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# LEGAL ALERT

June 25, 2009

## Seventh Circuit Denies Rehearing on Dismissal of ERISA Revenue Sharing/Excess Fees Complaint in *Hecker v. Deere*

Earlier this year, the U.S. Court of Appeals for the Seventh Circuit affirmed the dismissal of claimed ERISA violations for alleged revenue sharing and excessive fees against a retirement plan sponsor and the mutual fund complex that provided investment options and trust and other services for the plan. Yesterday, the Seventh Circuit denied plaintiffs' petition for rehearing but issued a short opinion addressing certain issues raised by the U.S. Department of Labor (DOL) in an amicus brief and emphasizing that its ruling was based on the particular facts alleged in this case. *Hecker v. Deere & Co.,* Nos. 07-3605 and 08-1224 (June 24, 2009).

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. The investment options consisted of 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 facility 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 individual 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.

In its February 12 opinion, the Seventh Circuit affirmed the dismissal of the complaint. (Click here for our Legal Alert on the district court decision and here for our Legal Alert on the February 12 appellate decision.) Among other rulings, the court held that 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. 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 Systems Corp.*, 476 F.3d 299 (5th Cir. 2007) and *Jenkins v. Yager*, 444 F.3d 916 (7th Cir. 2006).

Plaintiffs filed a petition for rehearing, focusing on the § 404(c) ruling and the fact that the plan made retail mutual funds available, which plaintiffs contended involved inherently excessive fees. Amicus briefs filed

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by DOL, AARP and others supported the request for rehearing. On June 24, 2009, the Seventh Circuit denied rehearing in a three-page opinion in which it addressed a number of issues raised by DOL. (Click here for the opinion.)

First, the Seventh Circuit rejected DOL's argument that it had failed to give proper deference to DOL's interpretation that § 404(c) did not provide a safe harbor for fiduciaries in the selection and monitoring of plan investment options, an interpretation set forth in a footnote in the preamble to DOL's § 404(c) regulations. After stating that it did not agree that a footnote in a preamble is entitled to full *Chevron* deference, the court reiterated that it did not make any definitive ruling on whether the § 404(c) safe harbor applies to selection of investment options and then observed:

> Thus, [the Secretary of DOL's] real quibble is with the panel's alternate holding that the complaint the court was evaluating contained enough information to warrant the conclusion that Deere was entitled to the safe harbor defense. In our view, the Secretary's concern is more hypothetical than real. She fears that some case in the future may arise in which a Plan fiduciary acts imprudently by selecting an overpriced portfolio of funds, and that this opinion will somehow immunize the fiduciary from accountability for that decision.
>
> The panel's opinion, however, stands for no such broad proposition. It was limited to the complaint before the court, as supplemented by the materials the panel found were properly before the district court. Applying the pleading standards enunciated in *Bell Atlantic Corp. v. Twombly,* 550 U.S. 544 (2007), we concluded that these plaintiffs failed to state a claim for the kind of fiduciary misfeasance the Secretary describes.

The court next rejected DOL's concern that the panel's opinion "could be read as a sweeping statement that any Plan fiduciary can insulate itself from liability by the simple expedient of including a very large number of investment alternatives in its portfolio and then shifting to the participants the responsibility for choosing among them":

> [The Secretary of DOL] is right to criticize such a strategy. It could result in the inclusion of many investment alternatives that a responsible fiduciary should exclude. It also would place an unreasonable burden on unsophisticated plan participants who do not have the resources to pre-screen investment alternatives. The panel's opinion, however, was not intended to give a green light to such "obvious, even reckless, imprudence in the selection of investments" (as the Secretary puts it in her brief). Instead, the opinion was tethered closely to the facts before the court. Plaintiffs never alleged that any of the 26 investment alternatives that Deere made available to its 401(k) participants was unsound or reckless, nor did they attack the BrokerageLink facility on that theory. They argued—and especially in their Petition for Rehearing they continue to argue—that the Plans were flawed because Deere decided to accept "retail" fees and did not negotiate presumptively lower "wholesale" fees. The opinion discusses a number of reasons why that particular assertion is not enough, in the context of these Plans, to state a claim, and we adhere to that discussion.

Finally, the court rejected plaintiff's argument that a large plan's use of retail funds was inherently improper, noting that the complaint was silent as to the services that the Deere plan participants received from the plans:

> It would be one thing if they were treated exactly like all other retail market purchasers of Fidelity mutual fund shares; it would be quite another if, for example, they received extra investment

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advice from someone dedicated to the Deere accounts, or if they received other extra services. If the Deere participants received more for the same amount of money, then their effective cost of participation may in fact have approached wholesale levels. We return, therefore, to the general point made in the opinion: *this* complaint, alleging that Deere chose *this* package of funds to offer for its 401(k) Plan participants, with this much variety and this much variation in associated fees, failed to state a claim upon which relief can be granted.

*If you have any questions regarding this alert, please feel free to contact any of the attorneys listed below or the Sutherland attorney with whom you regularly work*


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