Case No. 04-41760

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

RICHARD LANGBECKER, et al.,
Plaintiffs-Appellees,

v.

ELECTRONIC DATA SYSTEMS CORPORATION, et al.,
Defendants-Appellants.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF TEXAS, TYLER DIVISION
Civil Action No. 6:03-MD-1512; 6:03-CV-126 (ERISA)

CORRECTED BRIEF OF THE SECRETARY OF LABOR, ELAINE L. CHAO, AS AMICUS CURIAE IN SUPPORT OF PLAINTIFFS-APPELLEES REQUESTING AFFIRMANCE OF THE DISTRICT COURT'S DECISION

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STATEMENT OF THE ISSUES

The Secretary's brief as amicus curiae addressed the following two issues:

1. Whether plaintiffs' claims alleging that defendants' imprudence with regard to the company stock fund caused millions of dollars in plan losses state a derivative claim on behalf of the plan under ERISA sections 409 and 502(a)(2).

2. Whether the district court correctly held that ERISA section 404(c) does not provide a defense to plaintiffs' allegations that the fiduciaries imprudently maintained the EDS Stock Fund as an investment option for the plan.

INTEREST OF THE SECRETARY OF LABOR

The Secretary of Labor is charged with interpreting and enforcing Title I of the Employee Retirement Income Security Act of 1974 ("ERISA"), as amended, 29 U.S.C. § 1001, et seq. As the federal agency with primary interpretation and enforcement authority for Title I of ERISA, the Department of Labor has a strong interest in ensuring that courts correctly interpret ERISA. This case presents questions concerning the requirements for maintaining a class action under Rule 23 in a case involving an individual account plan under ERISA. The view espoused by defendants,

although ostensibly limited to class certification issues, if accepted fully by this Court, would undermine the duties of fiduciaries with regard to individual account plans, and likely eliminate the ability of participants in such plans (and perhaps the Secretary) to bring suit on behalf of the plan under section 502(a)(2) to remedy fiduciary breaches. Despite defendants' disclaimer that this case is factually distinguishable from the Enron and WorldCom ERISA cases in that EDS did not go bankrupt, a broad decision accepting defendants' views would undermine if not eliminate the ability of both private plaintiffs and the Secretary to bring suit for fiduciary breach in the context of an individual account plan, even in cases, such as Enron, of significant fiduciary malfeasance leading to catastrophic losses.[1] The Secretary has a strong interest in ensuring that this Court does not reach such a result.

STATEMENT OF THE CASE

EDS is a corporation that provides information technology services. It sponsors a defined contribution retirement savings plan. This Plan is an "eligible individual account plan" under ERISA section 407(d)(3), 29 U.S.C. § 1107(d)(3), and also a "qualified cash or deferred" arrangement under

[1] The Secretary has brought her own suit under Section 502(a)(2) against fiduciaries of the Enron individual account plan in a district court within this Circuit, and thus has a direct interest in the proper resolution of this issue.

I.R.C. § 401(k). As such, the Plan offers an array of investment options to the participating employees. The employees could invest up to 20% of their salary in the Plan, and could direct the Plan fiduciaries to invest these funds in one or more of the offered investment options, including an EDS Stock Fund, which invested up to 99% of its assets in EDS stock. The company also made matching contributions to employee investments, which were invested in the Stock Fund. These matching contributions were required to remain in that fund for two years.

Plaintiffs, current and former Plan participants and beneficiaries, brought suit in the Eastern District of Texas under ERISA after EDS stock steeply declined in value following announcements by EDS in September 2002 that the company would suffer a revenue decrease rather than an increase, and that its expected earnings per share would be roughly one-quarter of what it had predicted earlier. They named as defendants EDS, the company's chief executive officer, the EDS Compensation and Benefits Committee and its members, the EDS Benefits Administration Committee and its members, and the EDS Investment Committee and its members.

Plaintiffs claim that because of defendants' access to company information regarding undisclosed and improperly accounted for risks associated with the company's large outsourcing contracts, they should have

known that EDS stock was overvalued and an imprudent investment at the time, and could have avoided the millions of dollars in Plan losses that occurred following the earnings restatement. More specifically, they allege that defendants were Plan fiduciaries, either because they had authority over Plan assets or because they appointed and had a duty to monitor the other fiduciaries, and they breached their duties of prudence and loyalty with regard to the Stock Fund.[2]

On February 2, 2004, the district court issued a decision denying defendants' motion to dismiss. In re Elec. Data Sys. Corp. "ERISA" Litig., 305 F. Supp. 2d 658 (E.D. Tex. 2004). The court held, among other things, that all of defendants were ERISA functional fiduciaries, either by virtue of their exercise of discretion or control over the Plan investments, or by virtue of their appointment of other Plan fiduciaries. Id. at 666-67. The court also held that the heightened pleading standard of Rule 9(b), Fed. R. Civ. P., was inapplicable to plaintiffs' misrepresentation claims. Id. at 672.

Shortly thereafter, plaintiffs moved for class certification under Fed. R. Civ. P. 23, of a class consisting of "all participants in the Plan and their

[2] Plaintiffs also brought a claim for rescission under section 5 of the Securities Act, 15 U.S.C. § 77e(a)(2). In Count V of the Complaint, they allege that EDS issued unregistered stock to the plan in violation of that provision. That claim is not at issue in this appeal.

beneficiaries, excluding the Defendants, for whose accounts the Plan made or maintained investments in EDS stock through the EDS Stock Fund." Defendants objected, arguing that the claims could not be brought on behalf of the Plan under section 502(a)(2), but were instead individual claims under section 502(a)(3) that did not meet the typicality and adequacy requirements of Rule 23(a).

On November 8, 2004, the district court issued an order certifying, for purposes of the prudence claims, a class of all participants and beneficiaries whose accounts included investments in the company fund between September 9, 1999 and October 9, 2002. In re Elec. Data Sys. Corp. "ERISA" Litig., 224 F.R.D. 613 (E.D. Tex. 2004).

SUMMARY OF ARGUMENT

Defendants' primary argument is that plaintiffs are not entitled to proceed with a class action under Rule 23 because they are not entitled to bring a claim for monetary relief to the Plan for fiduciary breaches under ERISA section 502(a)(2). They argue that, as participants in a defined contribution plan, the individual plaintiffs, rather than the Plan, bore the risk of investment losses, and their claim under 502(a)(2) on behalf of the Plan consequently must fail. Instead, defendants contend, plaintiffs' claims are merely individual claims of harm that must be brought, if at all, under

ERISA section 502(a)(3), where the relief for fiduciary breach is limited, in defendants' view, to injunctive relief (or disgorgement of unjust gains by the fiduciary), and does not encompass the restoration of losses that plaintiffs seek. These individual claims, defendants argue, conflict with each other in various ways and thus do not meet Rule 23's requirements that the named plaintiffs be adequate class representatives and that their claims be typical of the class. This argument not only fundamentally misconstrues the nature of defined contribution plans under ERISA, but also misreads the case law interpreting the scope of ERISA's remedial provisions in general, and the scope of section 502(a)(2) in particular. No decision of the Fifth Circuit or the Supreme Court requires this Court to eviscerate the protections of section 502(a)(2) in this manner.

Defendants also misconstrue section 404(c). That statutory section exempts fiduciaries of individual account plans from liability for losses that stem from participant-directed investments, as determined by regulations promulgated by the Secretary. In the preamble to these regulations, the Secretary set forth her view, which she has reiterated on numerous occasions, that the act of designating a plan investment option is not a direct and necessary result of any participant direction and section 404(c) plan fiduciaries are thus still obligated by ERISA's fiduciary responsibility

provisions to prudently select the investment options under the plan and to monitor their ongoing performance. This interpretation sensibly allocates liability based on the parties' control over plan matters, and is entitled to controlling-weight deference under Chevron U.S.A., Inc. v. NRDC, 467 U.S. 837 (1984).

ARGUMENT

I. Plaintiffs' Claims Alleging That Defendants' Imprudence With Regard To The Company Stock Fund Caused Millions Of Dollars In Plan Losses State A Derivative Claim On Behalf Of The Plan Under ERISA Sections 409 And 502(a)(2)

Under section 3(34) of ERISA, a defined contribution pension plan is "a pension plan which provides for an individual account for each participant and for benefits based solely upon the amount contributed to the participant's account, and any income, expenses, gains, and losses, and any forfeitures of accounts of other participants which may be allocated to such participant's account." 29 U.S.C. § 1002(34). Defendants argue that because the Plan, like any defined contribution plan, allocates any money it holds between individual accounts, "the 401(k) Plan itself is thus indifferent as to how much money it holds and owes as benefits." Original Brief of Defendants-Appellants (Def. Br.) at 24. From this premise, defendants argue that plaintiffs in a defined contribution plan do not have standing to bring a derivative action for plan losses under section 502(a)(2), and

therefore cannot bring a class action to assert such claims. This argument misconstrues the nature of defined contribution plans and their assets, and would, in effect, remove such plans, which currently hold the majority of all pension plan assets (approximately $2.3 trillion), from ERISA's fiduciary protections.

Section 403 of ERISA requires that the plan's assets – consisting of all contributions and earnings – be held in trust by one or more trustees who have authority and discretion to manage and control the assets of the plan. See 29 U.S.C. § 1103(a); I.R.C. § 401(a). Upon receipt of the employee contributions weekly, bi-weekly or monthly, the plan fiduciary or custodian allocates, through accounting or bookkeeping entries, the plan assets to the various individual participant "accounts." Regardless of the allocation, these assets retain their nature as plan assets and the plan fiduciary retains its obligation to perform its fiduciary duties with respect to those assets. Thus, "contributions are made to a single funding vehicle, usually a trust," and "as amounts are contributed to the trust, they are allocated to the participant's account." David A. Littell et al., Retirement Savings Plans: Design, Regulation, and Administration of Cash or Deferred Arrangements 6 (1993).

Although the plan assets are allocated to individual "accounts," the participants do not have ownership of their accounts; legal title to all of the

trust assets is held by the trustee. See Rev. Rul. 89-52, 1989-1 C.B. 110, 1989 WL 572038 (Apr. 10, 1989) ("While a qualified trust may permit a participant to elect how amounts attributable to the participant's account-balance will be invested, it may not allow the participant to have the right to acquire, hold and dispose of amounts attributable to the participant's account balance at will.") (citations omitted). The total amount of assets held in the plan are not only used to pay plan benefits, but are also used to defray operating costs, including recordkeeping, legal, auditing, annual reporting, claims processing and similar administrative expenses.

The prudence claims brought by plaintiffs here seek millions of dollars in Plan losses stemming from alleged fiduciary breaches. These claims clearly fall within the express language of section 409, 29 U.S.C. § 1109, which requires a plan fiduciary that breaches its duties to make good "any losses" to the plan, and section 502(a)(2), which provides that an action may be brought "for appropriate relief under §1109." 29 U.S.C. § 1132(a)(2). Nothing in sections 409 or 502(a)(2) exempts defined contribution pension plans from their scope. Thus, a plain reading of the statute allows for the precise kind of loss claim that plaintiffs have brought here.

Moreover, this plain reading of the fiduciary breach and remedy provisions set forth in sections 409 and 502(a)(2) is entirely consistent with the statute's purpose and structure. First, in enacting ERISA, Congress expressly found that "the continued well-being and security of millions of employees and their dependents are directly affected" by employee benefits plans. 29 U.S.C. § 1001(a). Given the concomitant impact of these plans on employment stability and interstate commerce, Congress declared it the policy of ERISA to protect these interests by, among other things, "establishing standards of conduct, responsibility, and obligations for fiduciaries of employee benefit plans, and by providing for appropriate remedies, sanctions, and ready access to the Federal courts." Id. at § 1001(b). Considering these statements in the statute, it defies common sense to suggest that Congress intended, without saying so expressly, to exempt the largest segment of pension plans, which, it bears repeating, hold some $2.3 trillion in assets, from ERISA's primary remedial provision governing fiduciary breaches with respect to plans.

Ironically, section 404(c), which defendants cite as supporting their position that certification was improper, also bolsters what the plain language of sections 409 and 502(a)(2) provide: that plan participants in individual account plans may sue breaching fiduciaries for losses. Section

404(c) provides that where an individual account plan "permits a participant or beneficiary to exercise control over assets of his account," and where the participant or beneficiary does so in accordance with the Secretary's regulations, "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 . . . exercise or control." 29 U.S.C. § 1104(c)(1)(B). This exemption from liability for loss makes no sense if defendants are correct that fiduciaries to individual account plans have no such liability. But defendants are not correct. Instead, both ERISA's general statement of purpose, and its one provision that deals expressly with individual account plans, clarify that the statute gives a loss remedy to defined contribution plan participants that have been harmed by fiduciary mismanagement or malfeasance.

The decision issued by this Court last week in Milofsky v. American Airlines, Inc., No. 03-11087, 2005 WL 605754 (5th Cir. Mar. 16, 2005), is not to the contrary. In Milofsky, 218 pilots who were participants in one 401(k) plan brought suit under section 502(a)(2) after their company was acquired by a subsidiary of American Airlines and their account balances were transferred in an allegedly untimely and imprudent manner. Id. at *1. They sued the fiduciaries of the American plan, as well as the benefits

consulting firm for the plan, alleging that they were misled about how the transfer would be accomplished, and that because of fiduciary breaches with regard to the timeliness of the transfer, the value of their accounts, and thus the overall value of the plan, decreased. Id. They requested actual damages to be paid to the plan and allocated among their individual accounts. Id.

On appeal, this Court affirmed the district court's dismissal of the case. Relying on Massachusetts Mutual Life Ins. Co. v. Russell, 473 U.S. 134 (1985), the Court held that "plaintiffs lack standing because this case in essence is about an alleged particularized harm targeting a specific subset of plan beneficiaries . . . who seek only to benefit themselves and not the entire plan as required by § 502(a)(2)." 2005 WL 605754, at *7. The Court compared the pilots' claims to those of the plaintiff in Matassarin v. Lynch, 174 F.3d 549 (5th Cir. 1999), reasoning that in both cases "the plaintiffs have alleged breaches of fiduciary duty that uniquely concern only their individual accounts." 2005 WL 605754, at *3.[3] The Court held that because

[3] The plaintiff in Matassarin brought suit under section 502(a)(2) alleging that her account balance was miscalculated, that she should be entitled to an immediate cash distribution and that the plan fiduciaries had breached their duties by failing to comply with the tax code, which jeopardized the plan's tax qualified status. As the court correctly noted, only the allegation concerning the tax-qualified status of the plan was properly brought under section 502(a)(2) because it involved the interest of the plan as a whole. 174 F.3d at 565-66. The other allegations could not be brought under section 502(a)(2) because, unlike in this case, they did not concern an alleged injury

the plaintiffs in Milofsky sought relief "channeled only to the individual accounts of the plaintiff class members," and their claims did "not otherwise seek to vindicate rights of the entire plan – given that the alleged fiduciary breaches occurred only as to the members of the plaintiff class and were not directed to the whole plan membership – this claim does not benefit the entire plan." Id. at *4. The Court expressly stopped "short, however, of saying that there is no standing unless all plan participants would benefit from the litigation." Id. at *12 n.16. Instead, the Court noted that "[t]he central question, in the context of an individual account plan, is whether the suit inures to the benefit of the plan, which occurs whenever all plan participants would directly benefit (by all having increased balances in their individual accounts) or when the suit seeks to vindicate the rights of the plan as an entity when alleged fiduciary breaches targeted the plan as a whole – whether the suit is filed by all plan participants or only a subset thereof." Id.

Thus, the Court refused to "speculate on every possible situation in which a suit that demands relief beneficial to a large proportion of the beneficiaries can reasonably be said to 'protect the entire plan.'" 2005 WL

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to the plan, such as the diminution of current participants' accounts and the resulting diminution of the amount of plan assets held in trust. Id. at 567-68. Accordingly, Matassarin provides no support for the proposition that participants in a 401(k) or other defined contribution plan may not sue for relief under section 502(a)(2) for fiduciary mismanagement of plan assets.

605754, at *5. Rather, the Court concluded that "it is enough to say, for present purposes, that the specific relief here requested, affecting only 218 individual accounts out of a much larger plan [with presumably thousands of participants], is much too narrow to qualify." Id.

Accordingly, the decision in Milofsky does not support defendants' position here. First, plaintiffs here allege that the fiduciary defendants breached their ERISA duties by imprudently and disloyally retaining the EDS Stock Fund as an investment option at a time when they had reason to know that the financial statements of the company did not properly reflect the company's worth. These allegations concern breaches that, by their nature, affect the Plan as a whole, because they concern the imprudent nature of a particular investment option, not for any one individual, but for the Plan as a whole. In other words, because the fiduciaries' actions or inactions made the allegedly imprudent option available to all participants in the Plan, whether or not they chose to invest in that option, the fiduciaries breached their duties owed to all the participants. Thus, the claim here is akin to the failure to diversify claim in Steinman v. Hicks, 352 F.3d 1101 (7th Cir. 2003), which the Milofsky court recognized "inured to the benefit of the entire plan," and was thus distinguishable from the claims of "misrepresentations and untimely transfers made with respect to a specific

[and small] subclass of participants" at issue in the Milofsky case. 2005 WL 605754, at *6.

Second, and relatedly, the Stock Fund was not merely an investment option available for Plan participants to choose, it was also the vehicle through which EDS made its matching contributions to each of the participants. For this reason, as the district court found, nearly all of the approximately 61,000 participants were likely to have had an interest in EDS stock for at least part of the class period. 224 F.R.D. at 621 Thus, every participant (or nearly every one) is likely to "directly benefit (by all having increased balances in their individual accounts)." Milofsky, 2005 WL 605754, at *12 n.16. Far from supporting defendants' position that plaintiffs lack standing to bring a section 502(a)(2) claim in these circumstances, the decision in Milofsky appears to assume that such an action is available.

Nor can the Supreme Court's decision in Russell be read to exempt defined contribution plans from the scope of section 502(a)(2). Unlike this case, Russell involved a claim by a plaintiff for a direct recovery of individual damages stemming from a benefit denial. In Russell, a plan's disability committee terminated and then reinstated a participant's disability benefits. Claiming losses from the interruption in benefit payments, the participant brought suit under section 502(a)(2) for compensatory and

punitive damages, payable not to the plan for a loss of plan assets, but directly to the individual participant for injuries she personally sustained. 473 U.S. at 137-38. After reviewing the text of section 409, the provisions defining the duties of a fiduciary and the provisions defining the rights of a beneficiary, the Supreme Court held that the participant did not have standing to seek extra-contractual compensatory or punitive damages for improper or untimely processing of a benefit claim under sections 409 and 502(a)(2) of ERISA. Although sections 409 and 502(a)(2) of ERISA provide for the recovery of plan losses, those remedial provisions did not create an extra-contractual remedy for the individual injuries sustained by the participant in connection with her benefit claim. In so holding, the court stated "that recovery for a violation of § 409 inures to the benefit of the plan as a whole." Id. at 140.

Russell carefully distinguished relief to be paid to a plan as damages for the mismanagement of plan assets, as sought here, from relief to be paid to an individual as damages for personal pain and suffering caused by a benefit payment delay, as sought in Russell, 473 U.S. at 143-44. In Russell, the plaintiff sought individualized relief, payable to herself, for alleged injuries that she personally incurred without regard to whether the plan had suffered any loss or diminution of assets. She did not allege any injury to

the plan or reduction of its assets, nor did she seek a recovery payable to the plan. Thus, Russell cannot in any way be read to exclude from the scope of section 409(a) an action on behalf of a plan to recover losses caused by fiduciary breaches related to plan management.

Indeed, as the Supreme Court noted in Russell, "the principal statutory duties imposed on the trustees relate to the proper management, administration, and investment of . . . assets, the maintenance of proper records, the disclosure of specified information, and the avoidance of conflicts of interest." 473 U.S. at 142-43. Thus, the Court pointed out in Varity Corp. v. Howe, 516 U.S. 489 (1996), that the specific purpose of section 502(a)(2) is to allow suits to enforce "fiduciary obligations related to the plan's financial integrity," id. at 512, in accordance with "a special congressional concern about plan asset management" reflected in section 409, id. at 511; see also Russell, 473 U.S. at 140 n.8 ("the crucible of congressional concern was [the] misuse and mismanagement of plan assets by plan administrators and . . . ERISA was designed to prevent these abuses in the future").

There is, therefore, no basis for reading Russell so broadly that losses to a defined contribution plan caused by fiduciary mismanagement, which significantly diminish the retirement security of participants or the amount

of assets held in trust, cannot be recovered. The fact that the Plan, like all defined contribution plans, provides for individual accounts, does not remove it from the protection of ERISA, or make any less applicable Congress' goal to protect retirement plans and their participants, as many courts have explicitly or implicitly held. See, e.g., Steinman v. Hicks, 352 F.3d 1101 (clarifying that a claim for losses relating to financial mismanagement is properly brought under section 502(a)(2) even if the relief ultimately flows to individuals); In re WorldCom, Inc., 263 F. Supp. 2d 745, 765 (S.D.N.Y. 2003) (allowing claim under section 502(a)(2) based on allegations that 401(k) plan fiduciaries "were obligated to but failed to act with prudence regarding the Plan's continued offer of WorldCom stock as a Plan investment"); Tittle v. Enron Corp., 284 F. Supp. 2d 511 (S.D. Tex. 2003) (allowing claims against 401(k) and ESOP fiduciaries to proceed under section 502(a)(2)).[4]

[4] The district court in In re Schering-Plough Corp. ERISA Litig., No. Civ. A. 03-1204, 2004 WL 1774760 (D.N.J. June 28, 2004), held, we believe erroneously, that participants in individual account plans cannot sue under section 502(a)(2) to recover losses sustained by the plan as a result of fiduciary breaches where the losses will be distributed to individual accounts, and where the contributions to the accounts came solely from employees, which the court believed were not plan assets. This case is currently on appeal and the Secretary has filed an amicus brief urging reversal. On the other hand, In re Unisys Savings Plan Litigation, 74 F.3d 420 (3d Cir. 1996), said nothing about the ability to sue under section 502(a)(2), but instead addressed the affirmative defense in section 404(c),

Defendants argue that the claim is in reality an individual claim for "appropriate equitable relief" for fiduciary breach under ERISA section 502(a)(3), 29 U.S.C. § 1132(a)(3), and that such relief is limited to injunctive relief or disgorgement of unjust enrichment. Def. Br. at 17-18, 27-29. Although the Secretary has argued on numerous occasions that participants can recover under section 502(a)(3) for their direct monetary losses caused by fiduciary breaches, the courts have not been uniform in their approach to such relief. Compare, e.g., Rego v. Westvaco Corp., 319 F.3d 140, 144-46 (4th Cir. 2003) with Strom v. Goldman, Sachs & Co., 202 F.3d 138, 143-44 (2d Cir. 1999). If this court were to find that a section 502(a)(2) action is not permitted in this case, defined contribution plan participants would be without a monetary remedy unless this court holds that make-whole relief of this kind is available under section 502(a)(3), an issue the Fifth Circuit has not yet addressed. Cf. Milofsky, 2005 WL 605754, at *7 & n.23 (noting that section 502(a)(3) "might deny the plaintiffs the particular remedy they desire," and that the "Supreme Court has indicated

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which we discuss more fully below. See, infra, at 22-30. The Unisys court held that a defendant has the heavy affirmative burden of showing that section 404(c) applies. However, the court also held, in a case that arose before the effective date of the Secretary's 404(c) regulation, that if a defendant proves such control, a plaintiff may not recover his investment losses, even if the investment option was imprudently selected. Id. at 443-46.

that compensatory and punitive damages may not be available"). However, even if there may be an available remedy under section 502(a)(3), ERISA's "catch-all" provision, ERISA sections 409(a) and 502(a)(2) expressly provide that plan participants may bring suit for losses to the plan resulting from fiduciary breaches. There is simply no basis for the denial of such a remedy here. See Varity, 516 U.S. at 515 ("We are not aware of any ERISA-related purpose that denial of a remedy would serve.").

In essence, defendants imply that a defined contribution plan, such as a 401(k) plan, itself holds no plan assets, but instead is little more than an administrative device to hold, invest, and pay out benefits from the investment accounts of the numerous participants. If this is true, ERISA cannot meet its goal of protecting the security of retirement benefits promised by individual account plans. Not only would the defendants' argument effectively remove more than $2 trillion of plan assets from the scope of section 502(a)(2), but if taken to its logical extreme, would eliminate ERISA's stringent fiduciary responsibilities with respect to those assets. ERISA imposes no obligation of prudence or loyalty with respect to assets which do not belong to the plan. Similarly, ERISA's trust requirement applies only to the "assets of an employee benefit plan (ERISA section 403);" ERISA defines fiduciaries as persons with control over plan assets

(ERISA section 3(21)(A)); and many of ERISA's prohibitions on self dealing are limited to "assets of the plan" (ERISA sections 406(a)(1)(D), 406(b)(1), and (b)(3)). Under the defendant's logic, fiduciary defendants would be exempt from these important duties, as well as from the losses caused by their failure to adhere to ERISA's dictates, inasmuch as the only interests at stake are individuals' interests, rather than the plan interests protected by these essential ERISA safeguards. Rather than read these provisions out of the statute, however, the court should reject the defendants' argument and hold that the plaintiffs' allegations, if true, caused a loss to the Plan, notwithstanding the allocation of the loss between individual accounts. Such a reading comports with the statute's express language, and gives meaning to the protections Congress promised retirees when it enacted ERISA. Here, the district court correctly viewed plaintiffs' prudence claims, not as a collection of individual claims of harm, but as an overarching claim that the Plan was economically injured by the imprudence of the fiduciaries in managing the stock fund. Viewed in this light, the court was correct to treat as irrelevant defendants' contentions that individual members of the class had conflicting claims because of when, if ever, they divested their accounts of company stock.

II. The District Court Correctly Held That ERISA Section 404(c) Does Not Provide A Defense To Plaintiffs' Allegations That The Fiduciaries Imprudently Maintained The EDS Stock Fund As A Plan Investment Option

Defendants argue that the claims are not subject to class treatment because the Court must make individual determinations as to the applicability of ERISA section 404(c), which in some circumstances relieves the fiduciary of responsibility for participant-directed investments. ERISA section 404(c) applies to individual account plans that are designed and operated so that participants exercise independent control over the assets in their accounts. Under ERISA section 404(c)(1)(B), 29 U.S.C. § 1104(c)(1)(B), a "person who is otherwise a fiduciary" is not liable for losses to the plan resulting from the participant's selection of investments in his own account, provided that [the] participant . . . exercised control over the assets in his account (as determined under regulations of the Secretary)." Id. at § 1104(c)(1). Thus, to be exempt under section 404(c), the fiduciary must show that the plan met the detailed requirements of the Department of Labor's regulations. See 29 C.F.R. § 2550.404c-1.

As an initial matter, it is difficult to see why, given the particular claims here that the fiduciaries breached their duties by retaining the Stock Fund as an option for the Plan and continuing to make the employer match in that Fund when it was no longer prudent to do so, there will be any need

for the district court to make particularized determinations with regard to individual participants. Rather, it seems much more likely that the disagreements between the parties concerning the Plan's section 404(c) status will center on Plan-wide questions, such as whether the fiduciaries "concealed material non-public facts regarding the investment" not from any particular participant, but from all the participants. See Original Brief of Plaintiffs-Appellees (Plaintiff's Br.) at 37 n.25, quoting 29 C.F.R. § 2550.404c-1(c)(2). Furthermore, section 404(c) is an affirmative defense on which plaintiffs bear the burden of proof. See In re Unisys, 74 F.3d at 446; Allison v. Bank One-Denver, 289 F.3d 1223, 1238 (10th Cir. 2002). If the district court decides as a general matter that the Plan does not qualify under the Secretary's regulation, for instance, because of a failure to disclose accurate information, it will never have to decide whether any participants exercised individual control.[5]

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[5] The Secretary's regulation imposes detailed requirements for a plan to qualify as a section 404(c) plan, and many of them are plan-wide requirements. For instance, to qualify as a 404(c) plan, the participants must be provided an "explanation that the plan is intended to constitute a plan described in section 404(c) and [the regulations], and that the fiduciaries of the plan may be relieved of liability for any losses which are the direct and necessary result of investment instructions given by such participant or beneficiary." 29 C.F.R. § 2550.404c-1(b)(2)(B)(1)(i). Moreover, the regulation contains extensive provisions relating to the acquisition or sale of employer securities, including requirements relating to the dissemination of

In any event, defendants' section 404(c) argument fails for another, more fundamental reason. As the district court correctly held, even if the Plan is a 404(c) plan, defendants cannot escape liability for alleged imprudence with regard to offering the company stock fund. See, e.g., Enron, 284 F. Supp. 2d at 577. By its terms, ERISA section 404(c) provides relief from ERISA's fiduciary responsibility provisions that is both conditional and limited in scope. The scope of ERISA section 404(c) relief is limited to losses or breaches "which resulted from" the participant's exercise of control.

The preamble to the regulation states that "a fiduciary is relieved of responsibility only for the direct and necessary consequences of a participant's exercise of control." See 57 Fed. Reg. 46,906, 46,924 (1992). A clarifying footnote explains that the act of designating a plan investment option is not a direct and necessary result of any participant direction and section 404(c) plan fiduciaries are thus still obligated by ERISA's fiduciary responsibility provisions to prudently select the investment options under the plan and "to periodically evaluate the performance of such vehicles to determine . . . whether [they] should continue to be available as participant

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information to participants on the same basis as to shareholders, pass-through voting rights, and confidentiality of information relating to pass-through voting rights, all of which would not require any individualized determinations. See 29 C.F.R. § 2550.404c-1(d)(2)(E)(4).

investment options." Id. at n.27. The Secretary has reiterated this interpretation on numerous occasions, see DOL Letter No. 98-04A, 1998 WL 326300, at *3 n.1 (May 28, 1998), and 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), most recently in her amicus briefs in Tittle v. Enron Corp., No. 01-3913 (S.D. Tex. filed Aug. 30, 2002), and In re Schering-Plough Corp., No. 04-3073, at 17 & n.17 (3d Cir. filed Oct. 20, 2004).

In its amicus brief in support of defendants, the Business Roundtable argues (Brief at 12) that this interpretation is entitled to deference only to the extent that it has the power to persuade under the Supreme Court's decision in Skidmore v. Swift & Co., 323 U.S. 134, 140 (1944). It cites this Court's decision in Louisiana Environmental Action Network v. EPA, 382 F.3d 575 (5th Cir. 2004), for the proposition that the Secretary's position is only entitled to Skidmore deference because it was first set forth in the preamble to her regulation. The argument is wrong. Under the Supreme Court's decision in Auer v. Robbins, 519 U.S. 452, 457, 462 (1997), an agency's interpretation of its own regulation is entitled to the highest deference under Chevron U.S.A., Inc. v. NRDC, 467 U.S. 837. Louisiana Environmental holds that an interpretation set forth in a proposed regulation is only entitled

to Skidmore deference. 382 F.3d at 583. Here, the statute expressly delegated to the Secretary the task of promulgating a regulation governing when a participant will be viewed as having exercised independent control over the assets in his account for purposes of section 404(c). See 29 U.S.C. § 1104(c) ("if a participant or beneficiary exercise control over his account (as determined under regulations of the Secretary)"). The Secretary's contemporaneous interpretation of the final notice-and-comment regulation as preserving the fiduciary's duty to prudently select and monitor the investment options – published in the federal register with the regulation, and uniformly adhered to in numerous public pronouncements – is reasonable and entitled to controlling weight. Chevron, 467 U.S. at 845.

Thus, although the participants in defined contribution plans are given a measure of control over investment decisions, the plan fiduciaries nevertheless retain the duty to prudently choose and monitor the investment options. See Enron, 284 F. Supp. 2d at 577. Contrary to defendants' argument, Def. Br. at 37-38, this is true even where, as here, the Plan terms require that the Plan offer a company stock fund. Fink v. Nat'l Sav. & Trust Co., 772 F.2d 951, 955-56 (D.C. Cir. 1985); Eaves v. Penn, 587 F.2d 453, 458-60 (10th Cir. 1978). A "fiduciary is not required to blindly follow the Plan's terms," but, under ERISA section 404(a)(1)(D), 29 U.S.C. §

1104(a)(1)(D), must "act 'in accordance with the documents and instruments governing the plan' insofar as those documents are consistent with the provisions of ERISA." Rankin v. Rots, 278 F. Supp. 2d 853, 878 (E.D. Mich. 2003), quoting Best v. Cyrus, 310 F.3d 932, 935 (6th Cir. 2002). Thus, fiduciaries have a duty under section 404(a)(1)(D) to decline to follow the terms of the plan document where those terms require them to act imprudently in violation of ERISA section 404(a)(1)(B). Central States, Southeast & Southwest Areas Pension Fund v. Central Transp. Inc., 472 U.S. 559, 568 (1985) ("trust documents cannot excuse trustees from their duties under ERISA"); Fink, 772 F.2d at 954-56 (ERISA's prudence and loyalty requirements apply to all investment decisions made by employee benefit plans, including those made by plans that may invest 100% of their assets in employer stock). It follows that plan fiduciaries are obligated to act prudently and solely in the interest of the participants and beneficiaries in deciding whether to purchase or retain employer securities despite language requiring the plan to purchase employer securities. See, e.g., Laborers Nat'l Pension Fund v. N. Trust Quantitative Advisors, Inc., 173 F.3d 313, 322 (5th Cir. 1999); Kuper v. Iovenko, 66 F.3d 1447, 1457 (6th Cir. 1995); Moench v. Robertson, 62 F.3d 553, 569 (3d Cir. 1995); DOL Opinion Letter No. 90-

05A, 1990 WL 172964, at *3 (Mar. 29, 1990); DOL Opinion Letter No. 83-6A, 1983 WL 22495, at *1-*2 (Jan. 24, 1983).

There is no merit to the argument that the Secretary's interpretation of her regulation implementing section 404(c) effectively eliminates the statutory exemption because there would never be a scenario where it would be applicable. Brief of Amici Curiae Business Roundtable, et al., in Support of Appellants Seeking Reversal of the Ruling Below Granting Class Certification (Roundtable Br.) at 13. In a 404(c) plan, a fiduciary that oversees appropriate investment funds has no responsibility for the participant's own decisions as to how to allocate investments between funds. For example, even if a participant chooses to invest his entire account in a particularly volatile fund, or in a mix of funds that was wholly incompatible with the participant's particular retirement needs, 404(c) makes clear that the fiduciary is not responsible for the participant's poor judgment. What it does not do is relieve the fiduciary of its liability for choosing or retaining the investment options for the plan, a task over which the fiduciary, and not the participant, has control. Far from rendering section 404(c) meaningless, the Secretary's interpretation sensibly allocates liability (and relief from liability) based on whether the fiduciary or the participant has and exercises control over the choice.

Nor is there merit to the Business Roundtable's argument (Roundtable Br. at 15 & n.3) that modern portfolio theory, or the Fifth Circuit's embrace of that theory, N. Trust Quantitative Advisors, Inc., 173 F.3d at 317-18 , 322, is in any way inconsistent with a suit alleging that a particular investment was an imprudent option for an employee benefits plan. While it may be perfectly prudent, as a general matter, to include a relatively risky investment in a well-diversified portfolio of investments, this is only true where the risk associated with that investment is commensurate with the likely returns. It is certainly not the case where the investment is overvalued, as plaintiffs allege was the case here, because of improper accounting practices and false or misleading financial statements. Second Amended Consolidate Class Action Complaint at ¶ ¶ 124-127 (material but undisclosed risks in EDS's IT outsourcing contracts related to benchmarking), ¶ 139 (misleading SEC filings incorporated into summary plan descriptions), ¶ 152 (defendants should have EDS stock not a suitable investment because "EDS's inappropriate accounting and business practices").

For similar reasons, although the Secretary takes the position that plan participants may not recover under section 502(a)(2) to recover losses that result from a mere downturn, even a sharp one, in the price of a stock, see

Metzler v. Graham, 112 F.3d 207, 209 (5th Cir. 1997) ("[p]rudence is evaluated at the time of the investment without the benefit of hindsight"), the allegations here are not merely that the stock price dropped due to a number of "common business setbacks." Def. Br. at 8-9. Rather, contrary to the picture painted by defendants, plaintiffs allege that the fiduciary defendants, as corporate insiders, had reason to know that the company's financials were overstated. See Amended Complaint at ¶ 139, ¶ 152.

Consequently, if, as alleged, defendants violated their fiduciary duties when they continued to offer EDS stock as an investment option, section 404(c) provides no defense to their own fiduciary misconduct, and the district court was correct to disregard the effect of section 404(c) in determining whether the prudence claims should be certified as a class action. Instead, plaintiffs have the right, as determined by Congress, to seek relief on behalf of the Plan under section 502(a)(2) of ERISA, 29 U.S.C. § 1132(a)(2). Although defendants argue that this reading of section 404(c) is "inconsistent with the Congressional policy of personal responsibility embodied in" that section, Def. Br. at 42, in fact, their reading of section 404(c) (and indeed of sections 409 and 502(a)(2)) is inconsistent with the policy of fiduciary responsibility that is the cornerstone of ERISA.

CONCLUSION

For the reasons stated above, the Secretary of Labor urges this Court to affirm the district court's class certification order.

Respectfully submitted,

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CERTIFICATE OF SERVICE

In accordance with Fed. R. App. P. 25(d) and 5th Cir. R. 31.1, I hereby certify that on this 21st day of April, 2005, I caused to be served one electronic copy and one paper copy (sent via Federal Express) of the Corrected Brief of the Secretary of Labor, Elaine L. Chao, as Amicus Curiae in Support of Plaintiffs-Appellees Requesting Affirmance of the District Court's Decision on the following counsel:

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CERTIFICATE OF COMPLIANCE

I hereby certify that the Corrected Brief of the Secretary of Labor, Elaine L. Chao, as Amicus Curiae in Support of Plaintiffs-Appellees Requesting Affirmance of the District Court's Decision complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B) and contains 6,994 words, excluding the parts of the brief exempted by Fed. R. App. 32(a)(7)(B)(iii) . Also, this brief complies with the typeface requirements of Fed. R. App. 32(a)(5) and the type style requirements of Fed. App. P. 32(a)(6) and has been prepared in a proportionally-spaced typeface using Microsoft XP in Times New Roman 14-point font size.

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