



February 2009

ERISA LITIGATION UPDATE

Seventh Circuit Rules on Fiduciary Duties Related to 401(k) Fees

A bit of good news for sponsors of 401(k) plans was provided by the Seventh Circuit in *Hecker v. Deere & Co.*, Nos. 07-3605 & 08-1224 (7th Cir. Feb. 12, 2009), the first appellate decision to address the duties of fiduciaries to control fees. *Hecker* will reduce, at least until legislation is passed or regulations finally approved, the litigation pressure on employers sponsoring 401(k) plans due to fees charged to participants. *Hecker* suggests that to be safe, a plan should have multiple options and an investment portal.

In *Hecker*, the Seventh Circuit upheld the district court’s dismissal against Deere (sponsor of and named fiduciary for 401(k) plans), Fidelity Management & Research Company (the plans’ investment adviser) and Fidelity Management Trust Company (the plans’ directed trustee and record keeper) of claims that the defendants had violated a “fiduciary duty under ERISA by providing investment options that required the payment of excessive fees and costs and by failing adequately to disclose the fee structure to plan participants.”

Deere’s 401(k) plans offered participants the option to invest in 23 different Fidelity mutual funds, two investment funds managed by Fidelity Trust, a Deere company stock fund and a Fidelity-operated brokerage portal that permitted participants to invest in 2,500 additional funds managed by different companies. Fees were charged by the mutual funds to individual accounts based on a percentage of assets invested. Fidelity Research, as the investment adviser, shared some of the fees received by the mutual funds with Fidelity Management to cover the plans’ trustee and record-keeping expenses.

The plaintiffs claimed not only that the fees were excessive, but that there was an “impermissible lack of transparency in the fee structure” due to the lack of any disclosure of the sharing of the fees charged by the mutual funds.

The district court dismissed the disclosure claim on the pleadings on the ground that because ERISA’s “[d]isclosure requirements are generally limited to those expressly prescribed by the statutory language of ERISA,” Deere’s disclosures in its summary plan description (SPD), annual report and financial disclosures fully complied with ERISA’s statutory and regulatory requirements. The district court dismissed the excessive fee claim based on ERISA’s “safe harbor” provision, ERISA § 404(c), *codified at* 29 U.S.C. § 1104(c). In effect, the district court held that all required disclosures were provided by the SPD and prospectuses so that the safe harbor’s disclosure requirement in 29 C.F.R. § 2550.404c-1(b)(2)(B)(1)(v) & (2)(i) was satisfied; that receipt of “additional non-prescribed information” would not enhance participant investment decisions; and that because participants could invest in more than 20 mutual funds with access to “more than 2500 others,” if “participants incurred excessive expenses, those losses were the result of participants exercising control over their investments within the meaning of the safe harbor provision.” The district court, finding that Deere had not breached any duty, dismissed the claims against Fidelity Research and Fidelity Trust without determining the scope of their fiduciary duties, if any.

The Seventh Circuit affirmed the district court but applied some differing analysis, holding that there was no breach of fiduciary duty claim against Fidelity Trust and Fidelity Research because, as to the claims at issue, neither was a functional fiduciary. Although Fidelity Research was alleged to have been involved in the selection of the investment options, the plaintiffs conceded that Deere had “final authority” to select those



options. The Seventh Circuit then held that, as in the case of an attorney or other professional, the involvement in the selection of investment options by the provision of professional advice is insufficient to create fiduciary status. As a result, Fidelity Research was not subject to fiduciary duties with respect to the selection of the plans' investment options.

The Seventh Circuit also rejected the plaintiffs' allegation that Fidelity Research's sharing with Fidelity Trust fees that had been paid by participants to the mutual funds implicated a fiduciary duty arising from the exercise of discretion in the handling of plan assets. Instead, the court held that once the fees were paid to the mutual funds, they no longer were plan assets and no fiduciary duty could be predicated on the fee-sharing arrangement. The Seventh Circuit affirmed the dismissal of Fidelity Research and Fidelity Trust due to the absence of any fiduciary duty.

In affirming the district court's dismissal of the claims against Deere, the Seventh Circuit held that the total fees charged to participants were disclosed in the SPD and fund prospectuses so that no law was violated as to disclosure. The Seventh Circuit rejected the plaintiffs' claim that "the non-disclosure of the revenue sharing breached the general fiduciary duty imposed on Deere by 29 U.S.C. § 1104(a)(1)." As an initial matter, the Seventh Circuit noted that there was no "intentionally misleading statement" that could support a fiduciary breach claim under *Varity Corp. v. Howe*, 516 U.S. 489, 505 (1996). The court then rejected the plaintiffs' contention that the "omission of information about the revenue-sharing arrangement" is material to a participant because "[t]he total fee, not the internal, post-collection distribution of the fee, is the critical figure for someone interested in the cost of including a certain investment in her portfolio and the net value of that investment." Because the fee-sharing arrangement is not material, there was no breach.

The Seventh Circuit then rejected the plaintiffs' claim that Deere's selection of funds with excessive fees breached its fiduciary duties on the ground that the offering of more than 20 base funds and access to more than 2,500 other funds satisfied Deere's duties because "nothing in ERISA requires every fiduciary to scour the market to find and offer the cheapest possible fund (which might, of course, be plagued by other problems)." The Seventh Circuit further held that the selection of funds and services through Fidelity satisfied any fiduciary duty that existed because Deere only had the obligation to act as a prudent investor and many prudent investors limit themselves to a single family of investment funds. Additionally, the court suggested that the selection of investment funds may be a settlor, rather than fiduciary, function because setting a mix of investment funds "bears more resemblance to the basic structuring of a Plan than to its day-to-day management."

As an alternative basis for affirmance, the Seventh Circuit adopted the district court's application of the 404(c) safe harbor affirmative defense. Declining to determine whether the safe harbor shields fiduciaries from any imprudent selection of funds, the court held that the safe harbor "does protect a fiduciary that satisfies the criteria of § 1104(c) and includes a sufficient range of options so that the participants have control over the risk of loss." The court noted that the plans' provision to participants of the investment portal that created access to 2,500 mutual funds meant that fees, if excessive, were due to the participants' own choices.

The Seventh Circuit's decision limits an employer's risk in the wake of the Supreme Court's holding in *LaRue v. DeWolff, Boberg & Assocs., Inc.*, 128 S.Ct. 1020 (2008) in providing and maintaining 401(k) plans. Of crucial significance, however, is the Seventh Circuit's endorsement of plan structures that include multiple mutual funds in the base option available to participants and a portal for individual investment options. Indeed, to the extent that a 401(k) plan does not have an investment portal, plan sponsors and administrators should immediately consider addition of such an optional investment vehicle.



FOR MORE INFORMATION

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