No. 18-2569

UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

LAURA L. DIVANE, et al.,
Plaintiffs-Appellants,

v.

NORTHWESTERN UNIVERSITY, et al.,
Defendants-Appellees.

On Appeal from the United States District Court
for the Northern District of Illinois
No. 1:16-cv-08157 (Hon. Jorge L. Alonso)

BRIEF FOR THE CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA AND THE AMERICAN BENEFITS COUNCIL AS *AMICI CURIAE* IN SUPPORT OF APPELLEES

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APPEARANCE & CIRCUIT RULE 26.1 DISCLOSURE STATEMENT

Appellate Court No: 7th Circuit

Short Caption: Divane v. Northwestern, case #18-2569

To enable the judges to determine whether recusal is necessary or appropriate, an attorney for a non-governmental party or amicus curiae, or a private attorney representing a government party, must furnish a disclosure statement providing the following information in compliance with Circuit Rule 26.1 and Fed. R. App. P. 26.1.

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(1) The full name of every party that the attorney represents in the case (if the party is a corporation, you must provide the corporate disclosure information required by Fed. R. App. P 26.1 by completing item #3):

The Chamber of Commerce of the United States of America, and the American Benefits Council

(2) The names of all law firms whose partners or associates have appeared for the party in the case (including proceedings in the district court or before an administrative agency) or are expected to appear for the party in this court:

Goodwin Procter LLP and U.S. Chamber Litigation Center

(3) If the party or amicus is a corporation:

i) Identify all its parent corporations, if any; and

None

ii) list any publicly held company that owns 10% or more of the party's or amicus' stock:

None

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CORPORATE DISCLOSURE

Pursuant to Rule 26.1 of the Federal Rules of Appellate Procedure, counsel for *Amici Curiae* certifies as follows:

- The Chamber of Commerce of the United States of America has no parent corporation, and no company holds 10 percent or more of its stock.
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INTEREST OF THE *AMICI CURIAE*

The **Chamber of Commerce of the United States of America** (Chamber) is the world's largest business federation.[1] The Chamber represents 300,000 direct members and indirectly represents the interests of more than three million businesses and professional organizations of every size, in every industry sector, and from every region of the country. The Chamber's members include many employers that offer ERISA-governed benefit plans to their employees, as well as companies who fund or administer those plans.

The **American Benefits Council** (Council) is a national non-profit organization dedicated to protecting and fostering privately sponsored employee-benefit plans. Its approximately 440 members are primarily large, multistate employers that provide employee benefits to active and retired workers and their families. The Council's members also include organizations that provide employee-benefit services to employers of all sizes. Collectively, the Council's members either directly sponsor or provide services to retirement and health plans covering virtually all Americans who participate in employer-sponsored benefit programs.

Each organization has a strong interest in ERISA litigation and regularly participates as *amicus curiae* in this Court and in other courts on issues that affect employee-benefit design or administration. *E.g.*, *Fifth Third Bancorp v.*

[1] All parties have consented to the filing of this brief. No counsel for a party authored this brief in whole or in part. No party, no counsel for a party, and no person other than *Amici*, their members, and their counsel made a monetary contribution intended to fund the preparation or submission of this brief.

Dudenhoeffer, 573 U.S. 409 (2014); *Hecker v. Deere & Co.*, 556 F.3d 575 (7th Cir. 2009).

Amici's members include plan sponsors and fiduciaries that benefit from Congress's decision to create, through ERISA, an employee-benefits system that is not "so complex that administrative costs, or litigation expenses" discourage employers from sponsoring benefit plans or individuals from serving as fiduciaries. *Conkright v. Frommert*, 559 U.S. 506, 517 (2010) (citation omitted). The Supreme Court has recognized that undertaking a "careful, context-sensitive scrutiny of a complaint's allegations" to "weed[] out meritless claims" is an important mechanism for advancing Congress's goal. *Dudenhoeffer*, 573 U.S. at 425. Plaintiffs here seek a diluted pleading standard that would defeat dismissal based on conclusory assertions about a fiduciary's decision-making process, complaints about rational and common fiduciary decisions, and suggestions of alternative decisions that, with the benefit of 20/20 hindsight, would have been more profitable for plan participants. Plan sponsors and plan fiduciaries alike, including *Amici*'s members, have a strong interest in preventing such an empty standard.

SUMMARY OF ARGUMENT

In enacting ERISA, Congress encouraged employers to sponsor employee-benefit plans by affording sponsors and fiduciaries broad latitude to draw upon their experience to make decisions based on their present and future participants' diverse goals and needs. Fiduciaries are faced with numerous decisions in administering a plan, including how many investment options to make available,

the risk levels of those options, the investment vehicles for those options, and which service provider(s) to hire for the services provided to plan participants (such as recordkeeping services, participant loans, or investment advice). As to each of these issues, there is a wide range of reasonable options that a prudent fiduciary could pursue.

Given the sheer number of decisions fiduciaries have to make, and the inherent market uncertainty they face when doing so, Congress chose the "prudent man" standard to define the duties that fiduciaries owe to plan participants. 29 U.S.C. § 1104(a). And because ERISA "requires prudence, not prescience," *DeBruyne v. Equitable Life Assurance Soc'y of the U.S.*, 920 F.2d 457, 465 (7th Cir. 1990), fiduciaries are judged not by the outcome of their decisions but by the *process* by which those decisions were made, *see In re Unisys Sav. Plan Litig.,* 74 F.3d 420, 434 (3d Cir. 1996).

In recent years, however, plaintiffs' attorneys have filed dozens of ERISA class actions asking courts *to infer* an inadequate process from allegations that a plan underperformed for some (arbitrarily chosen) period of time.[2] Indeed, counsel for Plaintiffs here filed the first wave of similar lawsuits against 12 universities in just a two-week period.[3] But pleading a plausible ERISA claim requires more:

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[2] *See* John Sullivan, *How To Put The Brakes On 401k Ambulance Chasers*, 401K Specialist Mag. (Mar. 2, 2017), http://bit.ly/2o3LdX7 (noting significant uptick in 401(k) lawsuits, which "will stifle innovation").

[3] Carmen Castro-Pagan, *University Retirement Fee Cases: Where They Are Two Years Later*, Bloomberg Law (Aug. 20, 2018), https://www.bna.com/university-retirement-fee-n73014481848/; *see also* Greg Iacurci, *Have 403(b) lawsuits hit a*

district courts must engage in "careful, context-sensitive scrutiny of a complaint's allegations" to "divide the plausible sheep from the meritless goats." *Fifth Third Bancorp v. Dudenhoeffer*, 573 U.S. 409, 425 (2014).

That is precisely what the district court did here. The court examined each of the factual allegations that Plaintiffs contend imply an imprudent fiduciary process, and concluded that Plaintiffs' complaint did not plausibly suggest imprudence by the fiduciaries of the two Northwestern University 403(b) plans at issue in this case. Indeed, the court recognized that despite the complaint's considerable length, most of the "allegations" were "not specific to the defendants and the plans in this case" and instead were essentially a compendium "of plaintiffs' opinions both on ERISA law and on a proper long-term investment strategy for average people who lack the time to select either individual stocks or actively-managed funds." A5.[4]

The court also noted that Plaintiffs' allegations of fiduciary imprudence were largely premised on the five Named Plaintiffs' apparent preferences for particular types of investments—namely, their "clear preference for low-cost index funds," A19—and their dissatisfaction with other options in the plan's line-up, such as the CREF Stock Account, A4. ERISA fiduciaries must make decisions with *all* plan participants in mind, not just the five Named Plaintiffs: after all, "[a] professor of economics or finance might prefer investment options different from what a

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wall? Fifth university wins dismissal, Investment News (Jan. 9, 2019), https://bit.ly/2sm85DI.

[4] Counsel for Plaintiffs have asserted identical allegations (*viz.*, opinions) in boilerplate complaints filed against universities across the country. *Compare, e.g.*, A62-A65, A66-73, A79-82, *with* Am. Compl. ¶¶ 27-32, 33-49, 50-55, *Sweda v. University of Pa.*, No. 2:16-cv-04329-GEKP (E.D. Pa. Nov. 21, 2016), ECF No. 27.

professor of music might choose." A15. Thus, there were obvious, valid reasons for the diverse array of investment options that the Northwestern plans made available—rather than adopting Plaintiffs' "paternalistic" approach by limiting participant choice to only a limited number of index fund options, which were *already in the plan*. A15. As the district court properly concluded, the possibility that a different fiduciary might have adopted different options for a plan does not state a claim for a breach of fiduciary duty, particularly where the "good reasons" for the choices made by the fiduciary were apparent. A14. Plan fiduciaries have broad discretion to operate 403(b) plans to meet the needs and interests of their diverse participant base.

The district court's scrutiny of the conclusory assertions in Plaintiffs' complaint is squarely in line with the pleading standards set in *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 554 (2007), and *Ashcroft v. Iqbal*, 556 U.S. 662 (2009). District courts are *supposed* to scrutinize allegations in context to determine whether they are plausibly suggestive of wrongdoing, or whether they are equally consistent with rational, lawful behavior. *See Twombly*, 550 U.S. at 557 (citation omitted). And they are supposed to consider whether there is an "obvious alternative explanation" to the inference of wrongdoing that the plaintiffs ask the court to draw. *Iqbal*, 556 U.S. at 682. This is doubly true in complex cases, like this one, in which the "asymmetric" discovery burdens imposed on defendants would be enormously costly and could be used as leverage to extract settlements for meritless claims. *PBGC ex rel. St. Vincent Catholic Med. Ctrs. Ret. Plan v. Morgan Stanley*

Inv. Mgmt. Inc., 712 F.3d 705, 719 (2d Cir. 2013) (quoting *Am. Bank v. City of Menasha*, 627 F.3d 261, 266 (7th Cir. 2010)); *see also McCauley v. City of Chicago*, 671 F.3d 611, 616-617 (7th Cir. 2011) ("The required level of factual specificity rises with the complexity of the claim.").

At bottom, Plaintiffs suggest that they should be able to defeat dismissal simply by proffering, with the benefit of 20/20 hindsight, alternative fiduciary decisions that they believe could have resulted in better performance over a time period of their choosing. Plaintiffs' proposed standard would insulate duty-of-prudence claims from dismissal, as a plan fiduciary *always* could have made *some* decision that would have proved more profitable; it is not possible to beat the market every time. And allowing plaintiffs to plead ERISA claims merely by alleging poor performance or by second-guessing a fiduciary's discretionary choice among several reasonable alternatives "would impose high [fiduciary] costs upon persons who regularly deal with and offer advice to ERISA plans, and hence upon ERISA plans themselves." *Mertens v. Hewitt Assocs.*, 508 U.S. 248, 262 (1993). This is precisely what Congress sought to avoid in crafting ERISA.

This Court should reject Plaintiffs' invitation to dilute the pleading standard in ERISA cases and should thus affirm the district court's judgment.

ARGUMENT

I. ERISA Encourages The Creation Of Benefit Plans By Affording Flexibility And Discretion To Plan Sponsors And Fiduciaries.

A. ERISA Plan Fiduciaries Use Their Experience And Expertise To Make Numerous Discretionary Decisions While Accommodating A Participant Base With Diverse Interests.

When Congress enacted ERISA, it "did not *require* employers to establish benefit plans." *Conkright v. Frommert*, 559 U.S. 506, 516 (2010) (emphasis added). Rather, it crafted a statute intended to encourage employers to offer benefit plans while also protecting the benefits promised to employees. *Id.* at 516-517; *see also* H.R. Rep. No. 93-533, at 218 (1973), *reprinted in* 1974 U.S.C.C.A.N. 4639, 4647 (ERISA "represents an effort to strike an appropriate balance between the interests of employers and labor organizations in maintaining flexibility in the design and operation of their pension programs, and the need of the workers for a level of protection which will adequately protect their rights and just expectations"). In doing so, Congress "resolved innumerable disputes between powerful competing interests—not all in favor of potential plaintiffs." *Mertens*, 508 U.S. at 262. Congress knew that if it adopted a system that was too "complex," then "administrative costs, or litigation expenses, [would] unduly discourage employers from offering [employee-benefit] plans in the first place." *Varity Corp. v. Howe*, 516 U.S. 489, 497 (1996).

Congress also knew that plan fiduciaries must make a variety of decisions, often at times of considerable market uncertainty, and in a manner that accommodates "competing considerations." H.R. Rep. No. 96-869, at 67 (1980),

reprinted in 1980 U.S.C.C.A.N. 2918, 2935. They must take into account present and future participants' varying objectives, administrative efficiency, and the need to "protect[] the financial soundness" of plan assets. *Id.* As a result, Congress designed a statutory scheme that affords plan fiduciaries considerable flexibility—"greater flexibility, in the making of investment decisions …, than might have been provided under pre-ERISA common and statutory law in many jurisdictions." U.S. Dep't of Labor Opinion No. 81-12A, 1981 WL 17733, at *1 (Jan. 15, 1981). Indeed, the broad discretion conferred by Congress is the "sine qua non of fiduciary duty." *Pohl v. Nat'l Benefits Consultants, Inc.*, 956 F.2d 126, 129 (7th Cir. 1992).

Retirement plan fiduciaries draw upon their experience and expertise when making decisions about the investment options to offer to plan participants and the retention of any service providers. For example, unless the plan document specifically mandates certain decisions or otherwise limits fiduciary discretion, plan fiduciaries must make decisions concerning:

- the general investment policies for the plan (*e.g.*, whether certain types of investments, such as funds that invest in mortgage-backed securities, will be prohibited);
- the quantity of investment options to make available to plan participants (some plans offer a dozen, others offer more than two hundred);
- the risk levels of investment options to offer (ranging from very conservative capital-preservation options that aim to avoid loss, to aggressive growth strategies);
- the types of investment options to include (such as domestic equity funds, international funds, fixed-income funds, and target-date funds, among others);
- the structure of the investment options (*e.g.*, mutual funds or annuity contracts);

- the share classes of investment funds to offer, with certain share classes offering more "revenue sharing"—a common practice in which service providers of mutual funds share a percentage of the fees they receive with the administrative-service provider of a particular plan[5]—which can help defray participants' recordkeeping and other administrative costs; and
- any additional services that could be made available to plan participants, such as a self-directed brokerage window, participant loans, or investment-advice services.

Even after those decisions are made, plan fiduciaries must monitor the investment options selected and decide whether, and when, to change options. And contrary to assertions made in many ERISA complaints, prudent fiduciaries may reasonably decide not to remove an investment option from the plan anytime there is some indication of underperformance. Indeed, "chasing performance" by switching investments at times of underperformance may have a significant *negative* impact on investment returns.[6] Moreover, investing during a time of underperformance could be a way to obtain excellent performance results when the fund performance improves, as often occurs. And for plan participants who have invested in a particular fund, prematurely switching investments as soon as fund performance drops could negatively impact their retirement accounts, or even their inclination to continue participating in the plan, if they prefer buy-and-hold investing.

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[5] Deloitte Development LLC, *Defined Contribution Benchmarking Survey* 21 (2017) ("Deloitte Benchmarking Survey"), http://bit.ly/2BW7z6d.

[6] *See generally* Brian R. Wimmer, Daniel W. Wallick, & David C. Pakula, *Quantifying the impact of chasing fund performance* 1, Vanguard Research (July 2014), https://vgi.vg/2z3c8Yn); YiLi Chien, *Chasing Returns Has a High Cost for Investors*, Fed. Reserve Bank of St. Louis (Apr. 14, 2014), http://bit.ly/2EpHLkD.

Plan fiduciaries must also decide whether to outsource plan services (such as recordkeeping). And they must make decisions about elective services that may be provided to participants (such as participant-loan or investment-advice services). If fiduciaries elect to hire service providers, they must decide which service provider(s) to retain, negotiate the providers' compensation, and determine whether that compensation should be paid on a hard-dollar per-participant fee, an asset basis, or via specialized fees for particular services. Fiduciaries must also determine whether plan services and investment options should be coordinated through the same vendor—a common practice known as "bundling"[7]—to take advantage of potential discounts, or whether services and investment options should be provided by unrelated entities.

Moreover, the nature of the retirement plan can significantly affect the cost of administrative services provided and the fees of the investment options offered. For example, 403(b) plans—the type of retirement plans typically offered by universities—are more restricted than 401(k) plans in the types of investment options they are permitted to offer. IRS, *Retirement Plans FAQs regarding 403(b) Tax-Sheltered Annuity Plans* (last updated Nov. 9, 2018), https://bit.ly/2OiE6He. They have historically offered annuities—contractual insurance products that, in some varieties, offer guaranteed future payments to annuitants. Annuities have different beneficial attributes than mutual funds or other investments and, consequently, may have different fee structures and recordkeeping requirements.

[7] *See* Deloitte Benchmarking Survey 24.

These characteristics necessarily affect the decisions 403(b) plan fiduciaries must make when determining which service providers to retain and when negotiating service-provider compensation, and they make Plaintiffs' fee comparisons here to non-annuity products and 401(k) plans inapt.[8] *E.g.*, A156-A161.

Fiduciaries must also determine the duration of service-provider agreements and whether, and when, to switch providers. These decisions implicate numerous competing considerations, including cost, quality of services, and the need to facilitate a constructive working relationship between the plan and its providers. Most plans work with the same service provider(s) because they value continuity given the disruption and participant confusion that switching providers may cause. As of 2017, 41% of plans had a five-year contract with their current service provider and 53% had been with their current recordkeeper for more than 10 years.[9]

B. ERISA's "Prudent Man" Standard Affords Broad Discretion To ERISA Plan Fiduciaries.

Given the breadth of fiduciary decisions made in the face of market uncertainty and the diversity of American workplaces, Congress chose not to impose one-size-fits-all substantive requirements on retirement plan decision-making. Instead, Congress chose the "prudent man" standard to define the scope of the duties that fiduciaries owe to plans and their participants. *See* 29 U.S.C. § 1104(a). Congress chose this standard with a goal of providing fiduciaries with the flexibility necessary to determine how best to tailor their plans to their participants' needs.

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[8] *See* TIAA CREF, *Assessing reasonableness of 403(b) retirement plan fees* 7 (Jan. 2012), https://403bwise.com/pdf/TC_reasonableness_403b_fees.pdf.

[9] Deloitte Benchmarking Survey 24-25.

See Fine v. Semet, 699 F.2d 1091, 1094 (11th Cir. 1983). Neither Congress nor the Department of Labor provides a list of required or forbidden investment options, investment strategies, service providers, or compensation structures. Nor does the "prudent man" standard require fiduciaries to "scour the market to find and offer" the most profitable or cheapest investments and service providers, "which might, of course, be plagued by other problems." *Hecker v. Deere & Co.*, 556 F.3d 575, 586 (7th Cir. 2009). Instead, fiduciaries must make reasonably *prudent* decisions based on the information available at the time according to their own experience and expertise.

The flexibility Congress provided means that fiduciaries have a wide range of reasonable options for almost any decision they make. There are many administrative service providers (including Northwestern's recordkeepers, Fidelity and TIAA), which compete on a range of levels, with different fee structures, service offerings, quality, and reputations.[10] There are thousands of reasonable investment options with different investment styles and risk levels—nearly 10,000 mutual funds alone,[11] several thousand of which are offered in retirement plans, in addition to other investment options such as annuities—and nearly innumerable ways to structure a plan that employees can use to save for retirement.

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[10] *See, e.g.*, Chad Brooks, *Retirement Plan Providers for Your Business*, Business News Daily (Mar. 4, 2019), http://bit.ly/2GcvDzI; Andrew Wang, *401K Providers: 2016 Top 20 Lists*, Runnymede Capital Management Blog (July 26, 2016), http://bit.ly/2suEbjC.

[11] Investment Company Institute, *2017 Investment Company Fact Book* 19 (57th ed. 2017), https://www.ici.org/pdf/2017_factbook.pdf.

Thus, while ERISA plaintiffs (including Plaintiffs here) often try to challenge fiduciaries' decisions to offer specific investment options by pointing to less expensive or ultimately better-performing alternatives and then suggesting that the fiduciaries *must have* had an inadequate decision-making process, that is not how the prudence standard operates. There is no one prudent fund, service provider, or fee structure that renders any other choice imprudent. Instead, there is a wide range of reasonable choices, and Congress vested fiduciaries with the flexibility and discretion to choose from among those options based on their informed assessment of the needs of their plan. As the Department of Labor has put it, "[w]ithin the framework of ERISA's prudence, exclusive purpose and diversification requirements, … plan fiduciaries have broad discretion in defining investment strategies appropriate to their plans." U.S. Dep't of Labor Opinion No. 2006-08A (Oct. 3, 2006), http://bit.ly/2o3k06Y.

II. An ERISA Complaint Cannot Rely Solely On Inferences From Circumstantial Facts That Have An Innocuous Alternative Explanation Or Suggest The Mere "Possibility" Of Misconduct.

As noted above, ERISA's standard for acting prudently "focus[es] on a fiduciary's conduct in arriving at an investment decision, not on its results." *In re Unisys*, 74 F.3d at 434. "[T]he proper question" in evaluating an ERISA claim is not whether the results of the fiduciary decision were unfavorable, but whether a fiduciary "employed the appropriate methods to investigate." *Harris v. Amgen, Inc.,* 788 F.3d 916, 935-936 (9th Cir. 2014) (citation omitted), *rev'd on other grounds*, 136 S. Ct. 758 (2016); *accord St. Vincent*, 712 F.3d at 716. Thus, a plaintiff's complaint must plead sufficient facts to raise a "*plausible* inference" of an inappropriate

decision-making process without "rely[ing] on 'the vantage point of hindsight.'" *St. Vincent*, 712 F.3d at 718 (citation omitted).

Plaintiffs' amended complaint does not allege any facts regarding Defendants' decision-making process. Instead, Plaintiffs asked the district court to *infer* that the Northwestern plan fiduciaries were asleep at the wheel simply because there were alternative options that had lower fees than, or in hindsight outperformed, the options selected by plan fiduciaries during specified periods of time. That is not the law. For complaints that lack direct allegations of wrongdoing, this Court has consistently directed lower courts to carefully probe the circumstantial allegations to determine whether they plausibly suggest malfeasance or whether they are equally "consistent with lawful conduct." *McCauley*, 671 F.3d at 619.

A. Claims That Rely On Inferences Of Wrongdoing From Circumstantial Facts Must Allege "Something More" Than Allegations That Are Equally Consistent With Lawful Behavior.

There are numerous areas of the law in which courts must consider whether wrongdoing can be inferred from circumstantial factual allegations to satisfy the pleading standards set forth in *Twombly* and *Iqbal*.

Indeed, this Court has taken precisely this approach in a post-*Twombly* ERISA case, *Hecker v. Deere & Co.* As here, the plaintiffs in *Hecker* alleged that the Deere plan fiduciaries breached their fiduciary duties by including in the plan line-up funds with purportedly excessive fees, and by paying the plan recordkeeper through revenue sharing payments from the expense ratios collected by those funds. 556 F.3d at 578. This Court held that the complaint did not state a plausible claim for fiduciary breach because the plaintiffs were complaining that the fiduciaries

failed to satisfy a standard of fiduciary behavior that ERISA did not set. As this Court explained, ERISA does not require fiduciaries "to scour the market to find and offer the cheapest possible fund"; it requires fiduciaries to make available a reasonable "mix of investments" from which plan participants can exercise meaningful choice. *Id.* at 586. This Court reaffirmed this holding in *Loomis v. Exelon Corp.*, 658 F.3d 667 (7th Cir. 2011), when it rejected claims alleging that a plan "should have offered only 'wholesale' or 'institutional' funds," rather than a diversified plan line-up that included *both* "retail" and "institutional" funds, noting that "absen[t] from ERISA [is] any rule that forbids plan sponsors to allow participants to make their own choices." *Id.* at 671, 673. In both cases, the court declined to infer a breach from circumstantial allegations that were just as consistent with lawful fiduciary behavior.

The Court's reasoning in *Hecker* and *Loomis* mirrors its approach in numerous other contexts. For example, this Court addressed the issue in *McCauley v. City of Chicago*, an equal protection case in which the plaintiff alleged that the City of Chicago lacked adequate policies for the protection of female domestic violence victims. The Court explained that a complaint relying on inferences from circumstantial facts "must contain allegations plausibly suggesting (not merely consistent with) an entitlement to relief," and that courts should determine whether those allegations are consistent with an "obvious alternative explanation" to malfeasance by the defendant. 671 F.3d at 616 (quotation marks omitted). This Court scrutinized the plaintiffs' circumstantial allegations, evaluating whether they

supported a "reasonable inference that the City established a policy or practice of intentionally discriminating against female victims of domestic violence" or whether they were just as "consistent with lawful conduct." *Id.* at 618-619.

Courts have taken the same approach in RICO cases, *Limestone Dev. Corp. v. Village of Lemont*, 520 F.3d 797 (7th Cir. 2008); *Eclectic Props. E., LLC v. Marcus & Millichap Co.*, 751 F.3d 990 (9th Cir. 2014), securities cases (even outside the context of heightened pleading for claims under the PSLRA), *In re Century Aluminum Co. Sec. Litig.*, 729 F.3d 1104 (9th Cir. 2013), and discrimination cases, *McReynolds v. Merrill Lynch & Co.*, 694 F.3d 873 (7th Cir. 2012). In each context, when the plaintiffs failed to provide direct allegations about a foundational element, courts carefully scrutinized the circumstantial allegations and ordered dismissal when those allegations were equally consistent with lawful behavior.[12] As this Court has summarized, it is no longer sufficient "for a complaint to avoid foreclosing possible bases for relief; it must actually suggest that the plaintiff has a right to relief by providing allegations that raise a right to relief above the speculative level." *EEOC v. Concentra Health Servs., Inc.*, 496 F.3d 773, 777 (7th Cir. 2007) (quotation marks); *see also Century Aluminum*, 729 F.3d at 1108 ("When faced with

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[12] *Limestone Dev.*, 520 F.3d at 804 (concluding that "*[m]aybe* some promising prospect was scared off" by a purported RICO enterprise's actions but that the conclusory assertion was speculative); *Eclectic Props.*, 751 F.3d at 998-999 (significant increase in real estate prices was "consistent with Defendants' alleged fraudulent intent" but "does not tend to exclude a plausible and innocuous alternative explanation," such as the variability of property values and fluctuations in prices over time); *Century Aluminum*, 729 F.3d at 1108 (rejecting securities claims when the circumstantial allegations rendered wrongdoing "merely *possible* rather than plausible"); *McReynolds*, 694 F.3d at 886 (affirming district court's conclusion that inference of intentional discrimination was "implausible").

two possible explanations, only one of which can be true and only one of which results in liability, plaintiffs cannot offer allegations that are 'merely consistent with' their favored explanation but are also consistent with the alternative explanation." (citation omitted)).

This Court's decisions recognize, as the Supreme Court did in *Twombly*, the "practical significance" of the Rule 8(a) pleading requirement in cases in which the plaintiff does not present any direct allegations of wrongdoing but instead relies entirely on circumstantial allegations that, even if true, do not establish unlawful conduct. *Twombly*, 550 U.S. at 557. Because "discovery can be expensive" in complex, document-heavy cases, the mere threat of discovery "will push cost-conscious defendants to settle even anemic cases before reaching those proceedings" and thus encourage plaintiffs with groundless claims to file suit in the hopes of inducing a settlement. *Twombly*, 550 U.S. at 558-59; *see also Swanson v. Citibank, N.A.*, 614 F.3d 400, 405 (7th Cir. 2010) ("one powerful reason that lies behind the Supreme Court's concern about pleading standards is the cost of the discovery that will follow in any case that survives a motion to dismiss on the pleadings"). Thus, "a district court must retain the power to insist upon some specificity in pleading before allowing a potentially massive factual controversy to proceed." *Twombly*, 550 U.S. at 558 (citation omitted).

That is why this Court has repeatedly instructed that "[t]he required level of factual specificity rises with the complexity of the claim." *McCauley*, 671 F.3d at 616-617. "A more complex case … will require more detail, both to give the

opposing party notice of what the case is all about and to show how, in the plaintiff's mind at least, the dots should be connected." *Swanson*, 614 F.3d at 405. This is certainly true of ERISA cases, which are enormously complex, the costs of discovery are both asymmetrical and sky high, and the amount of plan assets at issue for a large employer are so significant that the potential judgment in even a likely meritless case creates extraordinary settlement pressure.

Indeed, this case provides a perfect example. The district court here authorized discovery to take place while Northwestern's motion to dismiss was still pending. Dkt. 67. And in the 16 months that elapsed between the filing of the motion to dismiss and the district court's order of dismissal, Northwestern was required to produce more than 450,000 pages of documents and incurred nearly $4 million in attorneys' fees and expenses related to discovery. Dkt. 154 ¶¶ 8, 28. These types of extraordinary and asymmetrical expenses, and the settlement pressure and incentives for meritless suits they create, are precisely why the "doors of discovery" should not be unlocked until a plaintiff has demonstrated "a plausible claim for relief." *Iqbal*, 556 U.S. at 678.

B. Allowing Hindsight-Based Disagreement With Discretionary Fiduciary Decisions Would Encourage Meritless Lawsuits And Undermine Congress's Intent.

There are also compelling practical reasons for applying the same careful inquiry of circumstantial allegations in ERISA cases that the court undertakes in other cases where the plaintiff's assertion of wrongdoing relies entirely on inference and conjecture. ERISA fiduciaries making discretionary decisions are at risk of being sued for a fiduciary breach seemingly no matter what decision they make.

Plaintiffs sue fiduciaries for failing to divest from stocks with declining share prices or high risk profiles.[13] And they sue fiduciaries for failing to *hold on to* such stock because high risk can produce high reward.[14] Plaintiffs here allege that it is imprudent for a plan to offer numerous investment options in the same style (A97-A98), while other plaintiffs complain that including *only one option* in each investment style is imprudent.[15] Some plaintiffs allege that plans offered imprudently risky investments,[16] while others allege that fiduciaries were *imprudently cautious*.[17] And in some instances, fiduciaries have simultaneously defended against "diametrically opposed" theories of liability in different lawsuits, giving new meaning to the phrase "cursed-if-you-do, cursed-if-you-don't."[18]

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[13] *In re RadioShack Corp. ERISA Litig.*, 547 F. Supp. 2d 606, 611 (N.D. Tex. 2008) (plaintiffs alleged that defendants failed "to divest the plans of all RadioShack stock … despite the fact that they knew the stock price was inflated").

[14] *E.g.*, *Thompson v. Avondale Indus., Inc.*, No. Civ.A.99-3439, 2000 WL 310382, at *1 (E.D. La. Mar. 24, 2000) (plaintiff alleged that fiduciaries "prematurely" divested ESOP stock).

[15] *E.g.*, Amended Compl., *In re GE ERISA Litig.*, No. 1:17-cv-12123-DJC (D. Mass. Jan. 12, 2018), ECF No. 35.

[16] *E.g.*, *In re Citigroup ERISA Litig.*, 104 F. Supp. 3d 599, 608 (S.D.N.Y. 2015), *aff'd sub nom.*, *Muehlgay v. Citigroup Inc.*, 649 F. App'x 110 (2d Cir. 2016); *St. Vincent*, 712 F.3d at 711.

[17] *See Brown v. Am. Life Holdings, Inc.*, 190 F.3d 856, 859-60 (8th Cir. 1999) (assuming without deciding that "the fiduciary duty of prudent diversification can be breached by maintaining an investment portfolio that is *too safe and conservative*"); Compl., *Barchock v. CVS Health Corp.*, No. 1:16-cv-00061-ML-PAS (D.R.I. Feb. 11, 2016), ECF No. 1 (alleging plan fiduciaries breached the duty of prudence by investing portions of the plan's stable value fund in conservative money market funds and cash management accounts).

[18] *E.g.*, *Evans v. Akers*, 534 F.3d 65, 68 (1st Cir. 2008).

Courts have recognized this dilemma, noting that ERISA fiduciaries often find themselves "between a rock and a hard place," *Dudenhoeffer*, 573 U.S. at 424, or on a "razor's edge," *Armstrong v. LaSalle Bank Nat'l Ass'n*, 446 F.3d 728, 733 (7th Cir. 2006). And the Supreme Court has instructed courts reviewing a motion to dismiss that "careful, context-sensitive scrutiny of a complaint's allegations" is the appropriate way to address this dilemma. *Dudenhoeffer*, 573 U.S. at 425.

Without this scrutiny, ERISA plaintiffs could impose serious discovery burdens on plan fiduciaries based on speculation. If ERISA plaintiffs were allowed to survive dismissal merely by pointing to alternative decisions that, with the benefit of hindsight, could have produced more favorable outcomes, then the "important mechanism" of the motion to dismiss "for weeding out meritless claims," *Dudenhoeffer*, 573 U.S. at 425, would be toothless. Plaintiffs' attorneys will always be able to identify an investment option that performed better or had lower fees during some arbitrarily selected time period, because there are thousands of investment options and numerous service providers that compete in the marketplace.

Given the "ominous" prospect of discovery in ERISA actions and the "probing and costly inquiries" that discovery entails (including the need to retain expensive fiduciary and financial experts), *St. Vincent*, 712 F.3d at 719, the superficial approach to analyzing ERISA complaints that Plaintiffs seek would "push cost-conscious defendants to settle even anemic cases," *Twombly*, 550 U.S. at 559, if not lead to outright "settlement extortion," *St. Vincent*, 712 F.3d at 719 (citation

omitted). And ERISA plaintiffs could exploit that standard to target large and generous plan sponsors, like Northwestern, in the hopes of pressuring the defendant into settling.

Given these incentives, adopting anything less than the "careful … scrutiny" of ERISA complaints prescribed in *Twombly* and *Dudenhoeffer* would create precisely the types of "undu[e]" administrative costs and litigation expenses that Congress intended to avoid. *Conkright*, 559 U.S. at 516-517. Even sponsors and fiduciaries with an exemplary decision-making process would face enormous settlement pressure due to the "ominous" costs of discovery in ERISA class actions. *St. Vincent*, 712 F.3d at 719. Others may feel pushed toward homogeneous product offerings—consisting entirely of the index mutual funds that plaintiffs and plaintiffs' attorneys prefer *now* while overall market conditions remain favorable[19]—and discouraged from the type of innovation and diversified plan offerings that increase participant choice and can offer protection from market downturns.

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[19] Though index mutual funds have grown in popularity during a decade-long bull market, the index fund line-up that Plaintiffs advocate could have negative repercussions for plan participants depending on market conditions. "[I]n a down market, … active managers can put cash on the sidelines or use other strategies to minimize losses, while index funds must continue to hold the same mix of assets no matter what." Jeff Brown, *Do Actively Managed Funds Really Pay Off for Investors?*, US News (Apr. 14, 2016), https://bit.ly/2DK8VRi. That is why "active managers have [historically] lagged behind benchmarks during long, strong bull markets," but "[t]hey tend to make up lost ground when markets level off or suffer corrections." Michael A. Pollock, *The Case for Actively Managed Funds*, Wall St. J. (Feb. 8, 2015), https://on.wsj.com/2HEQaTb ("nearly two-thirds of active large-cap funds beat the S&P" from 2000 to 2008).

For the twenty percent of plan sponsors that are small or mid-sized entities—a number that has already decreased in recent years[20]—there is a real risk that costs inflated through the need to defend meritless lawsuits may discourage them from offering ERISA benefits, just as Congress feared. *See Conkright*, 559 U.S. at 517. And for those that continue to sponsor plans, Plaintiffs' diluted pleading standard, and the strike suits it would encourage, would raise the costs of services, indemnification, and insurance—ultimately diverting resources from other aspects of employee-benefit programs, such as retirement matching contributions or subsidization of healthcare premiums. This would undermine the "careful balancing" Congress struck in ERISA following "a decade of congressional study," *Renfro v. Unisys Corp.*, 671 F.3d 314, 321 (3d Cir. 2011), and crimp the considerable flexibility Congress provided to encourage plan sponsors to administer employee-benefit plans.

Neither ERISA nor the pleading standards articulated by the Supreme Court supports such a result. This Court's approach to Rule 12(b)(6) motions in ERISA cases must be careful to guard against it.

C. The District Court Properly Dismissed Plaintiffs' Claims Here Because They Rely Entirely On Circumstantial Allegations That Are Entirely Consistent With Lawful Fiduciary Behavior.

As in the cases discussed above, ERISA plaintiffs often fail to present any direct allegations of the foundational element of their claims—here, an imprudent

[20] *See* Deloitte Benchmarking Survey 6 (reporting that more than one-third of plan sponsors surveyed by Deloitte in 2013 and 2014 employed 500 or fewer employees, while just one-fifth employed the same number of employees in 2017).

decision-making process that establishes a fiduciary breach. Instead, plaintiffs ask courts to infer wrongdoing entirely from circumstantial allegations, such as the performance or fees associated with funds included in a plan lineup compared to other available funds that could have been selected, or the fees service providers charged compared to alternatives. But those circumstantial allegations, made in hindsight, are often consistent with entirely lawful conduct, particularly given the range of reasonable options available to fiduciaries for each decision they must make. And when that is true, as it is here, the complaint should be dismissed.

Plaintiffs' attempt to infer that the Defendants' decision-making process was imprudent because not every investment in the plan line-up outperformed the market is a perfect example of this sort of speculation. First, as another court observed in an almost identical case against the University of Pennsylvania, a plan line-up in which some funds outperform the market and some funds underperform the market is precisely what one would expect in any "statistical sampling of funds": "[s]uch a *post* hoc analysis of market performance … *may* be consistent with a breach of fiduciary duty, but does not show that the plaintiffs have 'nudged their claims across the line from conceivable to plausible.'" *Sweda v. Univ. of Pa.*, No. 16-4329, 2017 WL 4179752, at *10 (E.D. Pa. Sept. 21, 2017) (citation omitted), *appeal filed*, No. 17-3244 (3d Cir. Oct. 13, 2017).

Second, as noted above, p. 12, *supra*, chasing performance by transferring investments from lower-performing to higher-performing options often leads to worse returns over time. Thus, it is perfectly consistent with lawful, responsible

fiduciary behavior to hold an underperforming investment during down periods—particularly if the investment has attributes that would allow it to outperform its benchmark during periods of market volatility, or provide less volatility in such markets. *See White v. Chevron Corp.*, No. 16-cv-0793-PJH, 2016 WL 4502808, at *17 (N.D. Cal. Aug. 29, 2016) ("[A] fiduciary may—and often does—retain investments through a period of underperformance as part of a long-range investment strategy.").

Third, even if a plausible inference of an imprudent fiduciary process could in theory be drawn from an investment underperforming alternatives with comparable investment strategies, Plaintiffs here rely on the improper (but all-too-common) tactic of comparing investments with *different* investment strategies. For example, Plaintiffs contend that the CREF Stock Account made available in the Plan lineup underperformed the Vanguard PRIMECAP Fund, and the Vanguard Capital Opportunity Fund. Pls.' Br. 7; A151-156. But those comparisons are not fair ones: these Vanguard funds are *not* the CREF Stock Account's actual benchmarks;[21] they

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[21] "Benchmark" refers to a carefully chosen index against which investment managers measure the performance of a particular investment depending on the investment strategy and performance goal chosen. Investopedia, *What is a Benchmark*, https://www.investopedia.com/terms/b/benchmark.asp. The Stock Account's benchmark is the CREF Composite Benchmark, and the Fund also compares itself to the Morningstar Aggressive Target Risk Index and Morningstar's 85%+ Equity Allocation category. TIAA, *CREF Stock Account Fact Sheet* (Dec. 31, 2018), https://go.tiaa.org/2GtSfAJ. The CREF Stock Account has tracked or exceeded the performance of each of these benchmarks at the one-year, three-year, five-year, and ten-year marks. *Id.*

are not even in the same general investment category as the CREF Stock Account.[22] When funds have different investment strategies, the fact that differences in performance emerge provides no basis to infer that the fiduciary's "decision-making process was flawed." *Meiners v. Wells Fargo & Co.*, No. 16-3981(DSD/FLN), 2017 WL 2303968, at *3 (D. Minn. May 25, 2017), *aff'd*, 898 F.3d 820 (8th Cir. 2018). To hold otherwise would allow a plaintiff to cherry-pick "comparison" investments in order to pursue a breach of fiduciary duty claim any time a plan does not offer the single best-performing investment at all times—a strategy that exposes every retirement plan to continuous suits and expensive litigation, and encourages constant turnover to chase performance in plan line-ups that are designed not for short-term gains, but for long-term investment for retirement.

Plaintiffs' suggested inference of imprudence from plan fiduciaries' choice of investments that have "layers of fees" that the Plaintiffs believe are "unnecessary" (Pls.' Br. 6, 8, 24, 33, 36) has likewise been correctly rejected by courts. *E.g.*, *Cunningham v. Cornell Univ.*, No. 16-cv-6525 (PKC), 2017 WL 4358769, at *6 (S.D.N.Y. Sept. 29, 2017). As this Court noted in *Hecker*, "[t]he total fee, not the internal, post-collection distribution of the fee, is the critical figure." 556 F.3d at 586. This point should be an obvious one: when a consumer purchases a Samsung television, she cares about its total cost, not whether the licensing fee embedded in

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[22] *Compare CREF Stock Account*, Morningstar, https://bit.ly/2IouTsJ (Investment Category: Allocation—85%+ Equity), *with Vanguard Diversified Equity*, *Vanguard PRIMECAP*, Morningstar, https://bit.ly/2GOPLfq (Investment Category: Large Growth), *and Vanguard Capital Opportunity*, Morningstar, https://bit.ly/2EfB0gm (same).

the total cost is reasonable or whether the amounts Samsung pays to manufacturers of the television's component parts are reasonable.

Similar flaws plague Plaintiffs' allegations that plan fiduciaries offered bundled products from TIAA and structured its plan line-up using investment options from only two providers. Pls' Br. 6, 7-8. (In an obvious irony, Plaintiffs simultaneously ask the Court to infer imprudence from the plan fiduciaries' *failure to bundle* all of their recordkeeping services with one service provider. Pls' Br. 10.) This precise argument was rejected in *Hecker*. *See* 556 F.3d at 586 ("[M]any prudent investors limit themselves to funds offered by one company and diversify within the available investment options."). Plaintiffs take particular aim at the decision to offer both the TIAA Traditional Annuity and the CREF Stock Account, which TIAA bundles together as a product offering under certain types of contracts for its retirement plan customers. Pls.' Br. 7-8. But far from plausibly suggesting fiduciary imprudence, these allegations are entirely consistent with "lawful, free market behavior in the best interests of those involved, including beneficiaries." *Sweda*, 2017 WL 4179752, at *8. As another court observed:

> Companies, for example, often "bundle" phone service in with the more popular cable and internet services, even when the users do not want a land line. In those instances, it is still a rational self-interested action to purchase the bundle because the other equipment is worth the price for the consumer, even with the unnecessary or undesired product or fee.

Id. at *8.

Finally, Plaintiffs' suggestion that the plan fiduciaries were running the plans on auto-pilot rather than engaging in an appropriate decision-making process

conflicts with Plaintiffs' allegations that Northwestern restructured its plan line-ups and effected a complete overhaul of the investment options offered to plan participants in 2016 (A104). These types of changes take years of research, consideration, planning, and implementation for plans as large as Northwestern's. Plaintiffs try to use these actions as somehow reflecting a *concession* of fiduciary malfeasance, but they are far more indicative of an engaged fiduciary acting in participants' best interests.

In short, because the alleged facts, when stripped of irrelevant legal conclusions, are equally consistent with rational, lawful behavior as compared to a fiduciary breach, the district court correctly dismissed Plaintiffs' complaint.

CONCLUSION

For the foregoing reasons, the decision of the district court should be affirmed.

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Respectfully submitted,

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This brief complies with the type-volume limitations of Federal Rule of Appellate Procedure 32(a)(7)(B) and Circuit Rule 29 because it contains **6,981** words, excluding the parts exempted by Federal Rule of Appellate Procedure 32(f)

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I hereby certify that on March 21, 2019, I electronically filed the foregoing with the Clerk of the Court for the United States Court by using the CM/ECF system. I certify that all participants in the case are registered CM/ECF users and that service will be accomplished by the CM/ECF system.

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