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Seventh Circuit Rules Decisively for Defendants in a “401(k) Fee” Case

On February 12, 2009, the U.S. Court of Appeals for the Seventh Circuit issued its opinion in *Hecker v. Deere & Co.* (“*Hecker*”). *Hecker* is one of the “401(k) fee” cases brought against large employers under ERISA. These cases allege, in various ways, that plan fiduciaries breached their fiduciary duties in selecting plan investment options so that participants paid higher fees than would be the case if the selection had been prudent. (See our October 2006 memo describing the 401(k) fee cases, available under “News & Publications” at <http://www.kattenlaw.com/employeebenefits/>.)

In *Hecker*, plaintiffs alleged that the plan sponsor, exercising its fiduciary duties, and the plan’s trustee/recordkeeper violated ERISA by (1) failing to disclose that some of the fees charged by the mutual funds offered under the plan were reallocated among corporate affiliates of the trustee/recordkeeper and (2) selecting plan investment options with “unreasonably high fees.” The district court dismissed all plaintiffs’ claims. 496 F. Supp. 2d 1006 (W.D. Wisconsin 2007). On appeal, the Seventh Circuit held decisively for defendants on all issues.

Trustee/recordkeeper was not a fiduciary. The court held that the mere fact that the trustee/recordkeeper offered its affiliated mutual funds as investment options, and even “played a role” in the selection process, was not enough to make it a fiduciary with respect to the plan’s investment options.

There was no failure to provide disclosures required by ERISA. First, the court determined that nothing in ERISA prohibited a “revenue sharing” arrangement, where a portion of the fees charged by mutual funds in which 401(k) plan assets were invested were transferred to the trustee/recordkeeper to pay for services provided to the plan. The amount of those fees was disclosed to participants, as required by regulations under ERISA § 404(c).

The court also determined that, since the amount of the fees charged by the mutual funds was disclosed to participants, the failure to disclose how those fees were subsequently allocated is not a violation of ERISA, unless there was an intentionally misleading statement or a material omission. Here, the court said, there was no allegation of a misleading statement, and the internal allocation of the fees was not material: “[t]he total fee, not the internal, post-collection distribution of the fee, is the critical figure.” (The court noted that the DOL had subsequently proposed regulations which would require more extensive disclosure about fees, but they were not applicable to this case. (See 73 FR 43014 (July 23, 2008).))

There was no breach of fiduciary duty in the selection of investment options. The opinion includes a brief discussion of whether the selection of plan investment options is part of the “basic structuring” of the plan so that it is not a fiduciary act. But, putting that issue aside, the court said that it was “undisputed that the Deere Plans offered a sufficient mix of investments for their participants.” In addition to 26 “core” options, there was a “mutual fund window” through which participants could access 2,500 other mutual funds, some of which had expense ratios as low as 7/100 of one percent. The fact that there might be some lower-expense funds available was irrelevant—“nothing in ERISA requires every fiduciary to scour the market to find and offer the cheapest possible fund.”

ERISA § 404(c) “Safe Harbor” applies to the selection of plan investment options. Under ERISA § 404(c), when a participant in a 401(k) plan exercises “independent control” to allocate his or her account assets among a “broad range of investment options,” no person who is otherwise a fiduciary to the plan will be liable for any loss that results from that exercise of control.

Defendants argued that, even if there was a fiduciary breach in the selection of investment options, so long as the requirements of § 404(c) were satisfied, any loss attributable to investment in high-fee funds was the result of the participant’s own election. The district court had accepted this argument, and the Seventh Circuit agreed:

If particular participants lost money or did not earn as much as they would have liked, that disappointing outcome was attributable to their individual choices. Given the numerous investment options, varied in type and fee, neither Deere nor Fidelity (assuming for the sake of argument that it somehow had fiduciary duties in this respect) can be held responsible for those choices.

We note two points on the § 404(c) holding. First, both the district court and the Seventh Circuit rejected the DOL’s position that the selection of investment options for a plan is a separate fiduciary act not covered by § 404(c). This view was originally expressed by the DOL in a footnote to the preamble to the § 404(c) regulations, and has been accepted by some other courts. Subsequent to the district court decision in *Hecker*, the DOL set out its position more directly in proposed regulation § 2550.404a-5(f). Second, while courts consider § 404(c) an “affirmative defense” that normally cannot be a basis for a motion to dismiss, the plaintiffs had, in their complaint, argued that § 404(c) was not applicable. This, according to the Seventh Circuit, opened the door and allowed defendants to argue the § 404(c) defense on the motion to dismiss.

Final thoughts. *Hecker*’s holdings that (1) absent intentional misrepresentation or material omission, ERISA does not require disclosure about 401(k) investment options beyond what is required by the statute and regulations, and (2) compliance with ERISA § 404(c) provides a defense against participant claims for losses based on alleged fiduciary breaches in selecting a plan’s investment options, are relevant to litigation beyond the 401(k) fee cases. For example, these same arguments might be made by defendants in a “stock drop” cases.

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