

## Seventh Circuit Denies Rehearing of Dismissal of Challenge to 401(k) Fee Arrangements

This past February the Seventh Circuit Court of Appeals issued the first federal appellate court decision in a series of class actions filed throughout the country, challenging the mutual funds fees charged to participants in 401(k) plans sponsored by a number of large, prominent employers. The Seventh Circuit affirmed the federal district court's summary dismissal of the complaint in its entirety. You can click on the following link to read our summary of that decision in favor of Deere & Company, Fidelity Management Trust Company and Fidelity Management and Research Company. [Seventh Circuit Affirms Dismissal of Challenge to 401\(k\) Fee Arrangements.](#)

As is customary, the case was heard and decided by a three judge panel of the Seventh Circuit. Before the plaintiffs are permitted to appeal their case to the United States Supreme Court, they were required to seek a rehearing by the full Seventh Circuit Court of Appeals. They did so in March, with the support of the Secretary of Labor, AARP and other organizations. Each of these petitioners filed briefs explaining their objections to the decision by the three judge panel.

The full Seventh Circuit has now denied the request for a rehearing. As part of that denial, however, the original three judge panel has taken the unusual step of supplementing its initial decision in order to address certain concerns raised by the Secretary of Labor in her brief supporting the request for rehearing.

In its original decision, the three judge panel, without deciding the issue, questioned whether the selection of plan investment options was a fiduciary responsibility at all, suggesting that it may instead be a plan design decision outside the fiduciary ambit. The Secretary of Labor objected to the suggestion, citing the Department of Labor's long standing position to the contrary, as stated in a footnote to the preamble to the 1992 final regulations under ERISA section 404(c). The Secretary argued that the 1992 footnote was entitled to judicial deference by the Seventh Circuit.

The Seventh Circuit disagreed. The panel explained that it deferred to the Secretary's concerns, albeit not to her footnote, insofar as it refrained from deciding the question of whether section 404(c) relieves a plan fiduciary from responsibility for selection of prudent investment options. Instead, the panel explained, it left the issue "open for future development, whether on the basis of a different set of pleadings, or on the basis of a regulation [as distinguished from a footnote] directed to this issue."

Second, the Seventh Circuit's original decision relied, in part, on the multiplicity of investment options under the Deere 401(k) plan (more than 20 core options and 2,500 other funds available through a brokerage window), together with disclosure to participants of the fees charged by the available funds, to conclude that participants were provided with a sufficient range of alternatives to allow them effectively to control their risk of loss. The Secretary expressed concern that the court's rationale could be used by a plan fiduciary to insulate itself from liability simply by "including a very large number of investment alternatives in its portfolio and then shifting to the participants the responsibility for choosing among them."

The panel denied that this was its intent and assured the Secretary that its "opinion was tethered closely to the facts before the court." The plaintiffs never complained that any of the core investment options was unsound or reckless, or that the brokerage window was improper. Instead, they argued that the fees charged by some of the funds were excessive, and that the fiduciaries had a duty to negotiate lower fees. The panel explained that these allegations, by themselves, were insufficient to avoid dismissal.

As to this last point, the panel observed that the plaintiffs' complaint said nothing about the services participants received in return for the fees charged by the funds. The court speculated that higher fees may have been justified by extra services.

The panel's supplement to its original opinion narrows the scope of that opinion in certain respects. It may offer suggestions that help plaintiffs in other cases avoid dismissal. Yet even with the panel's additional commentary, the Seventh Circuit's decision in this case should be viewed as a substantial victory for plan fiduciaries that can be expected to support dismissal of similar claims in other federal courts. The opinion also provides meaningful guidance to fiduciaries concerning the scope of their responsibility in choosing plan investments and informing themselves about associated fees and expenses. Finally, the opinion serves as a cautionary note to governmental agencies about the need to adhere to formal administrative procedures when making policy.

If you have questions or would like additional information about fiduciary issues relating to mutual fund fees and other plan administrative expenses, please feel free to contact Brian Dougherty at (215) 587-5919 or [bdougherty@postschell.com](mailto:bdougherty@postschell.com).

To ensure compliance with requirements imposed by the IRS, we inform you that any U.S. federal tax advice contained in this communication (including any attachments or enclosures) is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding penalties under the Internal Revenue Code or (ii) promoting, marketing or recommending to another party any transaction or matter addressed herein. In addition, we do not impose on any person or entity to whom this is addressed any limitation on disclosure of the tax treatment or tax structure of any transaction discussed herein (including in any attachments or enclosures).

**Disclaimer:** this E-Flash does not offer specific legal advice, nor does it create an attorney-client relationship. You should not reach any legal conclusions based on the information contained in this E-Flash without first seeking the advice of counsel.

© Copyright 2009 Post & Schell, P.C. All rights reserved  
"POST & SCHELL" and the Post & Schell Logo are registered trademarks of Post & Schell, P.C.  
[About Us](#) | [Our Attorneys](#) | [Practice Areas](#) | [Publications](#) | [Offices](#)