Case No. 17-1711

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIRST CIRCUIT

BROTHERSTON, *et al.*,
Plaintiffs-Appellants,

v.

PUTNAM INVESTMENTS, LLC, *et al.*,
Defendants-Appellees.

Appeal from a Decision of the United States District Court for the District of Massachusetts, Honorable William G. Young, Case No. 15-13825-WGY

BRIEF OF AMICUS CURIAE THE INVESTMENT COMPANY INSTITUTE IN FAVOR OF AFFIRMANCE IN SUPPORT OF DEFENDANTS-APPELLEES

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Dated: January 17, 2018

/s/Sarah M. Adams
Sarah M. Adams

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INTERESTS OF AMICUS CURIAE[1]

The Investment Company Institute ("ICI") is the leading association representing regulated funds globally, including mutual funds, exchange-traded funds, closed-end funds, and unit investment trusts in the United States, and similar funds offered to investors in jurisdictions worldwide. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. ICI's members manage total assets of $21.5 trillion in the United States, serving more than 100 million United States shareholders, and $7.1 trillion in assets in other jurisdictions. ICI carries out its international work through ICI Global, with offices in London, Hong Kong, and Washington, DC.

ICI serves as a source for statistical data on the investment company industry and conducts public policy research on fund industry trends, shareholder characteristics, the industry's role in United States and international financial markets, and the retirement market. For example, ICI publishes reports focusing on the overall United States retirement market, fees and expenses, and the behavior

[1] The Investment Company Institute certifies that no party or party's counsel authored this brief in whole or in part, or contributed money that was intended to fund the brief's preparation or submission, and further certifies that no person, other than the Investment Company Institute, contributed money intended to fund preparation or submission of this brief. *See* Fed. R. App. P. 29(a)(4)(E). Counsel for all parties have consented to the filing of this brief.

of defined contribution plan participants and IRA investors. In its research on mutual fund investors, IRA owners, and 401(k) plan participants, ICI conducts periodic household surveys that seek to gauge investor opinion on retirement investing.

Many of the institutions facing litigation for offering their proprietary investment products in their in-house retirement plans are ICI members. Those members who have not been sued operate under growing uncertainty as plaintiffs continue to bring new suits attacking this routine and expected practice. ICI's members have an interest in protecting their ability to provide their employees with the benefits of investing in their own investment products. ICI submits this brief as *amicus curiae* to assist the Court in putting the use of proprietary mutual funds in its appropriate historical and present-day context and to explain why, against this carefully-crafted legislative and regulatory backdrop, the Court should not construct a new burden-shifting rule that is in contravention of Congressional intent.

ARGUMENT

For decades—indeed, since before the Employee Retirement Income Security Act of 1974 ("ERISA") was enacted—mutual fund companies and their affiliated financial institutions have made the mutual funds they offer to the public available to participants in the retirement plans they provide their own employees.

This is unsurprising and for good reason. Congress recognized that "it would be contrary to normal business practices to require the plan" of a financial institution to use products from its competitors rather than "from the employer that maintains the plan." *See* H.R. Conf. Rep. No. 93–1280 (1974), as reprinted in 1974 U.S.C.C.A.N. 5038, 5094. Nonetheless, Plaintiffs decry Putnam's[2] participation in this typical and accepted practice as "an extreme case of fiduciary misconduct and self-dealing." Appellants' Brief, *Brotherston v. Putnam Investments, LLC*, No. 17-1711 (1st Cir. Nov. 2, 2017) ("Pls.' Br.") at 28. Nothing could be further from the truth. As Congress and the Department of Labor (the "Department") have long recognized, offering proprietary mutual funds to employees in their retirement plan is not only lawful and acceptable but also *beneficial* to participants like Plaintiffs. Indeed, prohibiting the use of proprietary mutual funds would require financial institutions either to exclude mutual funds from their plans entirely or to make available only the products of their competitors—leaving their participants without access to the very same investment products they offer to their customers.[3] For

[2] For purposes of this brief, ICI refers to Defendants-Appellees Putnam Investments, LLC, Putnam Investment Management, LLC, Putnam Investor Services, Inc., the Putnam Benefits Investment Committee, the Putnam Benefits Oversight Committee, and Robert Reynolds, collectively, as "Putnam."

[3] More than half of defined contribution plan assets are invested in mutual funds. *See* Investment Company Institute, *The US Retirement Market, Third Quarter 2017* (Dec. 2017), www.ici.org/info/ret_17_q3_data.xls (last visited Jan. 27, 2018). The widespread acceptance of mutual funds as plan investments by financial

this reason, Congress and the Department designed detailed and specific rules to accommodate this practice, and the judiciary need not impose its own burden-shifting rule that would upset this delicate balance.

I. Congress and the Department Have Facilitated the Use of Proprietary Funds for the Benefit of Plan Participants.

A. Congress Enacts ERISA's Prohibited Transaction Rules But Provides Special Treatment for Mutual Funds.

With the enactment of ERISA in 1974, financial institutions found themselves in a new era of regulation with respect to their transactions with employee benefit plans. Broadly speaking, the new statute imposed fiduciary obligations on anyone who exercised discretionary authority or control over ERISA plan assets, rendered investment advice for a fee, or had discretionary authority or responsibility in administering a plan. *See* ERISA § 3(21)(A); 29 U.S.C. § 1002(21)(A). Anyone who satisfied the fiduciary definition and failed to comply with the standards set forth in section 404 could face personal liability to make good any losses to the plan. ERISA § 409(a); 29 U.S.C. § 1109(a).

In addition to these fiduciary liability provisions, the statute delineated a series of "prohibited transactions" to address certain situations that Congress believed presented a heightened potential for abuse. *See Henry v. Champlain*

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institutions and non-financial institutions alike is well understood to be attributable to their hallmarks as professionally managed, diversified, and cost-effective means of investing.

Enters., Inc., 445 F.3d 610, 618 (2d Cir. 2006). Congress also recognized, however, that the literal terms of the transactions prohibited by section 406 would be vastly over-inclusive and would prohibit a variety of transactions that may actually be good for plan participants. For this reason, Congress included an array of statutory exemptions from section 406's prohibitions. *See At Variance with the Administrative Exemption Procedures of ERISA: A Proposed Reform*, 87 Yale L.J. 760, 760–61 (1978) ("Because many transactions fall within the Rules yet offer no opportunity for insider misconduct and, indeed, confer benefits upon plan participants, [section 408] provides for administrative variances and other exemptions from the absolute proscriptions of the Rules."). Those exemptions pertained to certain transactions with plan-affiliated financial institutions but were addressed primarily to banks and insurance companies, rather than to mutual fund companies.[4] However, Congress directed the Department to establish a procedure for granting additional exemptions in the Department's administrative discretion. ERISA § 408(a); 29 U.S.C. § 1108(a). Any such exemption must be: "(1) administratively feasible, (2) in the interests of the plan and of its participants and

[4] *See* ERISA § 408(b)(4)(A); 29 U.S.C §1108(b)(4)(A) (exempting transactions between banks and plans covering bank employees); ERISA § 408(b)(5)(A); 29 U.S.C § 1108(b)(5)(A) (exempting transactions between insurance companies and plans covering insurance company employees).

beneficiaries, and (3) protective of the rights of participants and beneficiaries of such plan." *Id*.

Although mutual fund companies were not subject to a statutory prohibited transaction exemption, there is no doubt that Congress intended to facilitate the offering of mutual funds to ERISA plans. It did so by excluding mutual fund companies from the broad definition of "fiduciary" under section 3(21)(B), 29 U.S.C. § 1002(21)(B). ERISA's legislative history indicates that Congress chose to treat mutual funds differently from other financial institutions, such as banks and insurers, because mutual funds already operated under an extensive statutory and regulatory regime. *See* H.R. Conf. Rep. 93-1280 (1974), as reprinted in 1974 U.S.C.C.A.N. 5038, 5077 ("Since mutual funds are regulated by the Investment Company Act of 1940 and, since (under the Internal Revenue Code) mutual funds must be broadly held, it is not considered necessary to apply the fiduciary rules to mutual funds merely because plans invest in their shares."); *see also* S. Rep. No. 93-383, at 95 (1973) ("Mutual funds are currently subject to substantial restrictions on transactions with affiliated persons under the Investment Company Act of 1940, and also it appears that unintended results might occur (such as preventing a trust from redeeming its mutual fund shares) if mutual funds were not excluded from these definitions.").

B. ICI Obtains Prohibited Transaction Exemption 77-3, Allowing Investment Companies' Plans to Invest in Proprietary Mutual Funds.

Despite the special exception under the ERISA fiduciary definition for mutual funds managing mutual fund assets, there was concern on the part of ICI's members that their use of proprietary funds in their in-house plans could be considered to result in a delineated prohibited transaction, for which section 408 provided no statutory exemption. For this reason, ICI applied to the Department for a class exemption allowing the retirement plans of investment companies and their affiliates to invest in proprietary mutual funds. *See* Pendency of Proposed Class Exemption Involving Mutual Fund In-House Plans Requested by the Investment Company Institute, 41 Fed. Reg. 54080 (Dec. 10, 1976). ICI noted that the practice was already widespread in the industry: "[i]n most instances" mutual fund organizations' "in-house employee benefit plans invest . . . in whole or in part in shares of one or more of the mutual funds in the fund organization." *Id.* at 54081. Denial of its application, ICI observed, would result in the oddity that "a plan covering employees of a firm specializing in investment management could not invest in the very investment vehicle managed by that firm, thus creating problems of employee morale." *Id.* ICI further explained that the class of transactions for which it was requesting an exemption was similar to those involving the investment in banks or purchases of insurance from institutions

whose employees are covered by the plan, as permitted by sections 408(b)(4)(A) and 408(b)(5)(A). *Id*.

ICI's application was uncontroversial: *everyone* who submitted comments to the Department regarding the proposed rule supported its issuance. *See* Class Exemption Involving Mutual Fund In-House Plans Requested by the Investment Company Institute ("PTE 77-3"), 42 Fed. Reg. 18734, 18734 (Apr. 8, 1977) (observing that "all [comments] express[ed] support for the grant of the exemption"). The Department agreed with ICI and issued Prohibited Transaction Exemption ("PTE") 77-3. *Id*. In granting ICI's application, the Department necessarily determined that the exemption satisfied the "burdensome procedures" set forth in section 408(a), *see Nat'l Sec. Sys., Inc. v. Iola*, 700 F.3d 65, 94 (3d Cir. 2012), explicitly finding that allowing the use of proprietary mutual funds was "administratively feasible; . . . in the interests of plans and of their participants and beneficiaries; [and] . . . protective of the rights of participants and beneficiaries." PTE 77-3, 42 Fed. Reg. at 18734. To protect the rights of plan participants, PTE 77-3 requires that four conditions be met: (1) the plan must not pay a sales commission; (2) the plan must not pay a redemption fee other than to the mutual fund itself; (3) the plan must not pay a separate investment management fee, investment advisory fee, or any similar fee; and (4) "[a]ll other dealings between the plan and the investment company [and its affiliates] are on a basis no less

favorable to the plan than such dealings are with other shareholders of the investment company." *Id.*. The district court concluded that the requirements of PTE 77-3 were satisfied. *Brotherston v. Putnam Invs., LLC*, No. 15-13825, 2017 WL 1196648, at *8–10 (D. Mass. Mar. 30, 2017).

In PTE 77-3 and repeatedly over the ensuing years, the Department has recognized that, as with the exemptions for banks and insurance companies upon which PTE 77-3 was modeled,[5] "it would be contrary to normal business practice for a company whose business is financial management to seek financial management services from a competitor." Participant Directed Individual Account Plans, 56 Fed. Reg. 10724-01, 10730 (Mar. 31, 1991) (acknowledging that the Department recognized this principle in both PTE 77-3 and PTE 82-63[6] and applying the same principle to exempt "in-house plans of financial institutions" from certain requirements related to participant-directed investments). Courts too have recognized that financial institutions offering their own mutual funds to their

[5] *See* Class Exemption for Securities Transactions Involving Employee Benefit Plans and Broker-Dealers, 51 Fed. Reg. 41686-01 (Nov. 18, 1986).

[6] PTE 82-63 provided an exemption allowing benefit plans, including financial institutions' in-house plans, to engage affiliated parties in securities lending. *See* Class Exemption To Permit Payment of Compensation To Plan Fiduciaries for the Provision of Securities Lending Services, 47 Fed. Reg. 14804-01, 14806 n.5 (Apr. 6, 1982) (relying on PTE 77-3). PTE 82-63 has since been subsumed into PTE 2006-16. *See* Class Exemption To Permit Certain Loans of Securities by Employee Benefit Plans, 71 Fed. Reg. 63786-01 (Oct. 31, 2006).

employees' retirement plans constitute a category of "transactions the DOL finds *non-abusive*." *In re Regions Morgan Keegan ERISA Litig.*, 692 F. Supp. 2d 944, 959 (W.D. Tenn. 2010) (emphasis added); *see also David v. Alphin*, 817 F. Supp. 2d 764, 777 n.9 (W.D.N.C. 2011), *aff'd*, 704 F.3d 327 (4th Cir. 2013) ("The court notes that there is no blanket prohibition on employers including proprietary funds in a 401(k) plan offered to employees.").

On the same day the Department issued PTE 77-3, it issued a companion exemption, PTE 77-4, allowing plans to invest in mutual funds for which the plans' investment manager also serves as the mutual funds' investment adviser. *See* Class Exemption for Certain Transactions Between Investment Companies and Employee Benefit Plans ("PTE 77-4"), 42 Fed. Reg. 18732 (Apr. 8, 1977).[7]

Together, the exemption from fiduciary status under section 3(21)(B), the statutory exemptions contained in section 408(b) for financial institutions, and the

[7] The applicants noted that the exemption in PTE 77-4 was "similar to transactions involving the purchase . . . by plans of interests in bank collective trusts and insurance company pooled investment funds, which . . . are exempt . . . pursuant to section 408(b)(8)." *See* Notice of Pendency of Proposed Class Exemption Requested by T. Rowe Price Associates, Inc., et al., 41 Fed. Reg. 50516-01 (Nov. 16, 1976). Similar to Congress' reasoning in enacting the exemptions in sections 408(b)(4)(A) and (b)(5)(A)—on which PTE 77-3 was modeled—section 408(b)(8) "was enacted to allow 'banks, trust companies and insurance companies' to continue their 'common practice' of investing their plans' assets in their own pooled investment funds." *Dupree v. Prudential Ins. Co. of Am.*, No. 99-CIV-8337, 2007 WL 2263892, at *41 (S.D. Fla. Aug. 7, 2007), *as amended* (Aug. 10, 2007) (citing H.R. Conf. Rep. No. 93–1280 (1974))

prohibited transaction exemptions issued by the Department, along with their interpretive caselaw, reflect the reasoned judgment by all three branches of government that the use of proprietary products, including mutual funds, is acceptable and even beneficial to plan participants.

C. Use of Proprietary Funds Continues to Be Widespread and Beneficial to Plan Participants.

By the time ICI applied for PTE 77-3, most in-house plans of investment companies and their affiliates were invested in proprietary funds. 41 Fed. Reg. at 54081; William M. Tartikoff, *Treatment of Mutual Funds Under ERISA*, 1979 Duke L.J. 577, 582 (1979) ("It is common practice for a mutual fund complex to fund an employee benefit plan covering its own employees with shares of one or more mutual funds within the complex."). The same is true today. The District Court correctly observed that the Putnam Retirement Plan's inclusion of Putnam-affiliated mutual funds is a "practice[] . . . common within the industry." *Brotherston v. Putnam Invs., LLC*, No. CV 15-1382-WGY, 2017 WL 2634361, at *8 (D. Mass. June 19, 2017); *see also* Colleen E. Medill, *Stock Market Volatility and 401(k) Plans*, 34 U. Mich. J.L. Reform 469, 506 (2001) ("As a result [of the Department issuing PTE 77-3], this practice continues to be widespread among employers in the financial services industry."). The very fact that the plaintiffs' bar has brought dozens of proprietary fund lawsuits in the last few years demonstrates that Plaintiffs attack a practice that is routine in the industry. In

short, mutual fund companies are—appropriately—engaging in the same Department-approved practice they have followed for years.

That this practice is now being challenged purportedly to vindicate the interests of plan participants is profoundly unfortunate considering that investment companies and their affiliates tend to offer very generous retirement packages to their plan participants, and prohibiting the use of proprietary mutual funds would make this more difficult. Indeed, large mutual fund companies[8] are significantly more likely to offer employer contributions in their 401(k) plans than are other employers, and they are also more likely to offer automatic contributions. For example, in 2015, Putnam contributed 5 percent of employee compensation to participants' 401(k) accounts, in addition to matching participant contributions of up to 5 percent. J.A. 4845.[9] Putnam's employer contribution rate is more than double the average employer contribution rate, putting Putnam's plan in the top 5 percent of all large 401(k) plans offering employer contributions.[10]

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[8] Based on a sample of ICI's 20 largest members.

[9] The parties' Joint Appendix is cited herein as "J.A."

[10] Tabulations are based on a random sample of 2,583 large 401(k) plans (plans with at least $1 million in assets and typically 100 participants or more) filing a 2015 Form 5500 with detailed information on employer contributions. (Among large 401(k) plans, nearly 90 percent offer employer contributions, and approximately three-quarters of those plans provide detailed information on the structure of their contribution formulas in their Form 5500 audited report.)

The Department's judgment that PTE 77-3 would be "in the interests of plans and of their participants and beneficiaries," PTE 77-3, 42 Fed. Reg. at 18734, was borne out in this case. As the District Court observed, Putnam's discretionary contributions have been particularly generous. *Brotherston*, 2017 WL 1196648, at *9 (noting that "Putnam made a total of $69.98 million in voluntary payments to Plan participants,"[11] and concluding that Plaintiffs would "be unjustly enriched" by further awards). In addition to its substantial discretionary contributions, Putnam directly paid the recordkeeping fees for its participants, which it was under no obligation to do.[12] *See Loomis v. Exelon Corp.*, 658 F.3d 667, 671 (7th Cir. 2011). In many plans, these recordkeeping fees are paid directly by plan participants. Putnam refrained from charging the participants the usual sales commissions, as required by PTE 77-3(c). *See Brotherston*, 2017 WL 1196648, at *8 (indicating that "Plaintiffs challenge only PTE 77-3(d)"). It of course received a fee for

[11] Putnam contributed $116,391.82 to Mr. Brotherston's Plan account and $207,501.19 to Ms. Glancy's Plan account. J.A. 495-96.

[12] The fact that the plan's investment in Putnam's mutual funds did not generate revenue sharing does not detract from the generous retirement plan offered to participants. Typically, revenue sharing is used to cover or reduce a plan's recordkeeping fees. Nothing in ERISA required Putnam to invest in mutual funds that generate revenue sharing back to its own retirement plan, particularly in the instance where Putnam had already covered the recordkeeping fees on the front end.

managing the fund—the same fee it receives when offering the fund to the public, as expressly permitted by PTE 77-3.

Against this backdrop, it is wholly expected and rational that financial institutions like Putnam would offer their own funds to their employees. When The Prudential Insurance Company of America faced a similar challenge to its use of proprietary funds, the court found after examining all the facts at trial that the benefits of offering proprietary products included the plan fiduciaries' personal familiarity with the investment managers overseeing the funds, which gave fiduciaries an increased level of confidence in their products. *Dupree*, 2007 WL 2263892, at *10. In addition, affiliated fund managers were easier to communicate with, providing a level of service and responsiveness that outside fund managers could not. *Id*. Here, too, the plan fiduciaries have intimate knowledge of the products they offer the participants. The senior investment professionals who have day-to-day responsibility for monitoring the Putnam funds are among those fiduciaries. J.A. at 2203-04. In addition, the plan fiduciaries who are not investment professionals interact with individuals on the fund management side on a daily basis. *Id*. at 2027-30, 2125. Offering plan participants the benefit of their own colleagues' knowledge and expertise is an advantage to plan participants, not an ERISA violation.

In addition, it would be nonsensical to require the fiduciaries of a mutual fund company's retirement plan to sift through the more than 9,000 different mutual funds offered by its competitors when the products it knows best are right in front of them. As the Seventh Circuit explained in *Hecker v. Deere & Co.*, "nothing in ERISA requires every fiduciary to scour the market to find and offer the cheapest possible fund (which might, of course, be plagued by other problems)." 556 F.3d 575, 586 (7th Cir. 2009). If the fiduciaries of a plan whose participants manufacture widgets do not need to scour the marketplace in such a manner, then surely neither do the fiduciaries of a plan whose participants operate the very type of investment the plan seeks.

This is particularly true considering that Putnam funds are frequently selected as investment options by the fiduciaries of a multitude of comparable plans not affiliated with Putnam. Under ERISA's statutory standard, fiduciaries are judged by reference to what other fiduciaries in similar situations would do. *See* ERISA § 404(a)(1)(B); 29 U.S.C. § 1104(a)(1)(B) (requiring a fiduciary to 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"); *Fifth Third Bancorp v. Dudenhoeffer*, 134 S. Ct. 2459, 2472 (2014). Putnam's employees deserve the opportunity to invest in the funds they operate

and support every day—and that participants in many other plans are permitted to utilize—rather than being forced into the funds of their competitors. *See* 41 Fed. Reg. at 54081 (noting the morale issues such a rule would raise).[13]

II. Use of Proprietary Funds Does Not Shift the Burden of Proof.

A. Shifting the Burden of Proof on Duty of Loyalty Claims Would Run Contrary to ERISA and Disregard the Treatment Approved by Congress.

In designing the carefully-tailored prohibited transaction and exemption structure, Congress and the Department in their discretion struck a balance between protecting participants when fiduciaries engage in certain potentially risky transactions and allowing them to benefit when those transactions may be advantageous. They delineated certain categories of transactions as *per se* prohibited under section 406 but then provided specific exemptions for situations

[13] The Securities and Exchange Commission ("SEC") recognized a similar rationale in encouraging investment companies to sell their mutual funds to their own employees and their benefit plans by permitting them to reduce or eliminate certain sales charges that would otherwise apply. *See* Variations in Sales Load Permitted for Certain Sales of Redeemable Securities, 23 Fed. Reg. 9601, 9602 (Dec. 11, 1958) ("[Codifying] the exemption[] . . . which the Commission has granted in the past with respect to sales for investment purposes at a reduced load or no load to officers, directors, partners and employees of an investment company, its principal underwriter and investment advisor, and to the trustees of qualified pension and profit-sharing plans for the benefit of such persons. . . . [S]uch sales serve legitimate corporate purposes by promoting employee incentive and good will, and . . . experience has shown that, with proper safeguards, no adverse effects upon the interest of investors would result."). The SEC now permits reduced or eliminated sales charges on a more wide-ranging basis. *See* 17 C.F.R. § 270.22d-1.

where the imposition of blanket prohibitions "would be contrary to normal business practice[s] . . . ." 56 Fed. Reg. at 10724-01)

As noted in Section I above, Congress and the Department have made important accommodations to allow plans of financial institutions to invest in their own products. Despite Congress' clear declaration that exempt transactions are not illegal, Plaintiffs attempt an end run around the purpose of the exemptions by arguing that participants should be relieved of their burden to prove fiduciary breach claims any time an allegation of conflict arises, even where the transaction fits neatly into the Department's exemption. Pls.' Br. at 41. ("Fiduciaries who engage in self-interested transactions bear the burden of proving they fulfilled their duties of loyalty and care[.]"). This argument is as untenable as it is unsupported.

First, shifting the burden whenever a plaintiff can identify a potential conflict would sweep in a vast array of everyday situations that pose no remarkable risk to plan participants. The Supreme Court has held that, unlike under trust law, an ERISA fiduciary "may have financial interests adverse to beneficiaries. Employers, for example, can be ERISA fiduciaries and still take actions to the disadvantage of employee beneficiaries, when they act as employers (e.g., firing a beneficiary for reasons unrelated to the ERISA plan), or even as plan sponsors (e.g., modifying the terms of a plan as allowed by ERISA to provide less generous benefits)." *Pegram v. Herdrich*, 530 U.S. 211, 225 (2000). An ERISA fiduciary

may thus wear "two hats"—one while acting in furtherance of the employer's business interests and one while pursuing the best interests of the plan participants. As this Court has aptly observed, "This conflict is, in many respects, an inherent feature of ERISA." *Vartanian v. Monsanto Co.*, 131 F.3d 264, 268 (1997). This inherent conflict means that a typical in-house ERISA fiduciary routinely operates under dual loyalties. Though the fiduciary may be liable if it fails to act in the best interest of participants while wearing its fiduciary hat, nothing in ERISA suggests that the burden should shift to the fiduciary every time a plaintiff identifies competing interests. *See Dupree*, 2007 WL 2263892, at *45 ("Simply because Prudential followed such a practice-the very result Congress intended to approve by enacting the § 408(b) exemptions-does not give rise to an inference of disloyalty, especially where these practices are universal among plans of the financial services industry.").

Shifting the burden in the manner Plaintiffs suggests would be a radical departure from the "two hats" doctrine, so it is unsurprising that Plaintiffs can cite no case supporting the idea. The best they come up with is the Ninth Circuit's decision in *Howard v. Shay*, 100 F.3d 1484, 1488 (9th Cir. 1996). Pls.' Br. at 41. When discussing the shifting burden, however, the court made clear that it was doing so in the context of the prohibited transaction claims at issue in the case, not the general fiduciary duty. *Howard*, 100 F.3d at 1488 (explaining that a "fiduciary

who engages in a self-dealing transaction *pursuant to 29 U.S.C. § 1108(e)* has the burden of proving that he fulfilled his duties of care and loyalty . . . .") (emphasis added).[14] As the Ninth Circuit has explained, "Congress never intended section 1104(a)(1) to establish a per se rule of fiduciary conduct, and no court has established such a violation." *Friend v. Sanwa Bank Cal.*, 35 F.3d 466, 469 (9th Cir. 1994) (holding that "[a] bank does not commit a per se violation of section 1104(a)(1) by the mere act of becoming a trustee with conflicting interests"). Applying the burden-shifting regime on section 404 duty of loyalty claims would be without precedent.[15]

B. The Burden of Proof Should Not Shift on Prohibited Transaction Claims.

Although some courts have held that prohibited transaction exemptions are affirmative defenses on which defendants bear the burden of proof,[16] such a view is not universal and should be rejected. *See, e.g., Leber v. Citigroup, Inc.*, No. 07

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[14] ICI submits that shifting the burden with respect to prohibit transaction claims is also incorrect. *See infra*, section II.B.

[15] Plaintiffs cite two cases suggesting that courts are obligated to "rigorously scrutinize the conduct" when dual loyalties arise. Pls.' Br. at 41 (quoting *Cunha v. Ward Foods, Inc.*, 804 F.2d 1418, 1432 (9th Cir. 1986)). Rigorous scrutiny does not equate to burden shifting, however, and *Cunha* does not even mention the idea. The discussion Plaintiffs cite, Pls.' Br. at 41, from *Niehoff v. Maynard*, 299 F.3d 41, 51 (1st Cir. 2002), pertains to equitable tolling in the Delaware Court of Chancery, not burden shifting under ERISA fiduciary standards.

[16] *See* Pls.' Br. at 73 n.15 (citing cases).

Civ. 9329 (SHS), 2010 WL 935442, at *11 (S.D.N.Y. Mar. 16, 2010) ("[A]bsent any allegation that defendants' conduct falls beyond the reach of the statutory exemption—and thus might plausibly be actionable under section 406—plaintiffs fail to state a valid claim."); *Mehling v. New York Life Ins. Co.*, 163 F. Supp. 2d 502, 510 (E.D. Pa. 2001) (dismissing prohibited transaction claims for failure to allege non-compliance with PTE 77-3). As discussed above, the prohibited transaction rules are exceptionally broad—that is why Congress enumerated exemptions. For example, section 406(a)(1)(C) prohibits any party in interest (which would include any entity that contracts with the plan) from furnishing any goods, services, or facilities to the plan. 29 U.S.C. § 1104(a)(1)(C). Without the exemption set forth in section 408(b)(2), a plan could not even contract with the recordkeeper—or even the copier repair service—that is necessary to allow the plan to function. Unless plaintiffs are required to establish facts to show that the applicable exemption does not apply, plaintiffs could pursue prohibited transaction claims for a multitude of daily actions by literally every ERISA plan in the country. Requiring plans and their fiduciaries to expend time and resources defending lawsuits without any evidence that they engaged in a transaction Congress intended to make unlawful benefits no one—least of all the plan participants—and it flies in the face of the very targeted exemption available to mutual fund companies (PTE 77-3).

In response to such arguments, certain courts have concluded that potential plaintiffs themselves will weed out unmeritorious lawsuits. *See, e.g.*, *Allen v. GreatBanc Trust Co.*, 835 F.3d 670 (7th Cir. 2016). "Why would anyone bother bringing a claim when the fiduciaries did nothing wrong?" they ask. This naïve view reflects an utter lack of understanding of the reality of class action litigation in this country and the ability of the plaintiffs' bar to extract significant settlements. *See Chadbourne & Parke LLP v. Troice*, 134 S. Ct. 1058 (2014) (acknowledging the problem of "abusive . . . class actions designed to extract settlements from defendants vulnerable to litigation costs"). In fact, the Supreme Court dealt with a similar issue in an analogous ERISA context. Recent years had seen an explosion in the number of putative class action cases alleging breaches of the fiduciary duties of loyalty and prudence when employers offered their own company's stock as an investment option in their in-house 401(k) plans and the value of that stock declined. The Supreme Court in *Dudenhoeffer* instructed lower courts to make more aggressive use of the motion to dismiss tool to weed out unmeritorious cases. 134 S. Ct. at 2471. Following *Dudenhoeffer*, plaintiffs have had a much more difficult pursuing unsupported claims that fiduciaries breached their duties when the company's stock declined.[17] If it is

[17] *See e.g.*, *Saumer v. Cliffs Nat. Res. Inc.*, No. 1:15 CV 954, 2016 WL 3355323, at *2 (N.D. Ohio June 17, 2016) ("The standards articulated in *Dudenhoeffer* make it extremely difficult for a plaintiff's prudence claim to survive a motion to

appropriate for courts to weed out unmeritorious claims related to employers offering their own stock in retirement plans they sponsor for their employees, then it should likewise be appropriate for courts to do so with respect to unmeritorious claims related to financial institutions offering their own investment products in the retirement plans they sponsor for their employees. Clearly, in the prohibited transaction context, too, courts should act to ensure that ERISA plan fiduciaries need not waste resources defending claims regarding transactions that ultimately will turn out to be exempt.

C. The Court Should Refrain from Creating Special Rules Under ERISA.

The Supreme Court has made clear that, under ERISA, it is *not* "necessary or desirable for courts to create special burden-of-proof rules" based on potential conflicts of interest or other concerns. *See Metro. Life Ins. Co. v. Glenn*, 554 U.S. 105, 116 (2008) (noting that the "lion's share" of ERISA-governed health insurance plans have the same entity acting as insurer and plan administrator); *see also Great-W. Life & Annuity Ins. Co. v. Knudson*, 534 U.S. 204, 209 (2002) ("We have observed repeatedly that ERISA is a comprehensive and reticulated statute, the product of a decade of congressional study of the Nation's private employee

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dismiss."); *Price v. Strianese*, No. 17-CV-652, 2017 WL 4466614, at *5 (S.D.N.Y. Oct. 4, 2017) ("This is a highly exacting standard that is incredibly difficult to satisfy.").

benefit system. We have therefore been especially reluctant to tamper with the enforcement scheme embodied in the statute . . . .”). Respectfully, this Court too should be reluctant to tamper with the statutory scheme established by Congress and should leave the burden of proof right where Congress laid it: on Plaintiffs.

* * *

For the reasons set forth above, ICI respectfully requests that the Court affirm the district court’s ruling in its entirety.

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Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

1. This document complies with the type-volume limitations of Fed. R. App. P. 29(a)(5) and Fed. R. App. P. 32(a)(7)(B) because the brief contains 5,512 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(f).

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CERTIFICATE OF SERVICE

I hereby certify that on January 17, 2018, I filed the foregoing Brief of Amicus Curiae The Investment Company Institute in Favor of Affirmance in Support of Defendants-Appellees with the Clerk of the United States Court of Appeals for the First Circuit via the CM/ECF system, which will send notice of such filings to all CM/ECF users including the following attorneys:

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