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Editor's Overview

This month's Newsletter features the Seventh Circuit's decision in *Hecker v. Deere* & Co., 2009 WL 332185 (7th Cir. 2009), which affirmed the dismissal of all of plaintiffs' fee claims. The article expands on the summary distributed through a recent Client Alert, and provides some initial reaction on the case from the legal community.

Also, be sure to review the rulings of interest. February was an interesting month for stock-drop actions and class certification motions, as well as arbitration and Section 204(h) issues. There also was another ERISA lawsuit filed regarding securities lending, and what appears to be the first ERISA filing on Madoff investments.

"Deere" in the Headlights: Plaintiffs' Fee Claims Receive Hostile Response from Seventh Circuit

By Stacey S. Cerrone

In a case of first impression among the circuit courts, the U.S. Court of Appeals for the Seventh Circuit affirmed the dismissal of all fee claims asserted in *Hecker v. Deere* & *Co.*, 2009 WL 332185 (7th Cir. 2009). Plaintiffs, on behalf of a putative class, contended that Deere, Fidelity Trust and Fidelity Research breached alleged fiduciary duties under ERISA by providing investment options that required the payment of allegedly excessive fees and costs, and by failing to adequately disclose the fee structure to plan participants. The district court granted defendants' motion to dismiss all claims and plaintiffs appealed.

Deere was the plan sponsor and plan administrator for a 401(k) plan for its employees. Deere retained Fidelity Management Trust Company as the plan trustee to perform record keeping and other administrative tasks. Under the trust agreement, Deere retained the authority to select investment options for the plan. The investment options included twenty-three different Fidelity mutual funds and a Fidelity-operated facility called BrokerageLink, which gave participants access to some 2,500 additional funds managed by different companies. Fidelity Research advised the Fidelity mutual funds offered by the plan.

Each fund included within the plan charged a fee, calculated as a percentage of assets the investor placed with it. Plaintiffs alleged that Fidelity Research shared its revenue, which it earned from the mutual fund fees, with Fidelity Trust. Plaintiffs further alleged that Fidelity Trust in turn compensated itself through those shared fees, rather than through a direct charge to Deere for its services as trustee.

Plaintiffs filed suit claiming that Deere violated its fiduciary duty under ERISA by providing investment options that required the payment of excessive fees and costs and failing to adequately disclose the fee structure to plan participants. Plaintiffs also sued Fidelity Trust and Fidelity Research on the theory that they were functional fiduciaries and therefore also liable for a breach of fiduciary duties.

In affirming the dismissal of plaintiffs' claims, the Seventh Circuit first concluded that Fidelity Trust and Fidelity Research were not functional fiduciaries because the trust agreement gave Deere, not Fidelity Trust, the final say on which investment options to include in the plan. For that same reason, the court rejected plaintiffs' allegations that the Fidelity entities were fiduciaries because they recommended Fidelity funds to Deere as investment options, and held that it was irrelevant that Deere may have discussed its decisions with Fidelity Trust. The court also distinguished plaintiffs' allegations from those in *Haddock v. Nationwide Fin. Services*, 419 F. Supp. 2d 156 (D. Conn. 2006), in which the service provider was found to be a fiduciary because it could delete and substitute mutual funds without seeking approval from the named fiduciary.

Second, the court rejected plaintiffs' claims that Deere breached its fiduciary duties by: (i) not informing the participants that Fidelity Trust received money from the fees collected by Fidelity Research; and (ii) imprudently agreeing to limit the investment options to Fidelity Research funds, and thus impermissibly offering only investment options with excessively high fees. With respect to the first claim, the court noted that the participants were in fact told about the total fees charged by the various funds through the information contained in the funds' prospectuses, which were referred to in the summary plan descriptions. In so holding, the court found that it was the total fees, not the internal distribution of those fees, that were material for participants interested in the cost of investment funds. Therefore, it concluded, the omission of the alleged revenue sharing between the Fidelity entities was not a breach of Deere's fiduciary duty. As for the second claim, the court determined that ERISA did not require Deere to provide investment options from more than one company (*e.g.*, from companies other than Fidelity Research). It was sufficient, according to the court, that Deere offered a number of investment options that provided participants with ample choices. The court also concluded that there was no basis to challenge the fees as excessive because there was a wide range of expense ratios among all of the funds. In addition, the court found it important that these funds were offered to investors in the general public, so the expense ratios were necessarily market rates.

Third, the court ruled that the safe-harbor defense, Section 404(c), 29 U.S.C. § 1104(c), provided an alternative ground for affirming the district court decision and dismissing both the disclosure/omission claims and the prudence claims. The Seventh Circuit concluded that Section 404(c) can be satisfied if the fiduciary provides a sufficiently broad range of options so that the participants can control the risk of loss. The court stated that the sufficiently broad range exists if the available investment alternatives can provide the participant or beneficiary the ability to accomplish three goals: "the ability materially to affect potential return and degree of risk in the investor's portfolio; a choice from at least three investment alternatives each of which is diversified and has materially different risk and return characteristics; and the ability to diversify sufficiently so as to minimize the risk of large losses." 29 C.F.R. §2550.404c1(b)(3)(i)(A)-(C). Observing that there were 2,500 mutual funds available to participants through a brokerage link provided for the Deere plan, the court found implausible plaintiffs' allegations that the options did not provide the participants with a reasonable opportunity to accomplish the three goals outlined in the Section 404(c) regulation, or control the risk of loss from fees. The court concluded that given the multitude of investment options offered by the Plan, varied in both type and fee, neither Deere nor Fidelity (assuming for the sake of argument that either had fiduciary duties in this respect) could be held responsible for those choices.

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The Seventh Circuit's decision has generated substantial debate in the ERISA community, as evidenced by a recent panel of speakers at the Midwinter Meeting of the Employee Benefits Committee of the American Bar Association Section of Labor and Employment Law. Elizabeth Hopkins, counsel for appellate and special litigation in the Labor Department, commented that she believed the Seventh Circuit's decision "missed the mark" on the issues being argued. According to Hopkins, the Seventh Circuit did not consider the size of the 401(k) plans and that the plan's fiduciaries may have been able to negotiate reduced fees. Counsel for the defendants in *Deere*, Deborah S. Davidson of Morgan Lewis & Bockius (Chicago), observed that there is no one-size-fits-all approach to structuring investments, stating that plan sponsors should take plan fees into consideration when they select service providers, but they also should consider the quality of the services offered by the providers.

Whether the Seventh Circuit's decision in *Deere* is the beginning of the end of these types of class action litigation remains to be seen. Plan fiduciaries should continue to monitor the 401(k) fee structures of the plans they oversee to make sure that the fees are reasonable in comparison to industry standards, and document their processes for conducting these reviews. In addition, plan sponsors and fiduciaries should continue to review plan documents, summary plan descriptions, and participant communications to ensure that they comply with ERISA's reporting and disclosure requirements.

Rulings, Filings and Settlements of Interest

- In *Schornhorst v. Ford Motor Co.*, 2009 WL 275727 (E.D. Mich. Feb. 5, 2009), the district court concluded that although Ford violated ERISA by not disclosing in its summary plan description that it would not pay accidental death benefits if a participant's death was alcohol-related, the participant's widow was not entitled to an award of benefits as a substantive remedy. In so holding, the court observed that the "Sixth Circuit has repeatedly held that a substantive award of benefits is not the appropriate remedy for a violation of the ERISA notice and disclosure requirements in denial of benefits claims." The court also concluded that there was no direct conflict between the SPD and the plan that would have called for the SPD to trump the plan: "The Court declines to permit the ambiguous or incomplete terms of the SPD [to] trump the wholly unambiguous terms of the Plan."
- In *Franke v. Poly-America Medical and Dental Benefits Plan*, 2009 WL 260519 (8th Cir. Feb. 5, 2009), the Eighth Circuit held that a plan participant must arbitrate with the plan over its decision to deny him benefits (medical expenses associated with the participant's heart attack), although certain provisions of the arbitration agreement in question (the requirements that the arbitration be binding and that the participate had to share the costs of arbitration) violated ERISA. In so holding, the court stated that the arbitration agreement was enforceable because it contained a "severability" provision stating that if any portion of the agreement was found to be invalid that portion would be severed from the agreement.
- In *In re Merck & Co. Sec., Derivative & ERISA Litig.*, 2009 WL 331426 (D.N.J. Feb. 10, 2009) (unpublished), the district court ruled that 401(k) plan participants who invested their retirement money in the company's stock could proceed with a class action on their prudence claim, although the class could not include employees who either profited from the artificially inflated stock or who signed post-separation settlement agreements waiving any claims they had under ERISA. The court concluded, however, that the disclosure claim was not suitable as a class claim because adjudication of the claim would require individualized determinations

about each employee's investment decisions and the information they received from Merck.

- In *In re Huntington Bancshares Inc. ERISA Litig.*, 2009 U.S. Dist. LEXIS 9103 (S.D. Oh. Feb. 9, 2009), the district court granted defendants' motion to dismiss a class action suit commenced by former employees of Huntington Bancshares ("Huntington") who alleged that defendants (the company, board of directors and several plan committees) breached various ERISA fiduciary duties by offering participants in a 401(k) plan the option of investing in Huntington's stock. Huntington's stock declined from $22 to $7 per share during the putative class period, during which time the company allegedly suffered $1.5 billion in losses as a result of a merger that exposed Huntington to the subprime market. The court first dismissed plaintiffs' prudence claim, concluding that dismissal was warranted irrespective of whether *Moench*'s presumption of prudence — which generally had been applied to 401(k) plan stock drop litigation — should apply. In so holding, the court observed that plaintiffs' allegations concerning the merger were "simply an attempt to second-guess Huntington's business decision and is not conduct governed by ERISA." In addition, the court noted that Huntington's stock price "moved in tandem with the other regional banks in Huntington's geographic footprint over the Class period" and concluded that nothing had occurred to trigger defendants' duty to investigate whether Huntington's stock continued to be an appropriate investment under the plan — that is, there was nothing "akin to a 'red flag' of misconduct." The court also dismissed plaintiffs' disclosure claims, concluding that defendants made numerous public disclosures regarding its potential exposure to credit and market risk throughout the class period and warned investors that it was "not immune to the effects of market turmoil." Finally, the court dismissed several secondary liability claims, including breach of the fiduciary duty to monitor, and co-fiduciary claims, reasoning that because plaintiffs did not adequately plead the existence of any underlying fiduciary breach, these claims must fail.
- In *Jones v. NovaStar*, 2009 WL 331553 (W.D. Mo. Feb. 11, 2009), the district court denied defendants' motion to dismiss various fiduciary breach claims relating to a 401(k) plan participant's investment in NovaStar stock. The complaint alleged, among other things, that the price of NovaStar stock declined 99% during the putative class period as a result of NovaStar's alleged "serious mismanagement and improper business practices" related to its subprime business. In a single paragraph, the court concluded that plaintiff "pleaded facts indicating a precipitous decline in NovaStar stock and that defendants knew, or should have known, of NovaStar's impending collapse . . . . Though the evidence will eventually show whether [plaintiff] can prove the allegations of Count I, she has adequately pleaded

facts overcoming any presumption of prudence applicable to the NovaStar stock investments." The court also declined to dismiss plaintiff's affirmative material misrepresentation claim, concluding that: (i) the heightened pleading requirements of securities laws do not apply to this ERISA action; and (ii) plaintiff need not identify the author or specific content of each misrepresentation in order to survive a motion to dismiss. Because the court declined to dismiss the prudence and disclosure claims, the court also declined to dismiss plaintiff's secondary liability claims. The court also rejected defendants' standing argument, concluding that plaintiff had adequately pled that she suffered a loss as a result of defendants' actions.

- In *Ruppert v. Alliant Energy Cash Balance Pension Plan*, 2009 WL 357942 (W.D. Wis. Feb. 12, 2009), the district court granted plaintiffs' motion for class certification in a case involving allegations that plaintiffs' benefits should have included a "whipsaw" calculation to increase their benefits. In so holding, the court concluded that the severance agreements plaintiffs signed posed no threat to the typicality or adequacy of the class because the agreements had carve outs for pension benefits, and the agreements did not apply to future conduct (the benefits were calculated and paid after the agreements were signed). The court also held that a statute of limitations defense could be addressed through a subclass. Finally, the court held that the named plaintiffs' relative lack of interest and independence did not prevent them from being adequate representatives of the class in light of their counsel's qualifications.
- In *Brady v. The Dow Chemical Co. Retirement Board*,2009 WL 394322 (4th Cir. Feb. 18, 2009) (unpublished), the Fourth Circuit held that a plan's failure to take corrective measures upon learning of participants' confusion about certain plan amendments converting the traditional defined benefit plan to a pension equity plan constituted an egregious failure under ERISA § 204(h).
- On new filings of note, in *Pension Fund Hospital & Healthcare Employees v. Austin Capital Management*, No. 2:09-cv-00615-PBT (E.D. Pa.), an investment manager is being sued under ERISA for investing in Madoff investments. In *Board of Trustees AFTRA Retirement Fund v. J. P Morgan*, No. 09-686 (S.D.N.Y.), the trustees are suing JP Morgan for allegedly breaching fiduciary duties regarding securities lending.

Related Professionals

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