No. 09-2796

UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

STEPHEN LINGIS, et al.,
Plaintiffs-Appellants

v.

MOTOROLA, INC., et al.,
Defendants-Appellees.

On Appeal from Final Judgment of the United States District Court For the Northern District of Illinois (Pallmeyer, J.)
Civil Action No. 03 C 5044

Brief of the Secretary of Labor, Hilda L. Solis, as Amicus Curiae in Support of Plaintiffs-Appellants

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STATEMENT OF THE ISSUE

Whether the district court erred in granting summary judgment for the Defendants based, in part, on the court's holding that ERISA section 404(c), 29 U.S.C. § 1104(c), immunizes fiduciaries from liability for selecting and maintaining an employer stock investment option even if the fiduciaries know it is an imprudent option, simply because the plan also provides a number of other investment options.

STATEMENT OF INTEREST

The Secretary of Labor ("Secretary") has primary enforcement and interpretive 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. See 29 U.S.C. §§ 1002(13), 1136(b); Secretary of Labor v. Fitzsimmons, 805 F.2d 682, 687-691 (7th Cir. 1986) (en banc).

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 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. In granting summary judgment, the district court addressed ERISA section 404(c) and its regulations through an application of this Court's decision in Hecker v. Deere & Co., 556 F.3d 575 (7th Cir. 2009). Importantly, the district court's opinion, issued on June 17, 2009, occurred before this Court's subsequent modification and narrowing of Hecker in an order denying rehearing en banc issued on June 24, 2009. 569 F.3d 708. In light of the Court's clarification of its initial Hecker opinion, the district court's analysis and application of ERISA section 404(c) is erroneous. The Secretary therefore seeks to ensure that the district court's ERISA section 404(c) ruling is overruled to the extent that it is inconsistent with this Court's second Hecker opinion.

The Secretary respectfully files this brief pursuant to her authority under Federal Rule of Appellate Procedure 29(a).

STATEMENT OF THE CASE

I. Factual Background

Defendant Motorola Inc. ("Motorola") is a telecommunications company that sells, among other things, broadband network infrastructure. (A. 1).[1] In 1999, a Motorola affiliate entered into an agreement with Turkey's second largest cell phone company, Telsim Mobil Telekomunikayson Hizmetleri, A.S. ("Telsim"), to finance Telsim's purchase of cellular infrastructure from Motorola. A. 4. By the end of September 2000, the Motorola affiliate had lent Telsim over $1.8 billion to finance the purchase, secured by a pledge of 66% of Telsim's stock. Id. Citing to SEC filings, the Plaintiffs claim that until Telsim defaulted on its first loan payment on April 30, 2001, and Motorola's affiliate issued a notice of default three weeks later, Motorola either made no mention of the Telsim transactions, or touted the $1.5 billion sales potential of the deal, but failed to mention the loan of $1.8 billion. Id. At least in part because of the Telsim transaction and default, "the price of Motorola's share's plummeted." A. 6.

[1] The Secretary's Factual Background is based on the district court's findings of fact in its June 17, 2009, summary judgment opinion. The district court's summary judgment opinion is cited by reference to the Plaintiffs' appendix as "A. ___."

Motorola common stock, in the form of the Motorola Stock Fund, was one of the investment options offered by Motorola to participants in its 401(k) individual retirement account plan ("Plan"). A. 2, 7. The Plan's governing documents expressly allowed, but did not require, the Plan to offer the Motorola Stock Fund. A. 7. Participants in the Plan were permitted to direct the investment of their own accounts among four investment options until July 1, 2000, and among nine investment options after that date; at all relevant times, the Motorola Stock Fund was one of the Plan's investment options. A. 6-7. In addition, up until July 1, 2000, employees could only invest up to 20% of their 401(k) account in the Motorola Stock Fund; after that date, by vote of the Motorola employees, the 20% cap was removed and employees could invest their entire 401(k) accounts in the Fund. A. 7-8.

The Plaintiffs are a class of former Motorola employees whose individual retirement accounts were invested in the Motorola Stock Fund from May 16, 2000, to May 14, 2001, a time period encompassing the Telsim transaction and default. A. 2-4. In Count I of their complaint, the Plaintiffs allege that the Defendants breached their fiduciary duty of prudence by offering the Motorola Stock Fund in light of the Telsim

transaction. A. 9.[2] Count II charges that the Defendants negligently misrepresented and failed to disclose material information related to the Telsim transaction in SEC filings. Id. Count III is brought only against individual Motorola board of director members for failing to appoint appropriate fiduciaries to the Plan's administrative committee, failing to adequately monitor committee members, and withholding material information from the committee. Id.

II. The District Court's Opinion

The district court granted summary judgment on all counts in favor of the Defendants based, in large part, on its conclusion that the safe harbor found in ERISA section 404(c), 29 U.S.C. § 1104(c), relieves fiduciaries from all liability where the plan allows participants to exercise control in investing their retirement accounts. A. 11-27. At the outset, the Plaintiffs argued that the Defendants were not eligible for the section 404(c) safe harbor, because the Defendants could not satisfy the pre-requisite that a plan fiduciary not "conceal[] material non-public facts regarding the investment

[2] The Defendants consist of fifteen separate entities and individuals, including Motorola, its directors and officers, and members of the Plan's administrative committee. A. 2-3. Unless otherwise noted, we refer to these entities and individuals collectively as "Defendants."

from the participant." A. 14.[3] The court concluded that no genuine issue of material fact existed on the concealment issue because the outside director Defendants did not possess enough information about the Telsim transaction to support a conclusion that they concealed material information about the transaction, A. 15-16, and the administrative committee Defendants had not concealed any material information because they "had not, as fiduciaries, provided the participants with any materially misleading information that they had the duty to correct." A. 21

Turning to Count I, the Plaintiffs asserted that ERISA section 404(c) did not relieve the Defendants of liability for the imprudent retention of the Motorola Stock Fund as an investment option because the selection of the Fund was a fiduciary responsibility that did not involve the participants' discretion or control. A. 22. As support, the Plaintiffs cited to a footnote in the preamble of the implementing regulations stating that the selection of investment options for "an ERISA 404(c) plan is a fiduciary function which . . . is not a direct or necessary result of any participant direction of such plan." Id. (citation omitted). The district court rejected the Plaintiffs'

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[3] Although the Plaintiffs also alleged that the Defendants did not qualify for section 404(c) coverage because participants were not given "sufficient information" regarding investment alternatives, A. 11-12, the court rejected this argument, concluding that the fiduciaries provided "more than adequate information" to participants. A. 13.

argument based on Hecker v. Deere & Co., 556 F.3d 575 (7th Cir. 2009), which the district court read as rejecting the preamble footnote as "unconvincing." A. 23. According to the court, Hecker held that section 404(c) protects a fiduciary of a plan that otherwise satisfies the section's criteria so long as the plan "includes a sufficient range of [investment] options so that the participants have control over the risk of loss." Id. (citation omitted). It then determined that the Plan, with eight options in addition to the Motorola Stock Fund, offered enough investment alternatives to qualify for Hecker protection. A. 24.

The district court further concluded that, even if "Hecker's rule" did not apply to this case, Count I failed on the merits because the Plaintiffs had not demonstrated a genuine dispute that continuing to offer the Motorola Stock Fund was imprudent. A. 24.[4] The court reasoned that removing the Motorola Stock Fund would not have been more prudent than maintaining

[4] The district court stated that the Defendants were not entitled to a presumption of prudence in offering the Motorola Stock Fund, as described in the Third Circuit case Moench v. Robertson, 62 F.3d 553 (3d Cir. 1995). A. 25. The court ruled that the so-called Moench presumption did not apply to the Defendants because the Plan did not require the Motorola Stock Fund as an investment option. Id. While not addressed in this brief, the Secretary has consistently taken a position that the Moench presumption has no basis in the statutory text, is contrary to the statute's purpose, and is unsupported by the legislative history. See, e.g., In re Citigroup ERISA Litig., No. 09-3804-cv (2d Cir.) (Brief of the Sec'y of Labor in Support of Appellant Requesting Reversal) (filed Dec. 28, 2009).

the Fund because doing so might have subjected the fiduciaries to liability "if the employer's securities thrive[d]," would have violated the "general principle that ERISA fiduciaries are not required to jump in and out of employer securities," and may have violated insider trading laws. Id. In the court's view, in the absence of imminent collapse or other extraordinary circumstances, the fiduciaries did not violate ERISA's prudence requirements by maintaining the stock. A. 26-27.

With regard to Count II, the court likewise concluded that the Defendants qualified for the section 404(c) safe harbor, and additionally were entitled to a favorable judgment as to Count II because: (1) the Seventh Circuit does not recognize negligent misrepresentation as a basis for fiduciary breach; (2) the alleged negligent misrepresentations made in SEC filings were not made in a fiduciary capacity; and (3) the fiduciaries had no affirmative obligation to disclose material non-public information about an investment where they had made no false or misleading statement to beneficiaries regarding such investment. A. 18-22.

Finally, the district court held that "Plaintiffs' losses here were caused by their own exercise of independent control over the assets in their 401(k) accounts, and the section 404(c) safe harbor serves as a defense to Count III of the Complaint as well." A. 27. Even if ERISA section 404(c) did not

apply to the monitoring claims, however, the court concluded that the Plaintiffs had failed to demonstrate that the members of the Plan's administrative committee were unqualified, that the directors' monitoring and outside auditing was insufficient, or that the committee was deprived of adequate information to enable it to perform its duties. A. 27-33.

SUMMARY OF ARGUMENT

The district court erred in holding that ERISA section 404(c) immunized the fiduciary Defendants from liability for imprudence in selecting and maintaining plan investment option simply because the Plan offered nine investment options. Section 404(c), and its implementing regulation make clear that fiduciaries escape liability only for plan losses that result from control exercised by plan participants and beneficiaries. The large losses that the Plaintiffs allege the Plan suffered here did not result from the participants' exercise of control under the 404(c) regulation, but rather from the fiduciaries' imprudence in offering company stock that was unduly risky because of nearly $2 billion in undisclosed corporate debt. From the time of the regulation's inception, the Secretary has consistently interpreted section 404(c) and her regulation as not exempting fiduciaries from liability for their imprudent selection of investment options. This consistent with the statute and its implementing regulations, which clearly

distinguish between losses caused by fiduciary actions – such as the selection and retention of 401(k) investment options – and losses caused by participant actions – such as the direction of retirement funds into prudent investment options selected by the fiduciaries.

This Court's decision in Hecker is not to the contrary. After the district court granted summary judgment in this case, this Court issued an order denying rehearing and amended its earlier decision. In this amended decision, the Court clarified that ERISA plan fiduciaries for 401(k) plans may not absolve themselves of liability for imprudently selecting an unduly risky investment option by simply including a large number of investment options. Rather, the Court recognized that it is the fiduciary's responsibility to screen investment alternatives so that imprudent options are not offered to plan participants.

ARGUMENT

ERISA SECTION 404(c) DOES NOT PROVIDE A DEFENSE TO THE DEFENDANTS' ALLEGED IMPRUDENCE IN OFFERING THE MOTOROLA STOCK FUND

The district court erred in applying ERISA section 404(c) as a defense to the Plaintiffs' claims that the fiduciaries breached their ERISA duties in maintaining the Motorola Fund as an investment option in the Plan. The statute and its regulations make clear that ERISA section 404(c) provides a

limited exception from liability for losses "which result from" a participant's or beneficiary's exercise of control over his individual account in an individual account plan. 29 U.S.C. § 1104(c)[5]; 29 C.F.R. § 2550.404c-1. 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 requirements of ERISA, including the core fiduciary duties of prudence and loyalty. If it has done so, then ERISA section 404(c) relieves the fiduciary from responsibility for losses that "result[] from" the participants' exercise of authority over their own accounts. A fiduciary would not be liable, for

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[5] Section 404(c) provides, in relevant part:

> (1) In the case of a pension plan which provides for individual accounts and permits a participant or beneficiary to exercise control over assets in his account, if a participant or beneficiary exercises control over the assets in his account (as determined under regulations of the Secretary) . . .
>
> (B) 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.

Pursuant to this express delegation of rulemaking authority, the Secretary issued her 404(c) regulation delineating a number of requirements that must be met before a plan can be considered to have given the participants and beneficiaries the requisite authority, and before the participants and beneficiaries can be considered to have exercised this control.

example, for participants' imprudent decisions on how to allocate their retirement assets between options on a prudently constructed line-up of fund investment alternatives (e.g., for an employee's decision to allocate all of his assets to a single relatively risky investment class, even though he had no appreciable assets outside of the plan and the plan offered every opportunity for the employee to construct a prudent and diversified portfolio). If, however, the funds offered to the participants were imprudently selected or monitored, were chosen as the result of disloyalty (or if they were prohibited under ERISA section 406, 29 U.S.C. § 1106, or violated other provisions of ERISA) the fiduciary is liable for losses attributable to the fiduciary's own actions that violate its responsibilities under ERISA.

This straightforward interpretation of the statute is reflected in the ERISA section 404(c) regulation. The Secretary's 404(c) regulation provides that "[i]f 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, in its text, 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.

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 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 404(c) regulation, and the Secretary's interpretation of her regulation, are consistent with, and indeed best serve, these statutory principles.

The 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). The Secretary's interpretation of her 404(c) regulation is 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.[6] See, e.g., Yellow Trans., Inc. v. Michigan, 537 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). The preamble language explaining the scope of the

[6] 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); Kanawi v. Bechtel Corp., No. 09-16253 (9th Cir.) (Brief of the Sec'y of Labor as Amicus Curiae in Support of Plaintiffs) (filed Dec. 28, 2009); In Re Schering-Plough Corporation ERISA Litig., 2009 WL 4893649 (3d Cir. 2009) (Brief of the Sec'y of Labor as Amicus Curiae in Support of Plaintiffs-Appellees) (filed 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 Sec'y of Labor as Amicus Curiae in Support of the Plaintiffs-Appellants and Brief of The Sec'y Of Labor as Amicus Curiae In Support Of Panel Reh'g); Langbecker v. Electronic Data Sys., No. 04-41760 (5th Cir.) (Brief of the Sec'y of Labor as Amicus Curiae in Support of Plaintiffs-Appellees Requesting Affirmance) (filed April 26, 2005); Tittle v. Enron Corp., 2002 WL 34236027 (Amended Brief of the Sec'y of Labor as Amicus Curiae Opposing Motion to Dismiss) (filed Sept. 30, 2002).

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 at Home Ltd. v. Coke, 127 S. Ct. 2339, 2349-50 (2007) (controlling deference to agency's interpretation of regulation set out in an advisory memorandum in response to litigation); Auer v. Robbins, 519 U.S. 452, 462 (1997) (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 National Cable & Telecom. Ass'n v. Brand X Internet Servs., 545 U.S. 962, 982 (2005) (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.

Contrary to the district court's conclusion, this regulatory interpretation – in both the preamble and the regulation itself – was not called into question by Hecker. Instead, this Court expressly "refrained from making any definitive pronouncement on 'whether the safe harbor applies to the selection of investment options for a plan,'" 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. Id.

In Hecker, the plaintiffs' primary claim was that the plans at issue in that case "were flawed because Deere decided to accept 'retail' fees and did not negotiate presumptively lower 'wholesale' fees," an assertion that the Court concluded "is not enough, in the context of these Plans, to state a claim." 569 F.3d at 711. Although this Court dismissed the action based in part upon 404(c), in its decision denying rehearing and amending the original decision, the Court expressly declined to make "a sweeping statement that any Plan fiduciary can insulate itself from liability by the simple expedient of including a very large number of investment alternatives in its portfolio and then shifting to the participants the responsibility for choosing among them."[7] Id. Indeed, the Court acknowledged that it was "right to criticize such a strategy" because it "could result in the inclusion of many investment alternatives that a responsible fiduciary should exclude." Id.

[7] The district court issued its order on summary judgment on June 17, 2009, and thus did not have the Benefit of this Court's June 24, 2009 opinion in Hecker.

The Plaintiffs here have clearly alleged that the Defendants included a stock investment alternative that a reasonable fiduciary should have excluded. Unlike in Hecker, where the plaintiffs "never alleged that any of the 26 investment alternatives that Deere made available to its 401(k) participants was unsound or reckless," 569 F.3d at 711, the Plaintiffs here allege that the Motorola stock was unsound as a Plan investment because of the riskiness associated with the undisclosed loan of $1.8 billion to Telsim. A. 9. Hecker was "not intended to give a green light to such . . . imprudence in the selection of investments." Id. at 711 (internal quotes omitted). Accordingly, the district court here erred in granting summary judgment to Defendants and dismissing the suit based on ERISA section 404(c).

CONCLUSION

For the foregoing reasons, the Secretary respectfully requests that the Court reverse the district court's grant of summary judgment to the extent that it relied on the erroneous conclusion that ERISA section 404(c) immunized the fiduciaries from any liability with respect to the availability of the Motorola Stock Fund as an investment option for the Plan.

Respectfully submitted,

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Dated: May 14, 2010

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I hereby certify that a virus check, using McAfee Security VirusScan Enterprise 8.0, was performed on the PDF file and paper version of this brief, and no viruses were found.

(s) _/s/ Stephen Silverman____
Attorney for U.S. Department of Labor, Plan Benefits Security Division
Dated: May 14, 2010

CERTIFICATE OF SERVICE

I hereby certify that on May 14, 2010, two copies of the foregoing Brief for the Secretary of Labor as Amicus Curiae were served using Federal Express and Electronic Mail upon the following:

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