Courts favor fiduciaries in suit over “imprudent” plan investments

By Editor Test *Wed, Oct 5, 2011*

Plan sponsors and fiduciaries have won another case at the U.S. Court of Appeals for the 7th Circuit—the third this year.

On September 6, 2011, in the case of *Loomis v. Exelon Corp.*(Case Nos. 09-4081 and 10-1755), the Seventh Circuit found that the fiduciaries of Exelon Corporation’s defined contribution retirement plan did not breach their fiduciary duties by offering “retail” mutual funds—funds sold to the general public—nor by requiring participants to bear the expenses of those funds.

The following is based on court documents and a report by Seyfarth Shaw, a national law firm with “a large management side labor and employment practice.”

The Exelon Plan offered 32 investments options, 24 of which were retail mutual funds with expense ratios of 30 to 96 basis points. The highest expense ratios were associated with actively managed funds and the lower ratios associated with index funds.

Citing *Hecker v. Deere & Co.*, 556 F.3d 575 (7th Cir. 2009), and other Seventh Circuit cases which have stressed the importance of participant choice in understanding fiduciary responsibility with respect to defined contribution plan investments, the Court rejected plaintiffs’ arguments:

> Plaintiffs, participants in Exelon’s Plan, contend that its administrators have violated their fiduciary duties under the Employee Retirement Income Security Act, see 29 U.S.C. §1104(a), in two ways: by offering “retail” mutual funds, in which participants get the same terms (and thus bear the same expenses) as the general public; and by requiring participants to bear the economic incidence of those expenses themselves, rather than having the Plan cover these costs. Plaintiffs contend that Exelon should have arranged for access to “wholesale” or “institu- tional” investment vehicles. Some mutual funds offer a separate “institutional” class of shares, and Exelon’s Plan also could have participated in trusts and invest- ment pools to which the general public does not have access.
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> Similar arguments were made in *Hecker* but did not prevail. Deere offered 25 retail mutual funds with expense ratios from 0.07% to just over 1% annually. We held that as a matter of law that was an acceptable array of investment options, observing that “all of these funds were also offered to investors in the general public, and so the expense ratios necessarily were set against the backdrop of market competition. The fact that it is possible that some other funds might have had even lower ratios is beside the point; nothing 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 opinion, written by Chief Judge Easterbrook and joined by Judges Posner and Tinder, concluded that the plaintiffs benefited from the “retail” funds’ transparency and liquidity. It also concluded that Exelon was not in a position to guarantee investments in a particular fund, and thus to use the Plan’s alleged bargaining power to secure lower cost options, because participants had complete discretion whether to invest in any of the offered funds.

The Court characterized the plaintiffs’ theory as “paternalistic” because the Plan had given choice over what investments to use to those most interested in the outcome — the participants. The Court emphasized, “all that matters is the absence from ERISA of any rule that forbids plan sponsors to allow participants to make their own choices.” The Seventh Circuit further concluded that an attempt to challenge the assessment of investment expenses against Plan participants failed because whether to make participants pay plan expenses is a non-fiduciary matter of plan design.

The Court also addressed the district court’s award of costs to Exelon and rejected plaintiffs’ assertion that in an ERISA case a showing of bad faith is required for the defendant to recover costs. The Court held that all that is required for an award of costs is that the prevailing party shows “some degree of success on the merits.”

Loomis, along with *Hecker*, and several Seventh Circuit decisions from the employer stock context, teaches that plan fiduciaries are not liable for offering allegedly imprudent investment options so long as they offer participants a reasonable choice of unchallenged investment options (i.e., at least three choices *see Howell v. Motorola, Inc.,* 633 F.3d 552, 569 (7th Cir. 2011)) and so long as the challenged investment is not “manifestly imprudent” (*see Peabody v. Davis*, 636 F.3d 368, 376 (7th Cir. 2011).