No. 17-3244

IN THE
UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

JENNIFER SWEDA, BENJAMIN A. WIGGINS, ROBERT L. YOUNG, FAITH PICKERING, PUSHKAR SOHONI, and REBECCA N. TONER, individually and as representatives of a class of similarly situated persons of the University of Pennsylvania Matching Plan,

Plaintiffs-Appellants,

v.

THE UNIVERSITY OF PENNSYLVANIA, INVESTMENT COMMITTEE, and JACK HEUER,

Defendants-Appellees.

On Appeal from the United States District Court
for the Eastern District of Pennsylvania
No. 2:16-cv-04329-GEKP (Hon. Gene E.K. Pratter)

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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TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES

Page(s)

Cases

Statute and Legislative Materials

Administrative Materials

Rules

Other Authorities

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 435 members are primarily large, multistate employers that provide employee benefits to active and retired workers and their families. The Council's membership also includes 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 every American who participates in employer-sponsored benefit programs.

[1] 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.

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. Dudenhoeffer*, 134 S. Ct. 2459 (2014); *Renfro v. Unisys Corp.*, 671 F.3d 314 (3d Cir. 2011).

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. *Fifth Third*, 134 S. Ct. at 2470-71. Plaintiffs here seek a diluted pleading standard that would authorize discovery 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, which would defeat dismissal in virtually every case.

SUMMARY OF THE 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 and additional services, including participant loans or investment advice). As to each of these myriad 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) (citation omitted), fiduciaries are judged not for the outcome of their decisions but for 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 containing *no* allegations about the fiduciaries' decision-making process and instead asking courts *to infer* an inadequate process from allegations that a plan underperformed for some (arbitrarily chosen) period of time.[2] Pleading a plausible ERISA claim requires more: 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*, 134 S. Ct. 2459, 2470 (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' allegations did not plausibly suggest imprudence by the Plan. Indeed, the court recognized that the inferences Plaintiffs asked it to draw were undermined by other allegations in Plaintiffs' own complaint or documents incorporated by reference in the complaint—for example, Plaintiffs' allegation that plan fiduciaries failed to adequately consider supposedly lower-fee institutional-share-class funds overlooked that "nearly half" of the funds "are *already* these lower-fee funds." A21 (emphasis added). The court also recognized

[2] *See* Rebecca Moore, *What the 403(b) Excessive Fee Lawsuits Do Not Consider*, PlanSponsor, Aug. 18, 2016, https://www.plansponsor.com/what-the-403b-excessive-fee-lawsuits-do-not-consider/ (discussing wave of lawsuits filed against universities); John Sullivan, *How To Put The Brakes On 401k Ambulance Chasers*, 401K Specialist Magazine (Mar. 2, 2017), http://bit.ly/2o3LdX7 (noting significant uptick in 401(k) lawsuits, which "will stifle innovation").

that the practices about which the Plaintiffs complained (such as the fee structure for administrative services, and bundling services and investment offerings among one or two providers) were "'just as much in line with a wide swath of rational and competitive business strategy' in the market as they are with a fiduciary breach." A17 (quoting *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 554 (2007)). The district court's analysis mirrors post-*Twombly* decisions in other contexts, in which courts have recognized that mere descriptions of lawful conduct coupled with conclusory assertions of wrongdoing fail to state a claim. *See* pp. 15-18, *infra* (discussing antitrust, retaliation, supervisory liability, RICO, and securities cases).

At bottom, Plaintiffs suggest that they should be able to unlock the doors to discovery simply by proffering, with the benefit of 20/20 hindsight, alternative fiduciary decisions that they believe could have been more profitable. Plaintiffs' standard could be met in virtually any case, 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 claims against an ERISA fiduciary merely by alleging poor performance or by second-guessing a fiduciary's discretionary choice among several reasonable options "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 (noting that 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"). As this court has recognized, "[i]n enacting ERISA, Congress resolved innumerable disputes between powerful competing interests—not all in favor of potential plaintiffs." *Renfro v. Unisys Corp.*, 671 F.3d 314, 321

(3d Cir. 2011) (quotation marks omitted). 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). As courts have recognized, 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 considerable experience and expertise when making decisions about the investment options to offer to plan participants and any service providers to retain. 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 appropriate quantity of investment options to make available to plan participants (some plans offer a dozen, others offer more than one hundred);
- the risk levels of investment options to offer (ranging from very conservative capital-preservation options simply intended to avoid loss, to aggressive growth strategies);
- the investment styles to include (such as domestic equity funds, international funds, allocation funds, fixed-income funds, and target-date funds, among others);
- the structure of the investment options (such as mutual funds, annuity contracts, separate accounts, or collective trusts);
- the share class 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 employer-sponsored plan[3]—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 investment decisions have been made, plan fiduciaries must monitor the investment options selected and decide whether, and when, to change options. And contrary to the refrain of the ERISA plaintiffs' bar, prudent

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

fiduciaries may reasonably decide not to drop investment options 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.[4] Literature suggests that, generally, "a period of above-market performance for a given fund will be followed (eventually) by a period of below-market performance" and vice versa—a concept known as "reversion to the mean."[5] Investing during a time of underperformance could be a way to obtain excellent performance results when the fund reverts back to or above the mean. 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. As a result, it is generally a reasonable strategy for fiduciaries to retain funds until performance improves or at least until such time as the fiduciary

[4] *See generally*, Brian R. Wimmer, Daniel W. Wallick, and David C. Pakula, *Quantifying the impact of chasing fund performance* 1, Vanguard Research (July 2014), *available at* https://vgi.vg/2z3c8Yn (discussing the "lure of performance-chasing" and providing an empirical analysis of why buy-and-hold strategies are more prudent); YiLi Chien, *Chasing Returns Has a High Cost for Investors*, Fed. Reserve Bank of St. Louis (Apr. 14, 2014), http://bit.ly/2EpHLkD.

[5] Mike Piper, *Chasing Performance: What It Is and How to Avoid It*, Oblivious Investor (Jan. 1, 2009), http://bit.ly/2ErRoiY.

determines that performance is not likely to get better given market conditions and the fund's investment strategy.

Plan fiduciaries must also decide whether to outsource plan services (such as recordkeeping). And they must make decisions about additional elective services that may be provided to plan 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 compensation for such providers, and determine whether such 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"[6]—to take advantage of potential discounts, or whether services and investment options should be provided by unrelated entities.

Here, too, the decisions must take account of several competing considerations. For example, structuring service-provider compensation on a hard-dollar, per-participant basis could mean that lower-balance, lower-income employees may shoulder a significantly larger share of the plan's fees, placing disproportionate burdens on a group that already faces barriers to retirement plan

[6] *See* Deloitte Benchmarking Survey 24.

enrollment.[7] Thus, fiduciaries may reasonably elect to structure service-provider compensation as a percentage of assets under management through revenue-sharing practices, which results in those participants who obtain the greatest rewards from the plan paying a proportionate share of the costs to manage the plan. Fiduciaries may also elect to use a combination of these compensation structures. *See* Deloitte Development LLC, *Defined Contribution / 401(k) Fee Study* 15 (2009), *available at* http://www.ici.org/pdf/rpt_09_dc_401k_fee_study.pdf. Thus, as the district court recognized, this compensation decision involves "a pure question of where the burden of recordkeeping costs should be placed—a question open to the discretion of a reasonable plan administrator." A19.

Moreover, the nature of the retirement plan can significantly impact the cost of administrative services provided and the fees of the investment options offered. For example, 403(b) plans—the type of retirement plans offered by universities and other tax-exempt 501(c)(3) entities—may not offer several types of investment options permitted for 401(k) plans, and they have historically offered annuities, which are contractual insurance products that, in some varieties, offer guaranteed future payments to annuitants. Annuities are more complicated investment options

[7] *See* Bureau of Labor Statistics, News Release, *Employee Benefits in the United States - March 2014* 5 (July 25, 2014), http://www.bls.gov/ncs/ebs/sp/ebnr0020.pdf (reporting that only 22% of workers in the bottom quartile wage group participate in retirement benefits, whereas 79% of wage earners in the top quartile do so).

that have different beneficial attributes than mutual funds or other investments and, consequently, may have different fee structures and record-keeping requirements. 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.

Fiduciaries must also determine the duration of service-provider agreements and whether, and when, to switch providers. These decisions also 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 for many years 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% of plans had been with their current recordkeeper for more than 10 years.[8]

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, Congress chose the "prudent man" standard to define the scope of the duties that these 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

[8] Deloitte Benchmarking Survey 24-25.

the flexibility necessary to determine how best to financially manage their plans. *See Fine v. Semet*, 699 F.2d 1091, 1094 (11th Cir. 1983); *supra* pp. 6-7. 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 that 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 the University of Pennsylvania's recordkeepers, Vanguard and TIAA), which compete on a range of levels, with different fee structures, service offerings, quality, and reputation.[9] There are also thousands of reasonable investment options with different investment styles and risk levels—nearly 10,000 mutual funds alone,[10] several thousand of which are

[9] *See, e.g.*, Chad Brooks, *15 Retirement Plan Providers for Your Business*, Business News Daily (July 14, 2014), http://bit.ly/2GcvDzI; Andrew Wang, *401K Providers: 2016 Top 20 Lists* (July 26, 2016), http://bit.ly/2suEbjC.

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

offered in retirement plans, in addition to many additional annuities, collective trusts, and other investment options—and nearly innumerable ways to put together a plan that employees can use to save for retirement.

Thus, while ERISA plaintiffs 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 everything else imprudent. Instead, there is a wide range of reasonable options, 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 particular 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 Advisory Opinion No. 2006-08A (Oct. 3, 2006), *available at* http://bit.ly/2o3k06Y.

II. An ERISA Complaint That Lacks Direct Allegations Of Wrongdoing 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. Thus, "the 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." *Id.*

Here, Plaintiffs admit that they do not allege any facts regarding Defendants' decision-making process. Pls.' Br. 36. They suggest instead that the district court should have *inferred* that Defendants had an imprudent process simply because there were alternative options that outperformed, or had lower fees than, those options selected by plan fiduciaries—even if there are reasonable explanations for those differences. Pls.' Br. 37. That is not the law. For complaints that lack direct allegations of wrongdoing, this Court has consistently probed the circumstantial facts from which plaintiffs ask it to infer misconduct to determine if those allegations plausibly suggest wrongdoing or simply represent a plaintiff's fishing expedition. ERISA claims should be treated no differently.

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*, 550 U.S. 544, and *Ashcroft v. Iqbal*, 556 U.S. 662 (2009). This Court addressed this issue in *Burtch v. Milberg Factors, Inc.*, 662 F.3d 212 (2011), an antitrust case. There, the court explained that

because the plaintiffs lacked direct allegations of illegal agreements among companies that finance purchase and sale transactions between garment retailers, the court had to determine whether the "circumstantial" allegations "plausibly show the existence of an agreement." *Id.* at 226. The court scrutinized each of the plaintiffs' circumstantial allegations, evaluating whether they were "just as much in line with a wide swath of rational and competitive business" decisions. *Id.* at 227 (quotation marks omitted). The court ultimately affirmed the dismissal, and in doing so noted that the plaintiffs' own allegations undermined any inference of an agreement because the complaint itself detailed numerous instances in which the defendants did not act in concert. *Id.* at 228.

Courts have taken the same approach in First Amendment retaliation cases, *George v. Rehiel*, 738 F.3d 562 (3d Cir. 2013), cases attempting to implicate supervisors in unlawful conduct, *Santiago v. Warminster Township*, 629 F.3d 121 (3d Cir. 2010), RICO cases, *Eclectic Props. E., LLC v. Marcus & Millichap Co.*, 751 F.3d 990 (9th Cir. 2014), and securities cases (even outside the context of heightened pleading), *In re Century Aluminum Co. Sec. Litig.*, 729 F.3d 1104 (9th Cir. 2013). In each context, when the plaintiffs failed to provide direct allegations about a foundational element of the claim, courts have carefully scrutinized the circumstantial factual allegations and ordered dismissal when those allegations did not support a plausible inference of wrongdoing because they were equally

consistent with lawful behavior.[11] As this Court summarized in *Santiago*, "'possibility' is no longer the touchstone for pleading sufficiency after *Twombly* and *Iqbal*. Plausibility is what matters. Allegations that are 'merely consistent with a defendants' liability' or show the 'mere possibility of misconduct' are not enough." 629 F.3d at 133 (citation omitted).[12]

Moreover, 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

[11] *See, e.g.*, *George*, 738 F.3d at 586 ("The TSA Officials' suspicion was an obvious alternative explanation for their conduct, which negates any inference of retaliation."); *Santiago*, 629 F.3d at 133 (noting, in an excessive force case against supervisors, that "one plausible explanation is that the officers simply used their own discretion in determining how to treat each occupant," and "[i]n contrast with that 'obvious alternative explanation' . . . , the inference that the force was planned is not plausible") (citation omitted); *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 real estate values and fluctuations in prices over time); *In re Century Aluminum*, 729 F.3d at 1109 ("When faced with 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)).

[12] Plaintiffs contend their complaint did not need to address rational alternative explanations for the circumstantial facts they allege, and they suggest such a requirement is limited to antitrust cases, like *Twombly*. Pls.' Br. 47. But in *Iqbal*, the Supreme Court expressly rejected a similar effort to create distinct pleading rules for different areas of law, reasoning that it was "not supported by *Twombly*" and was "incompatible with the Federal Rules of Civil Procedure." 556 U.S. at 684.

but instead relies entirely on circumstantial allegations that, even if true, do not establish unlawful conduct. *Twombly*, 550 U.S. at 557; *see also In re Ins. Brokerage Antitrust Litig.*, 618 F.3d 300, 370 (3d Cir. 2010). Such allegations are "much like a naked assertion" of wrongdoing that, "without some further factual enhancement," fall "short of the line between possibility and plausibility of 'entitle[ment] to relief.'" *Twombly*, 550 U.S. at 557 (citation omitted).

As the Supreme Court also recognized in *Twombly*, enforcing the pleading rules is necessary to guard against speculative suits that lead to nuisance settlements. Because "discovery can be expensive" in complex, document-heavy cases (whether arising under antitrust laws or ERISA), the mere threat of discovery "will push cost-conscious defendants to settle even anemic cases before reaching those proceedings" and encourage plaintiffs with even groundless claims to file suit in the hopes of inducing a settlement. *Id.* at 558-59. Thus, courts must require factual specificity "before allowing a potentially massive factual controversy to proceed." *In re Ins. Brokerage*, 618 F.3d at 370 (quoting *Twombly*, 550 U.S. at 558).

B. *Twombly* Should Apply With Full Force In ERISA Cases.

This Court recognized in *Renfro* that the *Twombly* analysis fully applies to ERISA claims. *See Renfro*, 671 F.3d at 328. As in the antitrust, retaliation, supervisory liability, RICO, and securities cases discussed above, ERISA plaintiffs

(including Plaintiffs here) often fail to present any direct allegations of the foundational element of their claims—here, an imprudent decision-making process that establishes a fiduciary breach. Instead, plaintiffs ask courts to infer wrongdoing from circumstantial allegations, such as the performance of funds included in a plan lineup compared to other available funds that could have been selected, or the fees of investment options or service providers compared to alternatives in the market. But those circumstantial allegations are often consistent with entirely lawful conduct, particularly given the range of reasonable options available for fiduciaries for each decision they must make. And when that is true, the claim should be dismissed.

Plaintiffs' attempt to infer that the Plan fiduciaries' decision-making process was imprudent based on the retention of two investment options that allegedly underperformed available alternatives is a perfect example of this sort of speculation. First, as noted above, pp. 8-9, *supra*, chasing performance by transferring investments from lower-performing to higher-performing options often leads to worse returns over time because periods of underperformance *and* periods of overperformance tend to revert to the mean. Thus, it is perfectly consistent with lawful, responsible fiduciary behavior to hold an underperforming investment during down periods—particularly if the investment had a prior history of significantly outperforming its benchmark during periods of market volatility—for

sufficient time to allow a fiduciary to determine whether the fund's performance will likely trend back upward.

Second, even if a plausible inference of an imprudent fiduciary process could in theory be drawn from an investment consistently underperforming alternatives with comparable investment strategies, Plaintiffs here rely on the improper (but all-too-common) tactic of comparing investment options with alternatives that have *different* investment strategies. For example, Plaintiffs contend that the CREF Stock Account made available in the Plan lineup underperformed "compared to actively managed benchmarks," which Plaintiffs define as the Vanguard Diversified Equity Investment Fund, the Vanguard PRIMECAP Fund, and the Vanguard Capital Opportunity Fund. A115-A117. But those comparisons are not fair ones: these Vanguard mutual funds are *not* the CREF Stock Account's actual benchmarks,[13] and they are not even in the same general investment category as the CREF Stock Account (which is an annuity, not

[13] "Benchmark" is a term of art that refers specifically to a carefully chosen index against which investment managers or advisers measure the performance of a particular investment depending on the investment strategy and performance goal chosen. *What is a 'Benchmark'*, Investopedia, https://www.investopedia.com/terms/b/benchmark.asp. The CREF stock account's benchmark, for example, 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. *CREF Stock Account Fact Sheet*, Teachers Insurance and Annuity Association of America (Dec. 31, 2017), *available at* 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.*

a mutual fund) because they have different investment strategies.[14] As other courts have recognized, when funds have different investment strategies, entirely unsurprising differences in performance provide 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), *appeal filed*, No. 17-2397 (8th Cir. June 23, 2017). 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.

Plaintiffs' suggested inferences of imprudence based on the Plan's selection of retail share classes of mutual funds, and the use of asset-based rather than hard-dollar fees, suffer from similar problems. As explained in Part I.A., each of these decisions requires fiduciaries to balance competing considerations and diverse participant preferences. The decision to offer retail share classes of mutual funds and pay recordkeeping expenses using an asset-based, revenue-sharing model—rather than to offer alternative investment structures that would require participants

[14] *Compare CREF Stock Account*, Morningstar, https://bit.ly/2IouTsJ (Investment Category: Allocation—85%+ Equity, Investment Style—Large Blend), *with Vanguard Diversified Equity*, Morningstar, https://bit.ly/2pZ6bYY (Investment Category: Large Growth, Investment Style: Large Growth); *Vanguard PRIMECAP*, Morningstar, https://bit.ly/2GOPLfq (same), *Vanguard Capital Opportunity*, Morningstar, https://bit.ly/2EfB0gm (same).

to pay separate hard-dollar recordkeeping fees—involves a discretionary judgment about who should shoulder the greater burden of plan recordkeeping expenses. If an asset-based, revenue-sharing model is chosen, the burden falls more heavily on participants with higher account balances. If a plan offers investment structures that do not pay revenue sharing (*e.g.*, institutional share classes of mutual funds or separate accounts), then all participants must pay the same hard-dollar fee, which disproportionately affects participants with smaller account balances. Neither choice is necessarily right or wrong, and neither choice provides any basis to infer that plan fiduciaries lacked a sound decision-making process.

The flaws in Plaintiffs' attempt to draw an inference of imprudence based on fiduciaries' reasonable, discretionary judgments is compounded by their disregard of documents incorporated by reference in their own complaint showing that the Plan *did* investigate relevant options and consider appropriate alternatives. For example, Plaintiffs insist that the Court should infer that plan fiduciaries "failed to investigate or failed to recognize" that "lower-cost" shares—specifically, institutional share classes of mutual funds—were available as alternatives to retail share classes. Pls.' Br. 40. But that inference is undercut by documents incorporated by reference, which established beyond dispute that numerous institutional share classes *were offered* throughout the putative class period, and that numerous funds *were replaced* with lower-cost share classes between 2011

and 2013. A236-A243. The district court properly considered this basic inconsistency in Plaintiffs' theory in concluding that their allegations were implausible. *See, e.g.*, *Burtch*, 662 F.3d at 228; *Santiago*, 629 F.2d at 133.

In short, this Court should apply the same approach to pleading that the Court and other circuits have already adopted in cases like *Burtch*, *Santiago*, *George*, *Eclectic Properties*, and *Century Aluminum*. Just as in those cases, the Court in reviewing ERISA complaints should carefully scrutinize circumstantial allegations to determine whether they are plausibly suggestive of wrongdoing, or whether they are equally consistent with rational, lawful behavior and therefore do not satisfy the *Twombly* pleading standard. *See Fifth Third*, 134 S. Ct. at 2470-2471.

C. Allowing Hindsight-Based Disagreement With Discretionary Fiduciary Decisions Would Encourage Meritless Lawsuits And Discourage Employers From Offering Employee Benefits.

There are also compelling practical reasons for applying the same careful inquiry of circumstantial allegations in ERISA cases that the court undertakes in antitrust, RICO, and 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 breach of the duty of prudence seemingly no matter what decision they make. Plaintiffs sue fiduciaries for failing

to divest from stocks with declining share prices or high risk profiles.[15] And they sue fiduciaries for failing to *hold on to* such stock because high risk can produce high reward.[16] 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.[17] In many cases, plaintiffs allege that fiduciaries were imprudent because they should have offered mutual funds from one particular investment manager (Vanguard),[18] while others complain that Defendants were imprudent *because* they offered mutual funds from that manager.[19] Some plaintiffs allege that plans offered imprudently risky investments,[20] while others allege that fiduciaries were

[15] *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").

[16] *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).

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

[18] *E.g.*, *Moreno v. Deutsche Bank Ams. Holding Corp.*, No. 15 Civ. 9936 (LGS), 2016 WL 5957307, at *6 (S.D.N.Y. Oct. 13, 2016); *George v. Kraft Foods Global, Inc.*, No. 08 C 3799, 2011 WL 5118815, at *8 (N.D. Ill. Oct. 25, 2011).

[19] *White v. Chevron Corp.*, No. 16-CV-0793-PJH, 2016 WL 4502808, at *9 (N.D. Cal. Aug. 29, 2016), *appeal filed*, No. 17-16208 (9th Cir. June 9, 2017).

[20] *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); *PBGC ex rel. St. Vincent Catholic Med. Ctrs. Ret. Plan v. Morgan Stanley Inv. Mgmt. Inc.*, 712 F.3d 705, 711 (2d Cir. 2013).

imprudently cautious in their investment approach.[21] And in some instances, fiduciaries have simultaneously defended against "diametrically opposed" theories of liability, giving new meaning to the phrase "cursed-if-you-do, cursed-if-you-don't."[22]

Courts have recognized this dilemma, noting that ERISA fiduciaries often find themselves "between a rock and a hard place," *Fifth Third*, 134 S. Ct. at 2470, 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 lower courts reviewing a motion to dismiss that "careful, context-sensitive scrutiny of a complaint's allegations" is the appropriate way to accomplish the "important task" of "divid[ing] the plausible sheep from the meritless goats." *Fifth Third*, 134 S. Ct. at 2470-71.

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[21] *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. 16-cv-61, (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).

[22] *E.g.*, *Evans v. Akers*, 534 F.3d 65, 68 (1st Cir. 2008) (involving claims that fiduciaries breached ERISA duties by maintaining a "heavy investment in Grace securities when the stock was no longer a prudent investment" and noting "[a]nother suit challenging the actions of Plan fiduciaries" that "asserted a diametrically opposed theory of liability"—"that the Plan fiduciaries had imprudently *divested* the Plan of its holdings in Grace common stock despite the company's solid potential to emerge from bankruptcy" (citation omitted)).

Without this careful 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," *Fifth Third*, 134 S. Ct. at 2471, 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), *PBGC ex rel. St. Vincent Catholic Med. Ctrs. Ret. Plan v. Morgan Stanley Inv. Mgmt. Inc.*, 712 F.3d 705, 719 (2d Cir. 2013), 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," *PBGC*, 712 F.3d at 719 (citation omitted). And ERISA plaintiffs could exploit that standard to target large and generous plan sponsors, like the University of Pennsylvania, in the hopes of pressuring the defendant into settling.

Given these perverse incentives, adopting anything less than the "careful … scrutiny" of ERISA complaints prescribed by the Supreme Court in *Twombly* and *Fifth Third* would create precisely the types of "undu[e]" administrative costs and litigation expenses that Congress intended to avoid in crafting ERISA. *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. *PBGC*, 712 F.3d at 719.

For the twenty percent of plan sponsors that are small or mid-sized entities—a number that has already decreased in recent years[23]—there is a real risk that costs inflated through the need to defend meritless lawsuits may discourage them from offering, or continuing to offer, benefits under ERISA—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 key aspects of employee-benefit programs, such as retirement matching contributions or subsidization of healthcare premiums. This would severely undermine the "careful balancing" Congress struck in ERISA following "a decade of congressional study," *Renfro*, 671 F.3d at

[23] *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).

321, and crimp the considerable flexibility Congress provided to fiduciaries in an effort to encourage them to implement 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.

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 Rules of Appellate Procedure 32(a)(7)(B) because it contains **6,465** words, excluding the parts exempted by Rule 32(f)

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CERTIFICATE OF BAR MEMBERSHIP

Pursuant to Local Rule of Appellate Procedure 46.1(e), the undersigned hereby certifies that he is a member of the bar of the United States Court of Appeals for the Third Circuit.

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