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A Timely Analysis of Legal Developments

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In *Hecker v. Deer Company*, the Seventh Circuit Court of Appeals affirms the dismissal of claims by ERISA 401(k) plan participants that the plan's sponsor and service providers violated their fiduciary duties by charging excessive fees and by failing to disclose fee information to plan participants.

The Seventh Circuit Dismisses ERISA 401(k) Revenue Sharing & Excessive Fee Lawsuit

By Susan Katz Hoffman, Daniel W. Srsic and Melanie A. Houghton

On February 12, 2009, the U.S. Court of Appeals for the Seventh Circuit issued a decision in *Hecker v. Deere Company*, Nos. 07-3605 & 08-1224, affirming dismissal of a complaint alleging that the fiduciaries of two 401(k) plans sponsored by Deere violated ERISA. The ruling is the first significant appellate decision in a recent wave of ERISA lawsuits brought by plan participants against large companies and their 401(k) plans. In general, these lawsuits allege that the plan sponsors breached their fiduciary duties under ERISA by paying excessive fees to 401(k) service providers and by failing to adequately disclose fee information to plan participants. The Seventh Circuit's ruling is important because it clearly rejects several of the theories advanced by plaintiffs in these cases, many of which are currently pending in federal courts throughout the country.

Background Facts

Deere offered its employees the opportunity to participate in two company-sponsored 401(k) plans. In 1990, Deere and Fidelity Management Trust Company ("Fidelity Trust") entered into a contract under which Fidelity Trust served as trustee for the plans. Another unit of Fidelity, Fidelity Management and Research Company ("Fidelity Research"), acted as investment advisor for the plans' mutual funds. Deere, as plan administrator, retained final authority to select the investment options for the plans.

Both of the Deere-sponsored plans offered participants a broad choice of investment options, including 23 Fidelity mutual funds, two investment funds managed by Fidelity Trust, a fund devoted to Deere's stock, and a Fidelity-operated facility called "BrokerageLink," which gave participants access to approximately 2,500 additional funds managed by different companies. Participants had control over their investments in the plans, subject to the limitation that the investment vehicle had to be one that the plans offered. Each available fund was subject to a variety of fees charged against the assets held within the mutual fund, calculated as a percentage of assets.

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Plaintiffs' Claims

The plaintiffs in the *Deere* case were participants in Deere's 401(k) plans. They brought suit on behalf of themselves and a class of plan participants, alleging that Deere, Fidelity Trust and Fidelity Research violated their fiduciary duties under ERISA by providing investment options that required the payment of excessive fees and costs. The plaintiffs also alleged that unbeknownst to participants, Fidelity Research shared its revenue, which it earned through the mutual fund fees, with Fidelity Trust. Fidelity Trust in turn compensated itself through those shared fees, rather than through a direct charge to Deere for its services as trustee. This arrangement, according to the plaintiffs, led to an impermissible lack of transparency in the fee structure and a further violation of the defendants' fiduciary duties.

The Seventh Circuit's Analysis

Fidelity Trust & Fidelity Research Did Not Function as Fiduciaries

Before addressing the merits of the plaintiffs' fiduciary breach claims, the court addressed whether Fidelity Trust and Fidelity Research were proper defendants in the case. According to the plaintiffs, one or both of the Fidelity entities were liable as fiduciaries of the plans because they exercised control over the selection of the plans' investment options. The Seventh Circuit disagreed, noting that Deere, rather than the Fidelity entities, had the final say on which investment options would be included in the plans. The court also rejected the plaintiffs' argument that the Fidelity defendants were fiduciaries because they exercised control over plan assets by deciding how much revenue Fidelity Research would share with Fidelity Trust. The court based its reasoning on an express provision in ERISA that states that the underlying assets of mutual funds are not to be considered assets of the ERISA plans invested in mutual fund shares. Therefore, the fees that were collected from the mutual fund's assets and transferred to one of the Fidelity entities were never assets of the plans.

Deere Did Not Have a Duty to Inform Participants About the Revenue-Sharing Arrangement

After affirming the dismissal of the Fidelity defendants from the case, the court turned to the question of whether Deere had a duty to disclose the revenue-sharing arrangement between Fidelity Trust and Fidelity Research. Agreeing with the district court, the Seventh Circuit found that Deere fulfilled its disclosure obligations under ERISA because the plan documents and fund prospectuses contained information about the total fees imposed by the various funds, and only that information was relevant to the participants' decisions about where to invest their accounts. Once the fee was charged, the participants had no interest in how the fees were allocated between the Fidelity entities. The court also noted that at the time of the alleged events, nothing in ERISA or its accompanying regulations required disclosure of revenue-sharing arrangements.

Deere Did Not Offer Investment Options with Excessive Fees

The court easily disposed of the plaintiffs' claim that Deere violated its fiduciary duties by selecting investment options with excessive fees. The court found that the Deere plans offered a sufficient mix of investments for the plan participants with a wide range of expense ratios, including 23 retail mutual funds and 2,500 non-Fidelity funds. According to the court, the fact that other funds might have had lower expense ratios was irrelevant. Nothing in ERISA requires fiduciaries to scour the market to find and offer the cheapest possible fund. Nor does ERISA require plan fiduciaries to include any particular mix of investment plan vehicles in a plan. Therefore, Deere did not violate ERISA by limiting the investment options (other than the brokerage window) to Fidelity mutual funds.

Deere's Selection of Investment Options was Protected by 404(c)'s Safe Harbor

As an alternative ground for dismissal of plaintiffs' claims, the Seventh Circuit found that Deere's action of selecting and offering investment options fell within ERISA Section 404(c)'s safe harbor protection. Under the safe harbor, a fiduciary of an individual account plan that meets the requirements of Section 404(c), is not liable for any loss or breach that results from the participant's exercise of investment control.

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The plaintiffs alleged that Section 404(c)'s safe harbor did not apply because the plan documents failed to disclose the revenue-sharing arrangement. The court rejected this allegation, reiterating its holding that Deere was not required under ERISA to disclose revenue-sharing arrangements. The plaintiffs also claimed that Section 404(c)'s safe harbor was inapplicable because Deere imprudently selected mutual funds with excessively high fees. The court rejected this claim because the plans offered numerous investment options with a wide range of fees. All of the funds were also offered to investors in the general public such that the expense ratios necessarily were set against the backdrop of market competition. According to the court, while Section 404(c) may not shield a fiduciary from an imprudent selection of funds "under every circumstance that can be imagined," it does protect a fiduciary like Deere that satisfies the requirements of Section 404(c) and offers a sufficient range of investment options so that plan participants have control over the risk of loss.

Conclusion

The court's ruling in *Deere* offers much needed guidance to companies that sponsor participant-directed 401(k) plans, but because the Department of Labor filed an *amicus* brief on behalf of the plaintiffs, it is likely that similar claims will be brought before courts in other Circuits. *Deere* expressly rejects the alleged need to disclose revenue sharing under then-existing law and provides a valuable defense to a claim of excessive fees where the plan offers a broad range of investment options, and where the options that are offered are in line with the market competition. Since *Deere* was filed in 2006, Congress and government regulators have shown a heightened interest in addressing 401(k) fee disclosure issues. In November 2007, the Department of Labor (DOL) issued revisions to ERISA Form 5500 to require more detailed disclosure of fee information. The DOL also proposed a rule requiring service providers to disclose fee arrangements to plan fiduciaries. As a result of this heightened scrutiny, most plan fiduciaries are pursuing greater transparency in fee arrangements, distributing more explicit disclosures, and fully documenting their due diligence efforts. It is unlikely that the result in *Deere* will be considered sufficient to cause fiduciaries to relax their vigilance with respect to their exercise of prudence in selection of plan investment options.

Susan Katz Hoffman is a Shareholder in Littler Mendelson's Philadelphia office. Daniel W. Srsic is a Shareholder and Melanie A. Houghton is an Associate in Littler Mendelson's Columbus office. If you would like further information, please contact your Littler attorney at 1.888.Littler, info@littler.com, Ms. Hoffman at shoffman@littler.com, Mr. Srsic at dsrsic@littler.com, or Ms. Houghton at mhoughton@littler.com.

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