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Seventh Circuit Affirms Judgment for Employer and Mutual Fund Complex in ERISA Revenue Sharing/Excess Fee Litigation

In an important opinion issued on February 12, 2009, the Seventh Circuit Court of Appeals affirmed the dismissal of claimed ERISA violations for alleged revenue sharing and excessive fees against the plan sponsor and the mutual fund complex that provided investment options and trust and other services for the plan. *Hecker v. Deere & Co.*, Nos. 07-3605 and 08-1224 (Feb. 12, 2009). (Click [here](#) for our Legal Alert on the district court decision.)

By way of background, in 1990 Deere & Company engaged the Fidelity fund complex to provide a range of services for two ERISA-covered 401(k) plans it offers to its employees. According to the court, each plan presented a “generous” array of investment options among which plan participants would direct the investment of their accounts, including 23 different retail mutual funds advised by Fidelity Research, two investment funds managed by Fidelity Trust (also the directed trustee and recordkeeper), a company stock fund, and a Fidelity open-architecture brokerage window providing access to approximately 2,500 additional mutual funds managed by different companies. Each fund included within the plans charged a fee disclosed in its prospectus and calculated as a percentage of assets.

Plaintiffs alleged that Fidelity Research shared its revenue, which it earned from the mutual fund fees, with Fidelity Trust and that Fidelity Trust in turn compensated itself through those shared fees, rather than through a direct charge to Deere for its services. Plaintiffs (plan participants on behalf of a purported class) claimed that this led to an impermissible lack of transparency in the fee structure, and alleged that the fees and expenses paid by the plans were (1) unreasonable and excessive; (2) not incurred solely for the benefit of the plans and the plans’ participants; and (3) not disclosed to participants. Plaintiffs argued that in allegedly subjecting the plans and their participants to these arrangements, Deere, Fidelity Research and Fidelity Trust violated fiduciary obligations under ERISA.

The district court dismissed the case on the pleadings with prejudice. In brief, the district court ruled, *inter alia*, that:

- Deere had complied with all applicable disclosure requirements imposed by ERISA;
- The facts asserted in the complaint established all the elements necessary for the defendants to take advantage of the relief from any fiduciary liability provided by the ERISA §404(c) “safe harbor” for participant-directed plans meeting certain requirements; and
- The Fidelity defendants were not fiduciaries for the purposes of making plan investment decisions and could not be held liable on that basis

On appeal, the Seventh Circuit affirmed the district court’s ruling in all respects. Specifically, the Seventh Circuit held:

- Fidelity Trust was not a fiduciary by virtue of limiting Deere’s selection of funds for which it would act as trustee to those managed by its corporate affiliate. “Merely ‘playing a role’ or furnishing professional advice is not enough to transform a company into a fiduciary,” and there was no

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allegation that the financial services provider exercised “final authority” over the choice of funds offered—in a distinction from *Haddock v. Nationwide Fin. Servs.*, 419 F.Supp. 2d 156 (D. Conn. 2006). (The Department of Labor (DOL) in an amicus brief had argued that the “functional fiduciary” allegations were sufficient to withstand a motion to dismiss.)

- The allegation that the Fidelity defendants exercised discretion over “plan assets” in determining how much revenue Fidelity Research would share with Fidelity Trust also failed to state a claim. The court held that the fees that Fidelity Research collected from the mutual funds became Fidelity’s assets rather than ERISA “plan assets” —a point with which DOL agreed and contrary to the *Haddock* opinion—which Fidelity Research could permissibly transfer to its affiliate Fidelity Trust.
- Deere did not breach any fiduciary duty by not informing the participants that Fidelity Trust received money from the fees collected by Fidelity Research. Specifically, the court held that disclosure of how Fidelity Research allocated the monies it collected was neither required under any ERISA statute or regulation, nor material to plan participants. (DOL had argued in its brief that such a disclosure obligation could arise under general ERISA fiduciary principles.) The court found it sufficient that Deere disclosed to the participants the total fees for the funds and directed the participants to the fund prospectuses for information about the fund-level expenses—the critical information for an investor, since the alleged fee sharing did not enlarge the fund charges beyond those disclosed in the prospectus and paid by all investors.
- Deere did not violate its ERISA duties in allegedly selecting investment options with excessive fees. The court found that Deere offered a sufficient mix of investments for participants in its plans. The court noted that there was a wide range of expense ratios among the funds available, and the fact that some other funds might have had even lower ratios was “beside the point; 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).”
- Deere did not “improperly” limit the investment options to Fidelity funds. Nothing in ERISA requires plan fiduciaries to include any particular mix of investment vehicles in their plans. Moreover, the court noted that the issue was akin to that of the basic structuring of a plan, which would not be a duty within Deere’s fiduciary responsibilities.
- Finally, the court found that the §404(c) defense was properly considered here because the plaintiffs affirmatively pled in their complaint why they contended the defense would not apply. The court ruled that there was no plausible allegation that the plans did not comply with §404(c). In particular, the court reasoned that §404(c) was available when a plan “includes a sufficient range of options so that the participants have control over the risk of loss,” and that it need not decide the question of whether there could be circumstances where a fiduciary’s selection of plan investment options might not be shielded by that provision. In this respect, this court neither endorsed DOL’s more limited view of the scope of fiduciary relief provided by §404(c), nor accepted the invitation to shift participants’ legal responsibility for their own investment choices in these circumstances, adding to the body of cases like *Langbecker v. Electronic Data Sys. Corp.*, 476 F.3d 299 (5th Cir. 2007) and *Jenkins v. Yager*, 444 F.3d 916 (7th Cir. 2006).

The Court also upheld the district court’s award of costs in excess of \$200,000 against plaintiffs.



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