

## **Major Victory for Morgan Lewis Client Deere & Company in Nationwide 401(k) Fee and Expense ERISA Class Action**

**February 19, 2009**

Morgan Lewis recently secured a major victory for its client Deere & Company in a 401(k) “fee and expense” ERISA class action when, on February 12, the Seventh Circuit Court of Appeals affirmed the lower court’s decision in *Hecker v. Deere & Company*, dismissing the complaint against Deere & Company and its co-defendants in its entirety. This decision is certain to have far-reaching effects on pending fee and expense cases, as well as on future claims brought against plan fiduciaries for alleged imprudent investment decisions.

Like several of the other pending fee and expense cases, the complaint against Deere amounted to a frontal assault on the investment management and administrative structure of its 401(k) plans. The claims alleged the following:

- The fiduciaries breached their duties by failing to disclose revenue sharing between the fund investment manager and the trustee
- The fiduciaries breached their duties by offering funds that charged excessive fees
- The fiduciaries overpaid various service providers because they did not take into account the revenue sharing provided by mutual fund managers or securities lending commissions and brokerage commission rebates that were available to the plans

The defendants in *Deere* included Deere itself as well as Fidelity entities that served in trustee, record-keeping, and investment management capacities for Deere’s 401(k) plans. The plans’ investment options included 23 Fidelity retail mutual funds, two investment funds managed by Fidelity, a Deere company stock fund, and a Fidelity-operated “brokerage window” that gave the plans’ participants access to some 2,500 non-Fidelity mutual funds. The plaintiffs sued the Fidelity entities along with Deere on the theory that they shared liability with Deere because they acted as “functional” ERISA fiduciaries.

In mid-2007, Judge John C. Shabaz of the U.S. District Court for the Western District of Wisconsin dismissed the case against Deere under Federal Rule 12(b)(6), finding that the plaintiffs had failed to state an actionable claim. The court found that the plan-related documents referenced in the complaint showed that Deere had disclosed to participants the amount of expenses paid to fund managers (though not their post-collection distribution). The court further determined that ERISA does not require disclosure of revenue-sharing arrangements, and that the ERISA section 404(c) “safe harbor” (which shields fiduciaries from liability related to participants’ own investment choices) provided a complete defense. The court rejected the plaintiffs’ argument that it should not decide the 404(c) affirmative

defense because the plaintiffs themselves had put the defense in play by pleading its unavailability in their complaint. Finally, Judge Shabaz also dismissed the claims against the Fidelity entities on the ground that they were not in fact fiduciaries.

In affirming the dismissal, the Seventh Circuit distilled the allegations against Deere into two fundamental claims: (1) Deere had breached its fiduciary duties by failing to disclose the “revenue sharing” arrangements between the Fidelity entities, and (2) Deere had limited the plans’ investment options to funds offered by Fidelity, thus offering only investment options with excessive fees.

As to the first claim, the Seventh Circuit held that ERISA does not prohibit revenue-sharing arrangements or compel their disclosure. In this regard, it noted recently proposed Department of Labor (DOL) regulations that would have required such disclosure, illustrating that disclosure of revenue-sharing payments made from one plan service provider to another is not currently required. The court also held that such payments did not constitute “plan assets” because they were drawn from the assets of the mutual funds in question. The court also stated that Deere’s disclosure in the fund prospectuses of the total, aggregate fees charged by each investment option was sufficient, stating that “the 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.”

The Seventh Circuit also affirmed the dismissal of the second claim. It held that the mutual fund fees could not be excessive because they were offered to the general investing public, and thus the expense ratios, which ranged from .07% to 1% of assets under management, were “set against the backdrop of market competition.” “[N]othing 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 court also held that Deere’s practice of limiting the funds’ investment options to those offered by Fidelity was prudent, given the diversity of the investment options, which included more than 20 Fidelity mutual funds and a brokerage window through which participants could invest in more than 2,500 other funds.

Finally, the Seventh Circuit held that section 404(c)’s “safe harbor” provided a complete defense because Deere satisfied its requirements. These requirements include that a plan offer a broad range of investment options with varied risk and return characteristics, and that the fiduciaries disclose sufficient information, including information about fees and expenses, to enable participants to make informed investment decisions. For these reasons, the Deere plan gave participants control over the assets in their accounts: “Even if § [404(c)] does not always shield a fiduciary from an imprudent selection of funds under every circumstance that can be imagined [as the plaintiffs argued], it does protect a fiduciary that satisfies the criteria of § [404(c)] and includes a sufficient range of options so that the participants have control over the risk of loss.” Given the array of investment options available through the brokerage window, the court characterized as “implausible” any allegation that the Deere plans’ investment options could have been imprudently selected by the plan fiduciaries.

*Deere* will have far-reaching influence on other 401(k) fee cases. First, the ruling that “revenue sharing” payments do not involve plan assets and need not be disclosed will bolster the defenses in the many 401(k) fee cases where revenue sharing is a principal focus of the plaintiffs’ claims. Second, the finding that the mutual fund fees charged by Fidelity were reasonable because they were “set against the backdrop of market competition” ratifies the use of mutual funds (even retail class mutual funds) as an appropriate investment option, even though they may not be the least expensive option. Third, *Deere* supports the view that section 404(c) precludes challenges to the selection of investment options by plan fiduciaries where the available options reflect a broad range of risk and return characteristics and the costs of the options are adequately disclosed to participants.

If you have any questions about the information contained in this LawFlash, please speak with any of the members of the firm's Labor and Employment Practice, or with one of the following attorneys:

**Chicago**

Charles C. Jackson	312.324.1156	<a href="mailto:charles.jackson@morganlewis.com">charles.jackson@morganlewis.com</a>
Sari M. Alamuddin	312.324.1158	<a href="mailto:salamuddin@morganlewis.com">salamuddin@morganlewis.com</a>

**Philadelphia**

Joseph J. Costello	215.963.5295	<a href="mailto:jcostello@morganlewis.com">jcostello@morganlewis.com</a>
Brian T. Ortelere	215.963.5150	<a href="mailto:bortelere@morganlewis.com">bortelere@morganlewis.com</a>

**San Francisco**

Nicole A. Diller	415.442.1312	<a href="mailto:ndiller@morganlewis.com">ndiller@morganlewis.com</a>
D. Ward Kallstrom	415.442.1308	<a href="mailto:dkallstrom@morganlewis.com">dkallstrom@morganlewis.com</a>

**Washington, D.C.**

Gregory C. Braden	202.739.5217	<a href="mailto:gbraden@morganlewis.com">gbraden@morganlewis.com</a>
Christopher A. Weals	202.739.5350	<a href="mailto:cweals@morganlewis.com">cweals@morganlewis.com</a>

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