No. 09-16253

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

BEVERLY KANAWI AND SALVADOR AQUINO
Plaintiffs-Appellants,

v.

BECHTEL CORPORATION, THE BECHTEL TRUST & THRIFT PLAN COMMITTEE, PEGGI KNOX, AND FREMONT INVESTMENT ADVISORS, INC.
Defendants-Appellees.

On Appeal from the United States District Court
For the Northern District of California
Case No. 06-05566 CRB

BRIEF OF THE SECRETARY OF LABOR, HILDA L. SOLIS, AS AMICUS CURIAE IN SUPPORT OF PLAINTIFFS

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STATEMENT OF THE ISSUES

1. Whether ERISA section 404(c), 29 U.S.C. § 1104(c), immunizes fiduciaries from liability for imprudence and disloyalty in selecting and maintaining plan investment options that charged the plan unnecessary and excessive fees.

2. Whether the district court applied the correct standards of prudence and loyalty under ERISA section 404, 29 U.S.C. §1104, and properly granted summary judgment, when it approved the fiduciaries' actions based upon findings that the fees paid by the plan were not "patently unreasonable," and that the fiduciaries acted "prudently and within their sound business judgment" in maintaining the mutual funds as investment options.

3. Whether the continued investment in mutual funds and the payment of fees to a fiduciary investment adviser during the statute of limitations period constitute transactions that occurred within the limitations period for purposes of the prohibited transaction rules of ERISA section 406, 29 U.S.C.§ 1106.

STATEMENT OF INTEREST

The Secretary of Labor has primary enforcement authority for Title I of the Employee Retirement Income Security Act ("ERISA"), 29 U.S.C.

§1001, et seq. Accordingly, the Secretary has a strong interest in the proper construction of ERISA's fiduciary provisions, which were enacted to ensure the prudent management of pension plan assets and to safeguard the security of retirement benefits.

This case concerns, in part, a 1992 Department of Labor regulation that delineates when fiduciaries are relieved from potential liability for imprudent investment choices by the participants' exercise of control over assets held in certain participant-directed individual account plans. 29 U.S.C. § 1104(c); 29 C.F.R. § 2550.404c-1. Under the statute and the regulation, fiduciaries to such plans remain obligated to ensure that the investment options offered by the plans are selected and maintained in accordance with ERISA's fiduciary provisions, while plan participants bear responsibility for the allocation of investments between funds appropriately chosen by the plans' fiduciaries. The district court agreed with the Secretary's "clear position that §404(c) does not shield a party from liability for claims of imprudent selection of Plan investment options," Kanawi v. Bechtel, 590 F. Supp. 2d 1213, 1232 (N.D. Cal. 2008), and the Secretary has a strong interest in having this upheld.

The Secretary likewise has a strong interest in correcting the district court's erroneous articulation and application of ERISA's prudence and

loyalty standards. The court granted summary judgment on the plaintiffs' prudence and loyalty claims based on findings that the fees paid by the plan were not "patently unreasonable," and that the fiduciaries acted "prudently and within their sound business judgment" in maintaining the mutual funds as investment options. 590 F. Supp. 2d at 1229. The fiduciary standards for prudence and loyalty, which are among the highest known to the law, are far more exacting than those articulated by the district court.

The district court also erred in holding that plaintiffs' prohibited transaction claims under ERISA section 406, 29 U.S.C. §1106, were time-barred because the initial decision to use certain mutual funds as investment options occurred more than six years before suit was filed, 590 F. Supp. 2d at 1229, even though the Plan continued to invest in the mutual funds and pay allegedly excessive fees during the limitations period. Both with regard to private litigation and her own litigation, the Secretary has a strong interest in the proper application of ERISA's statute of limitations.

STATEMENT OF THE CASE

Defendant Bechtel Corp. ("Bechtel") sponsors a 401(k) pension plan for its employees, The Bechtel Trust & Thrift Plan (the Plan), that is governed by ERISA. The Plan is administered by defendant The Bechtel Trust & Thrift Plan Committee (the "Committee"). Defendant Fremont

Advisors, Inc. (FIA),[1] the Plan's investment manager from 1987-2004, is a company created by Bechtel to take over the functions previously provided for free by its in-house investment management group. Plaintiffs allege that Bechtel owners, officers, family members, and members of the Committee retained ownership interests in FIA through FIA's parent company, Fremont Investors, Inc. In approximately 1994, the Plan began offering Fremont mutual funds as investment options for plan participants, for which FIA was paid investment advisory fees. Plaintiffs brought this class action, alleging that defendants chose the Fremont mutual funds as plan options, and paid excessive and unnecessary amounts of fees to FIA, for the purposes of benefiting FIA, and the Bechtel owners, officers and family members, at the expense of plan participants. Plaintiffs allege that these parties siphoned millions of dollars of excess fees from their employees' retirement savings by using the Fremont mutual funds. 590 F. Supp. 2d at 1219-20, 1228, 1231, Appellants' Brief at 1, 4-5, 11 13, 26-27, 29, 40-41, 46-47, 49-50, 53, 65, 67, 69-73.

Plaintiffs maintain that the payments of fees to FIA were prohibited transactions under ERISA section 406, 29 U.S.C.§ 1106, and that the

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[1] FIA was formerly known as Sierra Asset Management. 590 F. Supp. 2d at 1220.

payment of excessive fees for the Fremont mutual funds violated the fiduciaries' prudence and loyalty obligations under ERISA section 404(a), 29 U.S.C. § 1104(a). Plaintiffs sued Bechtel, the Committee, and FIA under ERISA sections 409, 502(a)(2) and 502(a)(3), 29 U.S.C. §§ 1109, 1132(a)(2), 1132(a)(3), for their alleged fiduciary breaches. 590 F. Supp. 2d at 1220.

The district court granted defendants' motions for summary judgment with respect to most of plaintiffs' claims. The court held first that the prohibited transaction claims based on the payment of asset-based mutual fund fees to FIA were time-barred because the initial decisions to invest in those mutual funds occurred more than six years before suit was filed. 590 F. Supp. 2d at 1229.

The court then held that the prudence and loyalty claims based on defendants continued use of the Fremont funds during the six years preceding suit were timely filed. Id. The court also rejected defendants' argument that they were immunized from liability for these claims of fiduciary breach by ERISA section 404(c). The court held that even if section 404(c) applied, defendants would not be absolved of liability for their own fiduciary breaches in selecting investment options for the Plan. The court stated:

> DOL has taken a clear position that § 404(c) does not shield a party from imprudent selection of Plan investment options. This position comports with commonsense. Where the options available to participants are tainted by conflicts of interest or imprudent management, a party should not be able to avoid liability simply by providing participants the opportunity to exercise control over their accounts.

590 F. Supp. 2d at 1232.

Nevertheless, the court rejected these claims on the merits, entering summary judgment for the defendants based on findings that the fees paid for the Fremont funds were not "patently unreasonable," and that defendants acted prudently and "within their sound business judgment" in maintaining the Plan's offering of the Fremont mutual funds. 590 F. Supp. 2d at 1229.

SUMMARY OF ARGUMENT

The statutory safe harbor in section 404(c) does not immunize the Plans' fiduciaries to the extent they acted imprudently or disloyally in offering the Fremont mutual funds as plan investments, as the district court correctly held. The Secretary's regulation interpreting section 404(c), issued after notice and comment pursuant to an express delegation of authority, reasonably interprets 404(c) as providing no defense to the imprudent selection or retention of an investment option by the fiduciaries of an individual account plan that provides for participant-directed investments. The Secretary's contemporaneous interpretation to that effect is expressed in

the preamble to her regulation, in briefs, and in Department of Labor Opinion Letters, and is therefore entitled to the highest level of deference under controlling Supreme Court precedent. For years, this interpretation has effectively ensured that plan fiduciaries retain responsibility – and accountability – for the prudent selection and monitoring of plan investment options in accordance with ERISA's stringent fiduciary obligations. The district court correctly agreed with the Secretary's interpretation.

However, the district court articulated and applied an incorrect legal standard for fiduciaries' prudence and loyalty obligations under ERISA. The district court entered summary judgment based on findings that the fees were not "patently unreasonable," and that their payment was within the "sound business judgment" of the fiduciaries, standards not in keeping with ERISA's far more exacting standards for fiduciary prudence and loyalty. For this reason, this Court has already recognized that the business judgment rule, a corporate law doctrine upon which the district court relied, has no application to an action for fiduciary breach under ERISA. Moreover, summary judgment was inappropriate because there were conflicting expert opinions regarding the reasonableness of the fees charged by the Fremont funds. See Appellants' Brief at 28-29, 38-39, 55, 61, 68.

The district court also erred in its application of ERISA's statute of limitations in holding that plaintiffs' prohibited transaction claims based upon the payment of investment advisory fees to FIA were time-barred because the initial decision to use the Fremont mutual funds occurred more than six years before suit was filed. The court did not address the fact that the plan paid asset-based fees to FIA throughout the time Fremont mutual funds were offered as plan investments, including during the six-year limitations period. Each payment to FIA was a potential prohibited transaction; accordingly, prohibited transaction claims based on payments made within six years of filing suit were timely.

ARGUMENT

I. ERISA SECTION 404(c) DOES NOT PROVIDE A DEFENSE TO THE DEFENDANTS' ALLEGED IMPRUDENCE AND DISLOYALTY IN OFFERING THE FREMONT MUTUAL FUNDS

Congress enacted ERISA expressly to safeguard the "financial soundness" of employee benefit plans "by establishing standards of conduct, responsibility, and obligation for fiduciaries of employee benefit plans, and by providing appropriate remedies, sanctions, and ready access to the Federal courts." 29 U.S.C. §§ 1001(a), (b). To this end, ERISA imposes on all plan fiduciaries the familiar trust law standards of prudence and loyalty,

and provides that plan participants and fiduciaries may bring suit to recover plan losses stemming from the breach of those duties. 29 U.S.C. §§ 1104, 1109, 1132(a)(2). Although ERISA fiduciaries are generally responsible under these provisions for all plan losses caused by their breaches and those of their co-fiduciaries,[2] section 404(c) provides a limited exception for losses resulting from a participant's or beneficiary's exercise of control over his individual account in a defined contribution plan. 29 U.S.C. § 1104(c). Thus, ERISA section 404(c)(1)(B) provides that "in the case of a pension plan which provides for individual accounts and permits a participant or beneficiary to exercise control over the assets in his account, if a participant or beneficiary exercises control over the assets in his account (as determined under regulations of the Secretary) no person who is otherwise a fiduciary shall be liable under this part for any loss, or by reason of any breach, which results from such participant's or beneficiary's exercise of control." Id. § 1104(c)(1)(B) (emphasis added).

Under the terms of the Act and the Secretary's 404(c) regulation, plan fiduciaries are shielded only for losses "which result[] from" the participant's exercise of control, and not from losses attributable to their own fiduciary misconduct. 29 U.S.C. § 1104(c)(1)(B); 29 C.F.R. § 2550.404c-1.

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[2] See 29 U.S.C. §§ 1132(a)(2), 1109(a), 1105.

Consequently, section 404(c) does not give fiduciaries a defense to liability for their own imprudence in the selection or monitoring of investment options available under the plan. The selection of the particular funds to include and retain as investment options in a retirement plan is the responsibility of the plan's fiduciaries, and logically precedes (and thus cannot "result[] from") a participant's decision to invest in any particular option. It is the fiduciary's responsibility to choose investment options in a manner consistent with the core fiduciary duties of prudence and loyalty. If it has done so, section 404(c) relieves the fiduciary from responsibility for losses that "result[] from" the participants' exercise of authority over their own accounts. If, however, the funds offered to the participants were imprudently selected or monitored, the fiduciary retains liability for the losses attributable to the fiduciary's own imprudence.

This straightforward interpretation of the statute is reflected in the 404(c) regulation, which provides: "If a plan participant or beneficiary of an ERISA section 404(c) plan exercises independent control over assets in his individual account in the manner described in [the regulation]," then the fiduciaries may not be held liable for any loss or fiduciary breach "that is the direct and necessary result of that participant's or beneficiary's exercise of

control." 29 C.F.R. § 2550.404c-1(d)(2); see also 29 C.F.R. § 2550.404c-1(b)(2)(i)(B)(1)(i). The preamble to the regulation explains that:

> the act of designating investment alternatives . . . in an ERISA section 404(c) plan is a fiduciary function to which the limitation on liability provided by section 404(c) is not applicable. All of the fiduciary provisions of ERISA remain applicable to both the initial designation of investment alternatives and investment managers and the ongoing determination that such alternatives and managers remain suitable and prudent investment alternatives for the plan.

57 Fed. Reg. 46,922 (Oct. 13, 1992). The preamble further explains, in a footnote, that the fiduciary act of making a plan investment option available is not a direct and necessary result of any participant direction:

> In this regard, the Department points out that the act of limiting or designating investment options which are intended to constitute all or part of the investment universe of an ERISA section 404(c) plan is a fiduciary function which, whether achieved through fiduciary designation or express plan language, is not a direct or necessary result of any participant direction of such plan. Thus, . . . the plan fiduciary has a fiduciary obligation to prudently select . . . [and] periodically evaluate the performance of [investment] vehicles to determine . . . whether [they] should continue to be available as participant investment options.

Id. at 46,922 n.27. In other words, although the participants in such defined contribution plans are given control over investment decisions among the

options presented to them, the plan fiduciaries nevertheless retain the duty to prudently choose and monitor the investment options.[3]

This regulatory interpretation is consistent with ERISA's purposes and overall structure, which places stringent trust-based fiduciary duties at the heart of the statutory scheme. See 29 U.S.C. § 1001(b), 1104. Under this scheme, fiduciaries are defined not simply by their titles, but also functionally, based on the discretionary authority they are granted and the control they exercise over the plan and its assets. See 29 U.S.C. § 1002(21). Thus, the Supreme Court has noted that ERISA "allocates liability for plan-related misdeeds in reasonable proportion to the respective actor's power to control and prevent the misdeeds." Mertens v. Hewitt Assocs., 508 U.S. 248, 262 (1993). Consistent with these principles, the statute provides that if

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[3] The Secretary has consistently adhered to this interpretation in regulatory pronouncements and amicus briefs. See, e.g., Department of Labor Opinion Letter No. 98-04A, 1998 WL 326300, at *3, n.1 (May 28, 1998); Letter from the Pension and Welfare Benefits Administration, U.S. Department of Labor, to Douglas O. Kant, 1997 WL 1824017, at *2 (Nov. 26, 1997); In Re Schering-Plough Corporation ERISA Litigation, 2009 WL 4893649 (3d Cir. 2009) (Brief of the Secretary of Labor as Amicus Curiae in Support of Plaintiffs-Appellees) (May 26, 2009); Hecker v. Deere & Co., 556 F.3d 575 (7th Cir.), reh'g denied, 569 F.3d 708 (2009) (Amended Brief of the Secretary of Labor as Amicus Curiae in Support of the Plaintiffs-Appellants and Brief of The Secretary Of Labor as Amicus Curiae In Support Of Panel Rehearing); Tittle v. Enron Corp., 2002 WL 34236027 (Amended Brief of the Secretary of Labor as Amicus Curiae Opposing Motion to Dismiss) (Sept. 30, 2002).

a fiduciary exercises control over the plan or its assets, it must do so prudently and loyally, and the fiduciary is relieved from liability only in the limited circumstances where the control that the fiduciary would otherwise have exercised is properly delegated to and exercised by someone else. See, e.g., 29 U.S.C. § 1105(c)(1) (permitting the named fiduciary in some circumstances to designate other fiduciaries to carry out specific functions, and relieving the named fiduciary of liability except with respect to appointing or monitoring the designee); 25 C.F.R. § 408b-2(e)(2) (explaining that a fiduciary does not self-deal under section 406(b)(1) if "the fiduciary does not use any of the authority, control, or responsibility which makes such person a fiduciary to cause the plan to pay additional fees"). The Secretary's 404(c) regulation and her interpretation of that regulation are consistent with, and indeed best serve, these statutory principles.

In their briefs in the district court, the defendants relied on the Fifth Circuit's decision in Langbecker v. Electronic Data Systems (EDS), 476 F.3d 299 (5th Cir. 2007), and may also rely on the recent decision of the Seventh Circuit in Hecker v. Deere & Company, 556 F.3d 575 (7th Cir.), reh'g denied, 569 F.3d 708 (2009), to argue that the 404(c) defense is available to plan fiduciaries that imprudently choose or maintain investment options that a reasonable fiduciary would not offer. The Secretary disagrees

with the Fifth Circuit's analysis in EDS. Contrary to the holding of the EDS majority, the Secretary's interpretation of section 404(c) is both consistent with the statutory provision and entirely reasonable, as the dissent in EDS pointed out. 476 F.3d at 320-22 & n.6 (Reavley, dissenting) (collecting cases holding that the fiduciary retains the duty to prudently select and monitor investment options even if a plan qualifies as a 404(c) plan); accord DiFelice v. U.S. Airways, Inc., 497 F.3d 410, 418 n.3 (4th Cir. 2007).

With respect to the Deere decision, the Seventh Circuit expressly "refrained from making any definitive pronouncement on 'whether the safe harbor applies to the selection of investment options for a plan,'" instead leaving the "area open for future development." 569 F.3d at 710 (citing earlier decision in Hecker, 556 F.3d at 589). The court also emphasized that its decision that the plaintiffs in that case failed to state a claim was limited and "tethered closely" to the specific factual allegations in the complaint before the court.[4] Id.

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[4] In the district court, the defendants also relied on the Third Circuit's decision in In re Unisys Sav. Plan Litig., 74 F.3d 420, 443-46 (3d Cir. 1996), for the proposition that if the Plan meets the requirement of 404(c), then the plaintiffs in this case may not recover plan losses even if the Fremont mutual funds were imprudently selected or maintained by the Plan's fiduciaries. However, because the Unisys case arose before the effective date of the Secretary's 404(c) regulation, which is entitled to the highest deference, the dicta in Unisys on which the defendants rely is not authoritative, as the

The Secretary's regulation was issued after notice-and-comment rulemaking pursuant to an express delegation of authority to the Secretary to determine the circumstances under which "a participant or beneficiary exercises control over the assets in his account." 29 U.S.C. § 1104(c). Consequently, it is entitled to controlling deference under Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc., 467 U.S. 837, 842-43 (1984). See Long Island Care at Home v. Coke, 127 S. Ct. 2339, 2349-50 (2007); United States v. Mead Corp., 533 U.S. 218, 229-30 (2001). The Secretary's interpretation of section 404(c) and of her own regulation is likewise entitled to the highest degree of deference because it is longstanding and consistently held, thoroughly thought out, and based on the Secretary's consideration of relevant policy concerns. See, e.g., Yellow Trans., Inc. v. Michigan, 537

Unisys court itself recognized. Id. at 441 n.1 (noting that because the conduct took place before the regulations effective date, "the regulation does not apply or guide our analysis in this case"); see also EDS, 476 F.3d at 322 (Reavley dissenting) (5th Cir. 2007); cf. Nat'l Cable & Telecom. Ass'n v. Brand X Internet Servs., 545 U.S. 967, 982 (2005) ("A court's prior judicial construction of a statute trumps an agency construction otherwise entitled to Chevron deference only if the prior court decision holds that its construction follows from the unambiguous terms of the statute and thus leaves no room for agency discretion."). In Unisys, the Court candidly acknowledged that the statutory text "neither defines nor clarifies its central element – the 'control' a pension plan may permit a participant or beneficiary to exercise." 74 F.3d at 445. As argued in text, the Secretary clarified that central element in her 404(c) regulation and preamble, and her regulation and interpretation are entitled to deference.

U.S. 36, 45 (2002) (giving Chevron deference to the ICC's interpretation of the Intermodal Surface Transportation Efficiency Act that was made in explanatory statement announcing the promulgation of the regulation rather than the regulatory text); Auer v. Robbins, 519 U.S. 452, 462 (1997). The preamble language explaining the scope of the regulatory and statutory exemption and declining to shield fiduciaries from liability for losses attributable to their own imprudent selection and monitoring of investment options represents the Secretary's authoritative interpretation of her own regulation and was itself the product of the same notice-and-comment rulemaking. Indeed, this interpretation was announced in the proposed regulation before it was adopted in the final regulation. See 56 Fed. Reg. 10724, 10832 n.21 (Mar. 13, 1991).

The Supreme Court has stressed the strength and importance of deference in such circumstances, Geier v. Am. Honda Motor Co., Inc., 529 U.S. 861, 877-80 (2000) (giving controlling deference to interpretation in preamble), and consistently has given controlling weight even to interpretations of regulations that were made later in much less formal settings. See Long Island Care, 127 S. Ct. at 2349 (controlling deference to agency's interpretation of regulation set out in an advisory memorandum in response to litigation); Auer, 519 U.S. at 462 (controlling deference to an

interpretation made for the first time in a legal brief). Even to the extent that the statutory language – which limits the section 404(c) defense to losses that "result[] from a participant's exercise of control" – leaves open how strict a standard of causation ought to apply, the Secretary's resolution of that issue ought to prevail. See Brand X, 545 U.S. at 982 (Chevron established a "'presumption that Congress, when it left ambiguity in a statute meant for implementation by an agency, understood that the ambiguity would be resolved, first and foremost, by the agency, and desired the agency (rather than the courts) to possess whatever degree of discretion the ambiguity allows.'") (citation omitted). As explained above, there are good policy reasons to conclude that losses that flow from a fiduciary's imprudent monitoring of investment options should be understood to result from the fiduciary's decisions rather than the individual participant's subsequent decision to select the flawed option. Thus, the Secretary's regulation sensibly draws the line between losses that "result from" a participant's own imprudence while exercising independent control and those that do not.

The plaintiffs here allege that the Plan fiduciaries chose to use the Fremont mutual funds, which charged excessive and unnecessary fees, for the purpose of benefitting FIA, Bechtel, Bechtel's owners, officers and their family members, at the expense of plan participants. For example, plaintiffs

allege that the defendant fiduciaries offered the Fremont Bond Fund, which was 100% sub-advised by another company, PIMCO, that provided all investment management services, so that FIA could extract investment advisory fees, rather than simply offering a direct investment with PIMCO. See Appellants' Brief at 19, 60-61, 73. Plaintiffs make similar allegations with respect to the use of other Fremont funds as investment options. Appellants' Brief at 17-20, 59-62, 73. If the plaintiffs' allegations are true, the losses to the Plan from the payment of unnecessary and excessive fees are not the "direct and necessary result" of the participant's exercise of control within the meaning of the Secretary's regulation, 29 C.F.R. § 2550.404c-1(d)(2)(i), but rather the result of the fiduciaries' imprudence in selecting and retaining the Fremont mutual funds as plan investment options when it was imprudent, or disloyal, to do so. If, as alleged, the defendants violated their fiduciary duties by selecting investment options with excessive fees, section 404(c) provides no defense to their fiduciary misconduct.

II. THE DISTRICT COURT ARTICULATED AND APPLIED THE WRONG LEGAL STANDARDS TO PLAINTIFFS' PRUDENCE AND LOYALTY CLAIMS, AND ERRED IN GRANTING SUMMARY JUDGMENT ON THOSE CLAIMS

The district court granted defendants' motion for summary judgment on plaintiffs' prudence and loyalty claims, finding that Fremont's fees were

not "patently unreasonable," and because defendants acted prudently and "in their sound business judgment" in offering the funds. The legal standards articulated by the court were erroneous. The tests for loyalty and prudence are far more exacting. Cf. Harzewski v. Guidant, 489 F.3d 799, 805 (7th Cir. 2007) ("The duty of care, diligence, and loyalty imposed by the fiduciary principle is far more exacting than the duty imposed by tort law not to mislead a stranger.").

As plan fiduciaries, Bechtel's Committee and FIA were obligated to discharge their duties to the Plan solely in the interest of participants and beneficiaries for the exclusive purpose of providing benefits and defraying reasonable expenses of administering the plan. See 29 U.S.C. § 1104(a)(1)(A). They were required to act "with the care, skill, prudence, and diligence" of a prudent person acting in a like capacity and familiar with such matters. ERISA section 404(a)(1)(B), 29 U.S.C. § 1104(a)(1)(B). The Committee and FIA also were required to act with an "eye single to the interests of the participants and beneficiaries." Leigh v. Engle, 727 F.2d 113, 123 (7th Cir. 1984) (quoting Donovan v. Bierwirth, 680 F.2d 263, 271 (2d Cir. 1982)). These core fiduciary duties of prudence and loyalty have been characterized as "the highest known to the law." Howard v. Shay, 100 F.3d 1484, 1488 (9th Cir. 1996) (quoting Bierwirth, 680 F.2d at 272 n.8).

Plaintiffs allege that defendants did not act in the interests of participants in selecting the Fremont mutual funds. Rather, plaintiffs allege that the Committee and FIA chose those funds to further their own pecuniary interests and those of Bechtel owners, officers and their family members who had interests in FIA. If those allegations are true, defendants breached their duty to act for the exclusive benefit of the plan's participants. See Donovan v. Mazzola, 716 F.2d 1226, 1232 (9th Cir. 1984) (trustees breached duty of loyalty by making loans for the purpose of aiding non-ERISA trust at the expense of ERISA plan); Chao v. Malkani, 452 F.3d 290, 294-98 (4th Cir. 2006) (fiduciaries breached duty of loyalty by diverting plan assets to themselves and to plan sponsor); Bierwirth, 680 F.2d at 274-76 (trustees' purchase of plan sponsor's stock to stave off corporate takeover likely breached duty of loyalty because purchase benefited sponsor but not the plan); Leigh, 727 F.2d at 129-32 (fiduciaries violated duty of loyalty by trust investments made not with an "eye single" to the interests of participants, but rather made at least in part to enhance the position of others in corporate control contests).

Plaintiffs also allege that defendants breached their fiduciary duties by using Fremont mutual funds that charged excessive and unnecessary layers of fees, and not properly considering alternatives that would have resulted in

lower fees for the same investment management. For example, plaintiffs allege that the defendant fiduciaries offered the Fremont Bond Fund, which was 100% sub-advised by PIMCO, rather than offering a direct investment with PIMCO, so that FIA could siphon off investment advisory fees from plan participants. Plaintiffs similarly allege that the fiduciaries chose Fremont funds for the plan's money market and index fund investment options (Funds C and D), which were excessively expensive for those kinds of funds, in order to funnel money to FIA. Plaintiffs make similar allegations with respect to the use of Fremont mutual funds in the Plan's Fund A investments, which they claim added extra costs without providing benefit to the plan. Plaintiffs also allege that defendants used the Fremont funds without properly investigating the use of less costly alternatives. See Appellants' Brief at 17-20, 59-63, 74. If true, this conduct would constitute a breach of defendants' fiduciary prudence duties. See, e.g., Wright v. Oregon Metallurgical Corp., 360 F.3d 1090, 1097 (9th Cir. 2004) ("[a] court's task in evaluating a fiduciary's compliance with [the prudence] standard is to inquire 'whether the individual trustees, at the time of the transaction, employed the appropriate methods to investigate the merits of the investment and to structure the investment'") (quoting Mazzola, 716 F.2d at 1232); Armstrong v. LaSalle Bank Nat'l Assoc., 446 F.3d 728, 732 (7th

Cir. 2006) (the duty of an ERISA trustee to behave prudently in managing the trust's assets is fundamental); Shay, 100 F.3d 1484, 1488-90 (9th Cir. 1996) (applying prudence standards to fiduciaries' review of stock valuation); Donovan v. Cunningham, 716 F.2d 1455, 1467-68 (5th Cir. 1983).

Moreover, where, as plaintiffs have alleged, fiduciaries have conflicting interests that raise questions regarding their loyalty, the fiduciaries "are obliged at a minimum to engage in an intensive and scrupulous independent investigation of their options to insure that they act in the best interests of the plan beneficiaries." Shay, 100 F.3d at 1488-89, quoting Leigh, 727 F.2d at 125-26. Such a heightened duty to investigate is implicated here, where plaintiffs allege the existence of an intricate web of relationships among the Committee, FIA, FIA's parent (Fremont Investors, Inc.), the Bechtel family, and Bechtel officers, contending that the choice of the Fremont mutual funds was made for the financial benefit of those people and entities, at the expense of plan participants. See e.g., Leigh, 727 F.2d at 128 (trust administrators whose income depended upon Engle group had potentially conflicting interest); Bierwirth, 680 F.2d at 272 (plan trustees who were officers of takeover target clearly had career and financial interests in the outcome of the control contest).

Although the court found that "the Committee met regularly to discuss the Plan's investments and sought the advice of Callan Associates to ensure that it was making proper decisions," 590 F. Supp. 2d at 1229, this is not a sufficient analysis of the potential conflicts plaintiffs allege, nor is it a determination that the fiduciaries engaged in an "intensive and scrupulous independent investigation of their options to insure that they act in the best interests of the plan beneficiaries," as required by Shay and Leigh. Cf. Shay, 100 F.3d at 1489-90 ("An independent appraisal 'is not a magic wand that fiduciaries may simply wave over a transaction to ensure that their responsibilities are fulfilled.'") (quoting Cunningham, 716 F.2d at 1474). Rather than engage in a careful analysis of the alleged conflicts under ERISA's stringent standards, the district court simply concluded that "[n]one of the members of the Committee during the relevant period owned a stake in FIA," and that "[p]laintiffs have not presented any evidence showing that any Committee member who was responsible for FIA's retention had an interest that would have affected his best judgment as a fiduciary." 590 F. Supp. 2d at 1228.

Plaintiffs' allegations that the fiduciaries breached their duties of loyalty, operated under conflicts of interests, and did not engage in the requisite investigation of alternatives appear to raise issues of material fact

appropriate for trial rather than disposition on summary judgment. Likewise, plaintiffs' allegations that investment in the Fremont mutual funds was imprudent because the fees were unreasonable also should not have been dismissed on summary judgment because this was apparently the subject of diametrically opposed expert testimony. Thus, the district court's grant of summary judgment based on its conclusion that the fees were not "patently unreasonable," and that "the overall performance of the Fremont Mutual Funds was competitive with the industry standard," Kanawi, 590 F. Supp. 2d at 1229-30, not only involves application of an impermissibly lenient standard of fiduciary conduct, it also appears inconsistent with the summary judgment standard. See, e.g., Provenz v. Miller, 102 F.3d 1478, 1490 (9th Cir. 1996) ("As a general rule, summary judgment is inappropriate where an expert's testimony supports the non-moving party's case.") (quoting In re Worlds of Wonder Sec. Litig., 35 F.3d 1407, 1425 (9th Cir 1994)); see also SEC v. Dain Rauscher, Inc., 254 F.3d 852, 856-59 (9th Cir. 2001) (industry standard is just one factor in determining whether reasonable prudence standard of care was met, and expert testimony presented genuine issues of material fact as to what the industry standard was and whether a standard of reasonable prudence was met).

Finally, the district court's finding that defendants acted "in their sound business judgment" suggests that the court erroneously applied a "business judgment rule" in assessing the plaintiffs' fiduciary breach claims. The business judgment rule, a state law corporate doctrine that focuses its inquiry on the subjective good faith of corporate actors, is not a defense to a fiduciary breach action under ERISA. The business judgment rule "exists to protect and promote the full and free exercise of the power of management given to the directors," and involves primarily an inquiry into the subjective "good faith" of the officers of a corporation. Fletcher Cyc. Corp. 1039 (Perm Ed.). By contrast, ERISA imposes an objective "prudent person" standard of care on ERISA fiduciaries, Mazzola, 716 F.2d at 1231-32, which, as discussed above, is a much more exacting standard derived from trust law. See Johnson v. Couturier, 572 F.3d 1067, 1077 (9th Cir. 2009). For this reason, the Ninth Circuit in Mazzola explicitly rejected the contention that the "business judgment rule" is an applicable standard by which to judge the actions of ERISA fiduciaries, and held, instead, that such fiduciaries are subject to the objective prudent person standard of care set forth in ERISA. 716 F.2d at 1231-32; see also Shay, 100 F.3d at 1489. Likewise, the business judgment rule, which is designed to impose a standard of care, not to immunize plans from potential conflicts, logically has no bearing on, and

thus cannot immunize ERISA fiduciaries from, the duty of undivided loyalty that ERISA also imposes upon plan fiduciaries.

III. EACH PAYMENT MADE TO FIA FOR PLAN ASSETS INVESTED WITH FREMONT MUTUAL FUNDS WAS A POTENTIAL PROHIBITED TRANSACTION

ERISA section 406(b)(3) provides that a fiduciary "shall not receive any consideration for his own personal account from any party dealing with such plan in connection with a transaction involving the assets of the plan." 29 U.S.C. § 1106(b)(3). Plaintiffs allege that the FIA's receipt of investment advisory fees from the Fremont mutual funds for the Plan's use of the Fremont mutual funds violates that prohibition. See, e.g., Kanawi, 590 F. Supp. 2d at 1228 (recognizing a possible violation of 29 U.S.C. § 1106(b)(3) for the Plan's payment to FIA for plan-level service fees from November 2003 to February 2004); Haddock v. Nationwide Financial Services, Inc. 419 F. Supp. 2d 156, 171 (D. Conn. 2006). Plaintiffs also allege that the payments to FIA violated ERISA section 406(a)(1)(C) as transfers to a party in interest that were not exempted by ERISA section 408(b)(2) because the payments exceeded "reasonable compensation." 29 U.S.C. § 1108(b)(2). The district court held that these claims were time barred under the applicable six year statute of limitations, 29 U.S.C. § 1113(1), because the

initial decision to invest in the Fremont mutual funds occurred more than six years before suit was filed. That decision was erroneous.

The district court's ruling ignored the fact that the fiduciaries continued offering Fremont mutual funds as plan investment options, and the plan and participants continued to pay asset-based fees to FIA for those investments throughout the time Fremont mutual funds were offered, including during the six-year limitations period. Each payment made to FIA for plan assets invested with Fremont mutual funds was a potential prohibited transaction, and plaintiffs' prohibited transaction claims based on payments made to FIA during the six years preceding suit were timely. Thus, in Martin v. Consultants & Adm'rs, Inc., 966 F.2d 1078, 1087-88 (7th Cir. 1992), the court held that while alleged ERISA violations concerning a 1984 contract bid were time-barred, the bidding activities leading up to the 1987 contract, although similar in nature, involved a new transaction and a distinct violation that was timely. The court explained that the 1987 bidding activity involved a repeated rather than a continuing violation. 966 F.2d at 1088. See also Boekman v. A.G. Edwards, Inc., 461 F. Supp. 2d 801, 814-15 (S.D. Ill. 2006) (holding that A.G. Edwards' continued payments of allegedly excessive mutual fund fees represented new fiduciary breaches, noting that "[i]n light of the continuing duty of prudence imposed on plan

fiduciaries by ERISA, each failure to exercise prudence constitutes a new breach of the duty, that is to say, a new claim."); Buccino v. Cont'l Assurance Co., 578 F. Supp. 1518, 1521 (S.D.N.Y. 1983) (holding that claims relating to the initial decision to purchase imprudently expensive insurance and the failures to correct that action that occurred more than six years before suit was filed were time-barred, but claims based on defendants' continued failure to take steps to terminate the Fund's insurance arrangement during the limitations period were not).

The Secretary's interpretation that the continued use of mutual funds and the payment of fees to a fiduciary investment adviser during the limitations period are subject to section 406's prohibited transaction restrictions is also reflected in the Secretary's Prohibited Transaction Class Exemption 77-4 (PTCE 77-4). 42 Fed. Reg. 18,732 (Apr. 8, 1977). Section 408(a) of ERISA authorizes the Secretary to grant exemptions from section 406's prohibited transaction provisions after consultation and coordination with the Secretary of the Treasury, and after publishing notice of the proposed exemption in the Federal Register. 29 U.S.C. § 1108(a). In PTCE 77-4, the Secretary granted a class exemption that exempts a plan's purchase and sale of shares of an open-ended investment company when a plan fiduciary (e.g., an investment manager) is also the investment adviser for the

investment company if the exemption's requirements are satisfied. One requirement is that a second independent and unrelated fiduciary, on the basis of specific information provided, approves "the investment advisory and other fees paid by the mutual fund in relation to the fees paid by the plan" prior to the commencement of the program. PTCE 77-4, Section II, parts (d), (e), 42 Fed. Reg. at 18,733. But in order to continue to be eligible for the exemption, the second fiduciary must be notified whenever there is a change in rates of fees, and must approve the continuation of purchases and sales, and the continued holding of any investment company shares acquired by the plan. PTCE 77-4, Section II, part (f), 42 Fed. Reg. at 18,733. Thus, the Secretary's interpretation of the statute, as reflected in its regulation granting an exemption from section 406's restrictions, makes it clear that it is not only the initial decision to offer mutual funds and pay a fiduciary investment advisory fees that is subject to the prohibitions of section 406, but also the continued use of those funds as plan investment options and continued payments to the fiduciary. Id.

The regulation was issued after notice-and-comment rulemaking pursuant to an express delegation of authority to the Secretary to grant exemptions "from all or part of the restrictions imposed by section 406," based on findings that an exemption is administratively feasible, in the

interests of the plan and its participants and beneficiaries, and is protective of the rights of participants and beneficiaries. 29 U.S.C. §1108(a); see 41 Fed. Reg. 50,516 (Nov. 16, 1976) (notice), 42 Fed. Reg. 18,732 (exemption). Consequently, as with the 404(c) regulation, the Secretary's reasonable interpretation of the statute, as reflected in its regulation, is entitled to controlling deference. Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc., 467 U.S. at 842-43; Long Island Care at Home v. Coke, 127 S. Ct. at 2349-50; United States v. Mead Corp., 533 U.S. 218, 229-30 (2001); Yellow Trans., Inc. v. Michigan, 537 U.S. at 45. Accordingly, plaintiffs' prohibited transactions claims based on the continued use of the Fremont mutual funds as plan options and the payments of investment advisory fees to FIA during the six years preceding suit were not barred by the statute of limitations.

CONCLUSION

For the foregoing reasons, the Secretary respectfully requests that the Court reverse the decision of the district court.

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This brief complies with the type-volume of Fed. R. App. P. 32(a)(7)(B) because it contains __6,658__ words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii).

This brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P 32(a)(6) because it has been prepared in a proportionally spaced typeface using Microsoft Office Word 2003, 14 pt. Times New Roman.

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I hereby certify that on December 28, 2009, I electronically filed the forgoing with the Clerk of the Court for the United States Court of Appeals for the Ninth Circuit by using the appellate CM/ECF system.

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I hereby certify that the attached brief is identical to the version that was electronically submitted to this Court on December 28, 2009.

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