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

BRIEF OF *AMICI CURIAE* BUSINESS ROUNDTABLE, THE CHAMBER OF COMMERCE OF THE UNITED STATES, AND THE NATIONAL ASSOCIATION OF MANUFACTURERS IN SUPPORT OF APPELLANTS SEEKING REVERSAL OF THE RULING BELOW GRANTING CLASS CERTIFICATION

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SUPPLEMENTAL STATEMENT OF INTERESTED PARTIES

Pursuant to Rules 26.1 and 29(c) of the Federal Rules of Appellate Procedure and Rule 29.2 of the Fifth Circuit Rules, *amici curiae* state as follows:

Business Roundtable, the Chamber of Commerce of the United States, and the National Association of Manufacturers have no parent corporation, and no publicly held company owns 10% of more of their stock.

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STATEMENT OF INTEREST OF THE *AMICI CURIAE*

Business Roundtable (the "Roundtable") is an association of the chief executive officers of approximately 150 member companies with a combined workforce of more than 10 million employees in the United States and about $4 trillion in revenues. The executives who created the Roundtable believed that the U.S. economy will be healthier, there will be less unwarranted intrusion by government into business affairs, and the interest of the public will be better served if the business sector plays an active and effective role in the formation of public policy. This brief is consistent with the Roundtable's overall goal of representing the views of its membership before all branches of government on important matters of policy affecting the business sector.

The Chamber of Commerce of the United States (the "Chamber") is the world's largest business federation, representing an underlying membership of more than three million businesses and organizations of every size and in every industry sector and geographical region of the country. A principal function of the Chamber is to represent the interests of its members by filing briefs in cases implicating issues of vital concern to the nation's business community. Many of the Chamber's members are sponsors of ERISA plans, including 401(k) plans and other individual account plans in which participants exercise control over their own investment decisions. The issues in this case are of great importance to sponsors of

ERISA plans throughout the nation, particularly those that offer employer stock as an investment option.

The National Association of Manufacturers (the "NAM") is the nation's largest industrial trade association, representing small and large manufacturers in every industrial sector and in all 50 states. The NAM's mission is to enhance the competitiveness of manufacturers by shaping a legislative and regulatory environment conducive to U.S. economic growth and to increase understanding among policymakers, the media, and the general public about the vital role of manufacturing to America's economic future and living standards. Many of the NAM's members offer employer stock as an investment choice in company-sponsored, participant-directed 401(k) plans.

All parties have consented to the filing of this brief.

INTRODUCTION: 401(k) PLANS AND THE ERISA § 404(c) DEFENSE

With this case, this Court will be among the first courts of appeals to address the important legal issues presented by the wave of ERISA fiduciary breach litigation that resulted from the market downturn of 2000-2001. If permitted to proceed on the legal theories presented by plaintiffs here and accepted by the district court, these cases threaten to end, or sharply curtail, one of the most popular innovations in employee benefits of the last quarter century—the provision of company stock on a tax-favored basis through employers' 401(k) plans. Under plaintiffs' ap-

proach here, this retirement investment option that is strongly *favored* under ERISA and the tax laws would become a legally *disfavored* option that employers could provide only at the peril of costly class action litigation and perpetual uncertainty as to their obligations under ERISA. Such a result is bad law and bad policy, and directly conflicts with the ERISA provision—Section 404(c)—that explicitly protects ERISA plan fiduciaries from suit for the informed investment decisions that participants make through the self-directed, independent investment approach of 401(k) plans.

1. Employee benefit plans organized pursuant to Section 401(k) of the Internal Revenue Code represent a vital component of the retirement savings of workers in the United States. Federal law strongly favors such plans, permitting employees to accumulate savings on a tax-deferred basis until retirement. Since being established in 1978, 401(k) plans have become the fastest growing type of retirement plan in the United States. Employee Benefit Research Institute, *History of 401(k) Plans: An Update*, at 1 (Feb. 2005). Currently, some $2 trillion are invested in 401(k) pension plans. *Id.* at 3.

One of the hallmarks of the typical 401(k) plan is that participants decide how to allocate their retirement funds among various investment options. Unlike many other retirement savings vehicles, 401(k) plans ordinarily permit employees to make their own investment decisions, reflecting their respective financial cir-

cumstances and risk tolerances, from a wide and diversified menu of investment options offered by most 401(k) plans. Some participants, such as younger workers, might quite sensibly prefer a mix of investments with a relatively greater overall level of risk and projected return, whereas other participants, such as workers nearing retirement age, might find more conservative investments more attractive. The flexibility, autonomy, and control that 401(k) plans provide to participants enable such plans to meet the investment needs for millions of employees throughout the nation.

Federal law also strongly favors the inclusion of an employer stock fund as an investment option in a 401(k) plan.[1] For example, although ERISA generally requires that plan investments be diversified, the statute expressly exempts investments in "qualifying employer securities" from this requirement. ERISA

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[1] *See, e.g.*, *Foltz v. U.S. News & World Report, Inc.*, 865 F.2d 364, 373-74 (D.C. Cir. 1989) ("ERISA, far from manifesting any intention to discourage long-term employee ownership, specifically favors that pattern by exempting Employee Stock Ownership Plans from ERISA's 10 percent cap on plans' holdings of 'employer securities.'"); *Wright v. Or. Metallurgical Corp.*, 360 F.3d 1090, 1098 n.3 (9th Cir. 2004) (citing *Foltz* and applying same principles in context of stock bonus plan); Present Law and Background Relating to Employer-Sponsored Defined Contribution Plans, etc. at 22, Joint Committee on Taxation, 107th Cong. (Feb. 26, 2002) ("The provisions of the Internal Revenue Code and ERISA have facilitated and encouraged the investment of defined contribution plan assets in employer stock. . . . Thus present law reflects the view that employer stock is not only a permissible investment for defined contribution plans, but also, at least to some extent, a *favored* investment.") (emphasis added).

§ 404(a)(2), 29 U.S.C. § 1104(a)(2). *See generally* Joint Explanatory Statement of the Committee of Conference, H.R. Conf. Rep. No. 93-1280 (1974), *reprinted in* 1974 U.S.C.C.A.N. 5038, 5097. Similarly, company stock in a 401(k) plan receives special tax treatment, which allows eligible participants under certain circumstances to take an in-kind distribution of the company stock from the plan, pay ordinary income tax at the time of the distribution on just the cost basis of the stock, and then pay the lower capital gains tax on all subsequent appreciation at the time of sale, thereby significantly reducing the taxes owed. *See, e.g.*, http://content.members.fidelity.com/Inside_Fidelity/fullStory/11251,00.html. Indeed, the availability of employer stock as an investment option in 401(k) plans promotes a greater sense of employee proprietorship in a business, something that is generally beneficial for employers and employees alike.

Because investment decisions in plans of this nature are left largely in the hands of participants, ERISA provides fiduciaries with a substantive defense when a participant's account experiences a loss because of a decline in value of the investment options selected by the participant. Section 404(c) of ERISA provides in pertinent part:

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

. . .

> (B) no person who is otherwise a fiduciary shall be liable under this part for any loss, or by reason of any breach, which results from such participant's or beneficiary's exercise of control.

29 U.S.C. § 1104(c)(1).

2. In good economic times, as was the case for much of the 1990s, investment in company stock provided 401(k) plan participants with substantial retirement savings. Unfortunately, with the economic downturn of 2000-2001, numerous 401(k) plan participants saw the value of their investments in company stock fall, sometimes substantially. These losses have led to a torrent of putative class actions seeking to hold plan fiduciaries liable for the consequences of the participants' election to invest in company stock.[2] This wave of ERISA litigation in-

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[2] For example, according to the web site of the Keller Rohrback firm, counsel to the plaintiffs in this case, that firm alone is involved in ERISA class actions against AON Corporation, BellSouth, Cardinal Health, Inc., Cigna Corp., CMS Energy Corp., Conseco, Dynegy, Inc., Electronic Data Systems Corp., Enron Corp., Fujitsu America, Inc., Global Crossing Ltd., Goodyear Tire & Rubber Co., Hartford Financial Services Group, Inc., HealthSouth, Household International, Krispy Kreme Doughnuts, Inc., Lucent Technologies, Inc., Marsh & McLennan Companies, Inc., Merck & Co., Inc., Nortel, Pfizer Inc., Polaroid, Southern Company, Syncor International Corp., Tyco International Ltd., Williams Companies, Inc., WorldCom, and Xerox Corporation. *See* http://www.erisafraud.com (last visited Mar. 7, 2005).

These cases, which are based on the decline of company stock, tend to be filed virtually in tandem with securities class actions, which they closely mirror. The effect of these cases—if successful—could be that companies had greater dis-

[Footnote continued on next page]

cludes companies, like EDS here, that remain viable and successful companies whose stock continues to be actively traded. A central claim of the plaintiffs here and in those other ERISA cases is that the plan fiduciaries should have eliminated company stock as an investment option for plan participants and are thus liable for the losses resulting from the drop in value of the company stock. In certifying a class here, notwithstanding the plain text of the statute, the lower court held that "the [Section] 404(c) defense is inapplicable to shield plan fiduciaries from liability for imprudently selecting the plan's investment options and overseeing their performance." Slip op. 16. The court found it "difficult to imagine" that Section 404(c) creates a "safe haven" for fiduciaries who breach their duties in that regard, even if the losses were, in fact, caused by the participant's decisions as to how to invest the available funds among the plan's various investment alternatives. Slip op. 17. The court's ruling effectively relieves participants from the consequences

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[Footnote continued from previous page]

closure obligations toward those who acquire their stock through the company 401(k) plan than toward those who purchase it on the financial markets. In fact, however, companies should have no higher obligation of disclosure than they already have to the securities markets. *Cf. Beach v. Commonwealth Edison Co.*, 382 F.3d 656, 660 (7th Cir. 2004) (noting that there is "no reason" for ERISA to be construed to require disclosures beyond those required by corporate or securities laws); *Baker v. Kingsley*, 387 F.3d 649, 662 (7th Cir. 2004) (imposing greater disclosure obligations under ERISA would run "the risk of disturbing the carefully delineated corporate disclosure laws"). Where fraud is shown, avenues for redress abound.

of their selection of riskier investment options—here the EDS stock fund was rated a 5+ on a 5-point risk scale—and transfers the entire economic risk of loss to plan fiduciaries, whose fault in hindsight was to allow participants to make their own investment choices from among the plan's various investment alternatives.

The acceptance of that paternalistic standard will, however, make it more expensive for employers to offer investment choices, and will have the inevitable effect of narrowing the range of investment options for participants by pressuring companies to remove their own stock as investment options in 401(k) plans, notwithstanding congressional policy encouraging investment in employer stock. If plaintiffs ultimately prevail on their radical theory, they will have succeeded in using the litigation process to transform company stock from the most *favored* investment option under federal law into the most *disfavored* option.

This approach toward company stock conflicts squarely with ERISA's treatment of company stock as a favored investment option in 401(k) plans. It also imposes wholly misplaced and paternalistic obligations with respect to retirement investment accounts that are, by definition, intended to be self-directed by the plan participant, rather than closely managed by the company itself. Any loss sustained by participants in this case or the other 401(k) cases due to their investment in company stock is, of course, most unfortunate. But the risk of loss—along with the potential for gain—exists virtually any time an individual makes an autono-

mous investment decision. When plan participants knowingly allocate funds to an investment option offering higher potential returns but with a concomitantly greater risk of loss, Section 404(c) places responsibility for any losses on the participants. In other words, where a 401(k) plan provides an appropriately broad range of investment options, along with the information necessary to evaluate those options, as required by Section 404(c)'s implementing regulations, plan participants cannot complain that the fiduciaries should bear the responsibility for participants' free and voluntary investment decisions.

3. In granting interlocutory review, this Court has recognized the importance of the issues presented here, which extends far beyond the parties to this particular litigation. The outcome of this case could affect how businesses across the nation make investment options—particularly, but not exclusively, company stock—available to plan participants, as well as the types of investment choices that plan participants will be allowed to make. Although there are other issues in this case that are being addressed by the parties and/or other *amici curiae*, the Roundtable, the Chamber, and the NAM will focus on the district court's handling of the Section 404(c) defense, which goes to the very heart of the self-directed nature of 401(k) plans. The brief will address as well the releases entered into by thousands of putative class members. The district court's decision that defenses supplied by Section 404(c) and the releases do not apply, and may be ignored in

the context of a putative class action brought by plan participants in the name of a plan, threatens to strip defendants of critical substantive rights guaranteed by federal law in order to facilitate otherwise uncertifiable class actions in which individualized issues plainly predominate.

ARGUMENT

The district court certified the putative class only after holding inapplicable certain legal defenses—specifically, Section 404(c) of ERISA and the release executed by a substantial percentage of plan participants—that would plainly be available to Plan fiduciaries in individual suits by participants of the EDS 401(k) Plan. The court held, among other things, that because plaintiffs purportedly bring this case on behalf of the Plan, instead of for their individual benefit, the defendants cannot assert these defenses, which would require individual determinations that would make the case unsuitable for class certification. Slip op. 14, 17-18. Indeed, the court apparently recognized that class certification would be improper if these defenses remain in the case. *Id.* at 14 ("individual determinations of the release's applicability would defeat typicality and make this case unsuitable for class certification"). In so ruling, the court violated the Rules Enabling Act and the substantive law of ERISA. *See, e.g.*, 28 U.S.C. § 2072(b); *Ortiz v. Fibreboard Corp.*, 527 U.S. 815, 845-46 (1999) ("The Rules Enabling Act underscores the need for caution."); *Amchem Prods., Inc. v. Windsor*, 521 U.S. 591, 612-13, 620, 628-29 (1997)

("Rule 23's requirements must be interpreted in keeping with . . . the Rules Enabling Act . . . .").

As shown below, the mere fact that this case purports to be a class action on behalf of the Plan, rather than the individual participants, does not affect the availability of otherwise applicable ERISA defenses. The court's conclusion that these defenses are not available constitutes legal error and an abuse of discretion requiring reversal of that portion of the court's order granting class certification. *See Koon v. United States*, 518 U.S. 81, 100 (1996) ("A district court by definition abuses its discretion when it makes an error of law.").

I. The District Court Erred In Holding That The Section 404(c) Defense Is Inapplicable

The defendants opposed class certification because, among other things, EDS's 401(k) plan meets the criteria of Section 404(c), which expressly relieves a fiduciary from liability if the plan (1) is an "individual account plan" and (2) permits the participants to exercise control over the assets in their accounts. 29 U.S.C. § 1104(c). Under that provision and its implementing regulations, plan fiduciaries are not responsible for losses resulting from a participant's own investment decisions. *See* 29 C.F.R. § 2550.404c-1(d)(2). The district court erroneously concluded that the Section 404(c) defense was inapplicable in this case.

A. The District Court Misconstrued Section 404(c)'s Text, History, And Rationale

The district court stated that "Section 404(c) only applies to losses that 'result from' the participant's exercise of control." Slip op. 15. The court relied on a footnote from the preamble to the Department of Labor's regulation, as well as authorities citing that footnote, to conclude that "the 404(c) defense is inapplicable to shield plan fiduciaries from liability for imprudently selecting the plan's investment options and overseeing their performance." *Id.* at 16 (citing, inter alia, Final Regulation Regarding Participant Directed Individual Account Plans (ERISA Section 404(c) Plans), 57 Fed. Reg. 46,906, 46,924 n.27 (Oct. 13, 1992)). For the reasons stated in EDS' brief (Defs.' Br. 37-42), the Department's interpretation of Section 404(c)'s applicability is entitled to only such weight as its persuasiveness warrants. Given that the Department's reasoning is contrary to the text and history of Section 404(c), its view is entitled to no weight whatsoever here.

1. The district court's suggestion that Congress did not intend to provide a defense where fiduciaries have breached their duties by allowing company stock to remain an investment option in a 401(k) plan plainly misperceives Section 404(c). Inherent in any situation where Section 404(c) could apply is the fiduciary's decision to make a given investment option available, coupled with the participant's decision to allocate some or all of the funds from his or her individual account to that investment option. As the Third Circuit has explained, Section 404(c) "allows

a fiduciary, who is shown to have committed a breach of duty in making an investment decision, to argue that despite the breach, it may not be held liable because the alleged loss resulted from the participant's exercise of control." *In re Unisys Sav. Plan Litig.*, 74 F.3d 420, 445 (3d Cir. 1996). The legislative history confirms that this provision was enacted to provide a defense in precisely the circumstances presented here. As the Conference Report puts the point: "if the participant instructs the plan trustee to invest the full balance of his account in, *e.g.*, a single stock, the trustee is not liable for any loss because of a failure to diversify or *because the investment does not meet the prudent man standards*." 1974 U.S.C.C.A.N. at 5086 (emphasis added).

As the text, the legislative history, and the more persuasive judicial interpretations of Section 404(c) all show, the defense presupposes that a fiduciary has breached its duty. Otherwise, there would be no basis for fiduciary liability in the first place, and thus no need for the Section 404(c) defense. The lower court's interpretation would effectively render Section 404(c) meaningless, because there could never be a scenario in which the defense would matter. Under the lower court's approach, if a fiduciary breached his duty by selecting an imprudent investment option, the defense would not be available, and if a fiduciary did not breach his duty, then there would be no need for the defense. Such constructions, which render statutory provisions superfluous, are obviously disfavored. *See, e.g.*,

Alaska Dep't of Envtl. Conservation v. EPA, 540 U.S. 461, 489 n.13 (2004) ("It is, moreover, a cardinal principle of statutory construction that a statute ought, upon the whole, to be so construed that, if it can be prevented, no clause, sentence, or word shall be superfluous, void, or insignificant.") (internal quotation marks omitted). Any proper interpretation of Section 404(c) must acknowledge that the defense will, where it applies, shield from liability a fiduciary of a 401(k) plan who would be liable for breach of fiduciary duty in the absence of Section 404(c).

2. The district court's analysis of Section 404(c) also fundamentally misapprehended the nature of self-directed individual account 401(k) plans like the EDS Plan at issue here, and the respective roles played by plan fiduciaries and participants. Perhaps the most significant difference between participant-directed individual account plans subject to Section 404(c) and other plans outside the scope of the statute (e.g., defined benefit plans) concerns who retains principal control over the allocation of assets. In plans that do not involve individual accounts, plan fiduciaries make the investment decisions on behalf of the plan, and plan participants have no say in how the plan's assets are invested. In contrast, in individual account plans subject to Section 404(c), participants play a determinative role in deciding how to invest the funds in their accounts, with the role of plan fiduciaries

limited to providing a broad range of investment options from which the participants may choose.[3]

Congress also intended that Section 404(c) qualified plans would be diversified investment vehicles. The legislative history to Section 404(c) notes that "the conferees expect that the regulations generally will require that for there to be independent control by participants, a broad range of investments must be available to the individual participants and beneficiaries." 1974 U.S.C.C.A.N. at 5086.

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[3] As EDS demonstrates in its brief, this Court and the Department of Labor have embraced modern portfolio theory, the focus of which is on the total mix of available investment options—including a range of risk and return characteristics—rather than on one specific option. *See* Defs.' Br. 39-41. So long as participants have a number of different investment options, a finding that one option standing alone might constitute an imprudent investment cannot defeat the Section 404(c) defense as any loss is a result of the participant's particular investment decision.

Indeed, in the related context of a defined benefit plan, this Court has recognized that allocating funds even to very risky investment options can be quite appropriate so long as the overall portfolio is sufficiently diversified. *See Laborers Nat'l Pension Fund v. N. Trust Quantitative Advisors, Inc.*, 173 F.3d 313, 317-18, 322 (5th Cir. 1999). *See also In re Unisys Sav. Plan Litig.*, No. 91-3067, 1997 WL 732473, at *2, *31 (E.D. Pa. Nov. 24, 1997) (Section 404(c) precludes fiduciary liability for providing one imprudent investment option where portfolio contained several other appropriate investment choices), *aff'd*, 173 F.3d 145 (3d Cir. 1999). That rule is, of course, consistent with good public policy, because it is the provision of more investment options that best serves the interests of participants. Significantly, there appears to be no allegation or evidence that in this case the EDS Plan provided anything other than a very broad and diverse range of investment choices. Reducing participant freedom of choice is not in the best interest of the participants, and it is not what Congress intended.

Congress intended for *participants* to have the freedom to choose investment options with greater or lesser risk. Section 404(c) provides that the control such participants exercise in making their investment decisions within the context of a diversified mix of options will shield plan fiduciaries from liability for investment losses.

Section 404(c) thus underscores the fact that along with the autonomy and control inherent in 401(k) plans comes enhanced individual responsibility for participants with regard to the performance of the investments in their accounts. But the statutory and regulatory regime underlying Section 404(c) does not leave plan participants unprotected. Rather, the Section 404(c) defense is only available where a plan satisfies several regulatory criteria designed to safeguard participants' interests by ensuring that they have adequate knowledge regarding their investment options and control over their accounts. *See generally* 29 C.F.R. § 2550.404c-1. For example, a plan must "[p]rovide[] an opportunity for a participant or beneficiary to exercise control over assets in his individual account" and "[p]rovide[] a participant or beneficiary an opportunity to choose, from a broad range of investment alternatives, the manner in which some or all of the assets in his account are invested." *Id.* § 2550.404c-1(b)(1)(i)-(ii). Participants must also be provided notice explaining "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," as well as "[a] description of the investment alternatives available under the plan and, with respect to each designated investment alternative, a general description of the investment objectives and risk and return characteristics of each such alternative." *Id.* § 2550.404c-1(b)(2)(B)(1)(i)-(ii).

Fiduciaries of an ERISA plan that does not meet the various detailed statutory and regulatory criteria may not be able to invoke the Section 404(c) defense. Where, however, those standards are met, the defense is available, and participants are responsible for their own investment choices. In particular, when plan participants elect to invest in employer stock, and the price of that stock falls, participants who have been provided a broad and diversified range of investment options and the appropriate information about those various options are not allowed to blame the plan fiduciaries for supposedly making imprudent decisions regarding the selection or continuing availability of particular investment choices. This result is eminently fair to plan participants, and it is a natural consequence of the various federal policies favoring 401(k) plans, participant free choice, and investment in company stock as a retirement savings vehicle.

In short, so long as the plan meets Section 404(c)'s statutory and regulatory criteria, any loss "results from" the participant's investment decisions, not the fiduciary's action in providing the investment option. ERISA § 404(c)(1)(B), 29 U.S.C. § 1104(c)(1)(B).

3. The regulations implementing Section 404(c) confirm that whether the defense applies involves a very fact-specific, claimant-specific inquiry. "Whether a participant or beneficiary has exercised independent control in fact with respect to a transaction depends on the facts and circumstances of the particular case." 29 C.F.R. § 2550.404c-1(c)(2). The district court recognized this reality as well, quoting a passage from the Federal Register stating that "[g]iven the transactional nature of the relief provided by section 404(c), it is necessary to determine in any particular case whether alleged losses or violations resulted from participant's or beneficiary's investment decision." Slip op. 16 (citation omitted). This highly individualized defense precludes class certification.

* * *

The district court's failure to understand the true meaning of Section 404(c), as well as the important correlation between Section 404(c) and the individually-directed nature of 401(k) plans, led it to the erroneous conclusion that the defense does not apply to the plaintiffs' claims. Properly understood, Section 404(c) clearly applies to this case.

B. The District Court Erroneously Held That Participants Who Bring A Class Action In The Name Of A Plan Have Greater Substantive Rights Than The Participants Would Have In Individual Lawsuits On Their Own Behalf

The district court voiced "other doubts about whether 404(c) can be applied to claims brought on a plan's behalf under section 502(a)(2)," observing that "[t]he

defense is transactional in nature and applied on a transaction-by-transaction basis against the particular plaintiff bringing the claim." Slip op. 17. The court feared that "[t]o hold that the defense is applicable to claims brought on a plan's behalf under ERISA section 502(a)(2) would be to hold that a plan, or the Labor Secretary, is subject to the individual defenses that the plan's participants are subject to." *Id.* at 18. The court concluded that "[a]s a separate entity, the Plan should not be subject to a defense that can only apply to particular participants and particular transactions." *Id.*

The district court's analysis is a *non sequitur*. Nothing in the text of Section 404(c) limits the applicability of the defense based on the identity of the plaintiff. Instead, the defense depends on the cause of the specific loss at issue. If a given loss "results from" a participant's "exercise of control," the fiduciary is not liable for that loss. And Section 502(a)(2), which authorizes suits on behalf of a plan, does not purport to restrict or to preclude the assertion of the Section 404(c) defense in suits brought on behalf of the plan by the Secretary, a plan fiduciary, or a plan participant. *See* 29 U.S.C. § 1132(a)(2).

Moreover, ERISA plans and their participants are not utterly unrelated strangers, as the district court's order seems to suppose. Instead, a plan is a legal entity that, in effect, is the sum of its parts: here, the individual accounts held in trust for the participants, who are beneficiaries of that trust. In the context of a de-

fined-contribution individual account plan such as EDS's Plan, there is no such thing as harm to the plan per se. Instead, particular events or transactions may cause the account balances of some or all participants to fall to a greater or lesser degree, depending on the particular allocation among investment options for each individual participant. In a participant-directed plan such as at issue here, this allocation is determined by each individual participant based on his or her investment objectives and risk-return preferences. Assuming that the aggregate losses in the individual accounts properly can be characterized as the "losses" of the plan—see the argument to the contrary in EDS's brief at 23-29—the plan comes to court as the collective representative of each of the individual participants, or at least those whose accounts allegedly suffered harm, and the plan's claim is the aggregation of the losses in the individual accounts.

Under the district court's view, an action on behalf of an ERISA plan allows the plan to recover for losses sustained by participants in their individual accounts, but denies fiduciaries the benefit of the Section 404(c) defense even when the losses at issue were the result of the participants' exercise of control, and the participants thus could not recover if they brought suit on their own behalf. That interpretation is contrary to law and to common sense. The court's decision to allow this case to proceed on a class basis by stripping defendants of their federal statu-

tory rights under ERISA violates the Rules Enabling Act and renders the certification order erroneous.

II. The District Court Erred In Rejecting The Defense Of Release

According to the district court, "thousands of absent class members signed releases agreeing not to sue Defendants." Slip op. 13. Defendants' opening brief places the number of releases at "approximately 9,000." Defs.' Br. 36. While acknowledging that individual determination as to the applicability of the release would normally "defeat typicality and thus make the case unsuitable for class certification," the court concluded that "the releases do not defeat the typicality requirement" because this lawsuit was brought on behalf of the plan and not the individual participants, and because the specific language of the release does not, in any event, bar absent class members. Slip op. 14-15. Neither of the court's reasons for disregarding the releases withstands scrutiny.

A. The District Court Erroneously Held That The Plan Can Pursue Claims On Behalf Of Participants Who Released Their Individual Claims

The district court held that "the releases are inapplicable . . . because Plaintiffs have brought this action on the Plan's behalf and do not advance individual claims, to which the releases may be applicable." Slip op. 14. "Because Plaintiffs are asserting causes of action on the Plan's behalf, rather than for their own indi-

vidual causes of action," the court concluded, "they are not subject to defenses Defendants may have against them individually." *Id.* The district court is mistaken.

As the Supreme Court has observed, "ERISA abounds with the language and terminology of trust law." *Firestone Tire & Rubber Co. v. Bruch*, 489 U.S. 101, 110 (1989). The fiduciary "responsibilities imposed by ERISA have the familiar ring of their source in the common law of trusts." *Pegram v. Herdrich*, 530 U.S. 211, 224 (2000). "[R]ather than explicitly enumerating *all* of the powers and duties of trustees and other fiduciaries, Congress invoked the common law of trusts to define the general scope of their authority and responsibility." *Central States, Southeast & Southwest Areas Pension Fund v. Central Transp., Inc.*, 472 U.S. 559, 570 (1985).

Under long-settled principles of trust law, the Plan is barred from pursuing relief on behalf of Plan participants who have released their claims. The *Restatement (Second) of Trusts* addresses the precise circumstances at issue here: "If a claim against a third person is held in trust, a discharge of the claim given by the beneficiary terminates the liability of the third person if, but only if, to hold the third person liable would result in circuitry of action." *Id.* § 328 (1959). The *Restatement* describes "circuity of action" as follows: "[i]f a claim against a third person is held in trust, it is the duty of the obligor to pay the trustee" and that "[p]ayment to the beneficiary does not give the obligor a *legal* defense to the

claim." *Id.* cmt. a (emphasis added). "[H]owever, were he compelled to make payment to the trustee, the trustee would be compelled to pay the amount recovered to the beneficiary, and the beneficiary having already been paid once would be compelled to make repayment to the obligor." *Id.* In that situation, "the obligor has an *equitable* defense to an action by the trustee against him." *Id.* (emphasis added).[4] The commentary specifically states that this rule applies when individual beneficiaries release their claims against third parties. *Id.* cmts. b, d.

The same principle applies here. According to plaintiffs, if they obtain the relief sought on behalf of the Plan, the Plan will, in turn, be required to allocate that recovery to participants' individual accounts. Any participants who executed releases will, in turn, be obligated to repay to defendants any funds they receive. There would be circuity of action, and thus the Plan may not pursue relief on behalf of participants who have released their claims.

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[4] *See, e.g.*, *McCluskey v. Rob San Servs., Inc.*, 443 F. Supp. 65, 70 (S.D. Ohio 1977) (upholding release: "The plaintiff is technically correct in her contention that only a personal representative has title to the cause of action for wrongful death, and is the only party capable of settling and releasing such a claim. Since the action is for the exclusive benefit of the surviving spouse, children, and next of kin, however, a settlement and release by the beneficiary equitably estops that beneficiary from sharing in a wrongful death award."); *Mattoon Gas Light & Coke Co. v. Dolan*, 105 Ill. App. 1, 1 (1902) (upholding release: "The beneficiary, if under no disability or limitation, may do what the trustee could do. The administrator could only sue for, recover and distribute the damages. The only distributee in this case is the widow of the deceased, and it would be anomalous to say that she could in this form receive two-fold compensation for a pecuniary loss.").

The courts have not permitted ERISA plaintiffs suing in the guise of the plan to obtain recoveries in those circumstances. For example, in *Van Noord v. Advantage Health*, No. 1:00-CV-775, 2001 U.S. Dist. LEXIS 11844 (W.D. Mich. Aug. 8, 2001), the beneficiary of an insurance policy that qualified as an employer welfare benefit plan under ERISA waived all claims against the insurance company. The beneficiary then sued the employer, which purchased the insurance policy, for breach of fiduciary duty under ERISA; and the employer cross-claimed against the insurance company for underpaying the beneficiary. The court held that "[the employer] cannot bring a claim under ERISA on behalf of [the beneficiary] after she expressly waived that right." 2001 U.S. Dist. LEXIS 11844, at *21. If the employer, as owner of the insurance policy, recovered money from the insurance company, it would have been required to turn those funds over to the beneficiary, who then would have been obligated to return the money to the insurance company based on the release. *See also Yablon v. Stroock & Stroock & Lavan Ret. Plan & Trust*, No. 01 CIV 452, 2002 WL 1300256, at *6-7 (S.D.N.Y. June 11, 2002) (participant who signed release cannot pursue claim against the plan itself), *aff'd*, 98 Fed. Appx. 55 (2d Cir. 2004).

Moreover, the common-sense proposition that a representative party cannot recover damages for individuals who have released their claims has been accepted even beyond the realm of trust and ERISA jurisprudence. In *EEOC v. Waffle*

House, Inc., 534 U.S. 279 (2002), for example, the Supreme Court stated that although an arbitration agreement signed by an employee did not limit the Equal Employment Opportunity Commission's possible remedies against the employer, if the employee "failed to mitigate his damages, *or had accepted a monetary settlement*, any recovery by the EEOC would be limited accordingly." *Id.* at 296 (emphasis added). This Court and many others have refused to allow public entities to recover on behalf of an individual who previously settled his claims. *See, e.g.*, *EEOC v. Cosmair, Inc.*, 821 F.2d 1085, 1091 (5th Cir. 1987) ("although an employee cannot waive the right to file a charge with the EEOC, the employee can waive not only the right to recover in his or her own lawsuit but also the right to recover in a suit brought by the EEOC on the employee's behalf"); *Faris v. Williams WPC-I, Inc.*, 332 F.3d 316, 322 (5th Cir. 2003) (employee may waive right to money damages under the Family and Medical Leave Act).[5] This rule prevents those individuals from unfairly receiving a double recovery. *Waffle House*, 534 U.S. at 297 ("it goes without saying that the courts can and should preclude double

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[5] *See also EEOC v. Goodyear Aerospace Corp.*, 813 F.2d 1539, 1543 (9th Cir. 1987) (EEOC could not seek back pay award on behalf of employee who had settled her claims because "any recovery of back pay by the EEOC would go directly to [the employee] who has freely contracted away her right to back pay"); *Hoffman v. United Telecomms., Inc.*, 687 F. Supp. 1512, 1514 (D. Kan. 1988) (settlement agreement legitimately limited employee's participation in EEOC action).

recovery by an individual") (internal quotation marks omitted). The same result should obtain here.

B. The District Court Misconstrued The Plain Language Of The Release

The district court concluded that "the release's plain language appears not to bar absent class members' claims." Slip op. 14. The operative release language, which is apparently identical for each of the 9,000 participants at issue, is quite broad, discharging "all claims or demands." *Id.* There seems to be no dispute that this language, standing alone, would bar any claims by individual participants who signed the release. *Id.* at 13-14.

The release carves out an exception, however, that the court apparently found to be applicable, thereby taking the claims here outside the scope of the release:

> This Release does not include, however, a release of Employee's right, if any, **to benefits he/she is entitled to under any EDS plan** qualified under Section 401(a) of the Internal Revenue Code, including the EDS Retirement Plan and the EDS 401(k) Plan, and COBRA benefits pursuant to Internal Revenue Code section 4980B.

Id. at 14 (emphasis added). The exception language is unambiguous, and it means exactly what it says: a participant who signs the release does not waive the right to claim "benefits he/she is entitled to under any EDS plan." The exception thus reserves a participant's right to bring a claim under ERISA § 502(a)(1)(B) "to re-

cover benefits due to him under the terms of his plan." 29 U.S.C. § 1132(a)(1)(B). Plaintiffs' claim here, however, is not a claim for benefits under Section 502(a)(1)(B), but rather a purported claim under ERISA § 502(a)(2), which authorizes "appropriate relief under section 1109 of this title." 29 U.S.C. § 1132(a)(2). That section, in turn, provides remedies for breaches of "any of the responsibilities, obligations, or duties imposed upon fiduciaries." ERISA § 409(a), 29 U.S.C. § 1109(a).

Claims for benefits under an ERISA plan and claims for damages resulting from breach of fiduciary duty are very different theories of recovery, against different defendants, grounded in separate provisions of ERISA. In the former, the plaintiff's benefits are paid from the assets of the plan, while in the latter the damages are recovered from the personal assets of the breaching fiduciary. *See, e.g.*, *Mass. Mut. Life Ins. Co. v. Russell*, 473 U.S. 134, 146-47 (1985) (explaining that § 502(a)(1)(B) allows recovery from plan for contractually-specified plan benefits, whereas § 502(a)(2) allows recovery from fiduciaries for breach of fiduciary duties); *Rhorer v. Raytheon Eng'rs & Constructors, Inc.*, 181 F.3d 634, 639 (5th Cir. 1999) (noting distinction between claims under § 502(a)(1)(B) and § 502(a)(2), including different standards of judicial review).

The exception to the release applies only to claims for benefits under the Plan, not to the fiduciary breach claims here. The court's interpretation of "the re-

lease's plain language" is, therefore, erroneous. Participants who signed the release are barred from obtaining further monetary recovery from defendants.

* * *

The district court thus had no legitimate basis for excluding the release from the class certification analysis. Nothing in ERISA authorizes participants who have already released their individual claims to use the Plan as a stalking horse to obtain a double recovery. Moreover, the plain language of the release applies to the many thousands of participants who have apparently executed releases, and the Plan may not pursue recovery on behalf of those participants. The district court acknowledged that the presence of the individualized issue of determining whether the release defense applied to each participant would destroy typicality and preclude class certification. ERISA, the common law of trusts, and the Rules Enabling Act require that substantive law not be distorted merely to accommodate a putative class action. The district court erred in certifying the class notwithstanding the release defense.

CONCLUSION

For these reasons, among others, the portion of the district court's order granting class certification should be reversed.

Respectfully submitted.

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March 8, 2005

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