage—to which Frederick basically responded "both." That didn't resolve the issue for Kagan, who pushed back on the consolidation point, arguing that at some point there would be a “downside” to having a non-diverse set of funds. Frederick acknowledged that that argument—that reducing the number of funds would reduce costs—was a “harder claim,” but suggested there was “a lot” of expert testimony and analysis that would support that argument.

Justice Gorsuch then expressed doubt that the courts had the requisite expertise to determine what a “right” number of funds would be—and that, “all things equal, choice is usually a good thing.” Frederick tried to respond by stating that there were industry standards, and that there was an opportunity to look to the “circumstances then prevailing.” To which Justice Kavanaugh pushed back commenting that industry norms were changing.

At this point, the direction of the arguments seemed to shift toward the decision to use more than one recordkeeper—at least that’s where Frederick responded, citing shifts among 403(b) plans to consolidate such that “by 2013… between 80 and 90 percent” of the plans had “consolidated to a single recordkeeper.”

‘Average’ Duty?

In one of the more puzzling lines of questioning, Chief Justice Roberts wondered (aloud): “Is the fiduciary duty average, or is it the highest standard?” He then cited as an example that you might well expect that someone going to fill their car with gas would opt for the cheapest price—but not expect that they would drive another 10 miles to acquire it. At which point Justice Breyer returned to his original questions about the table, wondering if, in fact, Northwestern *could* have obtained the cheaper funds outlined in the table. Frederick responded by stating that this was at the initial pleading stage—and that those inferences were supposed to be decided in favor of the plaintiff.

Justice Alito entered into the discussion at that point, pushing back on the consolidation notion, citing an example where there were funds that were popular, well-known, but had high fees—to which Frederick responded (primarily) that they were still at the pleading stage (and thus presumably didn’t have to answer that question yet), but then opined that it would come down to an evaluation as to the prudence of that investment.

Justice Sotamayor concurred with the retail versus institutional share argument, but questioned the $35/participant recordkeeping charge as a mere assertion without proof that it was, in fact, the “market price.” She also challenged the notion that one recordkeeper would necessarily be of more value than two, specifically how that would produce a lower fee.

Justice Gorsuch then returned to the discussion, returning to the issue of too many choices, and the subsequent move by Northwestern to reduce funds/recordkeeper—an issue that Frederick again said they would argue (if they could get past the pleading stage) indicated not only that they could have, but that the fiduciaries should have done earlier. But that brought Justice Breyer back to the question, “…it’s the easiest thing in the world if they have a lot of choices. You say you had too many choices. And if they have only a few choices, you say you had too few choices. And so whatever they do, you’re going to say this was wrong.” To which Frederick responded that “when you’re at the pleading stage, you read the complaint plausibly to assume the truth,” and in response Breyer noted that he “would have said that before *Twombly* and *Iqbal*.”

Justice Kavanaugh then moved to challenge that there hadn’t been “sufficient allegations that the minimum investment requirements were met or that you could get a waiver…”—picking up on arguments made by the defendants that the institutional share classes had specific asset thresholds to qualify for them. He also questioned whether it had been sufficiently alleged that they could have negotiated a better deal with recordkeeping fees without consolidation—but Frederick said that they had alleged that the complaint had cited the example of other similar plans that had negotiated to obtain the institutional share classes.

The Government's Perspective

Michael R. Huston of the U.S. Department of Justice started by challenging (as Frederick had) that the Seventh Circuit had asserted that ERISA fiduciaries couldn't be sued (successfully) "for offering imprudent funds with excessive fees so long as the fiduciaries offered some prudent funds with reasonable fees.

"That rule is wrong for at least four reasons," Huston said. "It flouts ERISA's text. It is—it has no support in the common law of trusts, from which ERISA's text derived. It is inconsistent with this Court's precedents, especially *Tibble* and *Dudenhoeffer*. And it would effectively immunize fiduciaries for broad swaths of imprudent management just because the fiduciaries performed their jobs adequately in at least a few instances."

Justice Thomas interrupted to ask if a fiduciary followed the directives to the detriment of returns or performance would he/she be considered imprudent—to which Huston responded that claims of imprudence don't focus "principally on returns"—and then Thomas interrupted to ask why it should focus principally on the expenses. Huston responded that it was focused on process, but that "expenses are an important part of prudent management."

Chief Justice Roberts then asked if that was the only factor—calling in examples that, based on familiarity/branding, people might want to invest in certain mutual funds, irrespective of costs (he even resurrected the old E.F. Hutton commercials). Huston responded that the allegations here were that the funds were identical, except for cost. Roberts then pivoted for Huston to weigh in on the notion that since Northwestern had "fixed" something with their plan did that "show that they were doing something wrong"—and that, if so, "would we be creating an incentive not to fix things if we said you're in trouble because you fixed them?"

'Duty to Fix Things'

Huston responded that fiduciaries have a duty to "fix things if they have an opportunity to do so," and that at the pleading stage it supports the plausibility of the plaintiffs' allegation. That said, he noted that "it's not dispositive by any means, but it's one piece of evidence that the trier of fact will need to consider…"

Gorsuch acknowledged: "It's a long complaint. Justice Breyer is right, it's got a lot of paragraphs. It's well done."

Huston said that "the obligation on the fiduciaries was to offer that specific investment at the lowest price that they could get it," going on to note that "…the core allegation in this complaint is that the fiduciaries failed to do that, and if they prove that allegation, there's simply no prudent explanation." Justice Kagan acknowledged the point—that "they didn't negotiate hard enough, they didn't put things out for competitive bids, they just—they were paying, you know, too much for the only thing that anybody wanted," before going back to her question as to whether if there had been a consolidation of funds or recordkeepers they could have gotten lower prices. "And as for me, that's the one that seems a little bit more, I don't know, I have to think about that," she commented.

Justice Gorsuch asked about the notion that too many funds confused participants to the point of injury—and Huston responded that the government hadn't taken a position on that claim. Pressed as to whether that might be a (positive) function of choice, he responded that if the cost of the choice was 20, 40, 80, 100 percent increases in fees, "all of a sudden maybe it's not prudent"—before returning to the argument that, at the pleading stage "all of the inferences have to be taken in the respondents' favor."

'Pleading' Stages

At that point Justice Alito asked how often these cases got beyond that pleading stage—distinguishing between those that settled prior to that stage—"We've heard from Mr. Frederick and you the phrase 'pleading stage' multiple times. This is just the pleading stage, don't worry about it, it can all be worked out at trial. It doesn't happen in the real world. What do we do about that?" Huston questioned that comment, and Justice Kavanagh responded, "It doesn't happen often because there's huge pressure to settle, which has happened in many of these university 403(b) cases over the last few years. And I'm not saying which way that cuts, but I'm just saying the 'just the pleading stage' thing, which we've heard over and over again, kind of forces us not to deal with the reality of what's going on."

Justice Kavanaugh then mentioned that a number of the "friend of the court" briefs said that "being a fiduciary now is really a difficult task for the person individually. They'll have individual problems in the wake of doing that and that the fiduciary insurance market is problematic now." Huston, while noting that Congress could always revise the rules, commented that he didn't think the court "…can amend or should amend the *Twombly* and *Iqbal* framework for analyzing the plausibility of an allegation in the complaint based on concerns about that there's too many of these lawsuits," that the Supreme Court was asked to do just that in the *Dudenhoeffer* case, but declined to do. Moreover, he said that he thought the "story in the real world is more complicated than Respondent and some of its *amici* suggest," that "fiduciaries are indemnified, they get insurance, and they get advice from the Department of Labor and others about how a reasonable fiduciary acts."

The Defendants' Arguments

Right off the bat, Gregory Garre of of Latham & Watkins LLP reminded the court that "this case is one of a barrage of damages actions filed against leading universities across the country, in Petitioners' own words, to revolutionize fiduciary practices not through prospective changes to ERISA or its regulations but through the blunt threat of damages actions for past conduct." He then went on to outline "three overriding reasons" that he said established that the plaintiffs had failed to state a claim.

First, he argued that it was "…based on a flawed conception of the duty of prudence which overlooks the role that Congress left for participant choice in this context and would strip fiduciaries of the leeway they have always had to consider tradeoffs in addition to cost, such as the impact that minimum investment requirements for institutional class shares would have on providing investment options generally."

Second, and "even if this Court adopts Petitioners' paternalistic conception of the duty of prudence," he argued that the plaintiffs failed to state a claim—specifically that they didn't "allege facts from which there could be a reasonable inference that the alternative fees and services that they claim should have been provided were actually available to the plans." Finally, he explained that "…allowing the cookie-cutter claims in this Court—in this case to proceed not only would subject retirement plans to endless damages litigation but would thrust the federal courts into the role of micromanaging those plans."

"Ultimately," he concluded before opening up for questions, "it's the employees and the retirees who would be the real losers as plans shed options, scale back services, and perhaps even fold up altogether in the wake of skyrocketing insurance premiums."

The 'Large Menu' Defense

Justice Thomas led off, focusing specifically on the Seventh Circuit's "large menu" defense—to which Garre responded that, "ERISA itself encourages plans to provide a diverse menu of investment options," going on to suggest that the notion that there is a line as to whether the plan's options are sufficiently diverse "is essentially a Goldilocks rule that the courts could never administer."

But having said that, Garre pivoted—noting that the plaintiffs' counsel had turned the "too many options" into an argument that it had an impact on the ability to negotiate on the minimum fee front for institutional shares—while also reminding the justices that the Administration had not supported the argument that there were too many funds.

Justice Kagan then stepped in—pressing on the allegation that the Northwestern fiduciaries simply hadn't negotiated a better fee deal from a position of strength. But Garre pressed back, arguing that in their suit, the plaintiffs hadn't actually provided examples or a benchmark of what they could have negotiated.

Kagan remained undeterred—noting that Northwestern defendants "didn't do standard things that you should do in order to decrease your fees. You didn't put it out for competitive bidding. You didn't go back and say we're demanding lower fees. You didn't do any of those. You just let it just accumulate over the course of years such that you were paying far more fees than you, you know, would have had to if you had been paying attention."

Garre responded that that "complaint hadn't been stated here," that the mere allegation wasn't sufficient to establish if that was actually possible to obtain those pricing differentials. "With respect," Garre commented, "their claim is that we should have charged a $35-per-participant fee. That number is plucked out of thin air." Garre went on to cite "Judge Collyer's decision in the *Georgetown* case, which says that there are no facts supporting that claim, $35, which is the same number they plucked out of the air in that case. There's no other university that they point to." Moreover, he asserted that "…they don't provide any factual content to support a reasonable inference that those funds were actually available. They don't identify the minimum requirements."

At that point Justice Breyer entered the discussion and returned to the comparison tables on fees and funds provided by the plaintiffs, noting that it's "fair to read that word 'available'" as meaning available to the defendant, and wondering if that wasn't, in fact, "stating a claim."

Garre responded that some of the funds in that table had minimum levels of investment to qualify for those institutional share classes. And he went on to "dispel the notion" that the retail and institutional shares were "identical." First there was the issue of investment minimums—and that in order to obtain them the plan would have had to "aggregate funds and lose investment options," which he described as a "real cost" in the plans.

He continued to explain that "the reason why institutional class shares are—are marginally more expensive is because important—a portion of those funds go to defraying administrative expenses for the plan as a whole, which is a particular benefit to smaller account holders, who otherwise would have to pay higher fees," which he noted was "an additional cost"—and those two reasons "why a prudent fiduciary would have a plan that allowed a mix of retail and institutional class shares, particularly if we hadn't the minimum requirements."

Justice Sotamayor wasn't buying it, however: "…[W]hat they claim is that for institutions as large as this one, Northwestern, that if they had asked for the waiver, they would have gotten it, and they showed how many other people had asked for waivers and gotten them. Why isn't that a plausible enough allegation to put you in to prove it at trial?"

Garre first sought to draw a distinction between 401(k) and 403(b) plans—specifically that the latter not only has tended historically to have more options, but also investment annuities. He dropped back to the requirements from *Iqbal* and *Twombly*, which he said held that "…you have to allege the factual content sufficient to support a reasonable inference. If you don't identify the minimum requirements, if you don't attempt to explain how those requirements are met through allegations, then you haven't raised a plausible inference." He continued, "It's simply not plausible to say just that this institutional fund was available when we don't know if it had a 100 million dollar investment requirement, 50 million, 200 million. We don't know at all because they didn't allege it."

And then Chief Justice Roberts asked, referring to the plan changes that the plaintiffs had alleged proved that the fiduciaries knew there was a problem, "if everything was going so well and you were doing everything right, why did you change?" In response, Garre cited regulatory changes in 2009 and—ironically enough—"the interim effect of damages litigation." And then commented that there was no basis to "hold the plan somehow accountable for the fact that it changed the way it operates in this new regulatory environment." Perhaps more critically, he noted, "If this kind of claim is okay, funds were available, you should have asked for a lower fee, then any claim is okay. And then once you get past the pleading stage for expensive discovery, the threat of settlement demands, I mean, you can look at what it is doing to the insurance premium market…"

He continued, "once the Court goes down the path of saying it's sufficient for any plan participant to identify a single investment, and that's the United States in the Petitioners' rule, and claim that you could have gotten that investment cheaper or you could have asked for a waiver or one-of-a-kind deal, and that that's sufficient in a class action to get to discovery and a threat of damages, I mean, that would be terrible for the retirement plans and for the participants in those plans. And that has never been the law."

Justice Sotomayor pushed back. "It's a fine balance, I agree with you. It's a fine balance between litigation and not, but some of this litigation has ended up being to the benefit of the retirees because the universities were not doing basic steps, like just asking for price reductions, like just asking for waivers. And when they did, they got them. And so I… I… I don't know, counsel, that we can say a rule as broad as the Seventh Circuit has without harming the beneficiaries."

At that point Huston stepped back in, describing the suit as "…massive in size but short on specifics as to Northwestern and the plans at issue. And that's because it was drafted as a part of an omnibus effort to go after 20 universities at once, which itself is inconsistent with the notion that they were somehow acting in an aberrant way that would breach a fiduciary duty." He then went on to specify that the problem with this particular complaint "…is it doesn't plead facts which would allow reasonable inference that the alternative fees and services they claim should have been provided were even available to the plan.

"Here you have a plan that had institutional class shares and retail class shares. If you looked at the plan, the most reasonable inference is that the plan was prudently exercising choice based on whether minimum requirements were met, and—and in light of the fact that retail class shares would help defray administrative expenses of the plan, which is exactly, by the way, what ERISA says. It looks to the administrative expenses of the plan."

Huston acknowledged that while cost is one consideration, "…it has to be taken into account along with other tradeoffs. And that's what's missing from their theory." He cited one of the earliest excessive fee cases—the *Hecker* case—where Judge Wood stated that, "there is no rule that we always scrutinize and scour the market for the cheapest available option. If—if that's the rule that the Court adopts, which is effectively what it would be doing if it allows this claim to go forward, then the federal courts really are going to have to take over the management of these plans, selection of assets, fine-tuning services, deciding whether or not something, at a given point in time, should have asked for a waiver or whether negotiation was sufficient. I mean, there's really no end to the way in which federal courts would be dragged into overseeing this and managing investment plans, which the Court has never done."

Garre commented that, "…when you're dealing with organizations over time using their services, it's not particularly common just to call out of the blue and say, you know what, I want a really lower fee. And these were prudently managed services, and over time, over a reasonable period of time, they eventually did negotiate a lower fee. But you can't hold that against them."

In response to questions from Justice Breyer, Garre cautioned that if "it's enough to say in the abstract a share is identical, a share is available, and that's it, you're off to the races with discovery and settlement demands and the like. And that really would—would pose, as the amicus briefs tell you in far better detail than I could, an intolerable burden on the plans."

"Ultimately, the costs of litigation, the costs of insurance, of premiums, themselves are going to be factored into the mix of administrative expenses that participants have to play. And, ultimately, as you limit options and scale back services, as a ruling by this Court in favor of Petitioners would require plans to do, you're harming participants as well."

Justice Kagan characterized the assessment of the Seventh Circuit as being that "fiduciaries can avoid liability for offering imprudent investments with unreasonably high fees if they also offer prudent investments with reasonable fees," though Garre rejected that positioning.

Justice Alito drew a comparison of a choice between brand name sodium chloride or non-brand name sodium chloride. "There are people who want the brand name sodium chloride. Is it—would it be imprudent to offer that choice?" To which, not surprisingly, Garre responded that it would not—and that there are also people who don't want to change, and that change involves costs in itself.

Frederick then had a chance to rebut—and he stepped through each of the justices comments in turn, commenting to Chief Justice Roberts that if Northwestern had made its changes in 2009 and 2010 when others did, “it would have saved the plan million and millions of dollars”; to Justice Alito that the sodium chloride they were talking about was identical, and whether you should charge $1 or $2 for the same bottle; to Justice Sotamayor that multiple recordkeepers meant inefficiencies and that there should have been a reduction in costs; to Justice Gorsuch that while confusion (“too many funds”) was not a cause of action, it was a process that produced financial harm and unnecessary recordkeeping fees; to Justice Kavanaugh that “the fees have decreased so much that there are almost no new cases being filed in this area”—“So I would urge you not to take seriously this idea about insurance premiums and all these other things because the reality is that the number of people who are taking advantage of defined-contribution plans has gone up from 75 million to 109 million. The number of plans has increased from 630,000 to almost 700,000 in the period since we filed this complaint. So you cannot say as an empirical matter that litigation is somehow causing a problem. The whole point of the Department of Labor’s regulations was to bring reform to this area. Some universities acted prudently and did so quickly, and they saved their retirees lots and lots of money. Northwestern did not. This case should be remanded so that we have an opportunity to prove at trial just how much they cost harm to our participants.”