No. 09-4370

IN THE UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

DAVID H. TULLIS AND MICHAEL S. MACK,

Plaintiffs-Appellants

v.

UMB BANK, N.A. AND JOHN JOE DEFENDANTS 1-10

Defendants-Appellees.

On Appeal from the United States District Court,
Northern District of Ohio, Western Division

BRIEF OF THE SECRETARY OF LABOR AS AMICUS CURIAE IN SUPPORT OF PLAINTIFFS-APPELLANTS

M. PATRICIA SMITH
Solicitor of Labor

TIMOTHY D. HAUSER
Associate Solicitor
Plan Benefits Security Division

NATHANIEL I. SPILLER
Counsel for Appellate and Special Litigation

JAMILA MINNICKS
Trial Attorney
U.S. Department of Labor
Room N-4611
200 Constitution Ave., N.W.
Washington, D.C. 20210
(202) 693-5522

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STATEMENT OF THE ISSUE

Section 404(c) of ERISA applies to pension plans that provide for participants to "exercise control" over plan assets in individual account plans, and relieves fiduciaries of liability "for any loss, or by reason of any breach, which results from such participant's . . . exercise of control." The question presented is: Whether the district court erred in relieving defendant, UMB Bank N.A. ("UMB"), of fiduciary liability under this safe harbor provision, when UMB:

(1) failed to disclose to plan participants that their investment advisor had previously embezzled funds from the pension account of another ERISA plan participant for whom UMB also served as a trustee;

(2) continued to take investment directions from the investment advisor and to process forged instruments from the advisor, although UMB had previously been a plaintiff in litigation against the investment advisor for embezzling plan assets; and,

(3) failed to correctly state the value of the assets held in the participants' individual accounts or to question the advisor's representations as to the value of those accounts.

STATEMENT OF INTEREST

Enacted, in part, to curb fiduciary abuses by those entrusted to engage in the prudent administration of retiree pensions and benefits, the Employee Retirement Income Security Act of 1974 ("ERISA"), 29 U.S.C. §§ 1001 et seq., protects the interests of plan participants by imposing stringent duties of prudence and loyalty on plan fiduciaries. See 29 U.S.C. § 1002(21)(A); H.R. Conf. Rep. No. 93-1280, p.296 (1974), U.S. Code Cong. & Admin. News

1974, pp.4639, 5076. The Secretary of Labor has primary enforcement authority for Title I of ERISA. See, e.g., Secretary of Labor v. Fitzsimmons, 805 F.2d 682, 687-691 (7th Cir. 1986) (en banc); Donovan v. Cunningham, 716 F.2d 1455, 1462-63 (5th Cir. 1983).

In this case, the district court's misreading of the 404(c) defense undermines these important protections by improperly immunizing plan fiduciaries from liability for their own misconduct that prevented the plaintiffs from exercising meaningful independent control over their individual retirement accounts. The Secretary has a significant interest in ensuring that section 404(c), and her regulations giving effect to that provision, are not read to immunize fiduciaries from liability for losses caused by the fiduciaries' own failure to disclose its knowledge of the investment advisor's history of misconduct with plan assets, its negligent processing of imprudent and even fraudulent transactions at the direction of the advisor, and its uncritical transmittal of inflated account values provided by the advisor. [1]

STATEMENT OF THE CASE

A. Factual Background

Drs. Michael Mack and David Tullis (the "plaintiffs") were participants in the Toledo Clinic Employees' 401(k) Profit Sharing Plan ("Plan"), an ERISA-governed "defined contribution" (or "individual account") pension plan. See 29 U.S.C. § 1002(34). In the early 1990s, they chose William Davis of Continental Capital Corporation ("Capital") (collectively,

[1] For purposes of this brief, the Secretary assumes the truth of the plaintiffs' alleged facts and takes the position that the district court erred in holding, as a matter of law, that, even if the allegations are true, the section 404(c) defense defeats the plaintiffs' claims. However, because the district court dismissed the case without necessarily finding the facts supporting the allegations to be actually proven or undisputed, once the 404(c) defense drops out of the analysis, disputed material facts may exist concerning the underlying fiduciary claims. Thus, while asserting that UMB committed multiple fiduciary breaches on the facts as alleged, the Secretary takes no position as to the ultimate merits of these claims.

the "investment advisor") as their investment advisor.[2] In 1999, the U.S. Securities and Exchange Commission entered a temporary restraining order against Capital because two of its brokers, including Davis, were engaged in fraudulent activities. In 2001, UMB filed suit against Davis and a subsidiary of Capital in connection with its management of another physician's individual–account plan, alleging that several investments were improper, severely declined in value immediately after being purchased, or fraudulent (i.e., simply never took place).

According to the complaint, the plaintiffs' pension funds "were self-directed and administered through Defendant, UMB Bank, N.A., as Trustee." Complaint, ¶ 6. UMB acted "as the Trustee for the Toledo Clinic Pension Fund for dozens of employees." Id. ¶ 2. As Trustee, UMB's duties included the obligation "to hold, administer, value, make sales and purchases for, distribute, account for, and otherwise deal with each Participating Plan Fund separately." Exhibit B to Complaint, ¶ 4.3. Under the terms of the Employees 401(k) Profit Sharing Plan & Trust ("Plan Document"), UMB was obligated to annually value the assets of the Plan at fair market value, and the Plan's Administrative Committee was assigned the responsibility of allocating the Plan's assets among separate bookkeeping accounts in the name of plan participants. Plan Document § 8.2. The Administrative Committee was entitled to, "in good faith, rely on any statement of the Trustee" to determine any facts pertinent to the Committee’s duties. Id. at § 9.4.

The plaintiffs allege that UMB failed to "protect [plaintiffs'] assets which it has custody and control over," Complaint ¶ 29; did not enforce note obligations due to it for the benefit of the

[2] Although the parties and district court use the term "investment advisor" to refer to the third-party wrongdoers in this case, it is clear that Davis and Capital did substantially more than give advice to participants. In particular, they actively managed the plaintiffs' assets by making investment decisions, executing trades, and giving directives to UMB, which was serving as trustee to the plaintiffs' individual account plans.

plaintiffs, id. ¶ 30; did not enforce note obligations on behalf of the plaintiffs, id. ¶ 30; accepted directives from the investment advisor, many of which turned out to be forged, id. ¶¶ 18, 40; purchased unregulated securities that were not registered in accordance with the state law for pension accounts, id. ¶¶ 24b, 39, 54; and purchased or was "involved in the issuance of bogus, false and fraudulent securities," id. ¶ 53, see id. ¶¶ 18, 38-40 ("various investment directives from [the advisor] . . . were forged"), 43, 53. The plaintiffs also allege that UMB provided monthly schedules of assets and "set forth the market value as to each component (asset) in the pension funds," id. ¶ 12, but failed in its responsibility to disclose that it did not "obtain the required statutory annual valuations" of plan investments, id. ¶¶ 24c-d, see id. ¶¶ 28, 44; or that it knew that Capital and Davis "were perpetrating frauds on other investors," since it was a co-plaintiff in the 2001 suit against them for such activities. Id. ¶ 24e; see id. ¶¶ 34-35. [3] Finally, the plaintiffs allege that these actions and failures caused combined losses in excess of $1 million to their plans, and that, had they known about them, they would have taken steps to protect their assets much earlier. Id. ¶¶ 24c, 29, 36.

In 2003, a bankruptcy court appointed a Trustee for Capital's parent company. Complaint ¶ 8. Davis is or was in jail for forgeries related to this case. Id. ¶ 41.

B. Procedural History and Decision Below

The plaintiffs filed the instant ERISA action on behalf of the Plan in January 2006. On November 21, 2006, the district court dismissed the plaintiffs' claim for lack of standing. On January 28, 2008, this Court reversed the decision and remanded the case to the district court.

[3] During litigation, the plaintiffs also alleged that UMB withheld information that it independently held regarding a separate settlement agreement executed between Dr. Joseph Roche – another Toledo Clinic Plan participant – and Davis in 1998. See Plaintiff's Corrected Notice of Discovery of Evidence, pp. 1-2.

See Tullis v. UMB Bank, N.A., 515 F.3d 673 (6th Cir. 2008).[4] On remand, the parties filed cross-motions for summary judgment. UMB argued that the plaintiffs controlled the assets in their individual accounts and were freely permitted to invest their plan assets as they saw fit. Accordingly, in UMB's view, it had no liability under ERISA section 404(c) "for losses resulting from Plaintiffs' exercise of control over their own assets." Tullis, 640 F.Supp.2d 974, 978 (N.D. Ohio 2009). The plaintiffs argued that UMB violated its duty as Plan Trustee to prudently manage and control plan assets and to disclose material nonpublic information regarding the investment advisor's fraudulent and illegal conduct; and they further argued that UMB violated its duty to protect plan assets and provide fair and accurate valuation information respecting their individual accounts. The 404(c) defense does not apply to these violations, the plaintiffs asserted, because the losses to their accounts resulted from UMB's failures to fulfill its obligations, not from anything the plaintiffs did.

On August 11, 2009, the district court granted UMB's motion for summary judgment and denied the plaintiffs' motion for summary judgment. The court held that the Plan gave the plaintiffs sufficient independent control over a broad range of investment alternatives to qualify their separate accounts as a section 404(c) plan, and that UMB "therefore properly invokes the 'safe harbor' defense with respect to [the plaintiffs'] claims." 640 F. Supp. 2d at 980. The court further held that "[UMB] cannot be held responsible for the valuation breach in question that resulted from [the plaintiffs'] exercise of independent control." Id. at 981. With regard to the charge that UMB concealed material nonpublic information, the court held that "because [the plaintiffs] made no timely inquiry . . . , [UMB] was under no affirmative duty to disclose." Id. at

[4] In an amicus curiae brief in the first Tullis appeal, the Secretary supported the plaintiffs' standing to bring their claims on behalf of the Plan.

982 ("[t]he 'safe harbor' defense only becomes unavailable when Defendant has concealed material non-public information").

The plaintiffs timely appealed on October 16, 2009, after the district court denied their motion for reconsideration on September 21, 2009.

SUMMARY OF THE ARGUMENT

This case concerns the interrelationship of sections 404(a) and 404(c) of ERISA. Section 404(a) of ERISA requires plan fiduciaries to "discharge their duties with respect to a plan solely in the interest of [plan] participants and beneficiaries" with "the care, skill, prudence and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use." 29 U.S.C. § 1104(a). These fiduciary standards are the "highest known to the law." Donovan v. Bierwirth, 680 F.2d 263, 272 n.8 (2d Cir. 1982). Section 404(c) provides a limited exception for fiduciaries of individual account pension plans which "permit[] a participant or beneficiary to exercise control over the assets in his account"; if such control is exercised by the participant or beneficiary, no fiduciary "shall be liable . . . for any loss, or by reason of any breach, which results from such participant's or beneficiary's exercise of control." 29 U.S.C. § 1104(c). By its terms, therefore, the 404(c) defense applies only where the participant in a participant-directed pension plan actually exercises control over his investments and the loss caused by imprudent conduct "results from" such exercise of control.

In this case, the losses suffered by the participants are directly attributable to UMB's breaches of its section 404(a) fiduciary duties, and thus do not fall within the section 404(c) safe harbor provision. UMB breached its duties of prudence and loyalty to the participants when it: (1) aided the investment advisor, which it knew to have been an embezzler in similar circumstances, in its looting of plan assets by failing to disclose material facts known only to the fiduciary but needed by the participants for their own protection; (2) despite this knowledge, took investment directions from the advisor and processed its transactions, including those involving forged instruments; and (3) reported overstated account valuations that deprived the plaintiffs of the ability to know the actual worth of their retirement accounts.

The plaintiffs lacked control over their individual accounts as a result of UMB's wrongful actions and failures to disclose material information about the advisor and its larcenous behavior. Critical to section 404(c) analysis, the losses in this case are not properly attributable to participants, but rather to UMB. Without disclosure of the advisor's history of embezzlement or receipt of accurate account statements reflecting the amounts that the advisor had taken from them, the participants were deprived of information that they needed to exercise meaningful independent control over their individual accounts. The plaintiffs lost any opportunity to exercise control over the assets of their account because UMB independently decided to give a known embezzler unmonitored access to participants' retirement accounts. The losses that resulted from this ruinous course of conduct did not "result from" the participants' informed decision, but instead resulted from UMB's breaches of its section 404(a) fiduciary duties. Allowing a fiduciary to engage in such conduct that directly contributed to the participants' losses effectively renders hollow ERISA's fiduciary provisions in section 404(a) and reads the causation limitation implicit in the "results from" language in section 404(c) out of the Act.

The Secretary's regulations interpreting section 404(c), issued after notice and comment rulemaking pursuant to an express delegation of authority and therefore entitled to full deference, dictate this conclusion by explaining that a loss "results from" a participant's exercise of control when it is the "direct and necessary result" of such exercise. See 29 C.F.R. § 2550.404c-1(d)(2);

id. § 2550.404c-1(c). The regulations also clearly prohibit fiduciaries from relying on the 404(c) safe harbor provision in circumstances where the participant has insufficient information with which to execute an informed investment decision, thereby depriving participants of any opportunity to "exercise independent control" over plan assets. See id. § 2550.404c-1(c)(2). The concealment of material non-public facts by a fiduciary is one instance where "independent control in fact" does not exist. See id.

UMB's failure to disclose material information necessary to the exercise of independent control and its further failure to fulfill its duty to accurately inform the plaintiffs of the true value of their plan assets based on its own evaluation of their worth irreparably interfered with the plaintiffs' ability to exercise the "independent control in fact" required to invoke the 404(c) safe harbor. Moreover, UMB's implementation of the advisor's directions, including the processing of forged instruments and the handing over of plan assets to the advisor, without the plaintiffs' knowledge or participation, was neither consonant with the independent "exercise of control" that is the linchpin of section 404(c) nor the "direct and necessary" result of the plaintiff's investment choices that is essential before the section 404(c) safe harbor defense can apply. Because the conditions for permitting participants to exercise independent control were not met and the losses were directly attributable to UMB's imprudent and disloyal actions, and not to any actions that the plaintiffs independently controlled or undertook, the court erred in holding that UMB is immunized from section 404(a) fiduciary liability by virtue of the section 404(c) defense.

ARGUMENT

UMB IS NOT ENTITLED TO THE SECTION 404(c) SAFE HARBOR DEFENSE BECAUSE PLAINTIFFS' LOSSES "RESULTED FROM" UMB'S VIOLATIONS OF ITS DUTIES OF PRUDENCE AND LOYALTY TO THE PARTICIPANTS AND THESE VIOLATIONS USURPED PLAINTIFFS' ABILITY TO EXERCISE "INDEPENDENT CONTROL IN FACT" OVER PLAN ASSETS

A. UMB Violated Its Fiduciary Duties Of Loyalty And Prudence On The Facts As Alleged

1. 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 benefits plans, and by providing appropriate remedies, sanctions, and ready access to the Federal courts." 29 U.S.C. §§ 1101(a), (b). ERISA imposes fiduciary status on any individual who exercises discretionary authority over the management of a covered plan or its assets. Id. § 1002(21)(A). Accordingly, ERISA protects plans and their participants by imposing stringent standards of conduct on plan fiduciaries and holding fiduciaries accountable for any plan losses resulting from the failure to adhere to those standards. See id. §1104(a).

ERISA section 404 requires fiduciaries to discharge their duties with respect to a plan solely in the interest of its participants and beneficiaries. 29 U.S.C. § 1104(a)(1)(A); Varity Corp. v. Howe, 516 U.S. 489, 506 (1996). A plan fiduciary must, accordingly, act "with the care, skill, prudence and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims." 29 U.S.C. § 1104(a)(1)(B). These duties and responsibilities "draw much of their content from the common law of trusts, the law that governed most benefit plans before ERISA's enactment." Varity Corp. 516 U.S. at 496. As incorporated into ERISA, these fiduciary standards have been described as the "highest known to the law." Bierwirth, 680 F.2d at 272 n.8.

In accordance with these fiduciary duties, ERISA fiduciaries have an affirmative duty to disclose material information that plan participants need to know to protect their interests. "The scope of that duty to disclose is governed by ERISA's Section 404(a)." Bins v. Exxon Co. U.S.A., 189 F.3d 929, 939 (9th Cir.1999) ("once an ERISA fiduciary has material information relevant to a plan participant or beneficiary, it must provide that information whether or not it is asked a question"). "[I]n some circumstances fiduciaries must on their own initiative 'disclose any material information that could adversely affect a participant's interests'"). Braden v. WalMart Stores, Inc., 588 F.3d 585, 598-599 (8th Cir. 2009) (citation omitted).[5]

Fiduciaries are prohibited from misleading participants through inaction or silence, and must protect participants from misleading information. See Bixler v. Cent. Penn. Teamsters Health & Welfare Fund, 12 F.3d 1292, 1300 (3rd Cir. 1993) (affirmative disclosure duty "where the trustee knows that silence would be harmful"); see also, e.g., Varity Corp., 516 U.S. at 506 ("lying is inconsistent with the duty of loyalty owed by all fiduciaries and codified in section 404(a)(1) of ERISA"); Devlin v. Empire Blue Cross and Blue Shield, 274 F.3d 76, 88-89 (2nd Cir. 2001); cf. Restatement (Second) of Trusts §713, cmt. c-d (1959) (beneficiaries are "always

[5] See Glaziers and Glassworkers Union Local No 252 Annuity Fund v. Newbridge, 93 F.3d 1171, 1181 (3rd Cir. 1996) ("[t]his duty to inform is a constant thread in the relationship between beneficiary and trustee; it entails not only a negative duty not to misinform, but also an affirmative duty to inform when the trustee knows that silence might be harmful"). See also Watson v. Deaconess Waltham Hospital, 298 F.3d 102, 115 (1st Cir. 2002); Griggs v. E.I. DuPont de Nemours & Co., 237 F.3d 371, 381 (4th Cir. 2001); Krohn v. Huron Memorial Hosp., 173 F.3d 542, 548 (6th Cir. 1999); Barker v. Am. Mobil Power Corp., 64 F.3d 1397, 1403 (9th Cir. 1995); McDonald v. Provident Indem. Life Ins. Co., 60 F.3d 234, 237 (5th Cir. 1995); Anweiler v. Am. Elec. Power Serv. Corp., 3 F.3d 986, 991 (7th Cir. 1993); Eddy v. Colonial Life Ins. Co. of Am., 919 F.2d 747, 750-751 (D.C. Cir. 1990).

entitled to such information as is reasonably necessary to enable [them] to enforce [their] rights under the trust or to prevent or redress a breach of trust"); Globe Woolen Co. v. Utica Gas and Elec. Co., 224 N.Y. 483, 489 (N.Y. 1918) (Cardozo, J.) ("[a] beneficiary, about to plunge into a ruinous course of dealing, may be betrayed by silence as well as by the spoken word").

2. As trustee of the Plan, UMB was a plan fiduciary. See 29 U.S.C. § 1002(21)(A)(i) (providing that any person that has "any authority or control respecting management or disposition of [plan] assets" is a plan fiduciary); id. §1103(a) (a plan trustee "shall have exclusive authority and discretion to manage and control the assets of the plan"); 29 C.F.R. § 2509-75-8, D-3 (the trustee of a plan is, by the very nature of its position, an ERISA fiduciary). Because it was a plan fiduciary, UMB had an obligation to act with prudence and undivided loyalty to the plan and its participants.[6]

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[6] While the district court considered UMB to be a "directed trustee," this characterization is misleading and unhelpful. A directed trustee has limited authority or discretion when the plan expressly subjects the trustee "to the direction of a named fiduciary who is not a trustee, in which case the trustees shall be subject to proper directions of such fiduciary which are made in accordance with the terms of the plan and which are not contrary to this Act." 29 U.S.C. §1103(a)(1). A directed trustee, however, has an obligation to make sure the directions are in accordance with the terms of the plan, and not contrary to ERISA. See DOL Field Assistance Bulletin ("FAB") No. 2004-03, at http://www.dol.gov/ebsa/regs/fab_2004-3.html (discussing role and duties of "directed trustee" with respect to publicly-traded employer stock) ; Herman v. NationsBank Trust Co., 126 F.3d 1354, 1361-62, 1371 (11th Cir. 1997). The relevant directions in this case did not come from a named fiduciary, but from the plaintiffs' investment advisor, and the determinations whether UMB committed fiduciary breaches or is entitled to the 404(c) defense do not turn on whether the "directed trustee" label applied to it for some purposes.

Even assuming that UMB was subject under the terms of the Plan to directions from a named fiduciary (not including the advisor or plan participants, neither of whom were "named fiduciaries"), making it a directed trustee for some purposes, UMB was still a fiduciary; it could only follow directions "made in accordance with the terms of the plan" and "not contrary to this Act," including ERISA's fiduciary provisions. 29 U.S.C. § 1103(a)(1); see FAB No. 2004-03. Moreover, UMB was not directed with respect to the valuation of participant accounts. Nor was UMB directed not to disclose its knowledge of the advisor's misconduct. "Under the terminology employed in ERISA, . . . a '[directed] trustee' remains designated a 'trustee,' though his role is qualified by the adjective 'directed.' . . . [T]he [directed] trustee retains certain

UMB fell short of meeting these stringent standards. According to the complaint and subsequent submissions, UMB knew that the investment advisor had engaged in a pattern of embezzlement with plan assets from other plan participants, and that the SEC had obtained a temporary restraining order against it for fraud. UMB itself sued the advisor for having engaged in identical improper and fraudulent transactions. But UMB said nothing to alert either the plaintiffs or the Plan's other fiduciaries (e.g., the Administrative Committee) to the danger, and instead made an independent choice to withhold material information from participants about the advisor's history of theft. UMB then exacerbated this breach by uncritically implementing the advisor's investment directives (including forged directives), and credulously accepting as true the advisor's inflated statements as to account values. This conduct prevented plaintiffs from gauging the true performance of their retirement accounts. Such conduct is not "solely in the interest of the participants and beneficiaries," nor consistent "with the care, skill, prudence and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use," see 29 U.S.C. §1104(a)(1), because no trustee can plausibly argue that directing plan assets to a known embezzler or looking the other way while the looting of plan assets is ongoing is prudent behavior. See Chao v. Merino, 452 F.3d 174, 182-85 (2d Cir. 2006) (holding a fiduciary liable for giving a known embezzler access to plan assets after the embezzler had stolen from the plan on three prior occasions); see also Braden, 588 F.3d at 598-99; Krohn, 173 F.3d at 548; Glaziers & Glassworkers, 93 F.3d at 1181 (failure

supervising and investigative duties and . . . is still bound by the terms of the plan documents and of ERISA and cannot escape its fiduciary or statutory obligations to the plan participants and beneficiaries." In re Enron Corp. Securities, Derivative & ERISA Litig., 284 F.Supp.2d 511, 590 (S.D. Tex. 2003).

to disclose cases). Indeed, "had [p]laintiffs known of the actions complained of by Dr. Nicholas Lopez, they would have stopped doing business with William C. Davis and the Continental Capital Entities." Complaint ¶ 24(e); see also id. ¶¶ 29, 36. Therefore, defendant's inattention to, and apparent complicity in, such a predictably ruinous chain of events is wholly incompatible with its obligations as a plan fiduciary under section 404(a) of ERISA.[7]

B. ERISA's 404(c) Safe Harbor Defense Is Not Available To UMB.

1. Section 404(c) provides, in relevant part, 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 the account (as determined under regulations of the Secretary [of Labor] –
>
> (A) such participant or beneficiary shall not be deemed to be a fiduciary by reason of such exercise, and
>
> (B) no person who is otherwise a fiduciary shall be liable under this [Title of ERISA] for any loss, or by reason of any breach, which results from such participant's or beneficiary's exercise of control.

29 U.S.C. § 1104(c)(1). The section 404(c) defense to fiduciary liability, therefore, is limited to circumstances where (1) the participant or beneficiary has an individual account plan that permits the exercise of control over the plan assets in the account, (2) the participant or beneficiary actually exercises such control, and (3) any loss or harm caused by imprudence "results from such participant's or beneficiary's exercise of control." The defense is unavailable

[7] Additionally, UMB should have notified its co-fiduciary (i.e., members of the Plan's Administrative Committee) of the grave danger to the plaintiffs' accounts posed by the advisor's misconduct. The governing plan document permitted the Administrative Committee to "establish reasonable rules limiting the investment discretion of a Participant, specifically including restricting the investments to specific investments or a range of specified investments, and limiting the times at which investments may be made." Plan Document, § 8.11. If UMB had alerted the Committee to the advisor's prior embezzlement of plan assets, the Committee could have made informed decisions about whether to preclude or limit participants' discretion to invest through the advisor. Instead, UMB's evident failure to give the Committee appropriate notice of the prior embezzlement prevented the Committee from taking action to protect the Plan's participants, thus contributing to the circumstances leading to the plaintiffs' losses.

where any of these conditions is unmet. As explained below, the defense is unavailable here because the plaintiffs, by virtue of UMB's fiduciary breaches, were deprived of the opportunity to exercise informed, independent control over their individual account plans, and because the resulting losses were consequently caused by UMB's breaches rather than by the plaintiffs' own exercises of control.

The regulations issued by the Secretary pursuant to the statutory grant of regulatory authority implement the section 404(c) requirements. They provide that section 404(c) applies only to an "ERISA section 404(c) plan," defined as an "individual account plan" that gives the participants both the "opportunity to exercise control" and the "opportunity to choose from a broad range of investment alternatives." 29 C.F.R. § 2550.404c-1(b).[8] According to the regulations, for a plan to qualify as a 404(c) plan that gives the participant an adequate "opportunity to exercise control," the participant must be provided "the opportunity to obtain sufficient information to make informed decisions with regard to investment alternatives available under the plan." Id. § 2550.404(c)(2)(i)(B). The regulations also enumerate a long list of mandatory disclosures that are necessary in order to provide the participant with sufficient information, including, for example, a description of an investment alternative's "risk and return characteristics." Id. § 2550.404(c)(2)(i)(B)(1(ii).

[8] An "individual account 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). The plaintiffs' plans at issue here were individual account plans. The parties appear to agree that the plan qualified as a 404(c) plan apart from the non-disclosure issues set forth in the text of this brief. Accordingly, we assume that each participant's plan was intended to operate as a 404(c) plan and otherwise met the regulatory conditions for treatment as such a plan. Nothing in this brief is intended to express any view on whether the use of a self-directed account with no limits placed on available investment options was prudent, or covered by the 404(c) safe harbor provision.

Significantly, the regulations emphasize that section 404(c) is conditioned upon the participant's exercise of "independent control in fact," and that a loss "results from" the participant's exercise of control only if the loss is "the direct and necessary result of the participant's or beneficiary's exercise of control," 29 C.F.R. § 2550.404c-1(c)(1)(i); id. § 2550.404c-1(d)(2)(i). Whether a participant has, in fact, exercised independent control "depends on the facts and circumstances of a particular case." Id. § 2550.404c-1(c)(2). [9]

2. Under the facts and circumstances of this case, the plaintiffs did not exercise independent control, and their losses were not "the direct and necessary result of" their exercise of control as participants. The plaintiffs allege that UMB knew as early as 1998 that their investment advisor engaged in inappropriate activity with plan assets, and that in 1999 the SEC had entered a temporary restraining order against it for securities violations. The plaintiffs further allege that UMB itself sued the advisor for misappropriating other ERISA plan assets. UMB, however, continued to follow directions from the investment advisor, executed forged directives, and uncritically accepted and transmitted in account statements their false representations on account values, without alerting the plaintiffs to the risk to which their plan assets were unwittingly exposed.

As we argue above, this course of conduct – a mix of disclosure, plan administration and asset management violations – adds up to multiple fiduciary breaches that were in no sense the result of the plaintiffs' own exercise of control over their investment accounts. Section 404(c) does not relieve from liability a fiduciary that withholds material nonpublic information that

[9] The Secretary's interpretation of section 404(c), as expressed in the regulations, is entitled to controlling deference under Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc., 467 U.S. 837, 842-43 (1984), and United States v. Mead Corp., 533 U.S. 218, 229-30 (2001). The Secretary's interpretation of her regulations, as expressed in this brief, is similarly entitled to controlling deference under Auer v. Robbins, 519 U.S. 452, 462 (1997).

could be crucial to participants' investment decisions or financial planning, or that processes fraudulent transactions by an advisor without the knowledge or informed participation of the participants, or that provides them with wildly overstated account information. Had UMB informed the plaintiffs of the advisor's history of embezzlement, been vigilant about handling investment instructions (some of which were fraudulent), and provided accurate account balances, then it might have satisfied the criteria for section 404(c) treatment if the plaintiffs incurred losses from continued investments through the advisor. However, as UMB withheld this information, forwarded plan assets to an embezzler and forger, and uncritically accepted and reported overvalued account balances to the plaintiffs, the participants were deprived of the opportunity to make informed investment decisions, rendering the 404(c) safe harbor provision inapplicable in this case. The plaintiffs' losses, therefore, were not a "direct and necessary" consequence of the plaintiffs' independent actions or informed decisions.

The section 404(c) regulations do not anticipate every circumstance in which participants may lose independent control in fact over their individual account assets, nor provide a laundry list of actions for which a fiduciary will continue to be held accountable. But it is specific that a participant is incapable of exercising independent control in fact if "a plan fiduciary has concealed material non-public facts regarding the investment from the participant or beneficiary, unless the disclosure of such information by the plan fiduciary to the participant or beneficiary would violate any provision of federal law or any provision of state law which is not preempted by the Act." Id. § 2550.404c-1(c)(2). Material facts are defined in the law as those that create a "substantial likelihood that [they] would mislead a reasonable employee in making an adequately informed retirement decision." Howath v. Keystone Health Plan East, Inc., 333 F.3d 450, 461-462 (3d Cir. 2003). "Concealment" is defined as "[a] withholding of something which one knows and which one, in duty, is bound to reveal." Burke v. Bodewes, 250 F.Supp.2d 262, 267 (W.D.N.Y. 2003) (quoting Caputo v. Pfizer, Inc., 267 F.3d 181, 189 (2d Cir. 2001)).

UMB's concealment of the advisor's history of embezzlement rendered the plaintiffs incapable of exercising "independent control in fact" over their accounts. In accordance with UMB's duties of prudence and loyalty, it was legally obligated to reveal what it knew about the investment advisor's embezzlement history. Given this past history, the most critical risk in this case – about which the 404(c) regulations require disclosure – was the undisclosed risk of fraud and embezzlement by the investment advisor.[10] Yet, UMB failed to disclose any information which would reveal "sufficient information" upon which the plaintiffs could make an informed decision, even though UMB, through its prior experience with another Plan participant, knew of the advisors' past wrongdoings.[11] UMB could not have reasonably assumed that the plaintiffs had any inkling of their advisor's history of embezzling plan assets from other participants, especially given their ongoing reliance on the advisor to make investments and administer or

[10] Concealment of a known investment risk involving use of a particular investment advisor is analytically no different than the imprudent selection and offering of imprudent investment alternatives by a fiduciary. The Secretary has consistently argued in amicus briefs in other cases that the act of designating investment alternatives in a participant-directed plan is a fiduciary activity to which the 404(c) defense does not apply. As the Department noted in the preamble to the 404(c) regulations, "[a]ll 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). When a plan fiduciary imprudently maintains a fund on the plan investment menu, the fiduciary retains liability for the inclusion of the fund, which should not have been on the menu in the first place. In such cases, the losses are not the direct and necessary result of the plan participants' actions, but rather of the fiduciaries' breach of duty in maintaining an imprudent framework for participant-directed investments. Id. at 46,922 n.27 (noting that the fiduciary act of making a plan investment option available is not "a direct or necessary result of any participant direction," as the regulations, at 29 C.F.R. § 2550.404c-1(d)(2), require for the 404(c) safe harbor to apply).

[11] There is no argument that disclosure of this information to the plaintiffs would have violated "any provision of federal law or any provision of state law which is not preempted by the Act." 29 C.F.R. § 2550.404c-1(c)(2).

control plan assets on their behalf even as the true value of their accounts, unknown to them, dwindled due to the advisor's conduct. Accordingly, the ensuing losses incurred by the plaintiffs should have been foreseeable by UMB. Contrary to the district court's analysis, 640 F.Supp.2d at 979, sufficient information and vital facts necessary to make informed decisions were concealed from the plaintiffs as a result of fiduciary misconduct.

So too, on these facts and circumstances, by providing inaccurate account valuations, UMB's own actions created a substantial likelihood that the plaintiffs were being misled into making bad investment decisions. See 29 U.S.C. § 1025(a)(1)(A)(i) (requiring plan fiduciaries to provide "at least once each calendar year to a participant who has the right to direct the investment of assets in his or her account" a "pension benefit statement"); see also Varity Corp., 516 U.S. at 502-503 ("[C]onveying information about the likely future of plan benefits, thereby permitting beneficiaries to make an informed choice about continued participation, would seem to be an exercise of a power 'appropriate' to carrying out an important plan purpose. After all, ERISA itself specifically requires administrators to give beneficiaries certain information about the plan. See, *e.g.*, ERISA §§ 102, 104(b)(1), 105(a)."). At best, UMB simply passed on valuations supplied by the investment advisor whose trustworthiness and honesty UMB had every reason to suspect, thereby depriving the plaintiffs of the control they thought they had over their accounts and compounding their losses. Thus, UMB's concealment of the advisor's history of embezzlement, together with the provision to the plaintiffs of grossly inflated account statements, deprived the plaintiffs of any meaningful opportunity to "exercise control" over plan assets. Consequently, not only did the losses not "result from" the plaintiffs' exercise of control, but fundamentally the conditions for retaining "404(c) plan" status – a necessary prerequisite to invoking the section 404(c) defense – were not even met. See 29 C.F.R. §§ 2550.404(c)(1)(i), 2550.404(c)(2), and 2550.404(d)(2)(i).

The plaintiffs thus could not in any meaningful sense be considered responsible for their own losses, or even have been parties to transactions in which UMB unquestioningly executed forged directives from the investment advisor. The losses in the alleged circumstances necessarily flowed from the actions and discretionary choices of UMB in violation of its duties as a plan fiduciary, not from the actions of the plan participants. Accordingly, the 404(c) defense is unavailable to UMB.

3. The district court found support for its view that UMB was relieved from fiduciary liability in one of the examples set forth in the regulations. The example reads, in pertinent part:

> Participant P instructs plan fiduciary F to appoint G as his investment manager pursuant to the terms of the plan which provide total discretion in choosing an investment manager. Through G's imprudence, G incurs losses in managing P's account . . . Plan fiduciary F has no fiduciary liability for G's imprudence because F has no obligation to advise P [citing paragraph (c)(4) which states that fiduciaries of 404(c) plans are not obligated to render investment advice] . . .

29 C.F.R. § 2550.404c-1(f)(9). The district court additionally cited plaintiffs' execution of documents entitled "Designation of Agent for an IDA [individually directed account]" as evidence that the plaintiffs willingly designated their investment advisor and thus satisfied the regulatory requirements for a 404(c) plan. The court's analysis, however, misinterprets the import and applicability of the regulatory example (as well as the designations), which is not apt to the question presented here. See p. 22, n.9 (Secretary's interpretation of own regulation, as expressed in brief, is entitled to highest deference).

The regulatory example does not contain the salient facts of this case, and is not intended to address them. The question presented by the example is whether the fiduciary can be held liable for losses caused solely by the misconduct of another fiduciary. However, the distinct question presented here is whether UMB can be held liable for its own misconduct, in circumstances where it failed to disclose critical information about the investment advisor to plan participants and other fiduciaries, failed to exercise diligence and care in its dealings with the investment advisor, and imprudently overvalued the participants' accounts.[12] If the plaintiffs merely sought to hold UMB liable for their own independent selection of an investment advisor or that advisor's entirely independent imprudence, the example and the IDA designations would be relevant. But the plaintiffs instead allege that UMB was complicit in the advisor's egregious, indeed criminal, wrongdoing. Unlike the example mistakenly relied on by the district court, UMB's fiduciary breaches defeated the Plan's status as a 404(c) plan, deprived the participants of the information they needed to exercise independent control, and caused losses to the plaintiffs' plan accounts.

Thus, as we have argued throughout this brief, the losses in this case cannot be fairly attributed to the participants because: (1) they were deprived of material information regarding the advisor's past misconduct and the true values of their accounts upon which they could make informed investment decisions and (2) because they were not privy to fraudulent transactions that UMB enabled the advisor to consummate through its administration of the plan accounts. Having persistently looked the other way in the face of continual wrongdoing by the investment advisor, UMB cannot hide behind section 404(c) to attribute the losses to the plaintiffs' conduct,

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[12] Under the regulations, UMB did not have an obligation to provide investment advice to plan participants. See 29 CFR § 2550.404c-1(f) – Example (9); DOL Advisory Opinion 2005-23A (available at http://www.dol.gov/ebsa/regs/AOs_2005-23A). The duty of prudence, however, consistently mandates that UMB had, at all times, a duty to disclose the chosen advisor's prior history of embezzlement and fraud with other participants' plan assets, to handle investment orders with the skill and care expected of a fiduciary, and to independently confirm the account values rather than simply transmit those provided by a known embezzler. Nothing in the regulations relieved UMB of those obligations.

rather than to its own misconduct. Nothing in section 404(c) or elsewhere in ERISA immunizes UMB from liability for such misconduct. Indeed, the stringent duties imposed on fiduciaries, and the corresponding participant rights to protection from mismanagement and dissipation of plan assets, provided by section 404(a) and implicit in the careful statutory and regulatory limitations on the safe harbor provided by section 404(c), would be a dead letter in many cases if the district court's overbroad construction of the 404(c) defense is upheld under the egregious facts and circumstances of this case.

CONCLUSION

For the foregoing reasons, the judgment of the district court should be reversed.

Respectfully submitted,

M. PATRICIA SMITH
Solicitor of Labor

TIMOTHY D. HAUSER
Associate Solicitor
Plan Benefits Security Division

NATHANIEL I. SPILLER
Counsel for Appellate and Special Litigation

/s/ Jamila B. Minnicks
JAMILA MINNICKS
Trial Attorney
U.S. Department of Labor
Room N-4611
200 Constitution Ave., N.W.
Washington, D.C. 20210
(202) 693-5522

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CERTIFICATE OF COMPLIANCE
WITH FED. R. APP. P. 32(A)(7)(B)

I certify that the foregoing brief complies with the type-volume limitation set forth in Fed. R. App. P. 32(a) (7) (B) (i). The brief contains 6,916 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a) (7) (B) (iii). The brief was prepared by using Microsoft Office Word, 2003 edition.

Dated: April 15, 2010

/s/ Jamila B. Minnicks
Jamila Minnicks
Trial Attorney

CERTIFICATE OF SERVICE

I hereby certify that on April 15, 2010, I electronically filed the forgoing with the Clerk of the Court for the United States Court of Appeals for the Sixth Circuit by using the appellate CM/ECF system.

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/s/ Jamila B. Minnicks
Jamila Minnicks
Trial Attorney