No. ________

In The
Supreme Court of the United States

DENISE MERRIMON and BOBBY S. MOWERY, individually and on behalf of all others similarly situated,

Petitioners,

v.

UNUM LIFE INSURANCE COMPANY OF AMERICA,

Respondent.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The First Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Do the ERISA-imposed fiduciary duties of an insurance company that gains possession of death benefits due ERISA beneficiaries in the course of service as an ERISA fiduciary continue so long as the insurance company retains possession of the death benefits?

Resolution of this question raises issues of law as to which there is disagreement among the circuits.

Are death benefits ERISA plan assets if the benefits flow from an insurance policy issued to the plan and purchased with plan assets?

Should the functional approach be applied for identification of plan assets?

Should the rule from the law of trusts that fiduciary duties continue so long as the fiduciary possesses his beneficiary's funds apply to ERISA fiduciaries?

What degree of deference should be accorded an *amicus* brief of the Department of Labor on issues of statutory construction and non-ERISA property law?

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INTRODUCTION

This case presents issues fully developed through trial and appeal as to whether undistributed death benefits due beneficiaries of ERISA-governed plans are plan assets and whether the fiduciary duties of an insurance company that gains possession of those funds in the course of service as an ERISA fiduciary continue as long as the fiduciary continues to retain possession of the beneficiaries' death benefits.

The relevant statutory provisions are straightforward. A person is a fiduciary "to the extent" that "he exercises . . . any authority or control" over plan "assets," or has "discretionary authority or discretionary responsibility" in the plan's "management" or "administration." 29 U.S.C. § 1002(21)(A).[8] The term "party in interest" includes, *inter alia*, fiduciaries and any "person providing services to" the plan. 29 U.S.C. § 1002(14). A fiduciary may not "deal with the assets of the plan in his own interest or for his own account." 29 U.S.C. § 1106(b)(1). The statute further forbids "a direct or indirect . . . lending of money or other extension of credit between the plan and a party in interest" or a "transfer to, or use by or for the benefit of a party in interest of any assets of the plan." 29 U.S.C. § 1106(a)(1).

The Employee Retirement Income Security Act of 1974, 29 U.S.C. § 1001, *et seq.*, has reached its

[8] The ERISA statutes and regulations addressed in this petition are set out in App. 106.

fortieth anniversary. The Act's definition of plan assets provides in pertinent part:

> (42) the term "plan assets" means plan assets as defined by such regulations as the Secretary may prescribe . . .

29 U.S.C. § 1002(42).

Over the past forty years, none of those who have served as Secretary of Labor have promulgated comprehensive regulations that define "plan assets." "Plan assets" are defined in only two contexts: (1) where an employee benefit plan invests assets by purchasing shares in a company, 29 C.F.R. § 2510.3-101, and (2) where contributions to a plan are withheld by an employer from employees' wages, 29 C.F.R. § 2510.3-102. Thus, no ERISA regulations clarify whether benefits that are payable pursuant to a life insurance policy owned by an ERISA plan, but which are retained by the plan's insurer, are plan assets.

The Labor Department has, however, by Advisory Opinions, a Field Assistance Bulletin and in briefs, expressed its opinions as to what it contends are, or are not, *plan assets*.[9] The positions asserted in these pronouncements are not consistent. The brief of the Secretary in the *Solis* case asserts that death benefits flowing from a life insurance policy are plan assets if the plan is the policyholder or if the insurance policy

[9] *Infra*, pp. 34-38.

was purchased with plan assets.[10] Under this test, the death benefits at issue in this case were plan assets, as Unum's Certificates of Insurance were issued to the ERISA plans, and the life insurance coverage was paid for by the ERISA plans. Nonetheless, the district court and the court below held that the death benefits were not plan assets, expressly deferring to a DOL *amicus* letter brief submitted post-argument in *Faber v. Metropolitan Life Ins. Co.*, 648 F.3d 98 (2d Cir. 2011).

The *Faber amicus* brief opines that death benefits provided by an insurance policy issued to an ERISA plan and paid for with plan assets are not *plan assets* if the summary plan description ("SPD") for the plan provides for settlement of death benefit claims by creation of retained asset accounts, with the insurance carrier that had been acting as a plan fiduciary thereby becoming a mere debtor to the plan beneficiaries with no continuing fiduciary duties. Pet.App. 169. The DOL did not address the issue of how an ERISA fiduciary can lawfully terminate its ERISA-imposed fiduciary duties by retaining the benefits owed to an ERISA plan beneficiary and thus becoming the beneficiary's debtor.

The DOL's positions set forth in its brief were not only adopted by the Second Circuit in *Faber*, but have

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[10] Secretary of Labor's Memo of Law in Support of Motion for Partial Summary Judgment (Doc. 269), *Solis v. Koresko*, No. 2:09-cv-00988-MAM (E.D.Pa.) at 17. (App. 201)

subsequently been adopted by the Third Circuit in *Edmonson*, and by the First Circuit below. Decisions of federal courts rendered prior to the *Faber* decision rejected, with one exception, arguments that ERISA plan death benefits are not plan assets. All decisions rendered since *Faber* have held that ERISA plan death benefits are not plan assets.[11] All of these courts have cited the DOL *amicus* brief favorably, but none have addressed why death benefits flowing from insurance policies issued to ERISA plans and paid for with plan assets are not plan assets, nor have they addressed how the duties of an ERISA fiduciary can terminate because the fiduciary has loaned the death benefits provided by an ERISA plan to itself, thus becoming the debtor of the beneficiary. None of these courts, including the court below, have explained why the rule from the law of trusts that holds that a fiduciary's duties continue so long as the fiduciary holds its beneficiary's funds should not apply to an ERISA fiduciary. Moreover, for an ERISA fiduciary to become its beneficiary's debtor in the course of fiduciary service conflicts with the spirit, if not the letter, of the prohibited transactions provisions set forth in 29 U.S.C. § 1106.

This Court addressed the issue of identification of plan assets in *John Hancock Mut. Life Ins. Co. v. Harris Trust and Savings Bank*, 510 U.S. 86, 114 S.Ct. 517 (1993), wherein the position espoused by

[11] *Infra*, pp. 32-34.

the Secretary of Labor was rejected in favor of a narrow reading of the 29 U.S.C. § 1101(b)(2)'s guaranteed benefit policy exemption and thus a broad definition of what are "plan assets," holding that "the guaranteed benefit policy exclusion from ERISA's fiduciary regime is markedly confined." *Id.*, 510 U.S. at 96, 114 S.Ct. at 524.

Whether a party is exercising discretion in the administration of an ERISA plan or is dealing with plan assets, and is therefore a fiduciary, is evaluated under a functional approach that is broader than traditional trust law. *Mertens v. Hewitt Associates*, 508 U.S. 248, 262, 113 S.Ct. 2063, 2071 (1993). The Ninth Circuit mirrored this policy by adopting a functional approach "to determine whether a particular item constitutes an 'asset of the plan,'" holding that plan assets include items that "may be used to the benefit (financial or otherwise) of the fiduciary at the expense of plan participants or beneficiaries." *Acosta v. Pacific Entrs.*, 950 F.2d 611, 620 (9th Cir. 1992).

Acosta has been cited with approval by numerous circuit and district courts, but has now been expressly rejected by the court below. The death benefits used by plan fiduciary UNUM to gain millions in profit comfortably fall in the ambit of ERISA plan assets if the functional approach is used to determine what are ERISA plan assets.[12]

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[12] *Infra*, pp. 21-23.

Over the past decade, the life-insurance industry has increasingly embraced the use of "retained asset accounts" – arrangements by which the insurer does not pay death benefits with a check but instead lends the death benefits to itself and memorializes its debt by mailing its beneficiary a book of blank drafts resembling a checkbook. Until the beneficiary writes a draft to collect some or all of the debt, the insurer invests the funds for its own profit, enjoying the spread between its earnings and the much lower interest rate credited to the beneficiary. The First Circuit in *Mogel* accurately described these accounts as "no more than an IOU." *Mogel v. Unum Life Ins. Co. of Amer.*, 547 F.3d 23, 27 (1st Cir. 2008).

The many millions earned by insurers from this self dealing in death benefits provided by ERISA plans provide no benefit to the plans, and do not in any way provide encouragement to employers to establish, maintain or expand ERISA plans for their employees.

Despite the ubiquity of this practice, the courts are divided over the legal ground rules to determine whether retained ERISA death benefits are plan assets and whether an insurer that exercises discretion in administration of claims for ERISA plan death benefits may terminate its fiduciary duties by declaring itself the debtor of its ERISA plan beneficiary. Positions expressed by the DOL in briefs, advisories and a field assistance bulletin have been inconsistent, raising the issue as to what deference, if any, should be accorded its *amicus* letter brief, a legal issue on which the circuits are divided. Billions of dollars, the benefits of millions of Americans, and the legality of the practices of some of the nation's largest insurers hang on the answer.

Only this Court can resolve that uncertainty. Because a chief goal of ERISA is to establish uniformity in the disbursement of benefits, the issue cries out for this Court's intervention.

OPINIONS BELOW

The First Circuit's opinion in this case is reproduced at Pet.App. 1 and reported at 758 F.3d 46. The district court's decision is reproduced at Pet.App. 29 and can be found at 2013 WL 4854367. The district court's decision granting in part and denying in part the parties' cross motions for summary judgment is reproduced at Pet.App. 65 and is reported at 845 F.Supp.2d 310.

JURISDICTION

The judgment of the court of appeals was entered on July 2, 2014. Pet.App. 1. On September 26, 2014, Justice Breyer granted an extension of time within which to file this Petition until November 21, 2014. This Court has jurisdiction under 28 U.S.C. § 1254(1).

STATUTES AND REGULATIONS INVOLVED

The relevant provisions of ERISA and the cited regulations are reproduced at Pet.App. 106.

STATEMENT OF THE CASE

A. Statutory Background

ERISA requires that plan fiduciaries discharge their duties "solely in the interest of the participants and beneficiaries" of the plan, and "for the exclusive purpose . . . of providing benefits to participants and their beneficiaries," 29 U.S.C. § 1104(a)(1); and may not "deal with the assets of the plan in his own interest or for his own account," *id.* at § 1106(b)(1). A person is a fiduciary "to the extent" that "he exercises . . . any authority or control" over plan "assets," or has "discretionary authority or discretionary responsibility" in the plan's "management" or "administration." *Id.* at § 1002(21)(A).

Fiduciary duties include:

§ 1104. Fiduciary duties

(a) Prudent man standard of care

> (1) Subject to sections 1103(c) and (d), 1342, and 1344 of this title, a fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and –

* * *

> (D) in accordance with the documents and instruments governing the plan insofar as such documents and instruments are consistent with the provisions of this subchapter and subchapter III of this chapter.

29 U.S.C. § 1104(a)(1)(D).

Section 406 of ERISA expressly prohibits the borrowing of plan assets by fiduciaries or any other "party in interest":

> **(a) Transactions between plan and party in interest**
>
> Except as provided in section 1108 of this title:
>
> (1) A fiduciary with respect to a plan shall not cause the plan to engage in a transaction, if he knows or should know that such transaction constitutes a direct or indirect –
>
> * * *
>
> > (B) lending of money or other extension of credit between the plan and a party in interest; [or]
> >
> > * * *
> >
> > (D) transfer to, or use by or for the benefit of a party in interest, of any assets of the plan[.]
>
> **(b) Transactions between plan and fiduciary**
>
> A fiduciary with respect to a plan shall not –

> (1) deal with the assets of the plan in his own interest or for his own account; [or]
>
> (2) in his individual or in any other capacity act in any transaction involving the plan on behalf of a party (or represent a party) whose interests are adverse to the interests of the plan or the interests of its participants or beneficiaries[.]

29 U.S.C. § 1106.

The term "party in interest" means, as to an employee benefit plan –

> (A) any fiduciary (including, but not limited to, any administrator, officer, trustee, or custodian), counsel, or employee of such employee benefit plan; [or]
>
> (B) a person providing services to such plan[.]

29 U.S.C. § 1002(14).

"Administration" means "to perform the duties imposed, or exercise the powers conferred, by the trust documents." *Varity Corp. v. Howe*, 516 U.S. 489, 502, 116 S.Ct. 1065, 1073 (1996). But that is not all it means:

> There is more to plan (or trust) administration than simply complying with the specific duties imposed by the plan documents or statutory regime; it also includes the activities that are ordinary and natural means of achieving the objective of the plan. Indeed, the primary function of the fiduciary duty is

> to constrain the exercise of *discretionary* powers which are controlled by no other specific duty imposed by the trust instrument or the legal regime.

Id., 516 U.S. at 504, 116 S.Ct. at 1073 (internal citations and quotation marks omitted).

No provision of ERISA permits an ERISA plan fiduciary to terminate its fiduciary duties by becoming the debtor of plan beneficiaries.

B. The *Mogel* Case

In *Mogel v. Unum Life Ins. Co. of Amer.*, 547 F.3d 23 (1st Cir. 2008), the court addressed whether Unum functioned as an ERISA fiduciary when it retained death benefits owed ERISA plan beneficiaries, invested their benefits for its own account, and memorialized its debts by sending books of blank drafts along with information about what it owed the beneficiaries. The court held that Unum functioned as a fiduciary when taking such actions because the "sums due plaintiffs remain plan assets subject to Unum's fiduciary obligations until actual payment," and because Unum's disposition of the benefits to the plaintiffs fell "comfortably within the scope of ERISA's definition of fiduciary duties with respect to plan administration." *Id*. at 26-27.

Mogel subsequently settled. The settlement was limited to beneficiaries of "AA" series policies that provided for "lump sum" payments.

C. The CXC Series Policy

This case involves Unum's "CXC" group life policies that provide: "If you or your dependent's life claim is at least $10,000, Unum will make available to the beneficiary a retained asset account (the Unum Security Account)[.]" Pet.App. 68. The policies define a "retained asset account" as "an interest-bearing account established through an intermediary bank in the name of you or your beneficiary as owner[,]" but do not specify the applicable interest rate or any method for calculating the rate. *Id*. Nor do the policies disclose that Unum will retain the beneficiary's benefits in its general account, invest those benefits for its own account, and keep for itself over eighty percent of the resulting profit. *Id.* The district court certified a class that included "anyone who, after October 28, 2004, was a beneficiary under an ERISA-governed 'CXC' group life policy issued by Unum under which an . . . [retained asset account] was set up." Pet.App. 31.

D. Unum's Retained Asset Account Practices

Following approval of a beneficiary's claim, Unum causes a third-party vendor to establish a process to clear drafts issued by the beneficiary through an intermediary bank. The vendor in turn contacts a printer to print a book of blank drafts in the name of the beneficiary. There is a necessary delay between the time that the death benefit claim is approved by Unum and the time that books of blank drafts have been printed and mailed to Unum's beneficiaries. When the vendor mails the blank drafts, the vendor includes information as to the amount Unum owes the beneficiary and guidance as to how the drafts can be used.

The district court described Unum's process:

> No funds are actually placed into the RAAs[13] when they are initially opened. Instead, Unum retains and continues to invest the amounts due under the approved claims until a draft is presented to the [b]ank for payment. When a draft is presented for payment, funds sufficient to cover the draft are transferred from Unum's general account to the [b]ank.
>
> * * *
>
> RAAs provide Unum an opportunity for earnings on the "interest spread," which is the difference between the income Unum earns from investing the funds backing the RAAs and the amount of interest it pays to beneficiaries on these accounts.

Pet.App. 71-72.

Unum holds and invests the death benefits it retains in its group life investment portfolio. C-Add.[14]

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[13] "RAA" is short for "retained asset account."

[14] C-Add. refers to the Addendum to the Brief of Appellees/ Cross Appellants.

7-9. During the class period, that portfolio held approximately $1 billion to $1.2 billion in assets, of which roughly one-third to one-half were death benefits that Unum had retained. Pet.App. 34, 37. The portfolio's net annual yield exceeded 6% throughout the class period. *Id.* at 36-37.

Unum determined how much of that yield to keep for itself and how much to share with beneficiaries when it decided the rate of interest to credit to their retained asset accounts. A committee within Unum met quarterly to review and set the interest rate to credit to its beneficiaries on their as yet undistributed death benefits. The motivation of the crediting committee is described by committee member Gary Piccolo:

> Only 4 [of about 100] companies have a rate lower than our 1%.
>
> * * *
>
> There is a risk that with such a low crediting rate, we could see heavy withdrawals – but we haven't seen that happen yet. Our persistency in the RAA is comparable with the overall persistency the vendor experiences for all customers combined. We are protected from a large level of withdrawals from the RAA due to about $200 million of liquid assets that can be liquidated without suffering a loss. **With over $500 million in the RAA, the income we get from the interest spread is substantial, and we will**

continue to manage the RAA to optimize our earnings.

Pet.App. 40-41 (emphasis added).

Nowhere in Unum's records are found any references to a duty or even a desire to be "fair" to the beneficiaries whose benefits Unum had retained. C-App.[15] at 833-841, 1007. Crediting committee members who testified at trial denied receiving any instruction in fiduciary duties, either before or after the First Circuit's decision in *Mogel*, or the district court's summary judgment ruling in this case. C-App. 1051.

The history of interest rates that have been credited to the accounts of beneficiaries whose benefits Unum retained has been a steady course of rate reduction for the beneficiaries and growing profit margins for Unum. Unum's retained asset program began in 1990, with beneficiaries being credited interest at 7.0% per annum. This rate was reduced in four steps to 6.30% by the end of 1990. The rate was dropped to 5.0% by the end of 1991, and was lowered to 4% through the end of 1996. It was lowered to 2.5% in 2001, was reduced to 1.5% in April 2002, and has been 1% since August 2003. C-Add. 1; C-App. 821-823, 845, 1003-1006.

These reductions in the crediting rate for the beneficiaries whose death benefits Unum retained

[15] C-App. refers to the First Circuit appendix.

have no apparent relationship to the gain being earned by Unum on its investment of their funds. The amount of profit retained by Unum grew from 23% in 1990 to 80% in 2003. During the class period, Unum's greed at the expense of its beneficiaries grew even further to include retention of 85% of the profit. C-App. 1014.

Petitioners presented evidence at trial of Unum's gross profit on investment of the retained funds with deductions for expenses and the one percent credited to beneficiaries. An allowance was made for a profit of 70 basis points, a figure in line with what insurance carriers customarily seek to earn for investments of large sums of money. These calculations show that Unum had an excess profit of $87,827,700 on its investment of retained ERISA benefits during the class period. C-App. 1015.

Unum has, through the years, benefitted further to the detriment of its beneficiaries whose benefits it has retained. For many years, Unum took no action to locate Unum retained asset account holders whose accounts had become dormant, and as of trial in 2013, Unum had never escheated even a dime of unclaimed funds to the appropriate state authorities. Unum has by inaction enriched itself tens of millions of dollars in unclaimed "retained" death benefits. *Id.* This failure to even try to locate holders of dormant accounts or their heirs or to escheat the funds has been facilitated by the absence of regulatory oversite by insurance, banking or securities authorities or by the Department of Labor.

Petitioners asserted that Unum violated its obligation to discharge its duties with respect to the plans solely in the interest of the plans' participants and beneficiaries, and that Unum violated ERISA's prohibition against dealing in the plans' assets in its own interest and for its own account. 29 U.S.C. §§ 1104, 1106. Petitioners sought appropriate equitable relief to redress these violations, including disgorgement of profits that Unum reaped. C-App. 30-31, ¶3; C-App. 37, ¶42.

Following discovery as to all issues except for remedies, Plaintiffs moved for class certification and summary judgment, and Unum cross-moved for summary judgment. The district court granted Plaintiffs' motion for class certification and granted in part and denied in part the parties' cross-motions for summary judgment. Pet.App. 105.

The district court acknowledged the ruling in *Mogel* that benefits retained by Unum using retained asset accounts "*remain* plan assets subject to Unum's fiduciary obligations until actual payment," but questioned the correctness of that court's finding that the benefits were plan assets *in the first place*. *Id*. at 83, citing *Faber*.

The district court noted that the First Circuit in *Mogel*:

> . . . may have been interpreting ERISA's "disposition of [the plan's] assets" language broadly to mean disposition of the policies themselves. **Once the policies, which all**

> **agree are plan assets,** become due and payable to beneficiaries, the insurer must dispose of those policies by paying the claims due. Perhaps the First Circuit was saying that until whatever payment promised under the plan is in the hands of the beneficiaries, the insurer has not met its fiduciary obligation to dispose of the plan assets, *i.e.* the policies.

Id. at 80 (emphasis added).

Alternatively, the district court observed that the court in *Mogel* may have been:

> adopting a functional test to determine whether the funds due beneficiaries were "plan assets." The "functional" approach to determining plan assets was articulated by the Ninth Circuit in *Acosta v. Pac. Enters.*, 950 F.2d 611, 620 (9th Cir. 1992). Under this approach, "to determine whether a particular item constitutes an 'asset of the plan' it is necessary to determine whether the item in question may be used to the benefit (financial or otherwise) of the fiduciary at the expense of plan participants or beneficiaries." *Id.*

Id.

The district court held that the holding in *Mogel* concerning the plan asset issue was not essential to "*Mogel*'s core holding – that Unum's 'disposition to the beneficiaries of benefits due under the plan falls comfortably within the scope of ERISA's definition of . . . plan administration[,]' " and concluded "that, if the First Circuit were required to address the issue squarely, it would not hold that the funds backing the RAAs in this case are plan assets." *Id*. at 82. It granted Unum summary judgment on Plaintiffs' claim that Unum self-dealt in plan assets. *Id*.

Turning to *Mogel*'s holding that the disposition of benefits to beneficiaries using retained asset accounts was an act of plan administration, the district court held that Unum exercised discretionary authority and responsibility in the administration of the plans, and thus functioned as a fiduciary, when it chose to award itself the business of administering Plaintiffs' retained asset accounts and when it chose the interest rate to be credited to the "accounts," because neither of these activities was dictated by the policies. *Id*. at 82-83, citing *Mogel* and *Varity Corp. v. Howe*. The district court further held that Unum breached its duty of loyalty to the Plaintiffs because it clearly "managed the RAAs to optimize its own earnings and not to optimize the[ir] earnings" by setting the interest rate on the accounts "just high enough to forestall mass withdrawal of the funds backing the accounts." Pet.App. 84-85.

The district court conducted a four-day bench trial to determine the relief that was appropriate to redress the breach of fiduciary duty it found Unum had committed, after which it awarded the class $13,392,906 including prejudgment interest. Pet.App. 64. This award represents the difference between the amount of interest that Unum credited to the plaintiffs and the average of the prevailing annual rates credited on money market mutual funds and money market bank accounts throughout the class period. *Id.* at 57-58.[16]

Both parties appealed from the portions of the district court's summary judgment order ruling against them and from the monetary relief awarded by the district court. The First Circuit affirmed the district court's entry of summary judgment against the plaintiffs on their claim that Unum self-dealt in plan assets in violation of 29 U.S.C. § 1106(b)(1), agreeing with the district court that the funds with which Unum self-dealt were not plan assets, Pet.App. 11-22, but reversed the district court's finding that Unum had breached the duty of loyalty imposed by 29 U.S.C. § 1104(a)(1) when it invested the plaintiffs' money for its own account, finding that Unum ceased functioning as a fiduciary once it established the plaintiffs' retained asset accounts even though it still had their money. Pet.App. 20-28.

[16] The award is based upon one of three models proffered by the plaintiffs' expert. The other two models would have yielded substantially higher awards, but were rejected by the district court. Pet.App. 42-44.

REASONS FOR GRANTING THE PETITION

I. There is a Split of Authority Among the Circuits as to What are ERISA Plan Assets.

Case law has adopted three non-exclusive tests to determine what is and what is not an ERISA plan asset. These include the document approach under which, for example, a share of stock that identifies a benefit plan as the owner is clearly a plan asset. *Secretary of Labor v. Doyle*, 675 F.3d 187, 204 (3d Cir. 2012) (plan assets held to include contracts to which plan is a party). Numerous courts have looked to ordinary notions of non-ERISA property law to determine what are plan assets. And, in *Acosta v. Pacific Entrs.*, 950 F.2d 611 (9th Cir. 1992), the Ninth Circuit adopted the functional approach that mirrors the test for whether a party is acting as an ERISA fiduciary. The court held:

> ERISA does not expressly define the term "assets of the plan." Nor has this circuit had an occasion to delineate the precise boundaries of the term as it is used in section 406(b)(1). However, ERISA's legislative history makes clear that "the crucible of congressional concern was misuse and mismanagement of plan assets by plan administrators and that ERISA was designed to prevent these abuses in the future." *Massachusetts Mut. Life Ins. Co. v. Russell*, 473 U.S. 134, 140 n. 8, 105 S.Ct. 3085, 3089 n. 8, 87 L.Ed.2d 96 (1985) (citing 120 Cong.Rec. 29,932, 29,951, 29,954, 29,957, 29,961, 29,194, 29,196-97, 29,206 (1974)). In light of

> Congress' overriding concern with the protection of plan participants and beneficiaries, courts have generally construed the protective provisions of § 406(b) broadly. *See, e.g.*, *Lowen v. Tower Asset Management, Inc.*, 829 F.2d 1209, 1213 (2d Cir.1987); *Leigh v. Engle*, 727 F.2d 113, 126 (7th Cir.1984).
>
> Appellees argue that the term "assets of the plan" encompasses only financial contributions received by the plan administrators. We decline to cabin the term in such a restricted definition. Congress' imposition of a broad duty of loyalty upon fiduciaries of employee benefit plans counsels a more functional approach. To determine whether a particular item constitutes an "asset of the plan," it is necessary to determine whether the item in question may be used to the benefit (financial or otherwise) of the fiduciary at the expense of plan participants or beneficiaries.

Id., 950 F.2d at 620.

Since 1992, other Ninth Circuit decisions and numerous district courts have followed *Acosta* and applied the functional approach for identification of plan assets. *E.g.*, *Kayes v. Pacific Lumber Co.*, 51 F.3d 1449, 1466 (9th Cir. 1995); *Patelco Credit Union v. Sahni*, 262 F.3d 897, 908 (9th Cir. 2001); *Grindstaff v. Green*, 133 F.3d 416, 432 (6th Cir. 1998) (Krupansky, J., dissenting); *Metzler v. Solidarity of Labor Org. Health & Welfare Fund*, 1998 WL 477964*5 (S.D.N.Y.), *aff'd sub nom.*, *Herman v. Goldstein*, 224 F.3d 128 (2d Cir. 2000), *cert. denied*, 533 U.S. 928 (2001);

In re Consolidated Welfare Fund ERISA Lit., 839 F.Supp. 1068, 1073 (S.D.N.Y. 1993) (commissions earned on insurance sold to plan held to be plan assets because they, "*did* benefit the fiduciary at the expense of plan participants and beneficiaries." Motion of Secretary for summary judgment under Section 406(b)(2) granted); *Ruppert v. Principal Life Ins. Co.*, 796 F.Supp.2d 959, 971 (S.D. Iowa 2010); *American Tel. and Tel. Co. v. Empire Blue Cross and Blue Shield*, 1994 WL 16057794*10 (D.N.J.); *In re Regions Morgan Keegan ERISA Lit.*, 692 F.Supp.2d 944, 960 (W.D.Tenn. 2010); *Shirk v. Fifth Third Bancorp*, 2008 WL 4449024*16 (S.D. Ohio).

Until recently, no circuit court had expressly disapproved of the functional approach to identify plan assets, but that has now changed. The court below expressly refused to apply the functional approach first expressed in *Acosta*:

> As a fallback, the plaintiffs invite us to adopt the Ninth Circuit's functional approach to determining which assets are plan assets. *See Acosta v. Pac. Enters.*, 950 F.2d 611, 620 (9th Cir.1991). The functional approach looks to "whether the item in question may be used to the benefit (financial or otherwise) of the fiduciary at the expense of plan participants or beneficiaries" as a means of ascertaining whether the item is a plan asset. *Id*. Although courts occasionally have found this approach useful, we have never endorsed it. Nor do we need to explore its possible utility today: while the functional approach might be of

> some assistance in doubtful cases, the assets with which we are concerned – the funds backing the RAAs – fall squarely within the compass of section 401(b)(2) prior to the establishment of an RAA, and they are not governed by ERISA subsequent thereto. As the DOL Guidance makes manifest, those funds are simply not plan assets.

Pet.App. 18-19.

Unum conceded at trial that the funds that Unum holds are its beneficiary's funds. In the words of Unum's 30(b)(6) witness:

> Q: Now, you would agree with me that the death benefits that UNUM holds that are due a beneficiary under one of its group life policies is money that belongs to the beneficiary?
>
> * * *
>
> A: If a beneficiary received a retained asset account from UNUM, those funds are the property of the beneficiary, yes.

C-App. 228.

Unum acquired possession of ERISA plan benefits in the course of fiduciary service and has profited greatly to the detriment of its beneficiaries who receive so little of the earnings produced by investment of their money. These funds are clearly plan assets under the functional approach.

This conflict among the circuits as to what are plan assets cries out for resolution by this Court. The Petition for Certiorari should be granted.

II. The Refusal of the Court Below to Apply the Rule from the Law of Trusts that Fiduciary Duties Continue so long as the Fiduciary Continues to Hold the Beneficiary's Funds is in Conflict with This Court's Repeated Holdings that Fiduciary Duties Under ERISA Should Conform to the Law of Trusts Absent a Statutory Reason not to do so.

ERISA invokes the common law of trusts to define the scope of a fiduciary's authority and responsibilities. This Court has succinctly explained the relationship between ERISA and the common law of trusts:

> [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.
>
> We also recognize, however, that trust law does not tell the entire story. After all, ERISA's standards and procedural protections partly reflect a congressional determination that the common law of trusts did not offer completely satisfactory protection.
>
> *   *   *

> Consequently, we believe that the law of trusts often will inform, but will not necessarily determine the outcome of, an effort to interpret ERISA's fiduciary duties. In some instances, trust law will offer only a starting point, after which courts must go on to ask whether, or to what extent, the language of the statute, its structure, or its purposes require departing from common-law trust requirements. And, in doing so, courts may have to take account of competing congressional purposes, such as Congress' desire to offer employees enhanced protection for their benefits, on the one hand, and, on the other, its desire not to create a system that is so complex that administrative costs, or litigation expenses, unduly discourage employers from offering welfare benefit plans in the first place.

Varity Corp. v. Howe, 516 U.S. 489, 496, 116 S.Ct. 1065, 1070 (1996) (internal citation, quotation marks and brackets omitted).

Thus, this Court has directed that the common law of trusts should be applied absent a statutory reason for not so doing. The decision of the court below fails to follow this Court's precedents, choosing instead the rules advocated by the DOL in the *Faber amicus* brief that disregard the law of trusts. Pet.App. 23.

Under the law of trusts, a trustee is obligated to transfer title or possession of trust property to the persons entitled to receive it upon termination of the trust. Rest. (2d) of Trusts § 345. Even when a trust terminates, the trustee's powers and duties continue until the trustee delivers the trust property to the persons entitled to it. Mary F. Radford, George G. Bogert & George T. Bogert, *The Law of Trusts and Trustees*, § 1010 (3d ed. rev. 2010). These well-settled rules apply for as long as a trustee retains trust property and may be extended indefinitely where a beneficiary consents to the trustee holding and administering the trust property after expiration of the trust. *Id.* ("If the beneficiaries consent to the trustee holding and administering the trust property after the expiration of the trust, the trust will be deemed extended and the powers and duties of the trustee continue unchanged.").

These rules are not limited to trusts. Whenever a person comes into possession of property while acting as a fiduciary, he remains a fiduciary with respect to the property for as long as he retains possession of the property. *E.g.*, *NRT New England, Inc. v. Moncure*, 78 Mass. App. Ct. 397, 937 N.E.2d 999, 1001-03 (2010) ("An escrow agent assumes a fiduciary duty to the parties to an escrow agreement when it accepts funds and deposits them into its account. That duty – to both parties – exists as long as the funds remain, undisbursed, in the escrow agent's account." (internal citation omitted)); *In re Walls' Guardianship*, 179 Misc. 924, 933-34, 38 N.Y.S.2d 879, 887 (Surr. Ct. Nassau Co. 1942) (if a guardian and ward relationship terminates, the guardian remains a fiduciary to the extent that he retains possession of the ward's property);

Burnett v. Sharp, 328 S.W.3d 594 (Tex. App. – Houst. 14th Dist. 2010) (a discharged attorney remains a fiduciary with respect to client funds in his possession).

The DOL *Faber* brief opined that the creation of a retained asset account created a "creditor and debtor's relationship between MetLife and the Account Holder" devoid of continuing fiduciary duties. Pet.App. 122. The court below held that after the establishment of the retained asset account, "the subsequent relationship between the insurer and the beneficiary was in the nature of a debtor-creditor relationship." *Id.* at 23. Thus, the DOL contended and the court below held that an ERISA fiduciary in the course of fiduciary service and in possession of ERISA plan benefits due an ERISA beneficiary may terminate its fiduciary duties by becoming a debtor of the ERISA beneficiary.

How can the holding below be squared with the law of trusts, or with the letter or spirit of the parallel statutory prohibition of a fiduciary dealing with assets of a plan "for his own interest," or the prohibition of an "extension of credit between the plan and a party in interest"? 29 U.S.C. § 1106.

The rule advocated by the DOL and adopted below and by the Second and Third Circuits in *Faber* and *Edmonson* invites much mischief.

The secret, unbargained-for earnings reaped by Unum and other carriers that sell policies to fund ERISA benefits and that administer claims for those benefits by "retaining," and thereby self dealing in those funds, in no way serve the interests of either the plans or their beneficiaries. It was undisputed below that Unum's massive profits from its investment of its beneficiaries' funds do not defray the cost of the coverage. Unum's long-time actuary testified that prospective earnings on retained asset accounts were not considered in calculating the price of Unum's group life insurance. T[17]-59:14-60:4. Unum's trial expert, actuary Timothy Pfiefer, testified in deposition that he knew of no life insurance company that charged less for policies that provided for use of retained asset accounts. *Merrimon*, No. 1:10-CV-447-NT (D.Me.), Doc. 131, dep. Pfiefer, pp. 47:12-48:24. Unum's practices in no way encourage employers to establish benefit plans nor do they protect the solvency of the plans. There is no evidence of disclosure to plans or to employers of Unum's windfall. Fiduciary service demands more. *See Meinhard v. Salmon*, 249 N.Y. 458, 464, 164 N.E. 545, 546 (1928) (Cardozo, J.).

If the established rule of the law of trusts is not to be applied to insurance companies who serve as ERISA fiduciaries, why should the rule apply to other fiduciaries, be they lawyers, executors, bank trustees, or other ERISA plan fiduciaries, who exercise control over other people's money? Should their fiduciary duties likewise be allowed to evaporate without divestment of their beneficiaries' funds so that they may also invest these funds for their own benefit?

[17] T- refers to the trial transcript.

Would any bar association condone a lawyer converting client trust funds to his own use because the lawyer had mailed his client a signed demand note before transferring the client's funds to his personal account?

Here, it is undisputed that Unum came into possession of beneficiaries' death benefits during the course of its service as an ERISA fiduciary. Under the law of trusts, Unum cannot terminate its fiduciary duties to its beneficiaries while it retains possession of their funds. Instead, Unum should be deemed a fiduciary with respect to the funds for as long as it retains possession of the funds.

The court below refused to apply this principle from the law of trusts, holding that Unum, by retaining the beneficiary's benefits, had "paid the death benefits," and this retention "constituted delivery in full of the policy proceeds to the person(s) entitled to those proceeds." Pet.App. 24. Lewis Carroll would have been amused by this tortured redefinition of words of well-established meaning.[18]

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[18] "When *I* use a word," Humpty Dumpty said, in rather a scornful tone, "it means just what I choose it to mean – neither more nor less."

"The question is," said Alice, "whether you *can* make words mean so many different things."

"The question is," said Humpty Dumpty, "which is to be master – that's all."

Lewis Carroll, *Through the Looking Glass*, chapter VI, p. 230.

The ruling below fails to follow *Varity*, *Mertens*, *Firestone* and other decisions of this Court that address the fiduciary duties imposed by ERISA and the law of trusts. This is a matter of great import that requires resolution by this Court. Certiorari should be granted.

III. There is a Split of Authority Among the Circuits as to the Degree of Deference to be Accorded an Opinion of the Secretary of Labor Expressed in an *Amicus* Brief, Particularly, Where Guidance from the Department has been Inconsistent.

The Sixth Circuit recently noted:

> The Supreme Court has yet to address the appropriate level of deference to give the construction of a statute articulated by an agency only in amicus briefs. See Bradley George Hubbard, Comment, *Deference to Agency Statutory Interpretations First Advanced in Litigation? The Chevron Two-Step and the Skidmore Shuffle*, 80 U. Chi. L.Rev. 447, 459 (2013). Although our Court has provided no answer either, some of our sister circuits have concluded that agency positions expressed in amicus briefs deserve *Skidmore* deference. We decline to afford either *Chevron* or *Skidmore* deference to the Secretary's "regulation by amicus" in this case.

Smith v. Aegon Companies Pension Plan, 769 F.3d 922, 927 (6th Cir. 2014) (declining to give deference to a DOL *amicus* brief).

The Tenth Circuit appears to be in accord. *Shikles v. Sprint/United Management Co.*, 426 F.3d 1304, 1315 (10th Cir. 2005) ("However, '*amicus* briefs, opinion letters and policy guidelines do not reflect the deliberate exercise of interpretive authority that regulations and guidelines demonstrate[.]' ").

The First, Second and Third Circuits have accorded the *Faber amicus* brief controlling deference. *See also Ball v. Memphis Bar-B-Q Co.*, 228 F.3d 360, 365 (4th Cir. 2000) (recognizing *Skidmore* deference "to the extent that those interpretations have the 'power to persuade' "); *Serricchio v. Wachovia Securities, LLC*, 658 F.3d 169, 194 (2d Cir. 2011) (applying *Skidmore* deference to DOL *amicus* briefs).

The degree of deference that is accorded opinions expressed by a government agency often controls the outcome. The history of this and other cases that have asserted that insurance carriers that provide policies and services to ERISA-governed employee benefit plans are fiduciaries prohibited from profiting from self-dealing demonstrates just how crucial is this issue of *deference*.

The first case that challenged the use of retained asset accounts as a device for insurance companies to self deal in ERISA plan benefits was *Mogel v. Unum Life Ins. Co. of Amer.*, 07-CA-10955 (D.Mass.). The district court held that delivery of a checkbook did not constitute payment, but granted the motion to dismiss based upon the guaranteed benefit policy exemption. *Mogel v. Unum Life Ins. Co. of Amer.*, 540 F.Supp.2d 258 (D.Mass. 2008). The First Circuit reversed, holding that delivery of a checkbook was not payment, that the retained death benefits continued to be plan assets and that Unum's ERISA-imposed fiduciary duties continued so long as it continued to hold its beneficiary's funds. *Mogel*, 547 F.3d 23. That case subsequently settled.

Thereafter and until the Second Circuit's decision in *Faber* that deferred to positions advocated by the DOL, all but one court followed *Mogel* and denied motions to dismiss. *Vander Luitgaren v. Sun Life Ins. Co.*, 2010 WL 4722269 (D.Mass.) (fiduciary duties continue until funds withdrawn; 12(b)(6) motion denied); *Edmonson v. Lincoln Nat. Life Ins. Co.*, 777 F.Supp.2d 869 (E.D.Pa. 2011) (12(b)(6) motion denied); *Otte v. Life Ins. Co. of N.A.*, 275 F.R.D. 50 (D.Mass. 2011) (fiduciary duties continue until money is fully withdrawn; class certified). *But see Faber v. Metropolitan Life Ins. Co.*, 2009 WL 3415369 (S.D.N.Y.).

Since *Faber*, all decisions have been for the insurance carrier except for the decision of the district court below. *Merrimon*, 845 F.Supp.2d 310 (D.Me. 2012), and 2013 WL 4854367 (D.Me.). *See Vander Luitgaren v. Sun Life Ins. Co.*, 765 F.3d 59 (1st Cir. 2014); *Merrimon*, 758 F.3d 46 (1st Cir. 2014); *Edmonson*, 725 F.3d 406 (3d Cir. 2013); *Vander Luitgaren*, 2013 WL 4058916 (D.Mass.); *Edmonson*, 899 F.Supp.2d 310 (E.D.Pa. 2012); *Faber*, 648 F.3d 98 (2d Cir. 2011).

The circuit court decisions in *Sun Life*, *Faber*, *Edmonson* and *Merrimon* expressly accorded controlling deference to the DOL *Faber amicus* brief.

The DOL has, however, issued other pronouncements relevant to matters at issue.

The term "float" is commonly used in banking to refer to the time between when a check is written and the time that it is presented for collection. "Float" thus gives a bank or at times its commercial customer added time to hold and invest money due the payee of the check. Even a few days of float on a large number of checks that are written for a cumulatively large amount of money can produce substantial earnings.

A retained asset account is a device that was created to extend the time that an insurance carrier can continue to possess and thus invest monies due its beneficiaries. David Evans, *Duping the Families of Fallen Soldiers*, Bloomberg (July 28, 2010), *available at* http://www.bloomberg.com/news/2010-07-28/duping-the-families-of-fallen-soldiers.html. Such accounts can be fairly viewed as "float" on steroids, for the added time for continued investment is not a few days, but months, years and maybe forever.

The DOL has twice issued guidance concerning the practice whereby fiduciaries and others that provide services to plans earn interest from the "float" that occurs between the time that a benefit check is issued and the time that it is cashed by the beneficiary. DOL Advisory Opinion 93-24A (Sept. 13, 1993), Pet.App. 249; DOL Field Assistance Bulletin 2002-3 (Nov. 5, 2002), Pet.App. 240.

In Advisory Opinion 93-24A, the DOL opined that "where a fiduciary . . . exercises discretion with respect to plan assets, its receipt of income from the 'float' on benefits checks . . . would [violate] . . . ERISA section 406(b)(1)." Pet.App. 252. In Field Assistance Bulletin 2002-3, the DOL clarified the circumstances under which an ERISA service provider may receive income from float without violating ERISA. *Id.* at 241. The DOL explained that float should be considered part of a service provider's compensation, and that in order for a service provider to receive income from float without violating ERISA, the income it will receive from float must be disclosed to, negotiated with, and approved by the plan fiduciary, and the service provider must have no discretion to affect the amount of income it receives from float.

The DOL recently issued guidance concerning whether an insurance company that provides recordkeeping and related services to a defined contribution plan violates ERISA when it receives "revenue sharing payments" from mutual funds and other investment vehicles in which the plan's participants invest. DOL Advisory Opinion 2013-03A (July 3, 2013), Pet.App. 231. The DOL could not determine from the facts provided whether or not the revenue sharing payments were "plan assets," but noted that the arrangement would be subject to the fiduciary provisions of ERISA regardless of whether the payments were plan assets. The arrangement would be subject to ERISA's general standards of fiduciary conduct, including Section 404(a)(1)'s requirement that "responsible plan fiduciaries must act prudently and solely in the interests of the plan participants and beneficiaries[.]" *Id.* at 237. The plan's fiduciaries therefore must ensure that the compensation received by the service provider *directly or indirectly* is reasonable. *Id.*

Central to the DOL's guidance is the principle that in order for a service provider's compensation to pass muster under ERISA, it must be fully disclosed to the responsible plan fiduciary and it must be openly negotiated with and approved by the fiduciary, in order to ensure that the amount of the compensation is reasonable. In addition, the service provider must possess no discretion to affect the amount of its compensation.

The income that Unum derives from the spread on retained asset accounts fails each of these requirements. There is no evidence that it was disclosed to, negotiated with, or approved by, a responsible plan fiduciary. Further, Unum possessed discretion to control the amount of compensation it received from the spread because it reserved unto itself unfettered discretion to set the interest rate to be credited to beneficiaries. Pet.App. 39. The undisclosed, unbargained for income that Unum receives from the spread is enormous and has been collected in secret with no hint of fiduciary restraint.

The DOL's failure to assess in the *Faber* brief the reasonableness of the undisclosed income gained by Metropolitan Life by use of retained asset accounts is inconsistent with its other pronouncements and therefore undermines the reliability of its brief that was submitted on short notice. A more recent brief makes assertions in direct conflict.

The DOL has now concurred with Petitioners' assertions that insurance policies issued to ERISA plans and the death benefits that flow therefrom are "plan assets":

> **The life insurance policies purchased with those [Plan] funds and for the benefit of the Plans, as well as any death benefits paid on those life insurance policies, are also Plan assets** because such policies were held by the Trust for the benefit of the Plans and paid for with Plan assets. . . . *See DOL Advisory Opinion No. 2005-08A* (May 11, 2005) ("Generally, a distribution such as the [death benefit payment], will be a plan asset if a plan has a beneficial interest in the distribution under ordinary notions of property rights . . . In the case where any type of plan or trust is the policyholder, or where the premium is paid entirely out of trust assets, it is the view of the Department that the entire distribution amount received by such policyholder constitutes plan assets.").

Secretary of Labor's Memo. of Law in Support of Motion for Partial Summary Judgment (Doc. 269), *Solis* *v. Koresko*, No. 2:09-cv-00988-MAM (E.D.Pa.) at 17 (emphasis added). Pet.App. 181.

The DOL cites the First Circuit's decision in *Mogel* as support for the above position, with a parenthetical describing the holding in *Mogel* that states, "death benefit proceeds remain plan assets of group death benefit plan subject to fiduciary obligations until actual payment of proceeds to beneficiary." Pet.App. 202.

The DOL then asserts:

> Therefore, the death benefit proceeds discussed below remained plan assets, even when the Koresko Defendants unlawfully removed them from the REAL VEBA Trust. Only the portion of the proceeds actually forwarded to beneficiaries lost their character as plan assets.

Id.

The court agreed with the DOL, holding that death benefits provided by an ERISA plan's insurance policy are plan assets. *Solis v. Koresko*, 884 F.Supp.2d 261, 289 (E.D.Pa. 2012).

It is undisputed that time passes between the time that a death claim is approved, thus ending any application of the guaranteed benefit policy exemption, and the time that drafts are ordered, printed and mailed by Unum's vendor to the designated plan beneficiary. Pet.App. 32. This important temporal fact was recognized by the district court below:

> *Mogel* is clear that the guaranteed benefit exemption is no longer applicable once Unum approves the death claim and the beneficiaries' rights to payment vest. *Mogel*, 547 F.3d at 27 ("once an insured's death occurs, we are no longer concerned with the management of plan assets in an insurance company's general account (which is all the guaranteed benefit exemption covers)").

Pet.App. 79.

As acknowledged by the DOL in *Koresko*, undistributed but due plan benefits are plan assets. This position conflicts with the assertion in the *Faber* brief and the holding below that the death benefits never were plan assets. Of course, if undistributed death benefits are plan assets, if even only for a few days, how can Unum, acting as a plan fiduciary, lend those plan benefits to itself, even if plan language allows it to do so? *See Varity Corp. v. Howe*, 516 U.S. at 504, 116 S.Ct. at 1073-1074 (ERISA fiduciary duties trump plan language. "If the fiduciary duty applied to nothing more than activities already controlled by other specific legal duties, it would serve no purpose."); 29 U.S.C. § 1104(a)(1)(D).

The above-cited DOL materials were each addressed below, both in briefs and in oral argument, but were not addressed in the opinion. Pet.App. 11-17. Moreover, the court below avoided application of this Court's holding in *Varity* by distinguishing the decision on its facts. *Id*. at 25-28.

The controlling deference granted the *Faber amicus* brief by the First Circuit is puzzling. It is the position of the DOL that the determination of what are plan assets should be based upon "ordinary notions of property rights under non-ERISA law." Pet.App. 155. Property law is almost all drawn from the common law and state statutes. Why should special deference be accorded the DOL on issues of state property law? What special expertise is the Secretary deemed to have in applying principles of property law or its sub-part, the law of trusts? Where is the authority drawn from non-ERISA property law for the proposition that a plan that is the policyholder of life insurance paid for with plan monies to fund obligations of the plan to its participants and their beneficiaries has no beneficial interest in the insurance contract to which it is a party?

The sixteen-page *amicus* brief given controlling deference below does not cite a single case, statute or treatise that addresses non-ERISA property law. Pet.App. 153. The DOL cites no support for its assertion that ERISA plans that buy policies from Unum to meet plan obligations have no beneficial interest in the proceeds of policies that they own.

The decision of the court below to read *Varity* so narrowly as to strip it of meaning, the failure to consider the conflicting policies and positions enunciated by the DOL, and the conflicting decisions among the circuits as to the deference to be accorded agency views expressed in an *amicus* brief all present an ideal record for review by this Court so as to provide clear guidance as to whether an *amicus* brief of a government agency on issues of statutory interpretation should be given *deferential* weight.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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United States Court of Appeals
For the First Circuit

No. 13-2128

DENISE MERRIMON and BOBBY S. MOWERY,

Plaintiffs, Appellees,

v.

UNUM LIFE INSURANCE
COMPANY OF AMERICA,

Defendant, Appellant.

No. 13-2168

DENISE MERRIMON and BOBBY S. MOWERY,

Plaintiffs, Appellants,

v.

UNUM LIFE INSURANCE
COMPANY OF AMERICA,

Defendant, Appellee.

APPEALS FROM THE
UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MAINE

[Hon. Nancy Torresen, *U.S. District Judge*]

Before

Torruella and Selya, *Circuit Judges*,
and McAuliffe,* *District Judge*.

Donald R. Frederico, with whom *Catherine R. Connors*, *Byrne J. Decker*, *Gavin G. McCarthy*, and *Pierce Atwood LLP* were on brief, for defendant.

James F. Jorden, *Waldemar J. Pflepsen, Jr.*, *Michael A. Valerio*, *Ben V. Seessel*, *John C. Pitblado*, *Jorden Burt LLP*, and *Lisa Tate* on brief for American Council of Life Insurers, amicus curiae.

Jeremy P. Blumenfeld, *Morgan, Lewis & Bockius LLP*, *J. Michael Weston*, and *Lederer Weston Craig* on brief for Defense Research Institute, amicus curiae.

John C. Bell, Jr., with whom *Lee W. Brigham*, *Bell & Brigham*, *Stuart T. Rossman*, *Arielle Cohen*, *National Consumer Law Center*, *M. Scott Barrett*, and *Barrett Wylie LLC* were on brief, for plaintiffs.

July 2, 2014

SELYA, *Circuit Judge*. In 1974, Congress enacted the Employee Retirement Income Security Act (ERISA). Pub. L. No. 93-406, 88 Stat. 829, codified as

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* Of the District of New Hampshire, sitting by designation.

amended at 29 U.S.C. §§ 1001-1461. One of ERISA's principal goals is to afford appropriate protection to employees and their beneficiaries with respect to the administration of employee welfare benefit plans. *See Nachman Corp.* v. *Pension Benefit Guar. Corp.,* 446 U.S. 359, 361-62 (1980). As is true of virtually any prophylactic statute, interpretive questions lurk at the margins. This class action, which arises out of an insurer's redemption of claims on ERISA-regulated life insurance policies through the establishment of retained asset accounts (RAAs), spawns such questions.

Here, the plaintiffs challenge the insurer's use of RAAs as a method of paying life insurance benefits in the ERISA context. They presented the district court with two basic questions. First, did the insurer's method of paying death benefits in the form of RAAs constitute self-dealing in plan assets in violation of ERISA section 406(b)? Second, did this redemption method offend the insurer's duty of loyalty toward the class of beneficiaries in violation of ERISA section 404(a)? The district court answered the first question in favor of the insurer and the second in favor of the plaintiff class. It proceeded to award class-wide relief totaling more than $12,000,000.

Both sides appeal. We agree with the district court that the insurer's use of RAAs in the circumstances of this case did not constitute self-dealing in plan assets. We disagree, however, with the district court's answer to the second query and hold that the insurer's use of RAAs did not breach any duty of loyalty owed by the insurer to the plaintiff class. Accordingly, we affirm in part and reverse in part.

I. BACKGROUND

We briefly rehearse the relevant facts, which are largely undisputed. Readers who hunger for more exegetic detail may consult the district court's fulsome rescript. *See Merrimon* v. *Unum Life Ins. Co.,* 845 F. Supp. 2d 310, 312-15 (D. Me. 2012).

The plaintiffs, Denise Merrimon and Bobby S. Mowery, represent a class of beneficiaries of ERISA-regulated employee welfare benefit plans funded by certain guaranteed-benefit group life insurance policies that the defendant, Unum Life Insurance Company of America (the insurer), issued.[1] In 2007, each named plaintiff submitted a claim for life insurance benefits. After reviewing the submissions, the insurer approved the claims.

The insurer redeemed the claims by establishing, through a contractor, accounts for the named plaintiffs at State Street Bank and credited to each plaintiff's account the full amount of the benefits owed: $51,000 to Merrimon and $62,300 to Mowery. At the same time, the insurer mailed books of drafts to the plaintiffs, along with informational materials

[1] Although the decedents' employers were the named administrators of the plans, each of them delegated to the insurer discretionary authority to make claim determinations.

regarding the accounts. The drafts empowered the plaintiffs to withdraw all or any part of the corpus of the RAAs; provided, however, that each withdrawal was in an amount not less than $250.

In short order, the plaintiffs fully liquidated their RAAs and the accounts were closed. During the time that funds remained in their RAAs, however, the insurer retained the credited funds in its general account and paid the plaintiffs interest at a rate of one percent (substantially less, the plaintiffs allege, than the return the insurer earned on its portfolio).

The closing of the RAAs did not end the matter. In October of 2010, the plaintiffs filed a putative class action complaint in the United States District Court for the District of Maine. Their complaint alleged that the insurer's method of redeeming their claims violated ERISA sections 404(a) and 406(b), 29 U.S.C. §§ 1104(a), 1106(b), and sought "appropriate equitable relief" under 29 U.S.C. § 1132(a)(3).[2] Following discovery, the parties cross-moved for summary judgment and the plaintiffs moved for class certification. The district court granted partial summary judgment in favor of the insurer on the plaintiffs' section 406(b) claims and granted partial summary judgment in favor of the plaintiffs on their section 404(a) claims. *See Merrimon,* 845 F. Supp. 2d at 327-28. The court

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[2] The complaint also advanced supplemental claims under Maine law. The district court dismissed those claims, and the plaintiffs have not attempted to renew them on appeal.

then certified the plaintiff class. *See id.* The insurer moved to reconsider the adverse summary judgment and class certification rulings, but the district court doubled down: it both denied the motion and struck it as untimely.

A bench trial ensued to determine the appropriate measure of relief based on the district court's determination (on partial summary judgment) that the insurer had violated section 404(a). When all was said and done, the court awarded the plaintiff class monetary relief in excess of $12,000,000 (exclusive of prejudgment interest). Neither side was overjoyed, and these cross-appeals followed.

II. JURISDICTION

The insurer argues, albeit conclusorily, that the plaintiffs lack constitutional standing to pursue their claims. One of the amici helpfully develops the argument in significantly greater detail. Although these circumstances might ordinarily give rise to questions of waiver, *see, e.g., United States* v. *Zannino,* 895 F.2d 1, 17 (1st Cir. 1990) (explaining that issues briefed in a perfunctory manner are normally deemed abandoned); *Lane* v. *First Nat'l Bank,* 871 F.2d 166, 175 (1st Cir. 1989) (explaining that a court will usually disregard issues raised only by amici and not by parties), no such obstacle exists here. The presence or absence of constitutional standing implicates a federal court's subject-matter jurisdiction. When an issue implicates subject-matter jurisdiction, a federal court is obliged to resolve that issue even if the parties have neither briefed nor argued it. *See Arizonans for Official English* v. *Arizona,* 520 U.S. 43, 73 (1997); *In re Sony BMG Music Entm't,* 564 F.3d 1, 3 (1st Cir. 2009).

The Constitution carefully confines the power of the federal courts to deciding cases and controversies. *See* U.S. Const. art. III, § 2; *Hollingsworth* v. *Perry,* 133 S. Ct. 2652, 2661 (2013). "A case or controversy exists only when the party soliciting federal court jurisdiction (normally, the plaintiff) demonstrates 'such a personal stake in the outcome of the controversy as to assure that concrete adverseness which sharpens the presentation of issues upon which the court so largely depends.'" *Katz* v. *Pershing, LLC,* 672 F.3d 64, 71 (1st Cir. 2012) (quoting *Baker* v. *Carr,* 369 U.S. 186, 204 (1962)); *see Muskrat* v. *United States,* 219 U.S. 346, 361-62 (1911). In order to make such a showing, "a plaintiff must establish each part of a familiar triad: injury, causation, and redressability." *Katz,* 672 F.3d at 71 (citing *Lujan* v. *Defenders of Wildlife,* 504 U.S. 555, 560-61 (1992)).

The pivotal question here involves the injury in fact requirement. The best argument for the absence of constitutional standing is the notion that the plaintiffs did not suffer any demonstrable financial loss as a result of the insurer's alleged transgressions and, therefore, did not sustain any injury in fact. Put another way, the argument is that because the plaintiffs received everything to which they were entitled under the ERISA plans, they suffered no actual harm.

This argument is substantial. When confronted with essentially the same question, the Second Circuit bypassed it and asserted jurisdiction on other grounds. *See Faber* v. *Metro. Life Ins. Co.,* 648 F.3d 98, 102-03 (2d Cir. 2011). The Third Circuit rejected the argument in a divided opinion. *See Edmonson* v. *Lincoln Nat'l Life Ins. Co.,* 725 F.3d 406, 415-17 (3d Cir. 2013), *cert. denied,* 134 S. Ct. 2291 (2014); *id.* at 429-33 (Jordan, J., dissenting). After careful perscrutation, we hold that the plaintiffs have constitutional standing.

An injury in fact is defined as "an invasion of a legally protected interest which is (a) concrete and particularized; and (b) actual or imminent, not conjectural or hypothetical." *Lujan,* 504 U.S. at 560 (footnote omitted) (internal citations and quotation marks omitted). But in order to establish standing, a plaintiff does not need to show that her rights have actually been abridged: such a requirement "would conflate the issue of standing with the merits of the suit." *Aurora Loan Servs., Inc.* v. *Craddieth,* 442 F.3d 1018, 1024 (7th Cir. 2006). Instead, a plaintiff need only show that she has "a colorable claim to such a right." *Id.* (emphasis omitted). The evaluation of whether such a showing has been made must take into account the role of Congress. After all, Congress has the power to define "the status of legally cognizable injuries." *Katz,* 672 F.3d at 75.

These principles are dispositive here. Congress has mandated ERISA fiduciaries to abide by certain strictures and has granted ERISA beneficiaries corresponding rights to sue for violations of those strictures. *See* 29 U.S.C. § 1132(a)(3) (authorizing beneficiaries to sue "to obtain . . . appropriate equitable relief" in order "to redress . . . violations" of ERISA). An ERISA beneficiary thus has a legally cognizable right to have her plan fiduciaries perform those duties that ERISA mandates.

We hasten to add a caveat. It is common ground that Congress cannot confer standing beyond the scope of Article III. *See Summers* v. *Earth Island Inst.,* 555 U.S. 488, 497 (2009) ("[T]he requirement of injury in fact is a hard floor of Article III jurisdiction that cannot be removed by statute."). This means, of course, that an insurer's violation of an ERISA-imposed fiduciary duty does not necessarily confer standing on all plan beneficiaries: a beneficiary must show that the alleged violation has worked some "personal and tangible harm" to her. *Hollingsworth,* 133 S. Ct. at 2661.

Here, however, the plaintiffs make colorable claims that they have suffered just such a harm. They contend that the insurer has wrongfully retained and misused their assets. If proven, this would constitute a tangible harm even if no economic loss results. *See, e.g., Restatement (Third) of Restitution and Unjust Enrichment* § 3 reporter's note a (2011) ("[T]here can be restitution of wrongful gain in cases where the plaintiff has suffered an interference with protected interests but no measurable loss whatsoever."); *see also CIGNA Corp.* v. *Amara,* 131 S. Ct. 1866, 1881 (2011). In addition, the injury – although common to a potentially wide class of beneficiaries – is particularized to the plaintiffs, each of whom claims that the insurer wrongfully retained his or her assets.

The Supreme Court has "often said that history and tradition offer a meaningful guide to the types of cases that Article III empowers federal courts to consider." *Sprint Commc'ns Co.* v. *APCC Servs., Inc.,* 554 U.S. 269, 274 (2008). Although ERISA is of relatively recent origin, its administration is informed by the common law of trusts. *See Varity Corp.* v. *Howe,* 516 U.S. 489, 496 (1996). Historically, courts have asserted jurisdiction over cases against a trustee "even though the trust itself ha[d] suffered no loss." George G. Bogert et al., *Law of Trusts and Trustees* § 861 (2013) (citing *Mosser* v. *Darrow,* 341 U.S. 267, 272-73 (1951); *Magruder* v. *Drury,* 235 U.S. 106, 120 (1914)); *see also Restatement (Third) of Restitution and Unjust Enrichment* § 3 reporter's note a (2011). A holding here that the plaintiffs have satisfied the requirements for constitutional standing would be entirely consistent with this historical practice.

To say more about the issue of constitutional standing would be to paint the lily. We hold that the plaintiffs have asserted colorable and cognizable claims of injuries in fact. Nothing more is needed here, from a jurisdictional standpoint, to wrap the plaintiffs in the cloak of constitutional standing.[3]

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[3] In its opening brief, the insurer suggests that the plaintiffs lack statutory standing under ERISA. Statutory standing

(Continued on following page)

III. THE MERITS

The district court made two pertinent liability rulings at the summary judgment stage. One of these is challenged by the plaintiffs and the other by the insurer. We review both rulings de novo. *See Kouvchinov* v. *Parametric Tech. Corp.,* 537 F.3d 62, 66 (1st Cir. 2008). Before addressing these rulings, however, we must resolve a threshold issue: whether deference is due to the relevant views of the United States Department of Labor (DOL). We start there.

A. *The DOL Guidance.*

The Second Circuit, puzzling over essentially the same riddle that confronts us today, asked the DOL to provide its interpretation of how the relevant ERISA provisions affect insurers' decisions to use RAAs as a method of claim redemption. *See Faber,* 648 F.3d at 102. The DOL responded by submitting a 16-page

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is, of course, different than constitutional standing. *See Katz,* 672 F.3d at 75; *Graden* v. *Conexant Sys. Inc.,* 496 F.3d 291, 295 (3d Cir. 2007). One way in which the two concepts differ is that arguments based on statutory standing, unlike arguments based on constitutional standing, are waivable. *See, e.g., Bilyeu* v. *Morgan Stanley Long Term Disab. Plan,* 683 F.3d 1083, 1090 (9th Cir. 2012), *cert. denied,* 133 S. Ct. 1242 (2013). Any possible defect in statutory standing has been waived in this case because the issue was not raised below. *See Teamsters Union, Local No. 59* v. *Superline Transp. Co.,* 953 F.2d 17, 21 (1st Cir. 1992) ("If any principle is settled in this circuit, it is that, absent the most extraordinary circumstances, legal theories not raised squarely in the lower court cannot be broached for the first time on appeal.").

amicus brief. See Secretary of Labor's Amicus Curiae Letter Brief in Response to the Court's Invitation (the DOL Guidance), *Faber,* 648 F.3d at 98 (No. 09-4901). In it, the DOL, after sedulous analysis, made it crystal clear that an insurer discharges its fiduciary duties under ERISA by furnishing a beneficiary unfettered access to an RAA in accordance with plan terms and does not retain plan assets by holding and managing the funds that back the RAA.

The insurer, citing *Skidmore* v. *Swift & Co.,* 323 U.S. 134, 140 (1944), exhorts us to defer to the DOL Guidance. The plaintiffs demur, arguing that the DOL Guidance was hastily prepared and is inconsistent with other authority.

It is important to note that the DOL "shares enforcement responsibility for ERISA." *John Hancock Mut. Life Ins. Co.* v. *Harris Trust & Sav. Bank,* 510 U.S. 86, 107 n.14 (1993) (citing 29 U.S.C. § 1204(a)). This responsibility paves the way for – but does not require – a finding that some deference is due to the DOL's views. An agency's interpretation of a statute that it administers may warrant judicial deference, depending on the degree to which the agency's exposition of the issue is deemed authoritative. *See United States* v. *Mead Corp.,* 533 U.S. 218, 228 (2001).

While agencies are generally presumed to have particular expertise with respect to the statutes that they administer, agencies speak in a variety of ways. As a result, authoritativeness often depends, at least in part, on context. For example, when an agency speaks with the force of law, as through a binding regulation, its interpretation of ambiguous provisions of a statute that falls within its purview is due judicial deference as long as that interpretation is reasonable. *See id.* at 229-30; *Chevron U.S.A. Inc.* v. *Natural Res. Def. Council, Inc.,* 467 U.S. 837, 842-45 (1984).

But when an agency speaks with something less than the force of law, its interpretations are entitled to deference "only to the extent that those interpretations have the 'power to persuade.'" *Christensen* v. *Harris Cnty.,* 529 U.S. 576, 587 (2000) (quoting *Skidmore,* 323 U.S. at 140). That is the situation here. We must, therefore, dig deeper.

To gauge persuasiveness, an inquiring court should look to a "mix of factors" that "either contributes to or detracts from the power of an agency's interpretation to persuade." *Doe* v. *Leavitt,* 552 F.3d 75, 81 (1st Cir. 2009). Those factors include "the thoroughness evident in [the agency's] consideration, the validity of its reasoning, [and the] consistency [of its interpretation] with earlier and later pronouncements." *Id.* (alterations in original) (quoting *Skidmore,* 323 U.S. at 140). "[T]he most salient of the factors that inform an assessment of persuasiveness [is] the validity of the agency's reasoning." *Id.* at 82.

We appraise the DOL Guidance with these factors in mind. In doing so, we are acutely aware that if this inquiry is to have any real utility, it must involve something more than merely determining whether the agency's views comport with the court's independent interpretation of the relevant statutory provisions. *See id.* at 80-81. If the relevant factors tilt in favor of giving weight to the agency's views, it would be an exercise in vanity for a court to disregard those views.

The DOL Guidance is plainly well-reasoned. Here, as in Doe, "the agency has consulted appropriate sources, employed sensible heuristic tools, and adequately substantiated its ultimate conclusion." *Id.* at 82. The meticulous nature of the agency's statement of its views, coupled with the logic of its position, combine to lend the DOL Guidance credibility.

To be sure, the DOL Guidance was not forged through a transparent and structured process, nor was it tempered in the crucible of public comment. Such accouterments would have given added heft to the DOL Guidance – but none of them is a condition precedent to deference. *See Sun Capital Partners III, LP.* v. *New Eng. Teamsters & Trucking Indus. Pension Fund,* 724 F.3d 129, 140-41 (1st Cir. 2013), *cert. denied,* 134 S. Ct. 1492 (2014); *Conn. Office of Prot. & Advocacy for Pers. with Disabs.* v. *Hartford Bd. of Educ.,* 464 F.3d 229, 239-40 (2d Cir. 2006) (Sotomayor, J.). Persuasiveness (or the lack of it) depends on the totality of the relevant factors.

So, too, the fact that the DOL's position is of relatively recent vintage is not fatal. While the longstanding nature of an agency interpretation may constitute an added reason for deference, *see Lapine*

v. *Town of Wellesley,* 304 F.3d 90, 106 (1st Cir. 2002), new interpretations – particularly new interpretations addressing questions not previously posed to the agency – can be convincing, *see, e.g., Conn. Office of Prot. & Advocacy,* 464 F.3d at 244; *In re New Times Sec. Servs., Inc.,* 371 F.3d 68, 81-83 (2d Cir. 2004).

In the last analysis, we are satisfied that the considerations of process and duration stressed by the plaintiffs are insufficient to sully the well-reasoned DOL Guidance. The amicus brief filed by the DOL bears the hallmarks of reliability. There is no good reason to dismiss it, especially since the agency was not a party to the litigation in which the amicus brief was filed but articulated its views only in response to the Second Circuit's direct request. *See Conn. Office of Prot. & Advocacy,* 464 F.3d at 236, 239-40. Taking into account the scrupulousness of the DOL Guidance, its analytic rigor, and its crafting of a set of clear and easily applied rules that are consistent with ERISA's structure, text, and purpose, we conclude that the DOL Guidance is deserving of some weight. *See Martin* v. *OSHRC,* 499 U.S. 144, 157 (1991).

B. *Section 406(b).*

The plaintiffs' remaining contention is that the insurer's method of redeeming life insurance policies by paying death benefits in the form of RAAs constituted self-dealing in plan assets in violation of ERISA section 406(b). ERISA section 406(b) prohibits a plan fiduciary from "deal[ing] with the assets of the plan in [its] own interest or for [its] own account." 29 U.S.C. § 1106(b)(1). The plaintiffs assert that the insurer violated this prohibition on self-dealing in plan assets by retaining and investing RAA funds for its own enrichment. The district court rejected this assertion, *see Merrimon,* 845 F. Supp. 2d at 319, and so do we.

ERISA nowhere contains a comprehensive definition of what constitutes "plan assets." *See Harris Trust,* 510 U.S. at 89. In an effort to fill this void, the DOL consistently has stated that "the assets of a plan generally are to be identified on the basis of ordinary notions of property rights under non-ERISA law." U.S. Dep't of Labor, Advisory Op. No. 93-14A, 1993 WL 188473, at *4 (May 5, 1993). Several of our sister circuits have adopted this formulation. *See, e.g., Edmonson,* 725 F.3d at 427; *Faber,* 648 F.3d at 105-06; *Kalda* v. *Sioux Valley Physician Partners, Inc.,* 481 F.3d 639, 647 (8th Cir. 2007); *In re Luna,* 406 F.3d 1192, 1199 (10th Cir. 2005). We too find this formulation persuasive.

The plaintiffs concede that, prior to the creation of an RAA, funds held in the insurer's general account are not plan assets. That is because

> [i]n the case of a plan to which a guaranteed benefit policy is issued by an insurer, the assets of such plan shall be deemed to include such policy, but shall not, solely by reason of the issuance of such policy, be deemed to include any assets of such insurer.

29 U.S.C. § 1101(b)(2).

The plaintiffs nonetheless posit that when a death benefit accrues and is redeemed by means of the establishment of an RAA, the RAA funds become plan assets if those funds are retained in the insurer's general account. As a corollary, they posit that those retained funds remain plan assets until the RAA is fully liquidated.

This argument lacks force. There is no basis, either in the case law or in common sense, for the proposition that funds held in an insurer's general account are somehow transmogrified into plan assets when they are credited to a beneficiary's account. Indeed, the DOL Guidance – to which a modicum of respect is owed – indicates exactly the opposite. *See* DOL Guidance at 7.

We add, more generally, that ordinary notions of property rights counsel strongly against the plaintiffs' proposition. It is the beneficiary, not the plan itself, who has acquired an ownership interest in the assets backing the RAA. *See Edmonson,* 725 F.3d at 428; *Faber,* 648 F.3d at 106. Unless the plan documents clearly evince a contrary intent – and here they do not – a beneficiary's assets are not plan assets.

The decision in *Mogel* v. *Unum Life Insurance Co.,* 547 F.3d 23, 26 (1st Cir. 2008), is not at odds with the conclusion that the monies retained by the insurer are not plan assets. *Mogel* involved a plan that contained a specific directive to pay beneficiaries in a lump sum. *See id.* at 25. The insurer ignored this specific directive and sought instead to redeem claims through the establishment of RAAs. *See id.* As has been widely recognized, this particularized policy provision explains this court's holding that the insurer, which had not paid the policy proceeds in a manner permitted by the plan documents, had violated its fiduciary duties. *See Edmonson,* 725 F.3d at 428; *Faber,* 648 F.3d at 106-07; DOL Guidance at 13-14. Thus, neither the holding in *Mogel* nor its broadly cast language is binding precedent for purposes of this materially different case. *See Mun'y of San Juan* v. *Rullan,* 318 F.3d 26, 28 n.3 (1st Cir. 2003) (explaining that "[d]icta comprises observations in a judicial opinion . . . that are 'not essential' to the determination of the legal questions then before the court," and that dicta "have no binding effect in subsequent proceedings").

As a fallback, the plaintiffs invite us to adopt the Ninth Circuit's functional approach to determining which assets are plan assets. *See Acosta* v. *Pac. Enters.,* 950 F.2d 611, 620 (9th Cir. 1991). The functional approach looks to "whether the item in question may be used to the benefit (financial or otherwise) of the fiduciary at the expense of plan participants or beneficiaries" as a means of ascertaining whether the item is a plan asset. *Id.* Although courts occasionally have found this approach useful, we have never endorsed it. Nor do we need to explore its possible utility today: while the functional approach might be of some assistance in doubtful cases, the assets with which we are concerned – the funds backing the RAAs – fall squarely within the compass of section 401(b)(2) prior to the establishment of an RAA, and they are not governed by ERISA subsequent thereto. As the DOL Guidance makes manifest, those funds are simply not plan assets.

The plaintiffs have one final shot in their sling. They say that even if the court below appropriately determined that the retained funds were not plan assets, its ultimate conclusion that the insurer did not offend section 406(b) was nevertheless incorrect. This is so, the plaintiffs' thesis runs, because the life insurance policies themselves were plan assets and the insurer exercised control respecting the management of the policies when it established the RAAs, retained and invested the RAA funds to its own behoof, and decided how much of the investment profit to keep and how much to pay in interest.

The insurer's first line of defense is that this claim was waived because it was not proffered below. The plaintiffs' disavowal points only to a single paragraph in their complaint. Standing alone, this solitary paragraph is too thin a reed by which to exorcize the evils of waiver. We explain briefly.

"Even an issue raised in the complaint but ignored at summary judgment may be deemed waived. If a party fails to assert a legal reason why summary judgment should not be granted, that ground is waived and cannot be considered or raised on appeal." *Grenier* v. *Cyanamid Plastics, Inc.,* 70 F.3d 667, 678 (1st Cir. 1995) (internal quotation marks omitted). That is precisely what happened here. After filing their complaint, the plaintiffs did nothing to develop this particular claim, and the summary judgment papers disclose no development of it. The claim is, therefore, waived.

This brings us to the end of the road. We hold that the funds backing the plaintiffs' RAAs were not, and never became, plan assets. Consequently, the court below did not err in holding that there was no showing of self-dealing sufficient to ground a section 406(b) claim.

C. *Section 404(a).*

ERISA section 404(a) provides, with certain reservations not relevant here, that "a fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries." 29 U.S.C. § 1104(a)(1). Relatedly, ERISA stipulates that

> a "person is a fiduciary with respect to a plan," and therefore subject to ERISA fiduciary duties, "to the extent" that he or she "exercises any discretionary authority or discretionary control respecting management" of the plan, or "has any discretionary authority or discretionary responsibility in the administration" of the plan.

Varity, 516 U.S. at 498 (quoting 29 U.S.C. § 1002(21)(A)). The crux of the plaintiffs' section 404(a) claims is that the insurer acted as a fiduciary when setting the RAA interest rate and that it did not set the rate solely in the interest of the beneficiaries.

The district court found this claim persuasive. The court premised its conclusion that the insurer was acting as a fiduciary on the insurer's retention of discretion both "to determine the interest rates and other features accruing to [the RAAs]" and "to award itself the business of administering the Plaintiffs' RAAs" while retaining the assets backing these accounts. *Merrimon,* 845 F. Supp. 2d at 319-20. With this premise in place, the court concluded that the insurer, as a fiduciary, "managed the RAAs to optimize its own earnings and not to optimize the beneficiaries' earnings." *Id.* at 320. It granted partial summary judgment holding the insurer liable under ERISA section 404(a). *See id.*

The insurer mounts a formidable challenge to this holding. The centerpiece of its challenge is the assertion that, by establishing the RAAs in accordance with the plan documents, the insurer fully discharged its fiduciary duties. Consequently, the subsequent relationship between the insurer and the beneficiary was in the nature of a debtor-creditor relationship, governed not by ERISA but by state law. In other words, when the insurer invested the retained funds and paid interest to the beneficiaries, it was not acting as an ERISA fiduciary.

The insurer's position makes sense, and it is bulwarked by relevant authority. To begin, the DOL has stated explicitly that a life insurer discharges its fiduciary duties when it redeems a death-benefit claim through the establishment of an RAA as long as that method of redemption is called for by the plan documents. *See* DOL Guidance at 11. We owe a measure of deference to this view. *See supra* Part III(A). This deference is especially appropriate because the only two courts of appeals to have addressed the issue subsequent to the DOL's statement of its views have reached the same conclusion. *See Edmonson,* 725 F.3d at 424-26; *Faber,* 648 F.3d at 104-05.

The plaintiffs beseech us not to follow these authorities. Their variegated arguments sound two related themes. First, they assert that the insurer continued to act as a fiduciary even after it established the RAAs because it continued to hold the policy proceeds in its general account. Second, they assert that the insurer acted as a fiduciary in setting the interest rate because the plan documents stipulated no specific interest rate. We treat these arguments separately.

1. ***Retention of Policy Proceeds.*** It is clear beyond hope of contradiction that sponsors of ERISA plans have considerable latitude in plan design, including the establishment of methods for paying benefits. *See Faber,* 648 F.3d at 104 (citing *Hughes Aircraft Co.* v. *Jacobson,* 525 U.S. 432, 444 (1999)); *see also Curtiss-Wright Corp.* v. *Schoonejongen,* 514 U.S. 73, 78 (1995). When ERISA deals with the payment of benefits, the term benefit "denotes the money to which a person is entitled under an ERISA plan." *Evans* v. *Akers,* 534 F.3d 65, 70 (1st Cir. 2008) (internal quotation marks omitted). Although fiduciary duties do encompass some acts connected to the distribution of plan benefits, *see Mogel,* 547 F.3d at 27, such fiduciary duties relate principally to ensuring that monies owed to beneficiaries are disbursed in accordance with the terms of the plan.

In this instance, each of the plans provides that the insurer will, upon proof of claim, pay the death benefit owed by "mak[ing] available to the beneficiary a **retained asset account**" (emphasis in original).[4] Each plan describes an RAA as "an interest bearing account established through an intermediary bank." The insurer followed this protocol precisely: it made available to each plaintiff an interest-bearing RAA established through an intermediary bank, which was credited with the full amount of the death benefit owed. No more was exigible to carry out the terms of the plans.

Once the insurer fulfilled these requirements, its duties as an ERISA fiduciary ceased. *See Edmonson,* 725 F.3d at 425-26; *Faber,* 648 F.3d at 105; DOL Guidance at 11. There is simply no basis for concluding that ERISA-imposed fiduciary duties remained velivolant after that point. *Cf. LaRocca* v. *Borden, Inc.,* 276 F.3d 22, 30 (1st Cir. 2002) (explaining that the purpose of ERISA is "to protect contractually defined benefits"). Any further obligation that the insurer had to the beneficiaries "constituted a straightforward creditor-debtor relationship." *Faber,* 648 F.3d

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[4] The plans except death benefits totaling less than $10,000. That exception is not relevant here.

at 105; *accord Edmonson,* 725 F.3d at 426; DOL Guidance at 10-11.

The plaintiffs labor to dull the force of this reasoning. They start by asseverating that the establishment of an RAA does not constitute payment of benefits. But this asseveration rests chiefly on our decision in *Mogel,* 547 F.3d at 26; and as we already have explained, *Mogel* is inapposite here. *See supra* Part III(B).

The plaintiffs also asseverate that, under general trust principles, "[e]ven when a trust terminates, the trustee's powers and duties continue until the trustee delivers the trust property to the persons entitled to it." Plaintiffs' Br. at 66. Here, however, the insurer paid the death benefits that were owed by delivering to the beneficiaries an instrument (the RAA) required by the terms of the plans. Under the plans, that delivery constituted delivery in full of the policy proceeds to the person(s) entitled to those proceeds. Therefore, the general trust principles relied on by the plaintiffs do not support their claim.

This analysis also explains why the plaintiffs' insistence that the insurer had to obtain the plaintiffs' informed consent before it invested the retained funds is without merit. This argument, too, is based on general trust principles; and the simple answer to it is that the insurer was not acting as a fiduciary when it invested the retained funds.[5] *See Edmonson,* 725 F.3d at 426.

2. ***Setting of Interest Rate.*** This leaves the second theme sounded by the plaintiffs. They contend that because the insurer retained discretion to set the interest rate to be paid on the RAAs, rate-setting was a fiduciary act, which the insurer did not carry out solely in the interest of the beneficiaries. *Cf.* 29 U.S.C. § 1002(21)(A) (defining a plan fiduciary in terms of discretion). The plaintiffs' reach exceeds their grasp. Discretionary acts trigger fiduciary duties under ERISA only when and to the extent that they relate to plan management or plan assets. *See id.*; *see also Varity,* 516 U.S. at 498; *Livick* v. *Gillette Co.,* 524 F.3d 24, 29 (1st Cir. 2008). In the circumstances of this case, the setting of the interest rate did not relate to

[5] The plaintiffs launch an array of other plaints based on DOL statements. These statements deal, inter alia, with the practice of fiduciaries "earn[ing] interest from the 'float' that occurs between the time a benefits check is issued and the time it is cashed by the beneficiary," Plaintiffs' Br. at 69 (citing U.S. Dep't of Labor, Field Assistance Bull. 2002-3, 2002 WL 34717725, at *2-3 (Nov. 5, 2002); U.S. Dep't of Labor, Advisory Op. No. 92-24A, 1993 WL 349627, at *1-2 (Sept. 13, 1993)), and with fiduciaries who "provide[ ] record-keeping and related services to a defined contribution plan," *id.* at 70 (citing U.S. Dep't of Labor, Advisory Op. No. 2013-03A, 2013 WL 3546834, at *3-4 (July 3, 2013)). These DOL statements are at best tenuously connected to the circumstances at hand. Thus, they cannot trump the on-point views expressed in the DOL Guidance. *Cf. United States* v. *Nascimento,* 491 F.3d 25, 41 (1st Cir. 2007) (adopting authority "more directly on point"); *United States* v. *Palmer,* 946 F.2d 97, 99 (9th Cir. 1991) (similar).

plan management but, rather, related to the management of the RAAs. The RAAs were not plan assets, *see Faber,* 648 F.3d at 106, and the setting of an interest rate for use in connection with the RAAs thus did not implicate any ERISA-related fiduciary duty, *see Edmonson,* 725 F.3d at 424 n.14; *cf.* DOL Guidance at 8 (indicating that the determination of whether the discretionary setting of an interest rate implicates ERISA depends in significant part on whether the interest-earning assets are plan assets).

This conclusion follows inexorably from our holding that the establishment of an RAA constitutes payment under the terms of the plans. When the insurer redeems a death benefit that is due a beneficiary by establishing an RAA, no other or further ERISA-related fiduciary duties attach. Thus, the insurer's setting of an interest rate for the RAAs does not implicate ERISA; rather, its setting of the interest rate must be viewed as part of the management of the RAAs, governed by state law.[6] *See Edmonson,* 725 F.3d at 425-26; *Faber,* 648 F.3d at 104-05; DOL Guidance at 11.

The Supreme Court's decision in *Varity,* loudly bruited by the plaintiffs, does not demand a contrary result. There, the Court was confronted with an

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[6] We are mindful that the district court characterized what happened here as the insurer "award[ing] itself the business of administering the Plaintiffs' RAAs." *Merrimon,* 845 F. Supp. 2d at 319. But this characterization is inapropos; the insurer did no more than carry out the express terms of the plans.

employer that lied to its employees about the effect of a pending corporate reorganization on their benefits. *See Varity,* 516 U.S. at 493-94. One issue was whether the employer, in communicating with its work force, was acting as an ERISA plan administrator or an employer. *See id.* at 498. In holding that the employer was acting in the former capacity, the Court noted that "[t]here is more to plan (or trust) administration than simply complying with the specific duties imposed by the plan documents or statutory regime." *Id.* at 504.

Like barnacles clinging to the hull of a sinking ship, the plaintiffs cling to these words. Their reliance is mislaid. *Varity,* which involved a plan administrator that "significantly and deliberately misled the beneficiaries," *id.* at 492, is plainly distinguishable. The Court's acknowledgment that a plan administrator may have extra-textual fiduciary duties that are implicated in such parlous circumstances does not mean that those duties are implicated here. *Varity* held that plan administration "includes the activities that are ordinary and natural means of achieving the objective of the plan," whether or not spelled out in the plan. *Id.* (internal quotation marks omitted). The objective of each of the plans at issue here was the delivery of a guaranteed death benefit to the beneficiary, and the delivery of the benefit through the establishment of an RAA fulfilled that objective. No other or further fiduciary duties attached.

Let us be perfectly clear. This case is not about the desirability, fairness, or social utility of retained asset accounts. It is, rather, about the boundaries of ERISA. The plaintiffs attempt to invoke ERISA to attack practices that fall outside the compass of the ERISA statute. Consequently, they are not entitled to relief.

IV. CONCLUSION

We need go no further.[7] The plaintiffs have not made out their claims that the insurer breached any of its ERISA-related fiduciary duties. Thus, we affirm the district court's order of partial summary judgment in favor of the insurer with respect to ERISA section 406(b) and reverse the district court's order of partial summary judgment in favor of the plaintiffs with respect to section 404(a). Accordingly, the trial (which was devoted to potential relief) was a nullity and the resultant judgment must be vacated. To conclude the matter, we remand to the district court with instructions to enter judgment in favor of the insurer. All parties shall bear their own costs.

So Ordered.

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[7] Inasmuch as we have resolved the liability issues adversely to the plaintiffs, the other issues that have been briefed and argued in connection with these appeals fall by the wayside. Without exception, those issues relate to relief, and we have determined that the plaintiffs are not entitled to any relief.

UNITED STATES DISTRICT COURT
DISTRICT OF MAINE

DENISE MERRIMON and BOBBY S. MOWERY, Plaintiffs, v. UNUM LIFE INSURANCE COMPANY OF AMERICA, Defendant.	Civil No. 2:10-cv-00447-NT

ORDER AND OPINION

(Filed Sep. 11, 2013)

I. PROCEDURAL BACKGROUND

This class-action lawsuit concerns the crediting of interest rates on certain retained asset accounts (RAAs) arising out of group life insurance policies that were issued by Defendant Unum Life Insurance Company of America (Unum) and governed by the Employee Retirement Income Security Act of 1974 (ERISA).

On February 3, 2012, the Court certified the class and granted partial summary judgment to the Plaintiffs on the question of Unum's breach of fiduciary duty. *Merrimon v. Unum Life Ins. Co. of Am.,* 845 F. Supp. 2d 201 (D. Me. 2012). The undisputed facts established that, pursuant to the terms of Unum's group life policies, Unum retained discretion to determine the interest rate credited to the Plaintiffs'

RAAs and to change the credited interest rate at any time. The Court held that under ERISA § 404(a), 29 U.S.C. § 1104(a) (2012), Unum was engaging in plan administration when it set interest rates on its RAAs, and that therefore ERISA imposed a statutory fiduciary duty on Unum to act solely in the interest of the beneficiaries. The Court also held that the undisputed material facts established that Unum breached this fiduciary duty. Left unresolved was the question of what, if any, damages the Plaintiffs sustained as a result of this breach.

From June 24, 2013 through June 27, 2013, the Court held a bench trial on the issue of damages. Set forth below are the Court's findings of fact and conclusions of law.

II. FINDINGS OF FACT

A. Background

Unum is a subsidiary of Unum Group, a publicly traded company with about $40 billion in total assets. Def.'s Exh. 65 at 12. In addition to Unum, Unum Group's subsidiaries include Unum Limited, Provident Investment Management Company (PIMCO),[1] Provident Life and Accident Insurance Company, the Paul Revere Life Insurance Company, and Colonial Life & Accident Insurance Company. *Id.* Unum sells

[1] PIMCO – Unum Group's investment subsidiary – manages the assets of Unum. Tr. 4 at 789; Def.'s Exh. 65 at 54.

life, disability, and long-term care insurance products, often to employers as parts of benefits packages that employers provide to their employees. Tr. 1 at 157; Def.'s Exh. 65 at 12-13.

Unum, along with other insurance companies, began using RAAs in the 1980s as an alternative to sending checks to beneficiaries when lump sum insurance payments are due. RAAs are frequently used in connection with the payment of term life insurance, though they may be set up following approval of claims under other types of insurance as well. The RAAs at issue in this case are governed by ERISA because they stem from group life insurance policies purchased by employers as part of benefits packages offered to their employees.

The class that was certified by the Court includes anyone who, after October 28, 2004, was a beneficiary under an ERISA-governed "CXC" group life policy issued by Unum under which an RAA was set up. The policies at issue in this case allow claims of $10,000 or more to be paid through the establishment of RAAs: "If you or your dependent's life claim is at least $10,000, Unum will make available to the beneficiary a **retained asset account** (the Unum Security Account). . . . Also, you or your beneficiary may request the life claim to be paid according to one of Unum's other settlement options." Revised Joint Stipulations of Fact (RJSF) ¶ 4 (ECF No. 132). CXC policies define an RAA as "an interest-bearing account established through an intermediary bank in the name of you or your beneficiary as owner." RJSF

¶5. CXC policies do not define the applicable interest rate or any method for calculating the interest rate. RJSF ¶ 6.

B. Features of Unum's RAAs

Following the death of a covered employee, the employer who holds the group life policy submits a claim to Unum that includes information on the beneficiary. Trial Transcript, June 24, 2013 (Tr. 1), pgs. 173-74 and 177 (ECF No. 146). Upon approval of the claim, Unum sets up an RAA with a third-party RAA administrator that establishes an account through an intermediary bank in the name of the beneficiary. *Id.* at 174-75. No money is transferred into the account, but UNUM sends the beneficiary a book of drafts that may be used to obtain the proceeds of the policy. *Id.* at 110-11 and 154. When the beneficiary presents a draft for payment, the intermediary bank presents the draft to Unum, and Unum then transfers funds sufficient to cover the draft from its own account to the bank. Court Exh. 2 at 34-36 (Dep. of Linda Bessman).

The RAA is a liquid account. Tr. 1 at 83; Trial Transcript, June 25, 2013 (Tr. 2), pg. 346 (ECF No. 147). The beneficiary may write drafts for payment at any time, and payment is made within the same timeframe as payment on an ordinary personal check. Tr. 2 at 346; Court Exh. 2 at 31-36. RAA drafts may only be written for amounts of $250.00 or greater, RJSF 9, and account holders are not permitted to add any money to their RAA. Unum reserves the right to change the applicable interest rate on RAAs, and it credits interest to each RAA on a monthly basis. Tr. 1 at 113-14; Trial Transcript, June 27, 2013 (Tr. 4), pg. 738 (ECF No. 149). RAA statements are also sent out once a month. Tr. 1 at 113-14. There are no fees for maintaining the RAA or for writing checks on the RAA. Tr. 1 at 93.

Unum is obligated to pay the principal and interest credited to its RAAs. Unum also asserts that its RAAs are guaranteed by its parent company, Unum Group. In support of this, Unum put into evidence a draft form letter to beneficiaries dated April 5, 2011, which stated that its RAAs are "fully guaranteed by Unum Group." Def.'s Exh. 4. But this letter was dated toward the end of the class period, and Unum was unable to establish when, if ever, it became part of the literature sent to the Plaintiff class. *See* Tr. 1 at 201 and 206. This draft letter also competes with different disclosures received by members of the Plaintiff class, which stated: "The UnumProvident Security Account is not insured by the FDIC. Principal and interest earned under the UnumProvident Security Account are fully guaranteed by the underwriting subsidiaries of UnumProvident Corporation." Def.'s Exh. 37, bates stamp UNUM00006759.[2] The Court cannot find that Unum

[2] This document, termed "UnumProvident Security Account Terms and Conditions" was captioned "date unknown" on the Revised Joint Exhibit List (ECF No. 144). At summary judgment,

(Continued on following page)

Group guaranteed Unum's RAAs based on this evidence.

C. Unum's Investments and Risks

Unum invests the premiums it receives from its insurance products, and it pays its insuring obligations out of a combination of maturing investments and incoming premiums. *See* Def.'s Exh. 65 at 13-18; RJSF ¶ 32. At the end of 2004, Unum's portfolio contained assets valued at $1.2607 billion, which were largely invested in a combination of instruments that provided a fixed return on capital. Pls.' Exh. 27. One of Unum's investment goals was to match the assets in Unum's portfolio with its insuring obligations so that Unum's liquid assets would be sufficient to pay Unum's obligations as they arose, a practice referred to as "duration matching." Def.'s Exh. 65 at 24-25. Actuaries were used to make predictions concerning the number of claims to be expected under Unum's policies, and PIMCO's investment professionals were used to balance the risks and returns in Unum's portfolio, given the projected size of Unum's obligations. *See id.*

Unum's portfolio was invested overwhelmingly in fixed-rate debt instruments, and Unum generally did not invest in stocks or other equity instruments,

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Unum filed the same papers (ECF No. 35), claiming that these terms and conditions were an "exemplar" of those sent to beneficiaries. Decl. of Marlene Ingraham ¶ 5 (ECF No. 32).

where the potential return on investment was unlimited but also unpredictable and thus not a good match for Unum's liabilities. Def.'s Exh. 65 at 14, 18-20, and 24-28. Unum was able throughout the class period to achieve a predictable return on investment that was well-matched to its liabilities. Pls.' Exh. 27; Tr. 2 at 379; Tr. 4 at 737-38.

Unum's investment strategy exposed it to three types of risk interest-rate risk,[3] default risk,[4] and liquidity risk. Def.'s Exh. 65 at 18-19. Liquidity risk, which was the most pertinent in this case, was the risk that Unum would not have sufficient cash on hand to cover its current liabilities and would be forced either to sell unmatured investments at a loss

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[3] Unum's fixed-rate instruments would lose market value as market interest rates rose and made its fixed rates comparatively less attractive. *See* Def.'s Exh. 65 at 29, 31. The longer the duration of Unum's fixed-rate investments, the greater the interest-rate risk those investments held. *See id.* Because Unum's products – term-life and disability-insurance products – promised fixed lump sum payments that would remain the same regardless of market interest rates, Unum was largely insulated from interest-rate risk. *See* Def.'s Exh. 65 at 24. So long as Unum's assets matched its liabilities, fluctuations in market interest rates were not a primary source of concern.

[4] Default risk was the risk that the entities to which Unum loaned money would not pay back their loans. Def.'s Exh. 65 at 18. Government bonds carried virtually no default risk, but high-yield corporate bonds carried comparatively high default risk. *See* Def.'s Exh. 64, slide 001A. During the course of the class period, as government bond rates declined, Unum took on more high yield corporate bonds which nearly tripled its default rate between 2008 and 2012. *See,* Pls.' Exh. 27.

or to apply for a loan. Def.'s Exh. 65 at 20, 35-38. Unum managed this risk by keeping some cash on hand, and also by laddering[5] its investments. Def.'s Exh. 65 at 29-31, 37-38. Ideally, Unum's incoming premiums and ongoing returns in maturing investments would cover liabilities as they came due, so that no assets would have to be sold prior to maturity. *See id.* Robert Hensley, PIMCO's vice president of asset liability management and investment strategies, testified that during his tenure, Unum never had a shortfall. Def.'s Exh. 65 at 49. If there had been a shortfall, Hensley stated that Unum would first look to sell investments in its own portfolio, and after that might apply for a loan from Unum Group or third-party sources. Def.'s Exh. 65 at 35-38. Throughout the class period, Unum at all times met its obligations, and Unum's claims-paying ability and overall financial picture were strong.[6]

Unum's conservative investment objectives created a portfolio that was an excellent fit for weathering the financial crisis that hit the nation in 2008. Unum's net annual effective portfolio yields, including default losses, were a very stable 6.87% in

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[5] Laddering refers to the continuous purchase of fixed-duration instruments so that, over time, the instruments continually mature and create a stream of income. Tr. 3 at 690.

[6] Between 2004 and 2012, Unum's claims-paying ability was rated by A.M. Best as either A- or A, which is an excellent, though not superior, rating (superior ratings include A+ and A++). Pls.' Exh. 79; Joint Exh. 11.

2004, 6.93% in 2005, 6.89% in 2006, 6.84% in 2007, 6.77% in 2008, 6.76% in 2009, 6.74% in 2010, 6.53% in 2011, and 6.37%[7] in the first half of 2012. Pls.' Exh. 75, Slide 2. At least up to the point of a total company failure,[8] it was Unum and not the Plaintiffs that bore the risk of its investments.

D. Unum's Investment of Funds Backing RAAs and the Benefit of RAAs to Unum

Throughout the class period, roughly one third to almost one half of Unum's portfolio consisted of retained assets, i.e. approved claims that had not yet been drafted out of RAAs by beneficiaries.[9] Robert Hensley testified that Unum's obligations on its RAAs

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[7] This number represents the percentage yield on an annual basis reporting for the first six months – *i.e.,* the portfolio would have yielded 3.19% for the first half of the year.

[8] Under the federal Bankruptcy Code, 11 U.S.C. § 109(b), insurance companies cannot enter bankruptcy. Instead, insurance companies are monitored by the states in which they do business, and, if an insurer becomes insolvent, in [sic] may be taken over by the state in a receivership. *See, e.g.,* Maine's Insurance Rehabilitation and Liquidation Law, 24-A M.R.S.A. §§ 4351-4386.

[9] In 2004, this was $524.9 million out of $1.2607 billion, or 42%; in 2005, $494.5 million out of $1.093 billion (45%); in 2006, $429.2 million out of $988.3 million (43%); in 2007, $374.3 million out of $961.1 million (39%); in 2008, $356.1 million out of $984.3 million (36%); in 2009, $370.4 million out of $999 million (37%); in 2010, $426.6 million out of $1.062 billion (40%); in 2011, $440.4 million out of $1.131 billion (39%); and in 2012, $444.4 million out of $1.2 billion (37%).*See* Joint Exh. 7; Pls.' Exh. 27 and Def.'s Exh. 65 at 66-67.

are "overnight" liabilities, meaning that RAA-holders may demand the entire amount due in their RAAs at any time, and such demands are payable overnight. Def.'s Exh. 65 at 27, 32, 47. Because RAAs are overnight liabilities, Hensley asserted, PIMCO did not perform duration-matching of its invested assets with RAA liabilities. *Id.* at 27.

The implication of Hensley's testimony is that Unum could not invest the funds backing its RAAs in any sort of long-term investments because it could be required to pay all of these obligations at any time. But that is not reflected in the way Unum handled the funds backing the RAAs. Tr. 2 at 314-315. In 2005, the funds obligated to RAAs accounted for 45% of Unum's investment portfolio, yet only 18.3% of its portfolio consisted of liquid assets.[10] Unum kept close tabs on the behavior of its RAA account-holders, obtaining regular reports from its third-party RAA administrator regarding percentages of withdrawals from RAAs as these accounts aged. Tr. 1 at 117, 193, 204; Pls.' Exhs. 40-45. To be sure, it was *possible* that all RAA-account holders could, in one moment, demand payment of all of the RAA obligations held by Unum in a run-on-the-bank scenario, but that cannot be what Unum expected. *See* Tr. 2 at 314-15.

[10] *See* Pls. Exh. 27 and n. 11, *infra see also* March 21, 2006 email, quoted *infra,* in which Unum's employee observed that Unum had "about $200 million of liquid assets" to cover its RAA obligations, which were "over $500 million," i.e., liquid assets sufficient to cover just under 40% of its RAA obligations.

E. Unum's Interest-Rate-Setting Procedures and Considerations

Throughout the class period, Unum maintained the same 1% annual rate of interest on its RAAs, credited monthly to the accounts. RJSF ¶ 36. It maintained the ability to change the credited rate at any time, and once approximately every quarter, a committee within Unum would review the rate. Tr. 4 at 738; Tr. 1 at 63. As part of the review, the committee looked at interest rates on interest-bearing checking accounts, money market bank accounts, and six-month certificates of deposit, and it also looked at the interest rates credited to RAAs by other insurance companies. Tr. 1 at 66-67, 125-126; Pls.' Exhs. 3-8. With respect to other RAA interest rates, Unum received data from its third-party RAA administrator, which for much of the class period was the largest administrator of RAAs, with up to 120 clients including Unum. Tr. 1 at 66-68.

During 2005 and 2006 as interest rates rose, Unum's RAA interest-rate committee considered whether it should raise its 1% rate. Pls.' Exhs. 3-8. The committee's discussions centered on the fact that, although Unum's interest rate was among the lowest rates credited by insurance companies on RAAs, it was still above rates set by banks on interest-bearing checking and money-market accounts. Unum had not yet seen heavy enough withdrawals from its RAAs to justify raising its rate. *See id.* One committee member, an actuary at Unum, summarized the committee's considerations in a March 21, 2006 email as follows:

> As I mentioned at [sic] staff meeting, I just want to bring you up to date on the operation of the RAA and get your thoughts on our Retained Asset Account crediting strategy.
>
> [The other committee members] and I review the Retained Asset Account crediting rate on a quarterly basis. We compare our crediting rate to that of our competitors, as well as to competing investment vehicles such as money market accounts and interest bearing checking accounts.
>
> Our crediting rate is 1%. Looking at pages 6-7 of the attachment, there are about 100 companies for which the vendor manages a RAA. Comparing competitor crediting rates to our rate:
>
> Minimum = 0.25%
> Maximum = 3.94%
> Average = 2.12%
> Median = 2.15%
> Only 4 companies have a rate lower than our 1%.
>
> Our competitors are really not competing for our beneficiary's dollars, because they can't transfer their money to a competitor's RAA. However, a beneficiary can transfer their dollars to competing investment vehicles, which are shown on pages 8-9 of the attachment. We are certainly competitive with the very liquid accounts (which are closest to the

characteristics of the RAA) such as money market accounts (0.78%) and interest bearing checking accounts (0.29%), but not that competitive with less liquid accounts such as a 6 month CD (2.91%).

I don't believe there is a marketplace risk due to our crediting rate being lower than our competitor's [sic] rates. I haven't heard of any situation where this has been an issue. The RAA appears to have little, if any, impact on sales.

There is a risk that with such a low crediting rate, we could see heavy withdrawals – but we haven't seen that happen yet. Our persistency in the RAA is comparable with the overall persistency the vendor experiences for all customers combined. We are protected from a large level of withdrawals from the RAA due to about $200 million of liquid assets that can be liquidated without suffering a loss.[11] With over $500 million in the RAA, the income we get from the interest spread is substantial, and we will continue to manage the RAA to optimize our earnings. At some point, although I don't think we are there

[11] This figure may refer to the combination of cash and floating interest rate (i.e. short-term) securities in Unum's portfolio, along with whatever other short-term or maturing investments were contained in the portfolio. As of December 31, 2005 Unum's portfolio contained $26.5 million in cash, $121 million in floating-rate securities, and Unum's $122.4 million pool of asset-backed securities had an average duration of four months. *See* Pls.' Exh. 27.

> yet, we may need to increase the crediting rate in order to keep the dollars here.
>
> We will continue to monitor the experience of the RAA and keep you apprised of the situation.

Pls.' Exh. 6. This email accurately reflects and represents Unum's considerations when setting interest rates on its RAAs.

F. A Model for Calculating Damages: Money Market Bank Accounts vs. Money Market Mutual Funds

In a separate order issued today (ECF No. 168) the Court granted Unum's motions to exclude two of three damages models offered by the Plaintiffs' expert Thomas A. McAvity, Jr. The remaining model, Model 3, uses the rates of return on other products comparable to RAAs as a benchmark for RAA interest rates. *See* Tr. 2 at 283-84. The Plaintiffs compared Unum's RAA interest rates to the returns provided on two large, well-known and well-regarded money market mutual funds: Vanguard Prime and Fidelity Cash Reserves. *Id.* at 284, 299-300. Money market mutual funds are made up of highly-rated bonds including government treasury bills. *Id.* at 283. Investors placing their funds in a money market mutual fund earn a minimal return compared to other investments on the expectation that their principal investment will not diminish. These funds are marketed by their managers, including such entities as Vanguard and

Fidelity, as extremely safe investments; indeed, the share price of money market mutual funds is typically tied to the dollar, such that one share of such a fund is worth \$1.00. *See* Tr. 2 at 405-06; Trial Transcript, June 26, 2013 (Tr. 3), pg. 596 (ECF No. 148). Unum's expert Bruce Stangle was able to cite only one instance in which a money market mutual fund "broke the buck" – a phrase that refers to the share price falling below \$1.00 with the consequence that the investors lost principal. Tr. 3 at 471-72; *see* Tr. 2 at 405-06. The Plaintiffs' expert, Thomas McAvity, noted that in that one instance, the investors lost only 1% of their principal investment. Tr. 2 at 405-06. Both experts also acknowledged that institutions have supported the value of their money market mutual funds when they were in danger of breaking the buck because of the importance of maintaining the integrity of such funds. Tr. 2 at 405; Tr. 3 at 596. The Plaintiffs presented evidence that Vanguard Prime and Fidelity Cash Reserves provided substantially higher average annual returns than 1% in 2005 (2.97%), 2006 (4.83%), 2007 (5.09%), and 2008 (2.83%). *See* Tr. 2 at 301; Pls.' Exh. 75, slide 6. After 2008, the rates on these funds declined to well below the 1% credited by Unum on its RAAs. Tr. 3 at 520-21; *see* Pls.' Exh. 75, slide 6.

Unum contended that its RAAs most resembled not money market mutual funds, but rather bank checking accounts and/or bank money market accounts. Tr. 2 at 468-471. Unum presented evidence that, as reported by the Bank Rate Monitor National

Index (BRMNI), the average rate of interest credited by banks on interest-bearing checking accounts and on bank money market accounts always fell below the 1% interest rate set by Unum on its RAAs. Def.'s Exh. 43. The highest average rate of interest credited by banks on interest-bearing checking accounts in the class period was .32% in September of 2006. *Id.* The highest average interest rate on bank money market accounts was .93%, credited during certain weeks in August and September of 2007, and for one week in January of 2008. *Id.* Rates on both types of accounts fluctuated through 2008 but began almost without exception a gradual, steady decline from 2009 through the end of 2012. *Id.* As of October 2012, the average credited rate for bank money market accounts was .11%, and for checking accounts was .05%. *Id.*

Checking accounts are designed to be used for everyday transactions. RAAs are liquid, but because they cannot be used for any transaction under $250, they do not function like checking accounts. In this regard, RAAs function more like money market accounts.

G. State Guaranty Association Insurance

Unum asserts that RAAs are insured through state insurance guaranty associations, sometimes up to $500,000. Tr. 3 at 469-71, 498-99, 607. Insurance companies are regulated by the states, and each state has an insurance guaranty association formed for the purpose of protecting insureds should their insurer become insolvent. If an insurer becomes insolvent, the state is empowered to take control of the company in a receivership, and the company is either rehabilitated or liquidated. The role of the guaranty association is to pay any benefits due to insureds that cannot be paid out of the insolvent insurer's own assets. *See, e.g.,* 24-A M.R.S.A. §§ 4351-4407 (Maine Insurance Rehabilitation and Liquidation Law); 24-A M.R.S.A. §§ 4431-4452 (Maine Insurance Guaranty Association Act); 24-A M.R.S.A. §§ 4601-4619 (Maine Life and Health Insurance Guaranty Association Act).

Whether RAAs are covered by state guaranty associations is a question of law analyzed below. But the practical worth of state guaranty association insurance coverage is a question of fact. The experts agreed that payment by the FDIC on insured bank accounts is swift and provides complete coverage up to $250,000 per account, and Unum's experts did not deny that payment from a state guaranty association could take months if not years to process. Tr. 2 at 400, 402, 404; Tr. 3 at 587-589, 595. For this reason, the Court finds that what coverage may have been available for RAAs through the state guaranty associations was less valuable than FDIC insurance.

III. CONCLUSIONS OF LAW

The question now before the Court is how to measure the damages, if any, that arose out of Unum's breach of its duty under 29 U.S.C. § 1104(a) to set interest rates on its RAAs solely in the interest of the Plaintiff beneficiaries.

A. The Standard

The Court has little guidance in making this determination. Under *Mogel v. UNUM Life Ins. Co. of Am.,* 547 F.3d 23, 26 (1st Cir. 2008), Unum's fiduciary duties under ERISA section 404(a) extend until the funds are withdrawn from the RAAs. But the fiduciary duties as described in section 404(a) appear to be written for plan investment managers, rather than administrators of RAAs. In attempting to craft the appropriate fiduciary duties for an institution offering ERISA-governed RAAs, the Court borrows the "prudent man standard" from section 404(a) which provides, in pertinent part, that an ERISA fiduciary:

> shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and . . . 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). The Court also turns for guidance to the cases involving the fiduciary duties of ERISA investment managers.[12]

[12] In cases such as *California Ironworkers Field Pension Trust v. Loomis Sayles & Co.,* 259 F.3d 1036, 1043 (9th Cir. 2001), the primary question in applying the prudence rule is "whether the fiduciaries, 'at the time they engaged in the challenged transactions, employed the appropriate methods to investigate the merits of the investment and to structure the investment.' ") (quoting *Donovan v. Mazzola,* 716 F.2d 1226, 1232 (9th Cir. 1983)).

The Court also considered the "excessive fee" cases in attempting to find a way to assess the interest rates credited to RAAs. *See Gartenberg v. Merrill Lynch Asset Mgmt., Inc.,* 694 F.2d 923, 928 (2d Cir. 1982) and its progeny. Under these cases, fiduciaries do not have an obligation to negotiate the "best deal" possible for beneficiaries, but rather, only to ensure that the fee charged for managing the beneficiaries' money is not "so disproportionately large that it bears no reasonable relationship to the services rendered. . . ." *Id., see also Young v. GM Inv. Mgmt. Corp.,* 325 Fed. Appx. 31, 33 (2nd Cir. 2009) (unpublished) (applying this standard, which originated as part of fiduciary duties imposed by the Investment Company Act, to ERISA). The Court ultimately rejects this standard for the same reason it finds Model 1 irrelevant. The excessive fee cases address what is an acceptable fee for management of other people's investments under a statutory fiduciary framework. But in this case, Unum's spread is not a fee for services rendered, but a result of investments it made on its own account with money it was permitted to retain. Unum correctly points out that it bears the risk of these investments, so the gain realized on Unum's investments cannot reasonably be described as a "fee," nor can the gain be examined for "reasonableness" because it was not guaranteed but depended on market performance and the wisdom of Unum's investments. Had Unum lost money on its investments, it still would have been required to pay the benefits due when the beneficiaries presented their drafts.

Although Unum was not placing the RAAs with a third party, using the "prudent investor" analogy, the Court concludes that Unum's discretion in setting the interest rate on its RAAs nevertheless required it to "investigate the merits" of the proposed rate, and imposed a fiduciary obligation to provide a rate of interest that was competitive with products that had a risk profile and features equivalent to Unum's RAAs.

B. Risks and Features of Unum's RAAs

The Court has already determined as a matter of fact that Unum's RAAs are not identical to bank checking accounts because those accounts are more flexible than RAAs. The Court considers bank money market accounts and money market mutual funds to be closer cousins to RAAs than checking accounts.

The parties disagree as to whether the RAAs are more like bank money market accounts or money market mutual fund accounts, and the argument is based primarily on an analysis of the investment risk. Unum contends that there is no difference in risk between its RAAs and bank money market accounts because, for both accounts, the risk of any investment made with funds backing these accounts is borne by the institution and not by the customer or beneficiary. Since money market mutual funds place the investment risk on the individual, Unum contends that they are not a useful comparison.

The Plaintiffs point out that bank money market accounts offer FDIC insurance, whereas beneficiaries bear the risk of the insurance company's insolvency. Therefore, Plaintiffs contend that bank money market accounts are not a useful comparison to the RAAs. Unum responds that insolvency risk should not trouble the Court because: (1) Unum did not become insolvent during the class period, (2) RAAs are covered by state insurance guaranty associations and (3) Unum's financials are strong.

1. Unum's Solvency

The fact that Unum never became insolvent is irrelevant because, in setting damages, the Court engages in a forward-looking analysis. *See, e.g., DiFelice v. U.S. Airways, Inc.,* 497 F.3d 410, 424 (4th Cir. 2007) ("whether a fiduciary's actions are prudent cannot be measured in hindsight . . . "); *Roth v. Sawyer-Cleator Lumber Co.,* 16 F.3d 915, 918 (8th Cir. 1994) ("[T]he prudent person standard is not concerned with results; rather it is a test of how the fiduciary acted viewed from the perspective of the time of the challenged decision rather than from the vantage point of hindsight." (internal quotation marks omitted)). At the time the Plaintiffs were provided with RAAs, there was a risk of insolvency that Unum was required to recognize.

2. Insurance Coverage for RAAs

The Court also rejects Unum's second contention, that its risk of insolvency was immaterial because of state insurance guaranty association coverage. The legal status of RAAs is in flux and varies by state. Since 2010, there has been a flurry of activity regarding coverage of RAAs by state insurance guaranty associations.

In about 2010, the National Association of Insurance Commissioners (NAIC) suggested to state insurance commissioners that they require insurers to disclose information about RAAs including that insurance companies are not guaranteed by the FDIC but are governed by "State Guaranty Associations." Def.'s Exh. 39. Nine state insurance commissioners took up this suggestion and sent out bulletins to insurers directing them to make RAA disclosures.[13] In Connecticut, the disclosure is required to state that RAAs "*may* be guaranteed by the state life and health insurance guaranty associations" (emphasis added), and in West Virginia, the disclosure is required to state that RAAs "are guaranteed, subject to certain

[13] Co. Dep't of Reg. Agencies, Div. of Ins. Bulletin No. B-4, 12 (April 29, 2011) (amended and reissued); Ct. Ins. Dep't Bulletin IC-27 (Feb. 3, 2011); Il. Dep't of Ins. Co. Bulletin 2011-03 (Dec. 12, 2011) (revised); Ia. Ins. Dep't Bulletin 11-01 (Feb. 8, 2011); Me. Bureau of Ins. Bulletin 376 (Jan. 24, 2011); N.H. Ins. Dep't Bulletin Ins. No. 10-046-AB (Dec. 21, 2010); NJ Ins. Order No. A11-101, 2011 WL 70388 (Jan. 5, 2011); Oh. Dept. of Ins. Bulletin 2011-01 (Jan. 3, 2011); W.V. Off. of Ins. Comm'r Informational Letter No. 178A (May, 2011).

limitations, by the respective state guaranty association." Prior to this, only one state, Kansas, had a state bulletin requiring RAA disclosures, and this bulletin required insurers to provide:

> a written explanation of what the limit of protection is for the retained asset account under the Kansas Life and Health Insurance Guaranty Association Act. It should also disclose that a lengthy delay is possible before a beneficiary can get the proceeds if insolvency occurs.

Ks. Ins. Bulletin No. 1995-22, 1995 WL 17800855 (Dec. 8, 1995). Unum has not pointed the Court to any further pronouncements, direct or indirect, by any other state insurance commissioners, to the effect that RAAs are covered by state guaranty associations.

Unum did introduce two statements from the National Organization of Life and Health Insurance Guaranty Association (NOLGHA).[14] The first was a July 29, 2010 statement that asserted that all state guaranty associations will cover RAAs up to at least $250,000. Def.'s Exh. 25. The second was a 2011 fact

[14] NOLGHA is a voluntary organization that concerns itself with setting policy and making recommendations regarding state law governing and affecting state insurance guaranty associations. NOLGHA does not create law, but its recommendations may be looked to as persuasive authority by state insurance commissioners and other decisional authorities. Tr. 3 at 644-46.

sheet about RAAs in which NOLGHA asserted that, "[g]enerally speaking, RAAs are provided guaranty association coverage on the basis that they represent a death benefit under a covered life insurance policy." Def.'s Exh. 24. Whether NOLGHA's interpretation of state law is correct is up for debate.

NOLGHA views RAAs as "death benefits" and thus presumably included under the various states' statutory coverage of group life policies. But Unum essentially argues that RAAs are not death benefits but the proceeds of death benefits. This stems from their position that RAAs are "supplemental contracts." Under this view, a claim is approved and then "paid" under the policy/plan by the establishment of an RAA. The insurer's obligation to pay the death benefit under the plan is discharged with the creation of the RAA, which is thereafter governed by the supplemental contract.

As of 2010, only six states clearly covered group life supplemental contracts.[15] But in the past three years, twelve additional states have amended their statutes to explicitly cover group life supplemental contracts.[16] There appears to be at least some

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[15] *See* Alaska Stat. § 21.79.020, Colo. Rev. Stat. § 10-20-104, Mass. Gen. Law ch.175 § 146B, Mich. Comp. Laws § 500.7704, N.J. Rev. Stat. § 17B:32A-3, Wis. Stat. § 646.01.

[16] *See* 2012 Ala. Laws Act 2012-319 (H.B. 403), 2013 Ariz. Legis. Serv. Ch. 214 (H.B. 2546) (West), 2013 Ark. Laws Act 456 (S.B. 464), 2012 Ga. Laws Act 668 (H.B. 786), 2012 Hawaii Laws Act 250 (S.B. 2767), 2011 Idaho Laws Ch. 196 (S.B. 1090), 2012

(Continued on following page)

movement by states both to categorize RAAs as supplemental contracts and also to make sure guaranty association coverage is provided for them, but the movement is of recent vintage.

At the same time, courts have only begun to address the question of the status of RAAs. The Second and Third Circuits have essentially taken the position that RAAs are supplemental contracts. *See Faber v. Metro. Life Ins. Co.,* 648 F.3d 98, 105 (2d Cir. 2011) ("To the extent MetLife remained obligated to honor the account holder's 'checks' and pay interest at a guaranteed rate, we believe that this arrangement constituted a straightforward creditor-debtor relationship governed by the Customer Agreements and state law, not ERISA."); *Edmonson v. Lincoln Nat'l Life Ins. Co.,* ___ F.3d ___, No. 12-1581, *14, 2013 WL 400755312 (3d Cir., August 7, 2013) (same, citing *Faber*). This view undermines NOLGHA's assertion that RAAs are covered by the state guaranty associations. Either RAAs are approved but as-yet unpaid death benefits under group life policies – in which case they may be covered by the state guaranty associations' coverage of group life policies – or they are the proceeds of already-paid death benefits, rolled over into an RAA and governed by a supplemental

Md. Laws Ch. 634 (H.B. 1340), 2011 Mont. Laws Ch. 27 (S.B. 78), 2012 N.M. Laws Ch. 9 (S.B. 47), 2011 N.D. Laws Ch. 220 (S.B. 2111), 2013 Or. Laws H.B. 3458 (West's No. 701), 2013 S.D. Laws Ch. 252 (HB 1102).

contract, in which case only seventeen states unambiguously provide the requisite coverage.

The First Circuit rejected the contention that funds in an RAA should be "deemed to belong" to a beneficiary until the beneficiary actually draws a check on an RAA. Mogel, 547 F.3d at 26. This is essentially the view that RAAs are approved, but as-yet-undistributed death benefits. Under this view, the prospect of across-the-board state guaranty association coverage for RAAs is much stronger. But the fact remains that, at present, and certainly during the class period, there is no definitive answer regarding the status of RAAs, or, consequently, any reasonable assurance that the Plaintiffs' RAAs were covered by state guaranty association insurance.

3. Strength of Unum's Financials

Finally, Unum contends that the Court should not be troubled by its insolvency risk because Unum's financials are strong. Unum's financials were strong throughout the class period, and thus, the risk of loss to beneficiaries in leaving their funds in Unum's RAAs was overall quite low even though Unum has not shown that its liabilities were guaranteed by its parent, Unum Group.[17] But the risk of loss to

[17] No assumptions can be made about a parent company's liability for its subsidiary's debts. *See, e.g.,* J.A. Bryant, Jr., *Liability of Corporation for Contracts of Subsidiary,* 38 A.L.R. 1102 § 2[a] (1971) ("It is clear that parental liability is not the norm, yet it may exist in a proper case.").

investors in a money market mutual fund is also quite low. Unum was only able to cite one fund that ever "broke the buck."

In sum, the risk profile of Unum's RAAs was somewhere between that of money market mutual funds, as very low-risk investments, and money market bank accounts, essentially no-risk savings products insured by the FDIC.[18] Indeed, this was where defense expert Dr. Bruce Stangle placed RAAs on a risk – return graph he had created. Def.'s Exh. 64, Slide 001B. Given that the RAA's risk profile fell between these two products, the Court concludes that an appropriate interest rate would be the average of the prevailing annual rate credited on money market mutual funds and the prevailing annual rate credited

[18] The interest-rate-setting parameters adopted in this opinion do not necessarily apply to every ERISA insurer. It may not be appropriate, for example, for an insurer with a different claims-paying ability rating or with different features in its RAAs to determine its crediting rate by simply adopting the average of the two index rates used in this case. Unum argued that an interest-rate-setting method that provides no certainty is fundamentally inconsistent with ERISA's efficiency, predictability, and uniformity concerns and would subject insurers to a new class of unheard-of-litigation. *See Conkright v. Frommert,* 559 U.S. 506, 519 (2010), *Pegram v. Hedrich,* 530 U.S. 211, 237 (2000). But the very fact that discretion is involved in Unum's rate-crediting decisions means that Unum's compliance with its fiduciary duties is not reducible to some nondiscretionary formula. If Unum or any other insurer wishes to take itself out of the fiduciary business of setting RAA interest rates, it may set its formula for determining RAA interest-rate in advance within the policies it sells.

on money market bank accounts throughout the class period. To the extent this average rate exceeded the 1% credit rate offered by Unum during any given year, the difference would measure the damages to the Plaintiffs.[19]

C. Calculating Damages

Having settled on a method for calculating an appropriate interest rate, the Court turns to the calculation of damages.

Unum presented testimony that there are indices that track both money market bank account interest rates and money market mutual fund returns, specifically, the BRMNI index for bank money market accounts, and the Lipper index for money market mutual funds. While Unum supplied BRMNI figures, neither party offered into evidence the historical rates of return for money market mutual funds as reported by the Lipper index. Instead, the Plaintiffs offered into evidence the rates of return of the Vanguard Prime and Fidelity Cash Reserves money market mutual funds. Unum objected to the cherry-picking of two funds. Thomas McAvity testified on cross-examination that he chose the Vanguard and Fidelity

[19] In 2004 and 2009-1012 [sic], the 1% rate credited by Unum exceeded the average. While Unum was entitled to pay its beneficiaries more than this average, it is not entitled to a set off for having done so.

funds because they were familiar, and he conceded that it would be reasonable to look at more funds.

The Lipper index provides a more comprehensive and therefore more reliable index for measuring money market mutual fund returns. The Court finds that the Lipper index, rather than an average of two funds hand-picked by the Plaintiffs, is the appropriate benchmark, averaged with the BRMNI index, for setting damages. At oral arguments following trial, the Court gave the parties an opportunity to be heard on the question of whether the Court may take judicial notice of the Lipper index under Federal Rule of Evidence 201(b)(2), *see Lussier v. Runyon,* 50 F.3d 1103, 1114 (1st Cir. 1995). Subsequently, the Court issued an order requesting that the parties submit agreed-upon Lipper index figures (ECF No. 157). The parties then submitted average annual returns for money market mutual funds during the class period.[20] Averaging the annual money market mutual fund index returns with the annual money market bank account index rates,[21] and subtracting the one-percent

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[20] The Lipper index figures provided by the parties were: in 2004, 1.24%; in 2005, 2.66%; in 2006, 4.51%; in 2007, 4.77%; and in 2008, 2.41%. In 2009-2012, the Lipper Money Market Index was always below 1%. Joint Submission Regarding Lipper Index Information (ECF No. 160).

[21] For class years 2004 through 2008, the average annual interest credited on money market bank accounts was: in 2004, .51%; in 2005, .653%; in 2006, .794%; in 2007, .853%; and in 2008, .717%. In class years 2009-2012, the interest credited to money market bank accounts remained below 1%. Def.'s Exh. 43.

rate credited by Unum throughout the class period, the Plaintiffs experienced a shortfall in the interest rate credited to their RAAs in class years 2005 through 2008 as follows: in 2005, .6565%; in 2006, 1.652%; in 2007, 1.8115%, and in 2008, .5635%.

According to Unum, 36.577% of its RAAs are not ERISA-governed, and are therefore not subject to this suit. RJSF ¶ 39. At trial, Unum pointed out that this percentage, which the Plaintiffs used to calculate their dollar damages, referred to the number of RAA accounts governed by ERISA and not to the actual dollar amounts governed by ERISA. Tr. 2 at 423-26. This defect is not fatal to the Plaintiffs' case. *See, e.g., Sec'y of U.S. Dep't of Labor v. Gilley,* 290 F.3d 827, 830 (6th Cir. 2002) (joining the Second, Eighth, and Ninth Circuits in holding that any ambiguity in determining the amount of loss in an ERISA action should be resolved against the breaching fiduciary); *N.Y. State Teamsters Council Health and Hosp. Fund v. Estate of DePerno,* 18 F.3d 179, 182 (2d Cir. 1994) (an ERISA case, borrowing from the law of trusts: "Where a person has wrongfully mingled trust funds with his own, the burden is on him to show how much of the mingled fund is his own. . . .") (quoting 5 Austin W. Scott & William F. Fratcher, Law of Trusts § 515, at 609 (2d ed. 1989)),

Unum asserts that the Plaintiffs bear the burden of proof on damages. As recently noted by the Supreme Court in *CIGNA Corp. v. Amara,* 131 S.Ct. 1866, 1881 (2011), "a fiduciary can be surcharged under § 502(a)(3) only upon a showing of actual harm

– proved (under the default rule for civil cases) by a preponderance of the evidence.” But *Amara* is not inconsistent with *Gilley* or *DePerno,* which deal not with the plaintiff’s burden to show harm, but with quantifying the harm that has been shown. The Plaintiffs met their burden under *Amara* of showing harm by showing that Unum failed during part of the class period to credit a sufficient rate of interest to their RAAs. Unum wishes to limit the calculation of damages by asserting that a portion of its RAA funds were not subject to ERISA. It is Unum’s burden to provide evidence of this. *See Gilley,* 290 F.3d at 829-30; *DePerno,* 18 F.3d at 182. This is especially true where Unum is the party in possession of the information necessary to satisfy this issue. *Cf. Central Pension Fund of Int’l Union of Operating Engineers and Participating Emp’rs v. Ray Haluch Gravel Co.,* 695 F.3d 1, 10 (1st Cir. 2012) (“an employer should not ‘be heard to complain that the damages lack the exactness and precision of measurement that would be possible had he kept records [as required]’ ” (quoting *Anderson v. Mt. Clemens Pottery Co.,* 328 U.S. 680, 688 (1946)).

Since Unum provided no numbers to impeach the 36.577% figure used by the Plaintiffs, the Court uses this figure in its calculation of damages. Using this figure, the following amount of RAA funds were subject to ERISA during each year of the class period: in 2005, $313,626,735; in 2006, $272,211,516; in 2007, $237,392,289 and in 2008, $225,849,303. Multiplying the total RAA dollars subject to ERISA by the shortfall rate, the dollar amount of the Plaintiffs' damages per year in class years 2005 through 2008 are: in 2005, $2,058,960; in 2006, $4,496,934; in 2007, $4,300,361; and in 2008, $1,272,661. Total damages are $12,128,916.

D. Prejudgment Interest

The Plaintiffs have requested, and Unum has not argued against, an award of prejudgment interest. The Court in this ERISA case has discretion to grant prejudgment interest. *Cottrill v. Sparrow, Johnson & Ursillo, Inc.,* 100 F.3d 220, 223 (1st Cir. 1996), *abrogated on other grounds by Hardt v. Reliance Std. Life Ins. Co.,* 560 U.S. 242 (2010). The purpose of prejudgment interest is the remedial objective of making the beneficiary whole for the period during which the fiduciary withholds money legally due. *Id.* at 224. ERISA contains no explicit provision for prejudgment interest, so a court that elects to award prejudgment interest in an ERISA case has broad discretion in choosing a rate. *Id.* at 224.

The Court exercises its discretion to award prejudgment interest to the Plaintiffs per calendar year for the total amount of damages accrued during that year, at the average annual rate for the one-year constant maturity (nominal) Treasury yield, as published by the Federal Reserve System. This rate is similar to the post-judgment interest rate specified under the federal post-judgment interest statute, 28 U.S.C. § 1961. The applicable rates during the class period are: in 2005, 3.62%; in 2006, 4.94%; in 2007, 4.53%; in 2008, 1.83%; in 2009, .47%; in 2010, .32%; in 2011; .18%, and in 2012; .17%.[22] For 2013, where the annual rate is not yet available, the Court selects as the prejudgment interest rate the same rate applicable for post-judgment interest under 28 U.S.C. § 1961, which is .16%. Accordingly, pre-judgment interest is awarded as follows: for 2005, $74,534; in 2006, $323,861; in 2007, $491,788; in 2008, $221,959; in 2009, $57,006; in 2010, $38,813; in 2011, $21,832; in 2012, $20,619; and in 2013, $13,578.[23] Total prejudgment interest is $1,263,990.

CONCLUSION

For the reasons stated, the Court awards $12,128,916 in damages to the Plaintiffs plus prejudgment interest in the amount of $1,263,990.

SO ORDERED.

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[22] Rates available at http://www.federalreserve.gov/releases/h15/data.htm.

[23] Based on the following calculations: for 2005, $2,070,044 x 3.62%; in 2006, $6,561,862 x 4.94%; in 2007, $10,858,188 x 4.53%; in 2008, $12,122,778 x 1.83%; in 2009, $12,122,778 x .47%; in 2010, $12,122,778 x .32%; in 2011, $12,122,778 x .18%, in 2012, $12,122,778 x .17%; and in 2013 $12,122,778 x .16% x .70 (prejudgment proportion of 2013 as of Wednesday, September 11, 2013).

Dated this 9th day of September, 2013.

/s/ Nancy Torresen
United States District Judge

UNITED STATES DISTRICT COURT
DISTRICT OF MAINE

DENISE MERRIMON AND BOBBY S. MOWERY et al.	)	**Docket No.**
Plaintiffs	)	**2:10-CV-00447-NT**
v.	)	
UNUM LIFE INSURANCE COMPANY OF AMERICA	)	
Defendant	)	

JUDGMENT

(Filed Sep. 12, 2013)

In accordance with the Order on Cross-Motions for Summary Judgment, issued on February 3, 2012 by Nancy Torresen, United States District Judge, JUDGMENT is hereby entered in favor of Plaintiffs Denise Merrimon and Bobby S. Mowery, on behalf of themselves and similarly-situated individuals within the Plaintiff class, against the Defendant Unum Life Insurance Company of America as to Unum's liability for breach of its fiduciary duty imposed under ERISA Section 404(a) in regard to its administration of the relevant plans. JUDGMENT is hereby entered in favor of the Defendant Unum Life Insurance Company of America against the Plaintiffs as to any breach of contract or liability under Maine's late payment statute, 24-A M.R.S.A. Section 2436.

This matter having come before the Court, the Honorable Nancy Torresen, United States District Judge, presiding and the issues having been duly tried, and pursuant to the Court's Opinion and Order entered on September 11, 2013, JUDGMENT is hereby entered in favor of Plaintiffs Denise Merrimon and Bobby S. Mowery, on behalf of themselves and similarly-situated individuals within the Plaintiff class, against the Defendant Unum Life Insurance Company of America. The Court awards $12,128,916 in damages to the Plaintiffs plus prejudgment interest in the amount of $1,263,990.

CHRISTA K. BERRY
Clerk

By: /s/Devon F. Richards
Devon F. Richards
Deputy Clerk

Dated: September 12, 2013

UNITED STATES DISTRICT COURT
DISTRICT OF MAINE

DENISE MERRIMON and BOBBY S. MOWERY,	)	
Plaintiffs,	)	
v.	)	Docket no. 1:10-CV-447-NT
UNUM LIFE INSURANCE COMPANY OF AMERICA,	)	
Defendant.	)	

ORDER ON CROSS-MOTIONS FOR SUMMARY JUDGMENT AND CLASS CERTIFICATION

(Filed Feb. 3, 2012)

I. INTRODUCTION

Plaintiffs Denise Merrimon and Bobby S. Mowery are beneficiaries of group life insurance policies administered by the Defendant, Unum Life Insurance Company of America ("**Unum**"). These policies are governed by the Employee Retirement Income Security Act ("**ERISA**") and Maine state law. This case comes before the Court on the Plaintiffs' motion for partial summary judgment regarding Unum's liability for: (1) breach of plan provisions and fiduciary duty under ERISA, (2) breach of contract, and (3) breach of Maine's late payment statute, 24-A M.R.S.A. § 2436 (2010) (the "**Late Payment Statute**"). Unum files a cross-motion for summary judgment on these claims. For the reasons set forth below, the Plaintiffs' motion for partial summary judgment is GRANTED IN PART with respect to their ERISA claims and DENIED with respect to their breach of contract and late payment claims. Unum's motion for summary judgment is GRANTED with respect to the Plaintiffs' claims for breach of contract and breach of Maine's late payment statute, but DENIED IN PART with respect to Plaintiffs' breach of fiduciary duty claim under ERISA.

The Plaintiffs also move to certify a class of similarly-situated plaintiffs including a subclass of beneficiaries whose policies are protected by the Late Payment Statute. Certification of the general class is GRANTED. Because the Court has granted Unum's motion for summary judgment on Plaintiffs' Maine state law claims, and because the subclass was based on those claims, certification of the subclass is unnecessary and is therefore DENIED.

II. FACTUAL BACKGROUND

The parties do not dispute any of the following facts, which were set forth by each side in their respective statements of material fact. In 2001, Peabody Investments Corp. established group life insurance coverage through Unum for the benefit of its employees ("**Peabody Policy**"), and in 2003, St. Joseph's Hospital did the same ("**St. Joseph's Policy**"). Plaintiff Bobby S. Mowery was a designated beneficiary of a Peabody Policy, under which benefits of $62,300 were payable upon the death of his son.

Plaintiff Denise Merrimon was a designated beneficiary of a St. Joseph's Policy, under which benefits of $51,000 were payable upon the death of her husband.

A. The Group Insurance Summaries of Benefits ("GISBs")

The parties agree that the GISBs are in all respects the relevant documents in this case. They are the contracts agreed to by the employers and Unum, and they contain the relevant portions of these employers' ERISA plans. They were written by Unum to fulfill ERISA's requirements for summary plan descriptions. These GISBs contain two critical provisions governing when and how the beneficiaries will be paid upon the approval of a claim. The pertinent wording of the two policies is identical.

1. When Benefits Would be Paid

In a section of the GISBs entitled "WHEN WILL YOUR BENEFICIARY RECEIVE PAYMENT?" the GISBs stated: "Your beneficiary(ies) will receive payment when Unum approves your death claim." *Peabody Policy Summary of Benefits,* p. 31 (Doc. # 33); *St. Joseph's Policy Summary of Benefits,* p. 30 (Doc. # 34).

2. How Benefits Would Be Paid

In a section of the GISBs entitled "HOW WILL UNUM MAKE PAYMENTS?" the GISBs provided:

> If you or your dependent's life claim is at least $10,000, Unum will make available to the beneficiary a retained asset account (the Unum Security Account).
>
> Payment for the life claim may be accessed by writing a draft in a single sum or drafts in smaller sums. The funds for the draft or drafts are fully guaranteed by Unum.
>
> If the life claim is less than $10,000, Unum will pay it in one lump sum to you or your beneficiary.
>
> Also, you or your beneficiary may request the life claim to be paid according to one of Unum's other settlement options. This request must be in writing in order to be paid under Unum's other settlement options.

Id. at p. 17 (Doc. # 33); *id.* at p. 11 (Doc. # 34). A glossary to both GISBs defined the term "Retained Asset Account" (hereinafter "**RAA**") to mean "an interest bearing account established through an intermediary bank in the name of you or your beneficiary as owner." *Id.* at p. 40 (Doc. # 33); *id.* at p. 47 (Doc. # 34). No particular rate of interest, or formula or index for calculation of the rate of interest for the RAA is specified in this section or anywhere within the GISBs.

B. Payment to Plaintiffs Mowery and Merrimon

Plaintiff Bobby S. Mowery's son died on or about September 23, 2007. On December 28, 2007, Mr. Mowery submitted a claim for death benefits, which was approved by Unum on January 4, 2007. That same day, Unum's contractor Open Solutions, Inc. ("**OSI**") mailed to Mr. Mowery a Welcome Kit which included information about the RAA established in his name, an opening statement, and a book of drafts to access the funds in an account at State Street Bank (the "**Bank**"). The drafts could be written for any amount over $250. In the Welcome Kit, Unum stated that it would credit interest to the account at 1% per year beginning January 4, 2008. It also stated, "If at any time after your account is established the available balance in your account falls below $250, it will be closed automatically. The balance remaining in the account will be sent to you, together with any interest due, after the 5th day of the following month."

Between January 12, 2008 and January 18, 2008, Mr. Mowery wrote out five drafts in the total amount of $62,304.51. He paid off his mortgage, two student loans, and the balance of the bill for his son's funeral, and then he transferred the balance of the account into his investment account. On February 5, 2008, because the account balance had fallen below the required minimum balance of $250, State Street Bank closed Mr. Mowery's account and sent him a treasurer's check in the remaining amount of $19.13.

In total, Unum paid Mr. Mowery $62,323.64, representing the full principal benefit plus $23.64 in accrued interest.

Plaintiff Denise Merrimon's husband died on or about July 13, 2007. Ms. Merrimon first contacted Unum about the death benefit due to her on August 3, 2007. Unum approved Ms. Merrimon's claim on September 10, 2007. Although Plaintiffs do not press the issue, Unum has explained that it did not immediately approve Ms. Merrimon's claim because it lacked the required claim form, death certificate, and beneficiary designation form. Unum further explained that it contacted St. Joseph's Hospital several times between August 3, 2007 and September 6, 2007, when it learned that St. Joseph's had closed due to bankruptcy. Although it did not have a beneficiary designation form, on September 10, 2007, Unum approved Ms. Merrimon's claim as the individual to whom the death benefit was payable in the absence of a beneficiary designation form.

On September 10, 2007, OSI mailed Ms. Merrimon a Welcome Kit which contained the same information and features as Mr. Mowery's kit. On November 13, 2007, Ms. Merrimon wrote out a single draft to herself in the amount of $51,036.34 and deposited that check into her personal checking account. On December 5, 2007, because the balance in Ms. Merrimon's RAA had fallen below $250, the Bank closed her account and sent her a treasurer's check in the remaining amount of $53.19. In total, Unum paid

Ms. Merrimon $51,089.53, representing the full principal benefit plus $89.53 in interest.

C. How the RAAs Work

No funds are actually placed into the RAAs when they are initially opened. Instead, Unum retains and continues to invest the amounts due under the approved claims until a draft is presented to the Bank for payment. When a draft is presented for payment, funds sufficient to cover the draft are transferred from Unum's general accounts to the Bank.

Unum acknowledges that the RAAs it creates under these contracts bear interest at a rate selected by Unum or its agents, and that Unum and its agents retain the right to change the applicable interest rate. A committee at Unum meets periodically to recommend the interest rate that will apply to its RAAs. The rate is set by analyzing the interest rates used by banks for money market accounts and certificates of deposit as well as interest rates applied to RAAs created by other insurance companies. Since October 28, 2004, Unum has set the interest rate for its RAAs at 1%. Among the factors that Unum considered in setting and keeping this rate since 2004 were the rate at which beneficiaries would draw down their accounts to place the funds into higher-yield accounts (thus depriving Unum of the benefit of continuing to invest the funds backing the accounts), and whether higher interest rates on RAAs offered by other insurers would cause Unum to lose business. According to

Unum's research, as of June, 2008 other insurers offered an average rate of about 2% on their RAAs, with some as high as 4%.

RAAs provide Unum an opportunity for earnings on the "interest spread," which is the difference between the income Unum earns from investing the funds backing the RAAs and the amount of interest it pays to beneficiaries on these accounts. The creation of RAAs is also intended to give beneficiaries time to recover from their loss before making a decision about what to do with their benefits.

III. PROCEDURAL BACKGROUND

On October 29, 2010, the Plaintiffs filed a three-count suit against Unum alleging: (1) that Unum breached the applicable plans as well as its fiduciary duties to them under ERISA by retaining and investing the funds backing their RAAs; (2) that Unum breached its contracts with them by failing to pay post-mortem interest as required by Maine state law, which law is incorporated into the relevant policies; and (3) that Unum is liable to them under Maine's late-payment statute, 24-A M.R.S.A. § 2436, for overdue interest at a rate of 1.5% per month (18% per annum). On March 10, 2011, the Court granted the Plaintiffs leave to file an amended complaint (Doc. # 19), which retained these three counts.

On June 14, 2011, the Plaintiffs filed a motion for partial summary judgment on liability (Doc. # 25) and a motion to certify a class (Doc. # 29). Unum filed a cross-motion for summary judgment (Doc. # 26). By agreement of the parties, several documents in the record were sealed from public view, and, on July 14, 2011, a consent confidentiality order was entered by the Court (Doc. # 45). Following responses and replies from both sides on all motions, Unum filed a request for oral argument (Doc. # 55), which the Court granted. Oral argument was held on January 19, 2012. Thereafter, the parties submitted their positions to the Court regarding the possibility of a stay and/or an interlocutory appeal of this case to the First Circuit. On January 30, 2012, the Court held a telephonic conference with the parties on this issue.

IV. STANDARD OF REVIEW

A. Summary Judgment

Summary judgment is authorized "if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law." Fed. R. Civ. P. 56(c).

On summary judgment, the Court reviews the record together with all reasonable inferences therefrom in the light most favorable to the non-moving party. *See Johnson v. Educ. Testing Serv.,* 754 F.2d 20, 25 (1st Cir. 1985), *cert. denied,*472 U.S. 1029, 105 S. Ct. 3504, 87 L. Ed. 2d 635 (1985). Only those facts in dispute that might affect the outcome of the suit under the governing law will bar the entry of summary judgment. Factual disputes which are irrelevant or unnecessary will not be considered. *See Anderson v. Liberty Lobby Inc.,* 477 U.S. 242, 248, 106 S. Ct. 2505, 91 L. Ed. 2d 202 (1986). To determine whether a dispute as to a material fact is genuine, the Court must decide whether the "evidence is such that a reasonable [fact-finder] could return a verdict for the non-moving party." *Id.*

As to issues on which the movant would be obliged to carry the burden of proof at trial, the movant must initially proffer record materials that support his position. *See In re Varrasso,* 37 F.3d 760, 763 (1st Cir. 1994) (citations omitted). This means that summary judgment is inappropriate if inferences are necessary for the judgment and those inferences are not mandated by the record. *Id.* (citing *Blanchard v. Peerless Ins. Co.,* 958 F.2d 483, 488 (1st Cir. 1992) (warning that summary judgment is precluded "unless no reasonable trier of fact could draw any other inference from the 'totality of the circumstances' revealed by the undisputed evidence."))

As to issues on which the non-movant has the burden of proof, the movant need do no more than aver "an absence of evidence to support the nonmoving party's case." *Blanchard,* 958 F.2d at 488 (citing *Celotex Corp. v. Catrett,* 477 U.S. 317, 325, 106 S. Ct. 2548, 91 L. Ed. 2d 265 (1986)). The burden of production then shifts to the non-movant, who, to avoid summary judgment, must establish the existence of at least one question of fact that is both "genuine" and "material." *Id.* (citing *Anderson,* 477 U.S. at 248.

B. Class Certification

Federal Rule of Civil Procedure 23 sets forth the substantive criteria for certifying a class. While the First Circuit has not articulated a particular level of proof or a set standard for the Court regarding findings relating to the substantive criteria, it has cautioned that "when a Rule 23 requirement relies on a novel or complex theory as to injury . . . the district court must engage in a searching inquiry into the viability of that theory and the existence of the facts necessary for the theory to succeed." *In re: New Motor Vehicles Canadian Exp. Antitrust Litig.,* 522 F.3d 6, 26 (1st Cir. 2008).

V. ANALYSIS

A. The ERISA Claims

The Plaintiffs claim that Unum has a fiduciary duty to use the life insurance benefits due to the Plaintiffs solely to benefit them and not to use those assets for its own interest. The crown jewel in the Plaintiffs' argument is a First Circuit case which held, on similar though not identical facts, that an RAA "was no more than an IOU which did not transfer the funds to which the beneficiaries were entitled out of the plan assets and hence UNUM remained a fiduciary with respect to those funds." *Mogel v. Unum Life Ins. Co.,* 547 F.3d 23, 27 (1st Cir. 2008). Unum counters that the present case is distinguishable from *Mogel*, which dealt with policies that promised lump sum payments as opposed to policies which promised

RAAs. Unum points to a Second Circuit case, *Faber v. Metropolitan Life Ins. Co.,* 648 F.3d 98 (2d Cir. 2011), and a recent advisory opinion from the Department of Labor ("**DOL Opinion**"), (Doc. # 26-2). Both the *Faber* decision and the DOL Opinion conclude that an insurance company discharges its ERISA obligations when it furnishes a beneficiary an RAA in accordance with the terms of a life insurance policy, and it does not retain plan assets by holding and managing the funds that back the RAA.

1. The Pertinent Provisions of ERISA

The group life insurance policies at issue are "employee welfare benefit plans" governed by ERISA. *See* 29 U.S.C. § 1002(1) (2009). ERISA provides:

> [A] person is a fiduciary with respect to a plan to the extent (i) he exercises any discretionary authority or discretionary control respecting management of such plan or exercises any authority or control respecting management or disposition of its assets . . . or (iii) he has any discretionary authority or discretionary responsibility in the administration of such plan.

29 U.S.C. § 1002(21)(A).

Particular fiduciary duties under ERISA are stated in Section 404(a) and 406(b). Section 404(a) provides: "a fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and – (A) for the exclusive purpose of: (i) providing benefits to participants and their beneficiaries . . . " 29 U.S.C. § 1104(a)(1). Section 406(b) provides: "[a] fiduciary with respect to a plan shall not – (1) deal with the assets of the plan in his own interest or for his own account . . . " 29 U.S.C. § 1106(b)(1).

2. Unum's Fiduciary Status

The threshold question to determine liability under ERISA is whether Unum was acting as a fiduciary when it opened and maintained RAAs for the beneficiaries. Under ERISA's fiduciary definition, Unum could have acted as a fiduciary if it exercised:

- any discretionary authority or discretionary control with respect to the management of the plan;
- any authority or control with respect to the disposition of the assets of the plan; or
- any discretionary authority or discretionary responsibility in the administration of the plan.

Unum argues that because the plan has no ownership interest in the payment due after a death benefit is approved, the moneys owed to the beneficiaries are not plan assets, and therefore Unum has no fiduciary obligation with regard to them. Relying on *Mogel*, the Plaintiffs claim that benefits payable to ERISA plan beneficiaries are plan assets and remain so until they are actually paid through the banking system. *See Mogel*, 547 F.3d at 26 ("the sums due Plaintiffs remain plan assets subject to UNUM's fiduciary obligations until actual payment.") The Plaintiffs also argue, however, that Unum's fiduciary obligations would continue as long as it managed and administered the RAAs *regardless* of whether the funds backing the RAAs were plan assets. *See id.* at 27 (citing 29 U.S.C. § 1002(21)(A)(i) and (iii)). Unum counters that its last discretionary fiduciary act is determining whether the Plaintiffs' claims are payable, and that its relationship with the Plaintiffs thereafter is strictly a contractual debtor-creditor relationship.

a. Control of Plan Assets

Under ERISA, there is no general definition of "plan assets," but only an indication of what are not "plan assets." Under the guaranteed benefit policy exemption insurers who provide policies for "guaranteed benefits" – *e.g.* life insurance policies stating a specific pre-defined payout upon the death of a plan participant such as the ones at issue in this case – are allowed the freedom to invest the proceeds of the premiums on such policies as they see fit without the restrictions otherwise imposed upon fiduciaries under ERISA. Under this exclusion, the policies themselves are considered the "plan assets," however the assets backing the benefits guaranteed under the policies are not "plan assets." *See* 29 U.S.C. § 1101(b)(2).

Mogel is clear that the guaranteed benefit exemption is no longer applicable once Unum approves the death claim and the beneficiaries' rights to payment vest. *Mogel*, 547 F.3d at 27 ("once an insured's death occurs, we are no longer concerned with the management of plan assets in an insurance company's general account (which is all the guaranteed benefit exemption covers)"). The critical question is whether the proceeds due to beneficiaries *become* plan assets once the insured dies and the benefit is approved.

Mogel concludes, without much discussion, that "the sums due plaintiffs *remain* plan assets subject to UNUM's fiduciary obligations until actual payment." *Id.* at 26. Unum points out, persuasively, that the Seventh Circuit decision in *Commonwealth Edison Co. v. Vega,* 174 F.3d 870, 872-73 (7th Cir. 1999), which the First Circuit cited in support of its conclusion, dealt not with an ERISA defined-benefits plan, but rather with a ERISA retirement plan, which began with a pool of funds that were themselves plan assets. In *Vega*, checks cut to beneficiaries were drawn from funds that were always plan assets and that *remained* so until the checks were presented to the plan for payment. *See id.* In this case, the funds due would have to somehow *become* plan assets following approval of the claim.

Faber, following the DOL Opinion, concludes that the amounts due the beneficiaries do not *become* plan assets because the plans "do not have an ownership interest – beneficial or otherwise – in them." 648 F.3d at 106 (citing DOL Opinion at pp. 9-10 (Doc. # 26-2)). Indeed, it is difficult to understand how these amounts, which must be drawn from Unum's general account where they have been sitting under the guaranteed benefit exemption up to the time of claim approval, would *become* plan assets when following the approval of the death benefit they become due directly to the beneficiaries.

The First Circuit in *Mogel* may have been interpreting ERISA's "disposition of [the plan's] assets" language broadly to mean disposition of the policies themselves. Once the policies, which all agree are plan assets, become due and payable to beneficiaries, the insurer must dispose of those policies by paying the claims due. Perhaps the First Circuit was saying that until whatever payment promised under the plan is in the hands of the beneficiaries, the insurer has not met its fiduciary obligation to dispose of the plan assets, *i.e.* the policies.

It is also possible that the First Circuit was adopting a functional test to determine whether the funds due beneficiaries were "plan assets." The "functional" approach to determining plan assets was articulated by the Ninth Circuit in *Acosta v. Pac. Enters.,* 950 F.2d 611, 620 (9th Cir. 1992). Under this approach, "to determine whether a particular item constitutes an 'asset of the plan' it is necessary to determine whether the item in question may be used to the benefit (financial or otherwise) of the fiduciary at the expense of plan participants or beneficiaries." *Id. Mogel* pointed out that Unum was the party enjoying the use of the funds. *Mogel,* 547 F.3d at 26 ("Until a beneficiary draws a check on the Security Account, the funds represented by that check are retained by UNUM and UNUM had the use of the funds for its own benefit. To say that the funds are 'deemed to belong' to the beneficiaries obscures the reality that UNUM had possession of them and enjoyed their use.") While the functional test may in many situations be a useful analysis, it results in somewhat circular logic in this case. It only appears that Unum used the amounts owed to Plaintiffs at their "expense" if one views them as plan assets to begin with. Furthermore, if the funds owed to the Plaintiffs are considered plan assets, the result will be an end to the RAA method of payment because insurers will be required to immediately cease investment of and segregate the funds due to beneficiaries. For reasons articulated in Section V(A)(3) *infra,* the Court finds this to be a drastic result which is not required by ERISA.[1]

[1] The Court has also considered the opinions in *Edmonson v. Lincoln Nat'l Life Ins. Co.,* 777 F. Supp. 2d 869 (E.D. Pa. 2011) (denying defendant's motion to dismiss), *Otte v. Life Ins. Co. of N. Am.,* 275 F.R.D. 50 (D. Mass. 2011) (certifying a Rule 23(b)(3) class of plaintiffs), and *Vander Luitgaren v. Sun Life Ins. Co. of Can.,* 2010 WL 4722269 (D. Mass.) (denying defendant's motion to dismiss). Only *Edmonson* contains an analysis of whether the funds backing the RAAs are plan assets. The *Edmonson* court relied on *Mogel* in determining that any funds the insurer had *not* transferred into the plaintiffs' RAAs were plan assets. The *Edmonson* court also cited *In re Luna,* 406 F.3d 1192 (10th Cir. 2005), which held that a plan "holds a future interest in the

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Mogel's core holding – that Unum's "disposition to the beneficiaries of benefits under the plan falls comfortably within the scope of ERISA's definition of fiduciary duties with respect to plan administration" – did not require the First Circuit to find that the sums due to those plaintiffs were plan assets.[2] *Mogel,* 547 F.3d at 27. The Court believes that, if the First Circuit were required to address the issue squarely, it would not hold that the funds backing the RAAs in this case are plan assets. Accordingly, the Court finds that the Plaintiffs have not stated a claim for breach of fiduciary duties under 406(b), which requires self-dealing in plan assets.

b. Plan Administration

Mogel made clear that "once an insured's death occurs," the concern was with the "insurance company's duties with respect to the payment that is now due the beneficiary." *Mogel,* 547 F.3d at 27. "[T]he disposition to the beneficiaries of the benefits due

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collection of the contractually-owed contributions" in assessing whether benefits in RAAs might constitute plan assets. 777 F.Supp.2d at 891 (citing *In re Luna,* 406 F.3d at 1199.) *In re Luna* is fundamentally distinguishable, however, because it involved contributions owed by an employer to a plan, not payments due directly to beneficiaries.

[2] The fiduciary definition dealing with plan administration does not refer to "plan assets." 29 U.S.C. § 1002(21)(A)(iii) ("a person is a fiduciary with respect to a plan to the extent he has any discretionary authority or discretionary responsibility in the administration of the plan").

under the plan falls comfortably within the definition of fiduciary duties with respect to plan administration." *Id.*

Unum asks us to distinguish *Mogel* because the plaintiffs in *Mogel* had policies that called for payment to the beneficiaries by a lump sum payment. Unum argues that these policies in the instant case require payment by RAAs and that Unum discharged its duties by providing RAAs. Unum cites *Faber,* which held that that once an insurance company "creates and credits a beneficiary's [RAA] and provides a checkbook, the beneficiary 'has effectively received a distribution of all the benefits that the Plan promised' and 'ERISA no longer governs the relationship'" between the insurer and the beneficiary. *Faber,* 648 F.3d at 102 (quoting DOL Opinion at p. 11 (Doc. # 26-2)).

The Court disagrees that simply providing RAAs to the Plaintiffs ends the inquiry into satisfaction of Unum's fiduciary duties:

> There is more to plan (or trust) administration than simply complying with the specific duties imposed by the plan documents or statutory regime; it also includes the activities that are "ordinary and natural means" of achieving the "objective" of the plan. Indeed the primary function of the fiduciary duty is to constrain the exercise of discretionary powers which are controlled by no other specific duty imposed by the trust instrument or the legal regime. If the fiduciary duty

> applied to nothing more than activities already controlled by other specific legal duties, it would serve no purpose.

Varity Corp. v. Howe, 516 U.S. 489, 504, 116 S. Ct. 1065, 134 L. Ed. 2d 130 (1996) (quoting Bogert & Bogert, *Law of Trusts and Trustees* § 551, at 41-52). The Court is obliged to look at whether Unum retained any discretion in its provision of RAAs to the Plaintiffs and, if so, whether it exercised that discretion solely in their interests.

3. Breach of the Duty to Administer the Plans Solely in the Interests of the Beneficiaries (29 U.S.C. § 1104(a))

The plans provide that payment will be by RAAs, which are defined as interest-bearing accounts established through an intermediary bank in the name of the beneficiary. When Unum chose to award itself the business of administering the Plaintiffs' RAAs and chose to retain the assets backing these accounts, Unum was exercising its discretionary authority and responsibility in the administration of the Peabody and St. Joseph's Plans.

In doing so, Unum chose to maximize its own profits by setting the RAAs' interest rate just high enough to forestall mass withdrawal of the funds backing these accounts. The Court is unaware of whether there are banks or other institutions which would have bid on Unum's book of RAA business, offering no-fee demand accounts on better terms than those offered by Unum. What is clear, however, is that Unum managed the RAAs to optimize its own earnings and not to optimize the beneficiaries' earnings. Unum is not required to place its pool of funds with a third party. However, Unum-the-fiduciary is under an obligation to look at Unum-the-RAA-service-provider with a critical eye. If Unum wished to retain the RAA business for itself, as a fiduciary it was under an obligation to offer terms comparable to the best terms available on the market. Unum's own research revealed that the 1% rate it provided was low compared to its competitors, which offered an average rate of about 2%, with some as high as 4%. Although further factual development would be required to determine the reasonableness of the interest rate at any particularly [sic] point in time, this evidence of competitors' rates suggests that Unum was acting in its own self-interest, not solely in the interest of the beneficiaries, in setting the interest rate. Accordingly, Unum has breached its fiduciary duty to the Plaintiffs under ERISA Section 404(a), and the Plaintiffs are entitled to partial summary judgment as to liability on this claim.

The Court wishes to emphasize that the RAA method of payment itself is not necessarily inconsistent with ERISA. The Court agrees with the DOL that *Mogel* does not imply any general restrictions on the method of payment chosen by plan settlors. *See* DOL Opinion at p. 13 (Doc. # 26-2) ("*Mogel* does not stand for the broader proposition that the insurance company can never 'retain' plan assets and use them for its own benefit, regardless of whether the plan specifically provided for a lump sum case distribution or simply for the creation of a [RAA].") The plan settlor generally has wide discretion to design an employee welfare benefit plan, *see Hughes Aircraft Co. v. Jacobson,* 525 U.S. 432, 444, 119 S. Ct. 74, 142 L. Ed. 2d 881 (1999), and the Plaintiffs have not pointed to any prohibition under ERISA against paying guaranteed-benefit claims through the establishment of RAAs. Indeed, RAAs are in some ways superior to lump sum payments in that they provide flexibility and at least some interest for people who are without a bank or who need time to consider their investment options. It is inconsistent with ERISA's goals to prohibit this type of arrangement.

Unum's difficulty in this case was not in using RAAs as a method of payment, but rather in offering insurance policies that left discretion to Unum to determine the interest rates and other features accruing to these accounts. If Unum had set forth the pertinent features of the proposed RAAs in the plan itself,[3] it could have removed discretion from the

[3] Unum asserted at oral argument that no insurer would commit to fixing an interest rate on future RAAs at the time policies are purchased, and that such a requirement would spell the end of RAAs as a method of payment for all ERISA-governed life-insurance policies. Unum acknowledged, however, that it is possible to set interest rates in advance that are tied to an index rate. There are surely other creative ways to define the features of these proposed RAAs so as to remove discretion from their creation at the time the benefits vest but that allows an avenue toward profit (and therefore an incentive to offer RAAs) for the

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administration of these plans. Setting forth the features of the RAAs in the plan also provides plan settlors with information that they can compare with other policies and aids settlors in making informed decisions regarding their group-life policy purchases.

4. Unum's Affirmative Defenses: Consent and Ratification

Unum argues that the Plaintiffs are not entitled to summary judgment on liability because the parties dispute the extent to which the Plaintiffs knew that Unum was retaining and investing their funds. Unum appears to argue that so long as beneficiaries allowed their funds to remain in the RAAs, knowing that Unum was retaining and investing the funds backing those accounts, they consented or ratified any breach of fiduciary duty that Unum committed.

Maine's Trust Code 18-B M.R.S.A. § 1009, cited by Unum in support of this assertion, does not equate mere knowledge of a trustee's actions with consent or ratification of a breach of the trustee's fiduciary duties. In fact, the Uniform Comment to this section states, "[a] consent, release, or affirmance under this section may occur either before or after the approved

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insurance companies. The Court acknowledges that setting forth these features in advance may lower the profitability of RAAs for insurance companies by removing some flexibility and creating pressure to compete with other insurance companies in the rates and other terms offered up front. This, however, does not appear to be a bad outcome for the market.

conduct. This section requires an affirmative act by the beneficiary. A failure to object is not sufficient. . . ." 18-B M.R.S.A. § 1009, Uniform Comment. Unum has presented no evidence that the Plaintiffs undertook any affirmative act indicating consent to its conduct.

Moreover, the Comment states that, "[t]o constitute a valid consent, the beneficiary must know of the beneficiary's rights and of the material facts relating to the breach." *Id.* Unum does not contend that it informed the Plaintiffs that it:

- retained the funds backing the RAAs for the purpose of generating investment income from those funds;
- set interest rates on the RAAs at the lowest rate that would maximize retention of those funds in the RAAs;
- had a fiduciary obligation to set interest rates on these accounts solely in the Plaintiffs' interest; or
- asked the Plaintiffs to consent to its self-interested interest-rate setting on these accounts.

For these reasons, Unum has failed to generate any material issues of fact with regard to consent or ratification by the Plaintiffs.

5. The Availability of the Relief Sought By the Plaintiffs

The Plaintiffs bring their ERISA claims under 29 U.S.C. § 1132(a)(3), which states in pertinent part that a claim may be brought:

> by a . . . beneficiary . . . (A) to enjoin any act or practice which violates any provision of this subchapter [regarding protection of employee benefit rights] or the terms of the plan, or (B) to obtain other appropriate equitable relief (i) to redress such violations or (ii) to enforce any provisions of this subchapter or the terms of the plan.

Unum contends that the relief that Plaintiffs seek amounts to a money judgment against Unum. It asserts that this is not equitable relief and therefore cannot be obtained by the Plaintiffs. The Plaintiffs style the relief they seek as a declaration that Unum was unjustly enriched by the "profits" it obtained from its investment of the funds backing their RAAs. They further seek to impose a constructive trust upon Unum's funds to the extent of these profits and to disgorge the funds held in the constructive trust.

The fact that the Plaintiffs may obtain monetary relief out of this litigation does not mean that their claims against Unum are not equitable. The Supreme Court recently considered the scope of relief available under Section 1132(a)(3), and concluded that monetary relief is available. *CIGNA Corp. v. Amara,* 131 S. Ct. 1866, 1880, 179 L. Ed. 2d 843 (2011) ("Equity courts possessed the power to provide relief in the form of monetary 'compensation' for a loss resulting from a trustee's breach of duty, or to prevent the trustee's unjust enrichment."). *See also Edmonson,* 777 F. Supp. 2d at 891-92 (finding that plaintiffs' request for disgorgement of insurer's investment profits on the funds backing their RAAs was appropriate under 29 U.S.C. § 1132(a)(3)).

It also appears under general trust principles that the remedies of a beneficiary against a trustee are almost exclusively equitable. *See Restatement (Second) of Trusts* (1959) §§ 197 and 198 ("the remedies of the beneficiary against the trustee are exclusively equitable" . . . except for cases in which the trustee is under an obligation to immediately and unconditionally transfer money or chattel to the beneficiary); *cf. Great-West Life & Annuity Ins. Co. v. Knudson,* 534 U.S. 204, 210, 122 S. Ct. 708, 151 L. Ed. 2d 635 (2002) (making distinctions between the equitable versus legal nature of restitution where the defendant was not a fiduciary but a beneficiary, and the claim was "for a contractual obligation to pay money relief that was not typically available in equity.") Accordingly, the Plaintiffs' claims do not appear to be barred by unavailability of the relief they seek.

However, this does not mean that the Plaintiffs are entitled to disgorgement of Unum's entire investment spread. Unum breached its fiduciary duties by awarding the RAA business to itself without offering the best overall RAAs to the Plaintiffs. No vendor would service interest-bearing demand accounts without either charging fees or obtaining an appreciable volume of assets from which to make an investment spread. Unum has "profited" from the Plaintiffs to the extent it used its proprietary position to retain these accounts on terms less favorable than other vendors might have offered for the same book of business.

B. Breach of Contract and Violation of 24-A M.R.S.A. § 2436

Under their breach of contract and statutory late payment claims, the Plaintiffs assert that, by setting up RAAs instead of issuing checks, Unum failed to make the complete, timely payment that was due to them under their contracts. The Court disagrees.

The plain language of these GISBs makes it clear to an ordinary person in the Plaintiffs' shoes that payment will be made upon approval of their claims by means of setting up an RAA.[4] An ordinary person

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[4] Maine law governs the Peabody and St. Joseph's Policies. Under ordinary rules of insurance contract interpretation in Maine, ambiguities are strictly construed against the insurer and in favor of the "coverage" sought by the insureds. *See e.g. Hughes v. Bos. Mut. Life Ins. Co.,* 26 F.3d 264, 268 (1st Cir. 1994); *Foremost Ins. Co. v. Levesque,* 2005 ME 34, ¶ 7, 868 A.2d 244, 246. Under Maine law, language in an insurance contract is ambiguous if it "is reasonably susceptible of different interpretations." *Peerless Ins. Co. v. Brennon,* 564 A.2d 383, 384 (Me. 1989). In addition, a policy of insurance is ambiguous if an ordinary person standing in the insured's shoes would not

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receiving the blank drafts, account statement and Welcome Kit issued by Unum would understand that she could obtain the entire amount of her benefit by writing out a draft to herself and depositing the draft into her personal account. An ordinary person in the Plaintiffs' shoes would not be confused about Unum's use of the term "payment" as referring to this uncomplicated procedure.

The Plaintiffs' statutory claim under Maine's late payment statute, 24-A M.R.S.A. § 2436, is contingent upon Unum's failure to timely make payment according to the terms of its contracts. This statute states in pertinent part:

> A claim for payment of benefits under a policy or certificate of insurance delivered or issued for delivery in this State is payable within 30 days after proof of loss is received by the insurer and ascertainment of the loss is made either by written agreement between the insurer and the insured or beneficiary or

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understand that the policy did not cover claims such as those brought. *Id.*

Unum claims that it is entitled to deferential review of its contract terms because it has provided itself with discretionary authority to interpret the terms and provisions of its summaries of benefits. *See Maher v. Mass. Gen. Hosp. Long Term Disability Plan,* 2011 WL 6061347 at *2 (1st Cir., Dec. 7, 2011). The Court need not determine whether this standard of review is applicable because even applying non-deferential rules of interpretation the plan is unambiguous.

> by filing with the insured or beneficiary an award by arbitrators as provided for in the policy. . . . A claim that is neither disputed nor paid within 30 days is overdue.

24-A M.R.S.A. § 2436(1).

The Court agrees with Unum that *Dodge v. United Servs. Auto. Ass'n,* 417 A.2d 969 (Me. 1980) provides whatever guidance is needed on the question of whether Unum's presentation of blank drafts, statements, and explanatory Welcome Kits to the Plaintiffs satisfies this statute's requirement of payment within 30 days. *Id.* at 973 ("Section 2436 neither purports to prescribe nor to prohibit any particular method of payment; it merely sets forth the applicable time limits beyond which payments shall be considered overdue."). As Unum points out, if it had presented checks to the Plaintiffs, they would have still had to deposit these checks to their accounts. It is by no means a violation of the late payment statute when an insurer presents a check to an insured which the insured thereafter fails to deposit. By providing blank drafts, account balances, and a plain language explanation of the RAAs to the Plaintiffs, Unum provided the Plaintiffs with unconditional access to their benefits, the same – considering the purpose of the Late Payment Statute – as if it had issued a check. Accordingly, Unum is entitled to summary judgment on the Plaintiffs' claims for breach of contract and under 24-A M.R.S.A. § 2436.

C. Class Certification

The Plaintiffs seek to certify two classes as follows:

> The "**ERISA Class**" [for] all persons who satisfy each of the following criteria:
>
> a. At any time after October 28, 2004 (the date six years immediately preceding the filing of the complaint) and continuing to the present;
>
> b. They were beneficiaries under ERISA-governed employee welfare benefit plans that were insured by UNUM under insurance contracts that contain the following settlement language:
>
> > (i) "If you or your dependent's life claim is at least $10,000, Unum will make available to the beneficiary a retained asset account (the Unum Security Account). RETAINED ASSET ACCOUNT is an interest bearing account established at an intermediary bank in the name of your beneficiary, as owner. Payment for the life claim may be accessed by writing a draft in a single sum or drafts in smaller sums. The funds for the draft or drafts are fully guaranteed by Unum;" or
> >
> > (ii) any other substantially similar operative settlement language providing for the settlement of death

benefit claims via a Retained Asset Account; and

c. Under which UNUM retained any part of their death benefits using Retained Asset Accounts ("RAA"), irrespective of the nomenclature used to refer to such account including, but not limited to, "Money Market Account," "Retained Asset Account," "UNUM Retained Asset Account" and/or "UNUM Security Account."

And:

The "**Maine PMI Subclass**" or "Subclass" [for] all members of the ERISA Class who satisfy each of the following criteria:

a. They were beneficiaries of ERISA-governed employee welfare benefit plans issued by UNUM wherein the "Governing Jurisdiction" is Maine; and

b. Under which UNUM did not pay post-mortem interest at the rate of 1.5% per month (18% per annum) on funds retained by UNUM for more than 30 days after ascertainment of loss.

Plaintiffs' Motion to Certify Class and Subclass at p. 1 (Doc. # 29).

The Court denies the Plaintiffs' motion for certification of the Maine PMI Subclass because it has granted summary judgment to Unum on the claims supporting this proposed class. The inquiry that follows concerns only certification of the general ERISA class.

Under Fed. R. Civ. P. 23, the Court engages in both a general and a specific set of inquiries relating to class certification. The general prerequisites for class certification are contained under Rule 23(a) as follows:

> One or more members of a class may sue or be sued as representative parties on behalf of all members only if:
>
> (1) the class is so numerous that joinder of all members in [sic] impracticable;
>
> (2) there are questions of law or fact common to the class;
>
> (3) the claims or defenses of the representative parties are typical of the claims or defenses of the class; and
>
> (4) the representative parties will fairly and adequately protect the interests of the class.

Fed. R. Civ. P. 23. The Court must then review the additional requirements contained under Rule 23(b) to determine if the plaintiffs fit within any of the particular types of classes articulated therein.

The Plaintiffs contend that the ERISA class meets the requirements of 23(b)(1) and 23(b)(3). These state respectively:

A class action may be maintained if Rule 23(a) is satisfied and if:

(1) prosecuting separate actions by or against individual class members would create a risk of:

(A) inconsistent or varying adjudications with respect to individual class members that would establish incompatible standards of conduct for the party opposing the class; or

(B) adjudications with respect to individual class members that, as a practical matter, would be dispositive of the interests of the other members not parties to the individual adjudications or would substantially impair or impede their ability to protect their interests;

* * *

(3) the court finds that the questions of law or fact common to class members predominate over any questions affecting only individual members, and that a class action is superior to other available methods for fairly and efficiently adjudicating the controversy. The matters pertinent to these findings include:

(A) the class members' interests in individually controlling the prosecution or defense of separate actions;

(B) the extent and nature of any litigation concerning the controversy already begun by or against class members;

(C) the desirability or undesirability of concentrating the litigation of the claims in the particular forum; and

(D) the likely difficulties in managing a class action.

Unum proceeds from the premise that this case is about "delayed payment" of funds due to the Plaintiffs and argues that each beneficiary's knowledge and motivation in choosing to leave their funds in RAAs is central to a determination of liability. Unum asserts that the unique knowledge and motivation of each Plaintiff precludes a finding of commonality, typicality, or adequacy of representation under Rule 23(b)(1), as well as a finding of predominance and superiority under Rule 23(b)(3). Unum refers particularly to the fact that in February of 2009, it began sending out letters that were explicit about the fact that Unum would retain and invest the funds backing the RAAs.

Unum's argument is based on a view of the issues not adopted by the Court. As discussed in the summary judgment portion of this Order, Unum's breach of fiduciary duty arose out of its discretionary choices to retain the assets behind the RAAs in its own general account and to set the features for these RAAs, including the applicable interest rates, in its own interest rather than solely in the interest of the beneficiaries.

These choices affected all of the beneficiaries in a similar manner – *i.e.* in the loss of additional interest to their accounts for the period of time in which they left their funds in the RAAs. The Plaintiffs' individual damages will be different depending upon when their benefits vested and how long they kept their money in the RAAs. However, the Plaintiffs' varying motivations for leaving money in these accounts are not relevant to Unum's liability or to the calculation of damages.

Unum also claims that the proposed class is divided by ERISA's three-year statute of limitations on claims for breach of fiduciary duty in which the plaintiff had actual knowledge of the breach or violation. *See* 29 U.S.C. § 1113.[5] Actual knowledge requires

[5] This section states:

No action may be commenced under this subchapter with respect to a fiduciary's breach of any responsibility, duty, or obligation under this part . . . after the earlier of –

> (1) six years after (A) the date of the last action which constituted a part of the breach or violation, or (B) in the case of an omission the latest date on which the fiduciary could have cured the breach or violation, or
>
> (2) three years after the earliest date on which the plaintiff had actual knowledge of the breach or violation; except that in the case of fraud or concealment, such action may be commenced not later than six years after the date of discovery of such breach or violation.

that a plaintiff know "the essential facts of the transaction or conduct constituting the violation." *Otte v. Life Ins. Co. of North America,* 275 F.R.D. 50, 56 (D. Mass. 2011) (quoting *Edes v. Verizon Commc'n, Inc.,* 417 F.3d 133, 142 (1st Cir. 2005)). In this case, unlike in *Otte,* Unum did not provide disclosure sufficient to illuminate its practices prior to February of 2009. Prior to February of 2009, Unum sent "Welcome Letters" to the Plaintiffs which stated that the Plaintiffs' money "has been deposited in a security account, which is a money market account set up in your name." While the Security Account Terms and Conditions included with the Welcome Letter stated "The Unum Provident Security Account is not insured by the FDIC," this notice was contained in very small type at the end of the terms and conditions. Even if some Plaintiffs read this inconspicuous notice, it is not clear how many would have understood that Unum was retaining and investing the funds behind these accounts.

The Plaintiffs filed their complaint on October 29, 2010, well within the three-year statute of limitations for those who received letters from Unum after it began making more complete disclosures in February of 2009. Thus, there appears to be no cause at this time to consider whether to certify a separate subclass consisting of those whose claims arose prior to October 29, 2007. If discovery discloses that, in spite of the inadequacy of the pre-February-2009 communications, some class members nevertheless understood that Unum was retaining and investing the assets behind their RAAs, the parties can request certification at that time of a sub-class to represent the specific interests of this group, including any defense against Unum's statute-of-limitations defense.

Unum also claims that some of the Plaintiffs may have either consented to or ratified Unum's actions in this case, a defense that requires individualized determinations that break up the commonality of the issues among the Plaintiffs and prohibit a finding of predominance. The Court found in its order on summary judgment that Unum has created no material issues of fact with regard to this defense. This determination was based on the facts relating to the named Plaintiffs. If discovery reveals that certain individuals within the class may have taken affirmative action constituting informed consent, the Court will entertain a request to certify a subclass in this regard. *See Smilow v. Sw. Bell Mobile Sys., Inc.,* 323 F.3d 32, 39 (1st Cir. 2003) (if "evidence later shows that an affirmative defense is likely to bar claims against at least some class members, then a court has available adequate procedural mechanisms" to address such contingencies, including exclusion of these members from the class or the creation of a subclass).

Unum also argues that certification under Rule 23(b)(1) is inappropriate. While the Court agrees,[6] the

[6] The Plaintiffs have requested, *inter alia,*"[t]hat the Court declare that Unum has violated ERISA and that Unum has been

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unjustly enriched as a result of its violations of ERISA" and "[t]hat the Court issue appropriate injunctive relief enjoining Unum's violations of ERISA and Maine law," First Amended Complaint, ¶ 74 (Doc. # 19). The Plaintiffs, citing a 2001 case from the Eastern District of Pennsylvania, assert that certification under Rule 23(b)(1)(A) is appropriate where plaintiffs seek broad declaratory and injunctive relief related to the defendant's conduct, because "conflicting declaratory and injunctive relief could make compliance impossible for defendants." *Thomas v. SmithKline Beecham Corp.,* 201 F.R.D. 386, 397 (E.D. Pa. 2001). While this is a sensible interpretation of Rule 23(b)(1)(A)'s aim, the Plaintiffs' claims for declaratory and injunctive relief are unnecessary and may even be untenable. With regard to the Plaintiffs' claims for declaratory relief, a "declaration" of the Plaintiffs' rights under 28 U.S.C. §§ 2201-2202 would not settle the controversy between the parties because Unum has already breached its fiduciary duties and some form of surcharge or disgorgement is the only adequate remedy. *See* Fed. R. Civ. P. 57 commentary on the 1937 adoption ("When declaratory relief will not be effective in settling the controversy, the court may decline to grant it.")

With respect to the request for injunctive relief, the named Plaintiffs have already withdrawn their funds from Unum's RAA's and they have no further relationship with Unum. There is thus no ongoing violation with respect to these Plaintiffs which would provide a basis for injunctive relief. While there are class members who may still have funds with Unum, the Plaintiffs have not brought forward any particular facts related to their circumstances, nor have they articulated what, if any sort of injunction they think would be necessary in the wake of a finding by the Court that Unum has breached its fiduciary duty to set interest rates solely in the interest of the Plaintiffs. Thus, because the Plaintiffs have not demonstrated that broad declaratory and injunctive relief are likely to result in this case, the Plaintiffs have not identified a basis on which to grant certification under Rule 23(b)(1)(A).

Certification is appropriate under Rule 23(b)(1)(B) in situations where the plaintiffs seek recovery to a plan of illegal

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Plaintiffs have demonstrated that certification under Rule 23(b)(3) is appropriate, and the Court grants certification under this provision. The Court acknowledges Unum's admonition that a rigorous analysis of the class certification requirements is in order, *see Wal-Mart Stores, Inc. v. Dukes,* 131 S. Ct. 2541, 2551 (2011), but notes that the work required in this regard has been accomplished by the Court's order on summary judgment.

In reviewing the summary judgment record and the arguments presented thereon by the parties, it is apparent that questions of law and fact common to class members predominate over any questions affecting individuals. Likewise, the class members' claims appear to be individually quite small,[7] making their interests in individually controlling this litigation

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profits from an ERISA fiduciary under 29 U.S.C. § 1132(a)(2). Unum points out that this is appropriate only because, once a fiduciary has been ordered to restore to the plan its improperly made profits, the claims of all other beneficiaries of the plan would, as a practical matter, be resolved. Unum's Response to Plaintiffs' Motion to Certify Class at p. 19 (Doc. # 49.) The Court agrees that, since the Plaintiffs do not seek to restore funds to a common plan but instead seek individual recoveries, the justification for Rule 23(b)(1)(B) certification disappears.

[7] For example, Mr. Mowery obtained $23.64 in accrued interest on his $62,300 in benefits. If the applicable rate for the period in which benefits remained in Mr. Mowery's account should have been 3% instead of the 1% he was given, his claim in this case would amount to $47.28. The rate of interest chosen for this example is for illustrative purposes only, and is in no way meant to suggest what the appropriate rate of interest should have been.

quite limited. The class action format should provide an efficient and fair method of combining and adjudicating these claims.

VI. INTERLOCUTORY APPEAL

The Court is of the opinion that, although this order is not otherwise appealable at this time, it involves controlling questions of law as to which there is substantial ground for difference of opinion, including the Court's determinations that the funds backing the RAAs are not plan assets and its determination that Unum breached its fiduciary duties to the Plaintiffs by failing to solely consider their interests when investing the funds behind the RAAs for its own benefit. The Court finds that pursuant to 28 U.S.C. § 1292, an immediate appeal from this order may materially advance the ultimate termination of the litigation, especially in light of the fact that similar issues are or may be addressed by the First Circuit in the appeal of *Otte v. Life Ins. Co. of N.A.,* 275 F.R.D. 50 (D.Mass.2011).

VII. CONCLUSION

The Plaintiffs have failed to demonstrate that Unum committed any breach of contract or that it is liable to the Plaintiffs under Maine's late payment statute, 24-A M.R.S.A. § 2436, and summary judgment is entered in favor of Unum on these counts of the Plaintiffs' First Amended Complaint. The Plaintiffs are, however, entitled to partial summary judgment on Unum's liability for breach of its fiduciary duty imposed under ERISA Section 404(a) in regard to its administration of the relevant plans. Unum is not liable, however, for self-dealing in plan assets under ERISA Section 406(b) because the funds retained by Unum were not plan assets. Accordingly, the Plaintiffs' motion for partial summary judgment is GRANTED IN PART and DENIED IN PART and Unum's motion for summary judgment is GRANTED IN PART and DENIED IN PART. The Plaintiffs' request for class certification is GRANTED under Fed. R. Civ. P. 23(b)(3).

VIII. SEALING OF THIS DECISION

The Court DIRECTS the Clerk of the Court to seal this opinion when docketed. The parties shall notify the Court by noon on Tuesday, February 7, 2012, with due regard to the public's interest in access to court proceedings, whether this opinion contains any confidential information that should remain sealed and, if so, indicate explicitly what language is proposed to be redacted, and why. If the Court does not hear from the parties by noon on Tuesday, February 7, 2012, this opinion will be unsealed.

SO ORDERED.

/s/ Nancy Torresen
United States District Judge

Dated this 3rd day of February, 2012.

29 U.S.C. 1002. Definitions

* * *

(14) The term "party in interest" means, as to an employee benefit plan –

(A) any fiduciary (including, but not limited to, any administrator, officer, trustee, or custodian), counsel, or employee of such employee benefit plan;

(B) a person providing services to such plan;

(C) an employer any of whose employees are covered by such plan;

(D) an employee organization any of whose members are covered by such plan;

(E) an owner, direct or indirect, of 50 percent or more of –

(i) the combined voting power of all classes of stock entitled to vote or the total value of shares of all classes of stock of a corporation.1

(ii) the capital interest or the profits interest of a partnership, or

(iii) the beneficial interest of a trust or unincorporated enterprise, which is an employer or an employee organization described in subparagraph (C) or (D);

(F) a relative (as defined in paragraph (15)) of any individual described in subparagraph (A), (B), (C), or (E);

(G) a corporation, partnership, or trust or estate of which (or in which) 50 percent or more of –

(i) the combined voting power of all classes of stock entitled to vote or the total value of shares of all classes of stock of such corporation,

(ii) the capital interest or profits interest of such partnership, or

(iii) the beneficial interest of such trust or estate, is owned directly or indirectly, or held by persons described in subparagraph (A), (B), (C), (D), or (E);

(H) an employee, officer, director (or an individual having powers or responsibilities similar to those of officers or directors), or a 10 percent or more shareholder directly or indirectly, of a person described in subparagraph (B), (C), (D), (E), or (G), or of the employee benefit plan; or

(I) a 10 percent or more (directly or indirectly in capital or profits) partner or joint venturer of a person described in subparagraph (B), (C), (D), (E), or (G).

The Secretary, after consultation and coordination with the Secretary of the Treasury, may by regulation prescribe a percentage lower than 50 percent for subparagraph (E) and (G) and lower than 10 percent for subparagraph (H) or (I). The Secretary may prescribe regulations for determining the ownership (direct or indirect) of profits and beneficial interests, and the manner in which indirect stockholdings are taken into account. Any person who is a party in interest with respect to a plan to which a trust described in section 501(c)(22) of title 26 is permitted to make payments under section 1403 of this title shall be treated as a party in interest with respect to such trust.

* * *

(21)(A) Except as otherwise provided in subparagraph (B), a person is a fiduciary with respect to a plan to the extent (i) he exercises any discretionary authority or discretionary control respecting management of such plan or exercises any authority or control respecting management or disposition of its assets, (ii) he renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan, or has any authority or responsibility to do so, or (iii) he has any discretionary authority or discretionary responsibility in the administration of such plan. Such term includes any person designated under section 1105(c)(1)(B) of this title.

(B) If any money or other property of an employee benefit plan is invested in securities issued by an investment company registered under the Investment Company Act of 1940 [15 U.S.C.A. 80a-1 et seq.], such investment shall not by itself cause such investment company or such investment company's investment adviser or principal underwriter to be deemed to be a fiduciary or a party in interest as those terms are defined in this subchapter, except insofar as such investment company or its investment adviser or principal underwriter acts in connection with an employee benefit plan covering employees of the investment company, the investment adviser, or its principal underwriter. Nothing contained in this subparagraph shall limit the duties imposed on such investment company, investment adviser, or principal underwriter by any other law.

* * *

(42) the term "plan assets" means plan assets as defined by such regulations as the Secretary may prescribe, except that under such regulations the assets of any entity shall not be treated as plan assets if, immediately after the most recent acquisition of any equity interest in the entity, less than 25 percent of the total value of each class of equity interest in the entity is held by benefit plan investors. For purposes of determinations pursuant to this paragraph, the value of any equity interest held by a person (other than such a benefit plan investor) who has discretionary authority or control with respect to the assets of the entity or any person who provides investment advice for a fee (direct or indirect) with respect to such assets, or any affiliate of such a person, shall be disregarded for purposes of calculating the 25 percent threshold. An entity shall be considered to hold plan assets only to the extent of the percentage of the equity interest held by benefit plan investors. For purposes of this paragraph, the term "benefit plan investor" means an employee benefit plan subject to part 4, any plan to which section 4975 of title 26 applies, and any entity whose

underlying assets include plan assets by reason of a plan's investment in such entity.

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29 U.S.C. § 1104 Fiduciary duties

(a) Prudent man standard of care

(1) Subject to sections 1103(c) and (d), 1342, and 1344 of this title, a fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and –

(A) for the exclusive purpose of:

(i) providing benefits to participants and their beneficiaries; and

(ii) defraying reasonable expenses of administering the plan;

(B) 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;

(C) by diversifying the investments of the plan so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so; and

(D) in accordance with the documents and instruments governing the plan insofar as such documents and instruments are consistent with the provisions of this subchapter and subchapter III of this chapter.

(2) In the case of an eligible individual account plan (as defined in section 1107(d)(3) of this title), the diversification requirement of paragraph (1)(C) and the prudence requirement (only to the extent that it requires diversification) of paragraph (1)(B) is not violated by acquisition or holding of qualifying employer real property or qualifying employer securities (as defined in section 1107(d)(4) and (5) of this title).

(b) Indicia of ownership of assets outside jurisdiction of district courts

Except as authorized by the Secretary by regulations, no fiduciary may maintain the indicia of ownership of any assets of a plan outside the jurisdiction of the district courts of the United States.

(c) Control over assets by participant or beneficiary

(1)(A) 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) –

(i) such participant or beneficiary shall not be deemed to be a fiduciary by reason of such exercise, and

(ii) 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, except that this clause shall not apply in connection with such participant or beneficiary for any blackout period during which the ability of such participant or beneficiary to direct the investment of the assets in his or her account is suspended by a plan sponsor or fiduciary.

(B) If a person referred to in subparagraph (A)(ii) meets the requirements of this subchapter in connection with authorizing and implementing the blackout period, any person who is otherwise a fiduciary shall not be liable under this subchapter for any loss occurring during such period.

(C) For purposes of this paragraph, the term "blackout period" has the meaning given such term by section 1021(i)(7) of this title.

(2) In the case of a simple retirement account established pursuant to a qualified salary reduction arrangement under section 408(p) of title 26, a participant or beneficiary shall, for purposes of paragraph (1), be treated as exercising control over the assets in the account upon the earliest of –

(A) an affirmative election among investment options with respect to the initial investment of any contribution,

(B) a rollover to any other simple retirement account or individual retirement plan, or

(C) one year after the simple retirement account is established.

No reports, other than those required under section 1021(g) of this title, shall be required with respect to a simple retirement account established pursuant to such a qualified salary reduction arrangement.

(3) In the case of a pension plan which makes a transfer to an individual retirement account or annuity of a designated trustee or issuer under section 401(a)(31)(B) of the Internal Revenue Code of 1986, the participant or beneficiary shall, for purposes of paragraph (1), be treated as exercising control over the assets in the account or annuity upon –

(A) the earlier of –

(i) a rollover of all or a portion of the amount to another individual retirement account or annuity; or

(ii) one year after the transfer is made; or

(B) a transfer that is made in a manner consistent with guidance provided by the Secretary.

(4)(A) In any case in which a qualified change in investment options occurs in connection with an individual account plan, a participant or beneficiary shall not be treated for purposes of paragraph (1) as not exercising control over the assets in his account in connection with such change if the requirements of subparagraph (C) are met in connection with such change.

(B) For purposes of subparagraph (A), the term "qualified change in investment options" means, in connection with an individual account plan, a change in the investment options offered to the participant or beneficiary under the terms of the plan, under which –

(i) the account of the participant or beneficiary is reallocated among one or more remaining or new investment options which are offered in lieu of one or more investment options offered immediately prior to the effective date of the change, and

(ii) the stated characteristics of the remaining or new investment options provided under clause (i), including characteristics relating to risk and rate of return, are, as of immediately after the change, reasonably similar to those of the existing investment options as of immediately before the change.

(C) The requirements of this subparagraph are met in connection with a qualified change in investment options if –

(i) at least 30 days and no more than 60 days prior to the effective date of the change, the plan administrator furnishes written notice of the change to the participants and beneficiaries, including information comparing the existing and new investment options and an explanation that, in the absence of affirmative investment instructions from the participant or beneficiary to the contrary, the account of the participant or beneficiary will be invested in the manner described in subparagraph (B),

(ii) the participant or beneficiary has not provided to the plan administrator, in advance of the effective date of the change, affirmative investment instructions contrary to the change, and

(iii) the investments under the plan of the participant or beneficiary as in effect immediately prior to the effective date of the change were the product of the exercise by such participant or beneficiary of control over the assets of the account within the meaning of paragraph (1).

(5) Default investment arrangements

(A) In general.

For purposes of paragraph (1), a participant or beneficiary in an individual account plan meeting the notice requirements of subparagraph (B) shall be treated as exercising control over the assets in the account with respect to the amount of contributions and earnings which, in the absence of an investment election by the participant or beneficiary, are invested by the plan in accordance with regulations prescribed by the Secretary. The regulations under this subparagraph shall provide guidance on the appropriateness of designating default investments that include a mix of asset classes consistent with capital preservation or long-term capital appreciation, or a blend of both.

(B) Notice requirements. –

(i) In general.

The requirements of this subparagraph are met if each participant or beneficiary –

(I) receives, within a reasonable period of time before each plan year, a notice explaining the employee's right under the plan to designate how contributions and earnings will be invested and explaining how, in the absence of any investment election by the participant or beneficiary, such contributions and earnings will be invested, and

(II) has a reasonable period of time after receipt of such notice and before the beginning of the plan year to make such designation.

(ii) Form of notice.

The requirements of clauses (i) and (ii) of section 401(k)(12)(D) of title 26 shall apply with respect to the notices described in this subparagraph.

(d) Plan terminations

(1) If, in connection with the termination of a pension plan which is a single-employer plan, there is an election to establish or maintain a qualified replacement plan, or to increase benefits, as provided under section 4980(d) of title 26, a fiduciary shall discharge the fiduciary's duties under this subchapter and subchapter III of this chapter in accordance with the following requirements:

(A) In the case of a fiduciary of the terminated plan, any requirement –

(i) under section 4980(d)(2)(B) of title 26 with respect to the transfer of assets from the terminated plan to a qualified replacement plan, and

(ii) under section 4980(d)(2)(B)(ii) or 4980(d)(3) of title 26 with respect to any increase in benefits under the terminated plan.

(B) In the case of a fiduciary of a qualified replacement plan, any requirement –

(i) under section 4980(d)(2)(A) of title 26 with respect to participation in the qualified replacement plan of active participants in the terminated plan,

(ii) under section 4980(d)(2)(B) of title 26 with respect to the receipt of assets from the terminated plan, and

(iii) under section 4980(d)(2)(C) of title 26 with respect to the allocation of assets to participants of the qualified replacement plan.

(2) For purposes of this subsection –

(A) any term used in this subsection which is also used in section 4980(d) of title 26 shall have the same meaning as when used in such section, and

(B) any reference in this subsection to title 26 shall be a reference to title 26 as in effect immediately after the enactment of the Omnibus Budget Reconciliation Act of 1990.

29 U.S.C. § 1106 Prohibited transactions

(a) Transactions between plan and party in interest

Except as provided in section 1108 of this title:

(1) A fiduciary with respect to a plan shall not cause the plan to engage in a transaction, if he knows or should know that such transaction constitutes a direct or indirect –

(A) sale or exchange, or leasing, of any property between the plan and a party in interest;

(B) lending of money or other extension of credit between the plan and a party in interest;

(C) furnishing of goods, services, or facilities between the plan and a party in interest;

(D) transfer to, or use by or for the benefit of a party in interest, of any assets of the plan; or

(E) acquisition, on behalf of the plan, of any employer security or employer real property in violation of section 1107(a) of this title.

(2) No fiduciary who has authority or discretion to control or manage the assets of a plan shall permit the plan to hold any employer security or employer real property if he knows or should know that holding such security or real property violates section 1107(a) of this title.

(b) Transactions between plan and fiduciary

A fiduciary with respect to a plan shall not –

(1) deal with the assets of the plan in his own interest or for his own account,

(2) in his individual or in any other capacity act in any transaction involving the plan on behalf of a party (or represent a party) whose interests are adverse to the interests of the plan or the interests of its participants or beneficiaries, or

(3) receive any consideration for his own personal account from any party dealing with such plan in connection with a transaction involving the assets of the plan.

(c) Transfer of real or personal property to plan by party in interest

A transfer of real or personal property by a party in interest to a plan shall be treated as a sale or exchange if the property is subject to a mortgage or similar lien which the plan assumes or if it is subject to a mortgage or similar lien which a party-in-interest placed on the property within the 10-year period ending on the date of the transfer.

§ 2510.3-101 Definition of "plan assets" – plan investments.

(a) *In general.* (1) This section describes what constitute assets of a plan with respect to a plan's investment in another entity for purposes of subtitle A, and parts 1 and 4 of subtitle B, of title I of the Act and section 4975 of the Internal Revenue Code. Paragraph (a)(2) of this section contains a general rule relating to plan investments. Paragraphs (b) through (f) of this section define certain terms that are used in the application of the general rule. Paragraph (g) of this section describes how the rules in this section are to be applied when a plan owns property jointly with others or where it acquires an equity interest whose value relates solely to identified assets of an issuer. Paragraph (h) of this section contains special rules relating to particular kinds of plan investments. Paragraph (i) describes the assets that a plan acquires when it purchases certain guaranteed mortgage certificates. Paragraph (j) of this section contains examples illustrating the operation of this section. The effective date of this section is set forth in paragraph (k) of this section.

(2) Generally, when a plan invests in another entity, the plan's assets include its investment, but do not, solely by reason of such investment, include any of the underlying assets of the entity. However, in the case of a plan's investment in an equity interest of an entity that is neither a publicly-offered security nor a security issued by an investment company registered under the Investment Company Act of 1940 its assets

include both the equity interest and an undivided interest in each of the underlying assets of the entity, unless it is established that –

(i) The entity is an operating company, or

(ii) Equity participation in the entity by benefit plan investors is not significant.

Therefore, any person who exercises authority or control respecting the management or disposition of such underlying assets, and any person who provides investment advice with respect to such assets for a fee (direct or indirect), is a fiduciary of the investing plan.

(b) *Equity interests and publicly-offered securities.* (1) The term *equity interest* means any interest in an entity other than an instrument that is treated as indebtedness under applicable local law and which has no substantial equity features. A profits interest in a partnership, an undivided ownership interest in property and a beneficial interest in a trust are equity interests.

(2) A *publicly-offered security* is a security that is freely transferable, part of a class of securities that is widely held and either –

(i) Part of a class of securities registered under section 12(b) or 12(g) of the Securities Exchange Act of 1934, or

(ii) Sold to the plan as part of an offering of securities to the public pursuant to an effective registration statement under the Securities Act of 1933 and the class of securities of which such security is a part is registered under the Securities Exchange Act of 1934 within 120 days (or such later time as may be allowed by the Securities and Exchange Commission) after the end of the fiscal year of the issuer during which the offering of such securities to the public occurred.

(3) For purposes of paragraph (b)(2) of this section, a class of securities is "widely-held" only if it is a class of securities that is owned by 100 or more investors independent of the issuer and of one another. A class of securities will not fail to be widely-held solely because subsequent to the initial offering the number of independent investors falls below 100 as a result of events beyond the control of the issuer.

(4) For purposes of paragraph (b)(2) of this section, whether a security is "freely transferable" is a factual question to be determined on the basis of all relevant facts and circumstances. If a security is part of an offering in which the minimum investment is $10,000 or less, however, the following factors ordinarily will not, alone or in combination, affect a finding that such securities are freely transferable:

(i) Any requirement that not less than a minimum number of shares or units of such security be transferred or assigned by any investor, provided that such requirement does not prevent transfer of all of the then remaining shares or units held by an investor;

(ii) Any prohibition against transfer or assignment of such security or rights in respect thereof to an ineligible or unsuitable investor;

(iii) Any restriction on, or prohibition against, any transfer or assignment which would either result in a termination or reclassification of the entity for Federal or state tax purposes or which would violate any state or Federal statute, regulation, court order, judicial decree, or rule of law;

(iv) Any requirement that reasonable transfer or administrative fees be paid in connection with a transfer or assignment;

(v) Any requirement that advance notice of a transfer or assignment be given to the entity and any requirement regarding execution of documentation evidencing such transfer or assignment (including documentation setting forth representations from either or both of the transferor or transferee as to compliance with any restriction or requirement described in this paragraph (b)(4) of this section or requiring compliance with the entity's governing instruments);

(vi) Any restriction on substitution of an assignee as a limited partner of a partnership, including a general partner consent requirement, provided that the economic benefits of ownership of the assignor may be transferred or assigned without regard to such restriction or consent (other than compliance with any other restriction described in this paragraph (b)(4)) of this section;

(vii) Any administrative procedure which establishes an effective date, or an event, such as the completion of the offering, prior to which a transfer or assignment will not be effective; and

(viii) Any limitation or restriction on transfer or assignment which is not created or imposed by the issuer or any person acting for or on behalf of such issuer.

(c) *Operating company.* (1) An "operating company" is an entity that is primarily engaged, directly or through a majority owned subsidiary or subsidiaries, in the production or sale of a product or service other than the investment of capital. The term "operating company" includes an entity which is not described in the preceding sentence, but which is a "venture capital operating company" described in paragraph (d) or a "real estate operating company" described in paragraph (e).

(2) [Reserved]

(d) *Venture capital operating company.* (1) An entity is a "venture capital operating company" for the period beginning on an initial valuation date described in paragraph (d)(5)(i) and ending on the last day of the first "annual valuation period" described in paragraph (d)(5)(ii) (in the case of an entity that is not a venture capital operating company immediately before the determination) or for the 12 month period following the expiration of an "annual valuation period" described in paragraph (d)(5)(ii) (in the case of an entity that is a venture capital operating company immediately before the determination) if –

(i) On such initial valuation date, or at any time within such annual valuation period, at least 50 percent of its assets (other than short-term investments pending long-term commitment or distribution to investors), valued at cost, are invested in venture capital investments described in paragraph (d)(3)(i) or derivative investments described in paragraph (d)(4); and

(ii) During such 12 month period (or during the period beginning on the initial valuation date and ending on the last day of the first annual valuation period), the entity, in the ordinary course of its business, actually exercises management rights of the kind described in paragraph (d)(3)(ii) with respect to one or more of the operating companies in which it invests.

(2)(i) A venture capital operating company described in paragraph (d)(1) shall continue to be treated as a venture capital operating company during the "distribution period" described in paragraph (d)(2)(ii). An entity shall not be treated as a venture capital operating company at any time after the end of the distribution period.

(ii) The "distribution period" referred to in paragraph (d)(2)(i) begins on a date established by a venture capital operating company that occurs after the first date on which the venture capital operating company has distributed to investors the proceeds of at least 50 percent of the highest amount of its investments (other than short-term investments made pending long-term commitment or distribution to investors) outstanding at any time from the date it commenced business (determined on the basis of the cost of such investments) and ends on the earlier of –

(A) The date on which the company makes a "new portfolio investment", or

(B) The expiration of 10 years from the beginning of the distribution period.

(iii) For purposes of paragraph (d)(2)(ii)(A), a "new portfolio investment" is an investment other than –

(A) An investment in an entity in which the venture capital operating company had an outstanding venture capital investment at the beginning of the distribution period which has continued to be outstanding at all times during the distribution period, or

(B) A short-term investment pending long-term commitment or distribution to investors.

(3)(i) For purposes of this paragraph (d) a "venture capital investment" is an investment in an operating company (other than a venture capital operating company) as to which the investor has or obtains management rights.

(ii) The term "management rights" means contractual rights directly between the investor and an operating company to substantially participate in, or substantially influence the conduct of, the management of the operating company.

(4)(i) An investment is a "derivative investment" for purposes of this paragraph (d) if it is –

(A) A venture capital investment as to which the investor's management rights have ceased in connection with a public offering of securities of the operating company to which the investment relates, or

(B) An investment that is acquired by a venture capital operating company in the ordinary course of its business in exchange for an existing venture capital investment in connection with:

(*1*) A public offering of securities of the operating company to which the existing venture capital investment relates, or

(*2*) A merger or reorganization of the operating company to which the existing venture capital investment relates, provided that such merger or reorganization is made for independent business reasons unrelated to extinguishing management rights.

(ii) An investment ceases to be a derivative investment on the later of:

(A) 10 years from the date of the acquisition of the original venture capital investment to which the derivative investment relates, or

(B) 30 months from the date on which the investment becomes a derivative investment.

(5) For purposes of this paragraph (d) and paragraph (e) –

(i) An "initial valuation date" is the later of –

(A) Any date designated by the company within the 12 month period ending with the effective date of this section, or

(B) The first date on which an entity makes an investment that is not a short-term investment of funds pending long-term commitment.

(ii) An "annual valuation period" is a pre-established annual period, not exceeding 90 days in duration, which begins no later than the anniversary of an entity's initial valuation date. An annual valuation period, once established may not be changed except for good cause unrelated to a determination under this paragraph (d) or paragraph (e).

(e) *Real estate operating company.* An entity is a "real estate operating company" for the period beginning on an initial valuation date described in paragraph (d)(5)(i) and ending on the last day of the first "annual valuation period" described in paragraph (d)(5)(ii) (in the case of an entity that is not a real estate operating company immediately before the determination) or for the 12 month period following the expiration of an annual valuation period described in paragraph (d)(5)(ii) (in the case of an entity that is a real estate operating company immediately before the determination) if:

(1) On such initial valuation date, or on any date within such annual valuation period, at least 50 percent of its assets, valued at cost (other than short-term investments pending long-term commitment or distribution to investors), are invested in real estate which is managed or developed and with respect to which such entity has the right to substantially participate directly in the management or development activities; and

(2) During such 12 month period (or during the period beginning on the initial valuation date and ending on the last day of the first annual valuation period) such entity in the ordinary course of its business is engaged directly in real estate management or development activities.

(f) *Participation by benefit plan investors.* (1) Equity participation in an entity by benefit plan investors is "significant" on any date if, immediately after the most recent acquisition of any equity interest in the entity, 25 percent or more of the value of any class of equity interests in the entity is held by benefit plan investors (as defined in paragraph (f)(2)). For purposes of determinations pursuant to this paragraph (f), the value of any equity interests held by a person (other than a benefit plan investor) who has discretionary authority or control with respect to the assets of the entity or any person who provides investment advice for a fee (direct or indirect) with respect to such assets, or any affiliate of such a person, shall be disregarded.

(2) A "benefit plan investor" is any of the following –

(i) Any employee benefit plan (as defined in section 3(3) of the Act), whether or not it is subject to the provisions of title I of the Act,

(ii) Any plan described in section 4975(e)(1) of the Internal Revenue Code,

(iii) Any entity whose underlying assets include plan assets by reason of a plan's investment in the entity.

(3) An "affiliate" of a person includes any person, directly or indirectly, through one or more intermediaries, controlling, controlled by, or under common control with the person. For purposes of this paragraph (f)(3), "control", with respect to a person other than an individual, means the power to exercise a controlling influence over the management or policies of such person.

(g) *Joint ownership.* For purposes of this section, where a plan jointly owns property with others, or where the value of a plan's equity interest in an entity relates solely to identified property of the entity, such property shall be treated as the sole property of a separate entity.

(h) *Specific rules relating to plan investments.* Notwithstanding any other provision of this section –

(1) Except where the entity is an investment company registered under the Investment Company Act of 1940, when a plan acquires or holds an interest in any of the following entities its assets include its investment and an undivided interest in each of the underlying assets of the entity:

(i) A group trust which is exempt from taxation under section 501(a) of the Internal Revenue Code pursuant to the principles of Rev. Rul. 81-100, 1981-1 C.B. 326,

(ii) A common or collective trust fund of a bank,

(iii) A separate account of an insurance company, other than a separate account that is maintained solely in connection with fixed contractual obligations of the insurance company under which the amounts payable, or credited, to the plan and to any participant or beneficiary of the plan (including an annuitant) are not affected in any manner by the investment performance of the separate account.

(2) When a plan acquires or holds an interest in any entity (other than an insurance company licensed to do business in a State) which is established or maintained for the purpose of offering or providing any benefit described in section 3(1) or section 3(2) of the Act to participants or beneficiaries of the investing plan, its assets will include its investment and an undivided interest in the underlying assets of that entity.

(3) When a plan or a related group of plans owns all of the outstanding equity interests (other than director's qualifying shares) in an entity, its assets include those equity interests and all of the underlying assets of the entity. This paragraph (h)(3) does not apply, however, where all of the outstanding equity interests in an entity are qualifying employer securities described in section 407(d)(5) of the Act, owned by one or more eligible individual account plan(s) (as defined in section 407(d)(3) of the Act) maintained by the same employer, provided that substantially all of the participants in the plan(s) are, or have been, employed by the issuer of such securities or by members of a group of affiliated corporations (as determined under section 407(d)(7) of the Act) of which the issuer is a member.

(4) For purposes of paragraph (h)(3), a "related group" of employee benefit plans consists of every group of two or more employee benefit plans –

(i) Each of which receives 10 percent or more of its aggregate contributions from the same employer or from members of the same controlled group of corporations (as determined under section 1563(a) of the Internal Revenue Code, without regard to section 1563(a)(4) thereof); or

(ii) Each of which is either maintained by, or maintained pursuant to a collective bargaining agreement negotiated by, the same employee organization or affiliated employee organizations. For purposes of this paragraph, an "affiliate" of an employee organization means any person controlling, controlled by, or under common control with such organization, and includes any organization chartered by the same parent body, or governed by the same constitution and bylaws, or having the relation of parent and subordinate.

(i) *Governmental mortgage pools.* (1) Where a plan acquires a guaranteed governmental mortgage pool certificate, as defined in paragraph (i)(2), the plan's assets include the certificate and all of its rights with respect to such certificate under applicable law, but do not, solely by reason of the plan's holding of such certificate, include any of the mortgages underlying such certificate.

(2) A "guaranteed governmental mortgage pool certificate" is a certificate backed by, or evidencing an interest in, specified mortgages or participation interests therein and with respect to which interest and principal payable pursuant to the certificate is guaranteed by the United States or an agency or instrumentality thereof. The term "guaranteed governmental mortgage pool certificate" includes a mortgage pool certificate with respect to which interest and principal payable pursuant to the certificate is guaranteed by:

(i) The Government National Mortgage Association;

(ii) The Federal Home Loan Mortgage Corporation; or

(iii) The Federal National Mortgage Association.

(j) *Examples.* The principles of this section are illustrated by the following examples:

(1) A plan, P, acquires debentures issued by a corporation, T, pursuant to a private offering. T is engaged primarily in investing and reinvesting in precious metals on behalf of its shareholders, all of which are benefit plan investors. By its terms, the debenture is convertible to common stock of T at P's option. At the time of P's acquisition of the debentures, the conversion feature is incidental to T's obligation to pay interest and principal. Although T is not an operating company, P's assets do not include an interest in the underlying assets of T because P has not acquired an *equity* interest in T. However, if P exercises its option to convert the debentures to common stock, it will have acquired an equity interest in T at that time and (assuming that the common stock is not a publicly-offered security and that there has been no change in the composition of the other equity investors in T) P's assets would then include an undivided interest in the underlying assets of T.

(2) A plan, P, acquires a limited partnership interest in a limited partnership, U, which is established and maintained by A, a general partner in U. U has only one class of limited partnership interests. U is engaged in the business of investing and reinvesting in securities. Limited partnership interests in U are offered privately pursuant to an exemption

from the registration requirements of the Securities Act of 1933. P acquires 15 percent of the value of all the outstanding limited partnership interests in U, and, at the time of P's investment, a governmental plan owns 15 percent of the value of those interests. U is not an operating company because it is engaged primarily in the investment of capital. In addition, equity participation by benefit plan investors is significant because immediately after P's investment such investors hold more than 25 percent of the limited partnership interests in U. Accordingly, P's assets include an undivided interest in the underlying assets of U, and A is a fiduciary of P with respect to such assets by reason of its discretionary authority and control over U's assets. Although the governmental plan's investment is taken into account for purposes of determining whether equity participation by benefit plan investors is significant, nothing in this section imposes fiduciary obligations on A with respect to that plan.

(3) Assume the same facts as in paragraph (j)(2), except that P acquires only 5 percent of the value of all the outstanding limited partnership interests in U, and that benefit plan investors in the aggregate hold only 10 percent of the value of the limited partnership interests in U. Under these facts, there is no significant equity participation by benefit plan investors in U, and, accordingly, P's assets include its limited partnership interest in U, but do not include any of the underlying assets of U. Thus, A

would not be a fiduciary of P by reason of P's investment.

(4) Assume the same facts as in paragraph (j)(3) and that the aggregate value of the outstanding limited partnership interests in U is $10,000 (and that the value of the interests held by benefit plan investors is thus $1000). Also assume that an affiliate of A owns limited partnership interests in U having a value of $6500. The value of the limited partnership interests held by A's affiliate are disregarded for purposes of determining whether there is significant equity participation in U by benefit plan investors. Thus, the percentage of the aggregate value of the limited partnership interests held by benefit plan investors in U for purposes of such a determination is approximately 28.6% ($1000/$3500). Therefore there is significant benefit plan investment in T.

(5) A plan, P, invests in a limited partnership, V, pursuant to a private offering. There is significant equity participation by benefit plan investors in V. V acquires equity positions in the companies in which it invests, and, in connection with these investments, V negotiates terms that give it the right to participate in or influence the management of those companies. Some of these investments are in publicly-offered securities and some are in securities acquired in private offerings. During its most recent valuation period, more than 50 percent of V's assets, valued at cost, consisted of investments with respect to which V obtained management rights of the kind described above. V's managers routinely consult informally

with, and advise, the management of only one portfolio company with respect to which it has management rights, although it devotes substantial resources to its consultations with that company. With respect to the other portfolio companies, V relies on the managers of other entities to consult with and advise the companies' management. V is a venture capital operating company and therefore P has acquired its limited partnership investment, but has not acquired an interest in any of the underlying assets of V. Thus, none of the managers of V would be fiduciaries with respect to P solely by reason of its investment. In this situation, the mere fact that V does not participate in or influence the management of all its portfolio companies does not affect its characterization as a venture capital operating company.

(6) Assume the same facts as in paragraph (j)(5) and the following additional facts: V invests in debt securities as well as equity securities of its portfolio companies. In some cases V makes debt investments in companies in which it also has an equity investment; in other cases V only invests in debt instruments of the portfolio company. V's debt investments are acquired pursuant to private offerings and V negotiates covenants that give it the right to substantially participate in or to substantially influence the conduct of the management of the companies issuing the obligations. These covenants give V more significant rights with respect to the portfolio companies' management than the covenants ordinarily found in debt instruments of established, creditworthy companies

that are purchased privately by institutional investors. V routinely consults with and advises the management of its portfolio companies. The mere fact that V's investments in portfolio companies are debt, rather than equity, will not cause V to fail to be a venture capital operating company, provided it actually obtains the right to substantially participate in or influence the conduct of the management of its portfolio companies and provided that in the ordinary course of its business it actually exercises those rights.

(7) A plan, P, invests (pursuant to a private offering) in a limited partnership, W, that is engaged primarily in investing and reinvesting assets in equity positions in real property. The properties acquired by W are subject to long-term leases under which substantially all management and maintenance activities with respect to the property are the responsibility of the lessee. W is not engaged in the management or development of real estate merely because it assumes the risks of ownership of income-producing real property, and W is not a real estate operating company. If there is significant equity participation in W by benefit plan investors, P will be considered to have acquired an undivided interest in each of the underlying assets of W.

(8) Assume the same facts as in paragraph (j)(7) except that W owns several shopping centers in which individual stores are leased for relatively short periods to various merchants (rather than owning properties subject to long-term leases under which substantially

all management and maintenance activities are the responsibility of the lessee). W retains independent contractors to manage the shopping center properties. These independent contractors negotiate individual leases, maintain the common areas and conduct maintenance activities with respect to the properties. W has the responsibility to supervise and the authority to terminate the independent contractors. During its most recent valuation period more than 50 percent of W's assets, valued at cost, are invested in such properties. W is a real estate operating company. The fact that W does not have its own employees who engage in day-to-day management and development activities is only one factor in determining whether it is actively managing or developing real estate. Thus, P's assets include its interest in W, but do not include any of the underlying assets of W.

(9) A plan, P, acquires a limited partnership interest in X pursuant to a private offering. There is significant equity participation in X by benefit plan investors. X is engaged in the business of making "convertible loans" which are structured as follows: X lends a specified percentage of the cost of acquiring real property to a borrower who provides the remaining capital needed to make the acquisition. This loan is secured by a mortgage on the property. Under the terms of the loan, X is entitled to receive a fixed rate of interest payable out of the initial cash flow from the property and is also entitled to that portion of any additional cash flow which is equal to the percentage of the acquisition cost that is financed by its loan.

Simultaneously with the making of the loan, the borrower also gives X an option to purchase an interest in the property for the original principal amount of the loan at the expiration of its initial term. X's percentage interest in the property, if it exercises this option, would be equal to the percentage of the acquisition cost of the property which is financed by its loan. The parties to the transaction contemplate that the option ordinarily will be exercised at the expiration of the loan term if the property has appreciated in value. X and the borrower also agree that, if the option is exercised, they will form a limited partnership to hold the property. X negotiates loan terms which give it rights to substantially influence, or to substantially participate in, the management of the property which is acquired with the proceeds of the loan. These loan terms give X significantly greater rights to participate in the management of the property than it would obtain under a conventional mortgage loan. In addition, under the terms of the loan, X and the borrower ratably share any capital expenditures relating to the property. During its most recent valuation period, more than 50 percent of the value of X's assets valued at cost consisted of real estate investments of the kind described above. X, in the ordinary course of its business, routinely exercises its management rights and frequently consults with and advises the borrower and the property manager. Under these facts, X is a real estate operating company. Thus, P's assets include its interest in X, but do not include any of the underlying assets of X.

(10) In a private transaction, a plan, P, acquires a 30 percent participation in a debt instrument that is held by a bank. Since the value of the participation certificate relates solely to the debt instrument, that debt instrument is, under paragraph (g), treated as the sole asset of a separate entity. Equity participation in that entity by benefit plan investors is significant since the value of the plan's participation exceeds 25 percent of the value of the instrument. In addition, the hypothetical entity is not an operating company because it is primarily engaged in the investment of capital (*i.e.,* holding the debt instrument). Thus, P's assets include the participation and an undivided interest in the debt instrument, and the bank is a fiduciary of P to the extent it has discretionary authority or control over the debt instrument.

(11) In a private transaction, a plan, P, acquires 30% of the value of a class of equity securities issued by an operating company, Y. These securities provide that dividends shall be paid solely out of earnings attributable to certain tracts of undeveloped land that are held by Y for investment. Under paragraph (g), the property is treated as the sole asset of a separate entity. Thus, even though Y is an operating company, the hypothetical entity whose sole assets are the undeveloped tracts of land is not an operating company. Accordingly, P is considered to have acquired an undivided interest in the tracts of land held by Y. Thus, Y would be a fiduciary of P to the extent it exercises discretionary authority or control over such property.

(12) A medical benefit plan, P, acquires a beneficial interest in a trust, Z, that is not an insurance company licensed to do business in a State. Under this arrangement, Z will provide the benefits to the participants and beneficiaries of P that are promised under the terms of the plan. Under paragraph (h)(2), P's assets include its beneficial interest in Z and an undivided interest in each of its underlying assets. Thus, persons with discretionary authority or control over the assets of Z would be fiduciaries of P.

(k) *Effective date and transitional rules.* (1) In general, this section is effective for purposes of identifying the assets of a plan on or after March 13, 1987. Except as a defense, this section shall not apply to investments in an entity in existence on March 13, 1987, if no plan subject to title I of the Act or plan described in section 4975(e)(1) of the Code (other than a plan described in section 4975(g)(2) or (3)) acquires an interest in the entity from an issuer or underwriter at any time on or after March 13, 1987 except pursuant to a contract binding on the plan in effect on March 13, 1987 with an issuer or underwriter to acquire an interest in the entity.

(2) Notwithstanding paragraph (k)(1), this section shall not, except as a defense, apply to a real estate entity described in section 11018(a) of Pub. L. 99-272.

[51 FR 41280, Nov. 13, 1986, as amended at 51 FR 47226, Dec. 31, 1986]

§ 2510.3-102 Definition of "plan assets" – participant contributions.

(a)(1) *General rule.* For purposes of subtitle A and parts 1 and 4 of subtitle B of title I of ERISA and section 4975 of the Internal Revenue Code only (but without any implication for and may not be relied upon to bar criminal prosecutions under 18 U.S.C. 664), the assets of the plan include amounts (other than union dues) that a participant or beneficiary pays to an employer, or amounts that a participant has withheld from his wages by an employer, for contribution or repayment of a participant loan to the plan, as of the earliest date on which such contributions or repayments can reasonably be segregated from the employer's general assets.

(2) *Safe harbor.* (i) For purposes of paragraph (a)(1) of this section, in the case of a plan with fewer than 100 participants at the beginning of the plan year, any amount deposited with such plan not later than the 7th business day following the day on which such amount is received by the employer (in the case of amounts that a participant or beneficiary pays to an employer), or the 7th business day following the day on which such amount would otherwise have been payable to the participant in cash (in the case of amounts withheld by an employer from a participant's wages), shall be deemed to be contributed or repaid to such plan on the earliest date on which such contributions or participant loan repayments can reasonably be segregated from the employer's general assets.

(ii) This paragraph (a)(2) sets forth an optional alternative method of compliance with the rule set forth in paragraph (a)(1) of this section. This paragraph (a)(2) does not establish the exclusive means by which participant contribution or participant loan repayment amounts shall be considered to be contributed or repaid to a plan by the earliest date on which such contributions or repayments can reasonably be segregated from the employer's general assets.

(b) *Maximum time period for pension benefit plans.* (1) Except as provided in paragraph (b)(2) of this section, with respect to an employee pension benefit plan as defined in section 3(2) of ERISA, in no event shall the date determined pursuant to paragraph (a)(1) of this section occur later than the 15th business day of the month following the month in which the participant contribution or participant loan repayment amounts are received by the employer (in the case of amounts that a participant or beneficiary pays to an employer) or the 15th business day of the month following the month in which such amounts would otherwise have been payable to the participant in cash (in the case of amounts withheld by an employer from a participant's wages).

(2) With respect to a SIMPLE plan that involves SIMPLE IRAs (*i.e.,* Simple Retirement Accounts, as described in section 408(p) of the Internal Revenue Code), in no event shall the date determined pursuant to paragraph (a)(1) of this section occur later than the 30th calendar day following the month in which the participant contribution amounts would

otherwise have been payable to the participant in cash.

(c) *Maximum time period for welfare benefit plans.* With respect to an employee welfare benefit plan as defined in section 3(1) of ERISA, in no event shall the date determined pursuant to paragraph (a)(1) of this section occur later than 90 days from the date on which the participant contribution amounts are received by the employer (in the case of amounts that a participant or beneficiary pays to an employer) or the date on which such amounts would otherwise have been payable to the participant in cash (in the case of amounts withheld by an employer from a participant's wages).

(d) *Extension of maximum time period for pension plans.* (1) With respect to participant contributions received or withheld by the employer in a single month, the maximum time period provided under paragraph (b) of this section shall be extended for an additional 10 business days for an employer who –

(i) Provides a true and accurate written notice, distributed in a manner reasonably designed to reach all the plan participants within 5 business days after the end of such extension period, stating –

(A) That the employer elected to take such extension for that month;

(B) That the affected contributions have been transmitted to the plan; and

(C) With particularity, the reasons why the employer cannot reasonably segregate the participant contributions within the time period described in paragraph (b) of this section;

(ii) Prior to such extension period, obtains a performance bond or irrevocable letter of credit in favor of the plan and in an amount of not less than the total amount of participant contributions received or withheld by the employer in the previous month; and

(iii) Within 5 business days after the end of such extension period, provides a copy of the notice required under paragraph (d)(1)(i) of this section to the Secretary, along with a certification that such notice was provided to the participants and that the bond or letter of credit required under paragraph (d)(1)(ii) of this section was obtained.

(2) The performance bond or irrevocable letter of credit required in paragraph (d)(1)(ii) of this section shall be guaranteed by a bank or similar institution that is supervised by the Federal government or a State government and shall remain in effect for 3 months after the month in which the extension expires.

(3)(i) An employer may not elect an extension under this paragraph (d) more than twice in any plan year unless the employer pays to the plan an amount representing interest on the participant contributions that were subject to all the extensions within such plan year.

(ii) The amount representing interest in paragraph (d)(3)(i) of this section shall be the greater of –

(A) The amount that otherwise would have been earned on the participant contributions from the date on which such contributions were paid to, or withheld by, the employer until such money is transmitted to the plan had such contributions been invested during such period in the investment alternative available under plan which had the highest rate of return; or

(B) Interest at a rate equal to the underpayment rate defined in section 6621(a)(2) of the Internal Revenue Code from the date on which such contributions were paid to, or withheld by, the employer until such money is fully restored to the plan.

(e) *Definition.* For purposes of this section, the term *business day* means any day other than a Saturday, Sunday or any day designated as a holiday by the Federal Government.

(f) *Examples.* The requirements of this section are illustrated by the following examples:

(1) Employer A sponsors a 401(k) plan. There are 30 participants in the 401(k) plan. A has one payroll period for its employees and uses an outside payroll processing service to pay employee wages and process deductions. A has established a system under which the payroll processing service provides payroll deduction information to A within 1 business day after the issuance of paychecks. A checks this information for accuracy within 5 business days and then

forwards the withheld employee contributions to the plan. The amount of the total withheld employee contributions is deposited with the trust that is maintained under the plan on the 7th business day following the date on which the employees are paid. Under the safe harbor in paragraph (a)(2) of this section, when the participant contributions are deposited with the plan on the 7th business day following a pay date, the participant contributions are deemed to be contributed to the plan on the earliest date on which such contributions can reasonably be segregated from A's general assets.

(2) Employer B is a large national corporation which sponsors a 401(k) plan with 600 participants. B has several payroll centers and uses an outside payroll processing service to pay employee wages and process deductions. Each payroll center has a different pay period. Each center maintains separate accounts on its books for purposes of accounting for that center's payroll deductions and provides the outside payroll processor the data necessary to prepare employee paychecks and process deductions. The payroll processing service issues the employees' paychecks and deducts all payroll taxes and elective employee deductions. The payroll processing service forwards the employee payroll deduction data to B on the date of issuance of paychecks. B checks this data for accuracy and transmits this data along with the employee 401(k) deferral funds to the plan's investment firm within 3 business days. The plan's investment firm deposits the employee 401(k) deferral

funds into the plan on the day received from B. The assets of B's 401(k) plan would include the participant contributions no later than 3 business days after the issuance of paychecks.

(3) Employer C sponsors a self-insured contributory group health plan with 90 participants. Several former employees have elected, pursuant to the provisions of ERISA section 602, 29 U.S.C. 1162, to pay C for continuation of their coverage under the plan. These checks arrive at various times during the month and are deposited in the employer's general account at bank Z. Under paragraphs (a) and (c) of this section, the assets of the plan include the former employees' payments as soon after the checks have cleared the bank as C could reasonably be expected to segregate the payments from its general assets, but in no event later than 90 days after the date on which the former employees' participant contributions are received by C. If, however, C deposits the former employees' payments with the plan no later than the 7th business day following the day on which they are received by C, the former employees' participant contributions will be deemed to be contributed to the plan on the earliest date on which such contributions can reasonably be segregated from C's general assets.

(g) *Effective date.* This section is effective February 3, 1997.

(h) *Applicability date for collectively-bargained plans.* (1) Paragraph (b) of this section applies to collectively bargained plans no sooner than the later of –

(i) February 3, 1997; or

(ii) The first day of the plan year that begins after the expiration of the last to expire of any applicable bargaining agreement in effect on August 7, 1996.

(2) Until paragraph (b) of this section applies to a collectively bargained plan, paragraph (c) of this section shall apply to such plan as if such plan were an employee welfare benefit plan.

(i) *Optional postponement of applicability.* (1) The application of paragraph (b) of this section shall be postponed for up to an additional 90 days beyond the effective date described in paragraph (g) of this section for an employer who, prior to February 3, 1997 –

(i) Provides a true and accurate written notice, distributed in a manner designed to reach all the plan participants before the end of February 3, 1997, stating –

(A) That the employer elected to postpone such applicability;

(B) The date that the postponement will expire; and

(C) With particularity the reasons why the employer cannot reasonably segregate the participant contributions within the time period described in paragraph (b) of this section, by February 3, 1997;

(ii) Obtains a performance bond or irrevocable letter of credit in favor of the plan and in an amount of not less than the total amount of participant contributions received or withheld by the employer in the previous 3 months;

(iii) Provides a copy of the notice required under paragraph (i)(1)(i) of this section to the Secretary, along with a certification that such notice was provided to the participants and that the bond or letter of credit required under paragraph (i)(1)(ii) of this section was obtained; and

(iv) For each month during which such postponement is in effect, provides a true and accurate written notice to the plan participants indicating the date on which the participant contributions received or withheld by the employer during such month were transmitted to the plan.

(2) The notice required in paragraph (i)(1)(iv) of this section shall be distributed in a manner reasonably designed to reach all the plan participants within 10 days after transmission of the affected participant contributions.

(3) The bond or letter of credit required under paragraph (i)(1)(ii) shall be guaranteed by a bank or similar institution that is supervised by the Federal government or a State government and shall remain

in effect for 3 months after the month in which the postponement expires.

(4) During the period of any postponement of applicability with respect to a plan under this paragraph (i), paragraph (c) of this section shall apply to such plan as if such plan were an employee welfare benefit plan.

[61 FR 41233, Aug. 7, 1996, as amended at 62 FR 62936, Nov. 25, 1997; 75 FR 2076, Jan. 14, 2010]

U.S. Department of Labor Office of the Solicitor
Washington, D.C. 20210

[SEAL]

Catherine O'Hagan Wolfe
Clerk of the Court
United States Court of Appeals for the Second Circuit
Thurgood Marshall United States Courthouse
40 Foley Square
New York, NY 1007 [sic]

Re: Secretary of Labor's *Amicus Curiae* Letter Brief in Response to the Court's Invitation, Case No. 09-4901-cv, *Faber v. Metropolitan Life Ins. Co.*

Dear Ms. Wolfe:

On December 1, 2010, this Court requested a letter brief from the Secretary of Labor ("Secretary") on three questions concerning the applicability of the Employee Retirement Income Security Act (ERISA) to a "Total Control Account" (TCA) established by defendant Metropolitan Life Insurance Company ("MetLife") to pay benefits distributed under group life insurance plans sponsored by Kodak and General Motors (the "Plans"). The Court asked (1) to what extent does the "guaranteed benefit policy exemption" in 29 U.S.C. § 1101(b)(2) apply in this case, (2) does MetLife discharge its ERISA fiduciary duty by establishing a beneficiary's TCA, and (3) to what extent does MetLife retain a beneficiary's benefits when it establishes a beneficiary's TCA.

For the reasons set forth below, the Secretary concludes that (1) the guaranteed benefit policy exemption does not apply to the TCAs at issue in this case, (2) MetLife and the Plans effectively discharge their ERISA obligations when they furnish beneficiaries a TCA in accordance with plan terms, and accordingly (3) MetLife does not retain plan benefits by holding and managing the assets that back the TCA. This brief first discusses ERISA's requirements, and then applies them to the facts of this case as presented in the Court's letter.

ERISA's Requirements

ERISA requires fiduciaries to manage plans prudently and solely in the interest of the participants and beneficiaries, and prohibits fiduciaries from dealing with plan assets in their own interest or for their own account. 29 U.S.C. §§ 1104, 1106(b)(1). A person is a fiduciary to the extent "he exercises any discretionary authority or discretionary control respecting management of such plan or exercises any authority or control respecting management or disposition of its assets." *Id.* § 1002(21)(A)(i). A person is also a fiduciary to the extent "he has any discretionary authority or discretionary responsibility in the administration of such plan." *Id.* § 1002(21)(A)(ii).

ERISA defines "plan assets" only for limited circumstances not applicable to this case. *See* 29 U.S.C. § 1002(42); *In re Halpin,* 566 F.3d 286, 290 (2d Cir. 2009) ("ordinary notions of property rights" generally determine plan assets). ERISA does provide, however, that "[i]n the case of a plan to which a guaranteed benefit policy is issued by an insurer, the assets of such plan shall be deemed to include such policy, but shall not, solely by reason of the issuance of such policy, be deemed to include any assets of such insurer." 29 U.S.C. § 1101(b)(2). "The term 'guaranteed benefit policy' means an insurance policy or contract to the extent that such policy or contract provides for benefits the amount of which is guaranteed by the insurer." *Id.* § 1101(b)(2)(B).

The Department of Labor has also provided guidance on the meaning of the term "plan assets." In the Department's view, "the assets of a plan generally are to be identified on the basis of ordinary notions of property rights under non-ERISA law"; assets will "include any property, tangible or intangible, in which the plan has a beneficial ownership interest," considering "any contract or other legal instrument involving the plan, as well as the actions and representations of the parties involved." U.S. Dep't of Labor Advisory Op. No. 93-14A (May 5, 1993); *see Halpin,* 566 F.3d at 290 & n.2 (quoting and deferring to Advisory Op. No. 93-14A). The Department also recognizes that a plan's interest in particular funds depends on "whether the plan sponsor expresses an intent to grant such a beneficial interest or has acted or made representations sufficient to lead participants and beneficiaries of the plan to reasonably believe that such funds separately secure the promised benefits or are otherwise plan assets." U.S. Dep't of Labor, Advisory Op. No. 94-31A, at *7 (Sept. 9, 1994); *see also Kalda v. Sioux Valley*

Physician Partners, Inc., 481 F.3d 639, 647 (8th Cir. 2007) (deferring to Advisory Op. No. 94-31A).

Benefits Provided by the Kodak and GM Plans

This Court's letter describes MetLife's arrangement with the Plans in this way:

> [T]he plaintiffs-appellants were beneficiaries of ERISA-regulated group life insurance plans. The benefits payable under the plans were funded with group life insurance policies issued by defendant-appellee Metropolitan Life Insurance Company ("MetLife"). Pursuant to the terms of the plans, if the amount of the proceeds payable to a beneficiary exceeds a specified amount, MetLife pays those benefits through an interest-bearing "Total Control Account" ("TCA"), a form of "retained asset account." MetLife establishes a TCA in the beneficiary's name, credits the account with the amount of benefits due, provides the beneficiary with a "checkbook" that he or she can use at any time to withdraw any or all of the balance, and guarantees the entire amount of the balance. However, until a check is drawn, MetLife retains the funds backing the TCA in its own account, and invests those funds for its own profit, earning the "spread" between its return on investment and the interest paid to the beneficiary.

The Kodak Summary Plan Description ("SPD") provides:

> Payment of a death benefit of $7,500 or more is made under MetLife's Total Control Account. The death benefit amount is deposited in an interest bearing money market account and your beneficiary is provided with a checkbook to use for writing checks to withdraw funds. Other payment options are available. However, if the total death benefit is less than $7,500, a lump sum payment will be made.

Joint Appendix ("J.A."), at 188. The GM SPD similarly states:

> If the benefit from a single claim is $6,000 or more, your beneficiary may receive basic life insurance benefits under one of the several options available under the Beneficiary's Total Control Account (TCA) Program. The TCA Program provides your beneficiary with total control of the proceeds from your life insurance. A personalized checkbook allows your beneficiary to easily use all, or a portion, of the money. Funds left with the insurance company earn interest at competitive rates. Several investment options also are available under TCA. A separate brochure describing the TCA options is available on request from the GM National Benefit Center.

J.A. at 520.

When MetLife establishes a TCA account, it provides the beneficiary with a "Total Control Account Money Market Option Customer Agreement" ("Customer Agreement"), which sets out the terms for the TCA account. J.A. at 633. Under the terms of the particular Customer Agreements included in the record, the beneficiary was entitled to withdraw insurance proceeds at any time without penalty or loss of interest. *Id.* MetLife had discretion to set the interest rate weekly based upon the performance of two money market indexes in the preceding week.[1] *Id.* Additionally, MetLife guaranteed that the annual yield on the account will "not be less than 1.5%, even if money market yields fall below that level." *Id.* As the Court notes in its letter, MetLife retains the funds backing the TCA in its general account and invests those funds for its own profit, earning the spread between its return on investment and the interest paid under the TCA.

[1] The Customer Agreement provides: "If your Account balance is $2,500 or more, the rate we set will be equal to or higher than at least one of the following indexes: the prior week's Money Fund Report Averages/Government 7-Day Simple Yield (a leading index of government money market mutual fund rates), or the 'Bank Rate Monitor' National Money Market Rate Index (a leading index of rates paid by 100 large banks and thrifts on money market accounts)." J.A. at A-633.

How ERISA's Requirements Apply to MetLife's TCA Accounts

The crux of the plaintiffs' claim is that MetLife, acting as a plan fiduciary, misappropriated plan assets for its own profit. *See* Appellants' Reply Br. at 5-6 & n.1. The claim thus turns on whether MetLife acts as an ERISA fiduciary after the TCA is created and whether the funds backing the TCA are plan assets.[2] To answer those questions in the context of this case, it is necessary to determine whether the establishment of a TCA constitutes the fulfillment or continuation of an ERISA plan insofar as the individual beneficiary holding the TCA account is concerned. If the plan relationship ends with the establishment of the TCA, it is plain that MetLife is not a plan fiduciary and is not managing or disposing of plan assets during the life of the TCA. *See* 29 U.S.C. § 1002(21)(A)(i). If, however, the plan relationship continues, MetLife could be a fiduciary controlling plan assets unless the TCA falls within the "guaranteed benefit policy exception" in 29 U.S.C. § 1101(b)(2).

It is difficult to make these determinations in the abstract. In general, plan design is a settlor function and the plan sponsor is given wide latitude to design

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[2] The use of plan assets (*e.g.,* employee contributions) to purchase the MetLife group policy does not appear to be at issue in the case, and the Secretary, accordingly, does not address the obligations of plan fiduciaries with respect to the initial purchase of the policies.

the plan as it sees fit, including specifying the type and level of benefits, the conditions and contingencies attached to the receipt of benefits, and the means of accomplishing the promised distribution of benefits. As the Supreme Court has recognized, ERISA gives the plan settlor broad discretion to establish the content and level of the benefits provided to participants and beneficiaries. *Lockheed Corp. v. Spink,* 517 U.S. 882, 893 (1996) ("ERISA 'leaves th[e] question' of the content of benefits 'to the private parties creating the plan. . . . [T]he private parties, not the Government, control the level of benefits'") (quoting *Alessi v. Raybestos-Manhattan, Inc.,* 451 U.S. 504, 511 (1981)); *Hughes Aircraft Co. v. Jacobson,* 525 U.S. 432, 444 (1999) (the plan's settlor makes the "decision regarding the form or structure of the Plan such as who is entitled to receive Plan benefits and in what amounts, or how such benefits are calculated"); *cf. Feifer v. Prudential Ins. Co. of Am.,* 306 F.3d 1202, 1209 (2d Cir. 2002) ("'[r]ules governing . . . definition of benefits . . . are the sorts of provisions that constitute a plan'") (quoting *Pegram v. Herdrich,* 530 U.S. 211, 223 (2000)). With respect to welfare plans, including life insurance plans, ERISA places relatively few substantive constraints on the structure of plan benefits. *E.g., Moore v. Metro. Life Ins. Co.,* 856 F.2d 488, 491-92 (2d Cir. 1988) (noting welfare plans are not subject to the specific funding and distribution rules that apply to pension plans). The plan's terms, however, must be comprehensively set out in written plan documents, accurately and comprehensibly communicated to participants in the "summary plan document" (which is itself a governing plan document), and honestly described in other communications to participants. The plan's fiduciaries – the persons or entities who have authority either to administer the plan or manage its assets – must follow the terms of the plan (so long as they do not violate the statute) and are subject to the fiduciary duties of prudence and loyalty with respect to the plan and its assets. 29 U.S.C. §§ 1022, 1102, 1104. Unless ERISA provides otherwise, the determination of whether an asset is the plan's asset is governed by ordinary property law principles. *Halpin,* 566 F.3d at 290; *Kalda,* 481 F.3d at 647.

Here, the key question is whether the Kodak and GM Plans satisfy their obligations to a plan's beneficiary, in accordance with the governing plan documents, when MetLife establishes a TCA for the beneficiary, gives full and immediate access to the TCA by providing a "checkbook" allowing for unlimited withdrawals up to the remaining balance on demand, and promises to credit interest on the account balance in accordance with the Plans' terms. Based on the record information the Secretary has seen, specifically the SPDs and Customer Agreements cited above, the Secretary believes that that is a proper interpretation of the Plans, representing the plan sponsors' intent to convert ERISA-covered life insurance plans to individual contracts between the beneficiary and MetLife once the participant has died and the distribution in the form of a TCA is made.[3] There is no indication in these documents that the Plans retain an ongoing interest in the TCA or in the MetLife assets backing the TCA once the account is created; or that they promised beneficiaries something more than the TCA arrangement (*e.g.,* by promising a "lump sum payment" in cash or by deposit it to some other account of their choosing); or intended to impress MetLife with ongoing trust duties and require it to segregate the life insurance proceeds in separate funds distinct from its general account. There is also no indication that the manner in which the TCA arrangement was implemented by MetLife contradicted or deviated from plan terms and no claim that MetLife breached any duty it may have had as plan administrator in setting up the TCA accounts or giving notice to the plaintiffs about them.

With this background understanding, there is no basis under the facts and circumstances of this case for overturning the district court decision. This

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[3] The SPDs are governing plan documents under ERISA. *See Kennedy v. Plan Adm'r for DuPont Sav. and Inv. Plan,* 129 S.Ct. 865, 877 (2009). The Customer Agreements appear to be the contract between MetLife and the beneficiary that controls the beneficiary's relationship to MetLife with respect to the TCAs once the plan benefit in the form of a TCA is distributed and the beneficiary signals acceptance by opting to keep some or all the insurance proceeds in the TCA. Other plan documents, including significantly the Kodak and GM insurance policies, do not appear to be in the record.

conclusion is informed by the following answers to the Court's three questions.

(1) The "guaranteed benefit policy exemption," 29 U.S.C. § 1101(b)(2), does not apply to the TCAs at issue here

As discussed above, ERISA defines "guaranteed benefit policy" in pertinent part to mean "an insurance policy or contract to the extent that such policy or contract provides for benefits the amount of which is guaranteed by the insurer." 29 U.S.C. § 1101(b)(2)(B). There appears to be no dispute that the group life insurance policies in this case are guaranteed benefit policies to the extent that they promise that each TCA will be credited with a fixed opening balance. *See* Appellants' Reply Br. at 17-20 (recognizing that the dispute is over whether the "guaranteed benefit policy exemption" applies after benefits become due and payable). The policies entitle beneficiaries to a guaranteed fixed level of insurance proceeds, which is payable either in a lump sum or deposited in a TCA depending on the proceeds amount. J.A. at 188, 520. Thus, pursuant to the guaranteed benefit policy exemption, MetLife does not hold plan assets prior to the creation of a TCA. Instead, the Plan's sole asset is the insurance policy, rather than any assets held by MetLife in its general account. *See* 29 U.S.C. § 1101(b)(2) ("[i]n the case of a plan to which a guaranteed benefit policy is issued by an insurer, the assets of such plan shall be deemed to include such policy, but shall not, solely by reason of the issuance of such policy, be deemed to include any assets of such insurer").

Once a TCA is established, however, the guaranteed benefit policy exemption is no longer relevant to the analysis of the legal relationships between the parties. The definition of "guaranteed benefit policy," applies only to contractual arrangements with plans. *See* 29 U.S.C. § 1101(b)(2) ("in the case of a plan . . . "). Once the TCA is created, the Plan has discharged its obligations to its beneficiaries and has no ongoing authority over the TCA or the assets held in MetLife's general account.

Accordingly, the guaranteed benefit policy exception does not apply to the post-distribution relationship between the insurer and the individual TCA account holder. The Plans live up to their end of the bargain, when they give beneficiaries a TCA. When the beneficiary receives his "checkbook," he is free to withdraw the funds or to leave the funds in the account subject to the terms of the Customer Agreement between MetLife and the "Account Holder." He has effectively received a distribution of all the benefits that the Plan promised. At that point, the "Account Holder" is the individual beneficiary and the contractual rights associated with the TCA belong to the Account Holder, not the plan. *See, e.g.,* J.A.at 28, 3133. The Secretary has seen no language in the plan documents or Customer Agreement pointing to any ongoing plan obligations, trust requirement, or continuing fiduciary oversight of the TCA or of MetLife's general account. *See* n.7 *infra.* The relevant contractual arrangement is no longer between the Plan and MetLife, but rather between MetLife and the individual Account Holder – a relationship governed by state and other non-ERISA law. Because the Plan has already discharged its obligations, the "guaranteed benefit policy" provision is irrelevant. *See, e.g., Harris Trust and Sav. Bank v. John Hancock Mut. Life Ins. Co.*, 302 F.3d 18, 30-31 (2d Cir. 2002) (agreeing with insurer that it had no extra-contractual fiduciary obligations to a plan fiduciary after fulfilling its obligations under the guaranteed benefit policy). Nothing in this benefit arrangement would support a holding that the assets in MetLife's general account suddenly become plan assets, for the first time, only after the Plan has given the beneficiary all control over the TCA and retained no independent authority over the account.

If, however, the Court disagrees with the Secretary's analysis and concludes that the TCA reflects an ongoing relationship between the Plan and MetLife that is subject to ERISA, the Secretary would disagree with MetLife's contention that the interest rate guarantee set forth in the Customer Agreement (but not the SPDs) satisfies the test for a guaranteed benefit policy. *See* Appellee's Br. at 34. Even if the interest rates on the TCAs are set prospectively, MetLife retains discretion over the interest rates credited each week; the Agreements do not clearly advise the beneficiary how to ascertain current or prospective rates; and the Agreements do not specifically require any particular timing for MetLife's disclosure of the weekly rate. Because a significant component of the arrangement is insufficiently guaranteed, the contract would fail the test. The Supreme Court has held that "[a] component fits within the guaranteed benefit policy exclusion only if it allocates investment risk to the insurer. Such an allocation is present only when the insurer provides a genuine guarantee of an aggregate amount of benefits payable to retirement plan participants and their beneficiaries." *John Hancock Mutual Life Insurance Co. v. Harris Trust & Savings Bank,* 510 U.S. 86, 106 (1993). Based on the Customer Agreements and the SPDs, not all of the investment risk has been allocated to the insurer, nor has the beneficiary been provided a full and meaningful opportunity to withdraw assets before MetLife adjusts interest rates.[4] Moreover, the arrangement would also probably fail the statutory test because it is not an insurance contract within the meaning of section 401(b)(2) inasmuch as

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[4] By way of contrast, the Secretary has treated an annuity contract as "a guaranteed benefit policy" in circumstances where the insurer declared the interest rate in advance for multi-year periods, applied the rates prospectively, and gave "full disclosure to the contractholder" regarding interest rate changes with the opportunity to withdraw before the changes took effect. Information Letter from Louis Campagna, Chief, Division of Fiduciary Interpretations, Office of Regulations and Interpretations, Employee Benefits Security Administration, U.S. Department of Labor, to Jon W. Breyfogle, Esq., Groom Law Group, 2004 WL 349101 at *4 (January 6, 2004).

the insurable event – the death of the insured – occurred prior to the creation of the TCA.[5]

(2) and (3) MetLife discharges its ERISA obligations by establishing a TCA and does not "retain" plan benefits by holding and managing the assets that back the TCA

As this Court recognized, "the third and last question is in many ways encompassed within the previous two." This section primarily addresses question three. The response to the question whether MetLife retains plan assets (question three) also largely answers whether MetLife assumes or retains fiduciary status (question two) because the plaintiffs' claim alleges breaches of fiduciary obligations that exist only if MetLife had "control" over plan assets and thus hinges on whether MetLife's "retained assets" are plan assets.[6]

As discussed *supra,* pp. 4-5, plan sponsors GM and Kodak were free under ERISA to structure the Plans to provide life insurance benefits through cash

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[5] Whether the TCA is nonetheless subject to state insurance regulation or covered by a state guaranty fund is a separate question and beyond the scope of this brief.

[6] The Secretary recognizes, *infra*, pp.14-15, that MetLife has other fiduciary obligations unrelated to the control of plan assets, including obligations to follow plan documents and to communicate truthfully and accurately about plan benefits. It appears, however, that the plaintiffs have waived any arguments based upon breach of these duties.

payments or in the form of TCAs – ERISA does not dictate a particular choice. Similarly, the Plans' ownership rights, if any, in assets held by MetLife are determined by the specific choices reflected in the plan documents and contractual arrangements between the parties. In general, whether any particular asset belongs to a plan is determined by "ordinary notions of property rights." *In re Luna,* 406 F.3d 1192, 1199 (10th Cir. 2005); *see Halpin,* 566 F.3d at 292 ("commonly understood definition of 'assets' ensures that plans and related parties can look to an established body of rules and principles to structure relationships"); *Kalda,* 481 F.3d at 647 (determining whether assets were plan assets by considering "whether the plan sponsor expresses an intent to grant . . . a beneficial interest or has acted or made representations sufficient to lead participants and beneficiaries of the plan to reasonably believe that such funds separately secure the promised benefits or are otherwise plan assets"). Thus, for example, in *Halpin,* when an employer failed to comply with its contractual obligations to make plan contributions, the plan did not acquire an ownership interest in the employer's general account, even though the employer had wrongfully retained assets that should have gone to pay contributions. In the absence of an agreement to hold the unpaid amounts in trust for the plan, this Court held that the plan did not have a "beneficial ownership interest" in the employer contributions. *Halpin,* 566 F.3d at 290 ("the unpaid amounts are debts; they are not assets held in trust for the benefit of the creditor"). While the Court recognized that the parties were "free to contractually provide for some other result," the parties had chosen to apply the default presumption that employer contributions to the plan are governed by the "language of creditor and debtor." *Id.*

As in *Halpin,* 566 F.3d at 290, the underlying property interest after a TCA is created is not described in terms of a fiduciary relationship but in the "language of [a] creditor and debtor" relationship between MetLife and the Account Holder. Accordingly, the Account Holder has a contractual right to payments in accordance with the Customer Agreement and MetLife, for its part, has a corresponding debt obligation to make the required payments on demand. Thus, for all the reasons set forth in the preceding section, the Plans do not have an ownership interest in the MetLife assets backing the TCA. The GM and Kodak Plans discharge their responsibilities by giving the beneficiary a TCA with all of the associated contractual rights, including the unilateral authority to withdraw funds from the account. The Plans do not retain any ongoing ownership interest in the TCA or MetLife's general account. Because there are no "plan assets" after the TCA is created, MetLife cannot be held liable as an ERISA fiduciary for breaching its obligations with respect to "plan assets."

Nothing in the SPDs or Customer Agreements cited above gives the GM or Kodak Plans or participants and beneficiaries an ownership interest in

MetLife's assets or conveys title to any such assets.[7] These documents do not point to any ongoing role for the Plans after a TCA is established for a particular beneficiary; assert any ownership interest by the Plans in the TCA or in assets backing the TCA; or reasonably suggest to the Plans' beneficiaries that plan fiduciaries would retain responsibility for the disposition of the account or the management of assets held by MetLife. *See* Dep't of Labor Advisory Op. No. 92-24A ("a welfare plan generally will have a beneficial interest in particular assets if the employer establishes a trust on behalf of the plan, sets up a separate account with a bank or other third party in the name of the plan, or specifically indicates in the plan documents or instruments that separately maintained funds belong to the plan"). Of course, GM and Kodak could have created a contractual agreement with MetLife under which the Plans retained an ownership interest in the funds backing the TCAs and thereby retained an ownership interest in assets held by MetLife. *Cf. Halpin,* 566 F.3d at 290 (recognizing that parties can create a contract whereby

[7] This case was decided on a 12(b)(6) motion to dismiss, and, as noted, *supra* n.3, it does not appear that the group insurance policies were included in the record. As a result, the Secretary cannot say if these policies contain any provisions that could change the inherently factual analysis necessary to determine whether the policies gave the Plans an ownership interest in the TCAs or in the MetLife assets backing the TCAs, or indeed conflicted with or rendered ambiguous the SPDs. Accordingly, this Court could consider remanding the case for further discovery and record development.

assets are deemed to be "plan assets" for purposes of ERISA). But that does not appear to have happened here.

Instead, because each Plan promised its benefits in the form of a TCA, the Plan's stated purpose is discharged once the account is created and the beneficiary is given control over his account. At that point, the Plan has effectively distributed the promised benefit and the Plan has no ongoing authority over the TCA. The relationship between MetLife and the individual account holder is now governed by the Customer Agreement defining their contractual relationship under state law, not by a fiduciary relationship established in the plan documents under ERISA. The beneficiary is free, to withdraw some, none, or all funds from the account, without any involvement by the Plan. Any subsequent breaches of the contractual relationship are governed by state and other non-ERISA law. After the creation of the TCA, ERISA no longer governs the relationship between MetLife and the TCA account holders.

There is nothing unusual about a plan discharging a welfare benefit obligation by providing benefits in the form of a promissory instrument similar to a TCA. In other contexts, plans often discharge their obligations by issuing a contract to the beneficiary or by crediting amounts to an account controlled by the beneficiary in this manner. *E.g.,* U.S. Dep't of Labor Field Assistance Bulletin 2006-2 (October 27, 2006) (Q. and A. No. 11) (noting that beneficiaries may choose to receive health benefit distributions from

Health Savings Accounts in the form of credit on their "debit, credit, or stored-value cards"); U.S. Dep't of Labor Field Assistance Bulletin 2004-01 (April 7, 2004) (recognizing that employer contributions distributed into Health Savings Accounts, an account controlled solely by the employee, are not covered under ERISA); *see generally Pompano v. Michael Schiavone & Sons, Inc.,* 680 F.2d 911, 916 (2d Cir. 1982) ("[n]either [ERISA] nor its legislative history comments on the mode or manner in which benefits should be paid"); *Fine v. Semet,* 699 F.2d 1091, 1093 (11th Cir. 1983) ("[a]ny right to . . . a particular method of payment must be found in the individual agreements"); *Woolsey v. Marion Labs., Inc.,* 934 F.2d 1452, 1457 (10th Cir. 1991) (same) (listing other cases).

Even in the pension context, the Department's regulations provide that an individual is no longer a participant covered under the plan when the individual's benefits "(1) [a]re fully guaranteed by an insurance company, insurance service or insurance organization licensed to do business in a State, and are legally enforceable by the sole choice of the individual against the insurance company, insurance service or insurance organization; and (2) [a] contract, policy or certificate describing the benefits to which the individual is entitled under the plan has been issued to the individual." 29 C.F.R. 2510.3-3(d)(2)(ii). Similarly, the regulatory safe harbors for automatic rollovers to IRAs and for distributions from terminated individual account plans permit plans to discharge their obligations through savings account deposits and insurance contracts meeting certain conditions. 29 C.F.R. 2550.404a-2(b), (c)(iii); 29 C.F.R. 2550.404a-3(d).

Thus, as these rules recognize, a plan can fulfill its obligations by giving the participant a set of contractual rights against a financial institution, rather than by making cash distributions or conveying title to any of the institution's underlying assets. In each instance, neither the participant nor the plan has an ownership interest in the assets of the financial institution, even though the institution "retains" assets backing its contractual obligations and seeks to make a profit through the investment of those assets. In this regard, the only significant difference between pension plans and welfare plans is that ERISA imposes fewer constraints on a welfare plan's authority to structure and define the benefits that the plan provides and the means by which they will be distributed.[8] Nothing in ERISA prohibits a welfare plan from defining the benefit as a contract or TCA, rather than the payment of cash benefits.

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[8] In the case of a welfare plan, the Department's regulations do not restrict the range of acceptable distributions to specifically defined categories of benefits, as in the pension context. Accordingly, the Department's regulations simply provide that the participant ceases to be "covered under the plan" on the earliest date that the participant is "ineligible to receive any benefit" and is "not designated by the plan as a participant." 29 C.F.R. 2510.3-3(d)(2).

The Parties Give Insufficient Weight to the Essentially Contractual Nature of ERISA Plans and Misread *Mogel*

As discussed above, the determination of whether a particular asset is a "plan asset" requires a factual inquiry into the parties' representations and understandings. *See* U.S. Dep't of Labor Advisory Op. No. 92-24A, 1992 WL 337539, at *3 (Nov. 6, 1992) (noting the "inherently factual" nature of the inquiry). Accordingly, both parties' briefs are wide of the mark to the extent that they seek to formulate broad rules for all retained asset account arrangements in the abstract, without regard to the specific documents and instruments governing specific cases.

The plaintiffs categorically argue (and the defendants categorically deny) that, as a legal matter, MetLife necessarily retains plan assets until the money is fully disbursed from the TCA. Appellant's Br. at 24. Viewed this way, regardless of how the Plans are written, the TCAs are backed by undistributed plan benefits (*i.e.*, plan assets) that MetLife has retained and wrongfully managed in its general account for its own benefit. They also argue that *Mogel v. Unum Life Ins. Co. of America,* 547 F.3d 23, 26-27 (1st Cir. 2008), supports their position, notwithstanding the significant factual differences between *Mogel* and the present case. Appellant's Br. at 25.

In *Mogel,* the First Circuit held that defendant Unum had failed to discharge its responsibilities to the beneficiaries of a death benefit plan – and that it remained an ERISA fiduciary – when it issued a checkbook to a plan's participants, rather than "a lump sum payment," as required by the plan's terms. 547 F.3d at 26. The First Circuit was unwilling to "deem" the sums to have been effectively distributed by the plan until the insurer actually paid beneficiaries the lump-sum benefits as promised by the plan. *Id.* at 26. *Cf. also* U.S. Dep't of Labor Advisory Op. No. 93-24A (Sept. 13, 1993) (when trust company sets plan funds aside after cutting benefit check, the funds nevertheless remain plan assets until the check is actually paid).

Unlike the situation in this case, however, the particular plan before the First Circuit in *Mogel* expressly defined the plan's benefits in the form of lump sum cash payments, which defendant Unum quite literally retained for itself. *Mogel,* 547 F.3d at 25; *see also id.* at 26 ("[t]he district court found, and we agree, that delivery of the checkbook did not constitute a 'lump sum payment' called for by the policies"). Notwithstanding arguably broader dicta, therefore, *Mogel* is best understood as addressing a specific factual setting not present here: when an insurer fails to abide by the settlor's plan terms requiring the benefits to be in the form of a lump sum payment. Contrary to the plaintiffs' view, *Mogel* does not stand for a broader proposition that the insurance company can never "retain" plan assets and use them for its own benefit, regardless of whether the plan specifically provided for a lump sum cash distribution or simply for the creation of a TCA. Appellant's Reply Br. at 5-6 n.1. Such a broad reading ignores the plan's own definition of the benefit and ignores the many circumstances in which plans discharge their responsibilities through the delivery of a contract or insurance policy, rather than cash.

In contrast to the facts in *Mogel,* the Kodak and GM Plans here specifically contemplate distribution through the creation of a TCA, subject to the beneficiary's control; only beneficiaries with small balances are entitled to distribution through a cash payment. J.A. at 188, 520. Thus, the Plans discharge their obligation by opening a MetLife account, which the beneficiary controls pursuant to a contractual arrangement with the insurer. No plan language points to any ongoing plan obligations, trust requirement, or continuing fiduciary oversight of the TCA or of MetLife's general account. As explained above, this conclusion hinges on reading the governing plan documents as providing that the Plans' obligations to a beneficiary are satisfied with the creation of a TCA. If, instead, the Plans had provided (as in *Mogel*) solely for lump-sum cash payments, or if they had contemplated that the assets would be segregated and held in trust for the plan or its beneficiaries pending payment from the TCA, MetLife might well have retained its status as a plan fiduciary.

Unlike in *Mogel,* the plaintiffs do not allege that MetLife deviated from following the plan documents when it established the TCAs, rather than making immediate cash payments to the beneficiaries. Thus, any other fiduciary obligations MetLife may have had with respect to MetLife's establishment of the TCAs are not implicated by this case. It is worth noting, however, that MetLife, as a claims administrator, and therefore, an ERISA fiduciary, has a responsibility to follow the plan documents in distributing the Plans' benefits. *Kennedy,* 129 S.Ct. at 875; *see* J.A. at 187-188 (noting that claims for benefits must be submitted to MetLife in accordance with MetLife procedures) (Kodak Plan); J.A. at 609 (referring to MetLife claims procedures) (GM Plan). Accordingly, if MetLife had failed to establish the TCAs in the manner set forth in the governing plan documents, the beneficiaries would have had an action for breach of MetLife's fiduciary responsibilities and to compel compliance with the terms of the plan.

In its capacity as claims administrator and fiduciary, MetLife also has a duty to avoid misrepresentations to participants and beneficiaries concerning the content and structure of benefits paid through the TCAs. *E.g., Bouboulis v. Trans. Workers Union of Am.,* 442 F.3d 55, 65-66 (2d Cir. 2006) (recognizing that exercise of authority to communicate to participants about benefits is a fiduciary function); *see also* J.A. at 478 (recognizing that MetLife provides information and a package for death benefit claimants) (Kodak Plan); J.A. at 609 (referring beneficiaries to MetLife for claims procedures and information) (GM Plan). The plaintiffs allege, as a factual matter, that MetLife promoted a false impression that the funds in their TCAs would be transferred into a money market account at a bank; they also allege that MetLife had concealed the fact that it "retains and invests the proceeds for its own account"; and concealed the fact that it deposits the amount of death benefits into the TCA upon the presentment of a check for payment from a beneficiary. *Faber v. Metro. Life Ins. Co.,* 2009 WL 3415369, at *2 (S.D.N.Y. Oct. 23, 2009). While the plaintiffs made these factual allegations in their complaint, however, they "expressly disavow any claim that MetLife's alleged concealment of the way in which the TCA would work was itself a breach of duty, and they make no claim for misrepresentation." *Id.* at *7 n.8. Whether MetLife breached its duty to disclose truthful information and not to mislead participants is, therefore, not at issue in the appeal to this Court.

While MetLife may have had discretion over certain plan administrative tasks and be subject to corresponding fiduciary obligations as described above, such fiduciary obligations do not extend to the otherwise distinct responsibilities for managing non-plan assets; nor does the fiduciary's control over certain plan administrative tasks transform non-plan assets into plan assets subject to fiduciary oversight. *See Halpin,* 566 F.3d at 289.

In sum, under the facts and circumstances of this case, the Secretary has no reason to believe that MetLife has mismanaged plan assets, or indeed is acting as a plan fiduciary, in its conduct following its creation of the TCAs pursuant to the terms of the Plans. Once a TCA is established, the beneficiary account holder receives all of the rights and benefits that the plan provided, and the beneficiaries (rather than the Plans) are given complete discretion over the exercise of those rights and benefits – including the right to take all, some, or none of the assets out of the account. Accordingly, after establishing the TCAs, ERISA no longer governs the relationship between MetLife and the TCAs' account holders.

Conclusion

For the reasons set forth above, the Secretary submits to this Court her view that (1) the guaranteed benefit policy exemption does not apply to the TCAs at issue in this case, (2) MetLife and the Plans effectively discharge their ERISA obligations when they furnish beneficiaries a TCA in accordance with plan terms, and accordingly (3) MetLife does not retain plan benefits by holding and managing the assets that back the TCA.

Respectfully submitted,

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UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF PENNSYLVANIA

HILDA L. SOLIS, SECRETARY OF LABOR, UNITED STATES DEPARTMENT OF LABOR, Plaintiff, v. JOHN J. KORESKO, V, *et al*., Defendants.	CIVIL ACTION No. 2:09-cv-00988 (MAM) (Filed Feb. 28, 2012)

SECRETARY OF LABOR'S MEMORANDUM OF LAW IN SUPPORT OF HER MOTION FOR PARTIAL SUMMARY JUDGMENT AGAINST KORESKO DEFENDANTS

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[4] **I. INTRODUCTION**

Pursuant to Rule 56 of the Federal Rules of Civil Procedure and the Local Rules of this Court, Hilda L. Solis, Secretary of Labor, U.S. Department of Labor ("the Secretary"), respectfully submits this Memorandum of Law supporting her Motion for Partial Summary Judgment. As there is no genuine dispute as to any material fact, the Secretary is entitled to partial summary judgment against Defendants John J. Koresko, V, Jeanne Bonney, PennMont Benefit Services, Inc., the Koresko Law Firm, and Koresko & Associates, P.C. (collectively "Koresko Defendants") for their violations of the provisions of Title I of the Employee Retirement Income Security Act ("ERISA" or the "Act"), 29 U.S.C. § 1001 *et. seq*., as a matter of law. *See Celotex Corp. v. Catrett*, 477 U.S. 317, 327 (1986).

Federal Rule of Civil Procedure 56(a) provides that summary judgment shall be granted "if the pleadings, the discovery and disclosure materials on file, and any affidavits show that there is no genuine dispute as to any material fact and that the movant is entitled to judgment as a matter of law." The trial court's function is not "to weigh the evidence and determine the truth of the matter but to determine whether there is a genuine issue for trial." *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 249, 106 S.Ct. 2505, 91 L.Ed.2d 202 (1986). "The mere existence of some evidence to support the nonmoving party is not sufficient for denial of summary judgment; there must be 'sufficient evidence favoring the nonmoving party for a jury to return a verdict for that party.'" *Bailey v. Allgas, Inc.*, 284 F.3d 1237, 1243 (11th Cir. 2002) (quoting *Anderson*, 477 U.S. at 249). "If the evidence is merely colorable, or is not significantly probative, summary judgment may be granted." *Anderson*, 477 U.S. at 249-250 (internal citations omitted).

[5] As a result of their violations of ERISA with respect to the three plans listed below, the Secretary seeks an Order barring the Koresko Defendants from serving as fiduciaries or service providers to these three plans, removing the Koresko Defendants as fiduciaries to these plans, directing the plan sponsors to appoint new fiduciaries to these plans, and directing the Koresko Defendants to restore $1,261,430.10 in losses to these plans, plus $676,032.82 in interest, for a total of $1,937,462.90 for losses caused by their fiduciary misconduct.

II. BACKGROUND

The Koresko Defendants administer and act as fiduciaries to certain ERISA-covered employee benefit plans. Because the plans are covered by ERISA, the Koresko Defendants must comply with ERISA's high standards of fiduciary care. Rather than acting with the loyalty and prudence demanded by ERISA, however, the Koresko Defendants have taken over one million dollars in death benefit proceeds that belonged to the Décor Coordinates, Cetylite and Domenic Castellano, D.D.S. Plans (individually, "the Plan" and collectively, "the Plans") and transferred that money to bank accounts controlled by the Koresko Defendants.

The Koresko Defendants were not the Plans' trustees and had no right to the money transferred to their control. Contrary to the Koresko Defendants' belief, the assets of these ERISA-covered Plans are not sources of supplemental funds that they can spend at their whim. Nor is this a contract dispute where the Koresko Defendants' actions may be solely governed by their interpretation of a contract, independent of and without regard for any federally mandated statutory obligations and standards. Rather, because (1) the Koresko Defendants exercised both actual authority and control over the Plans' [6] assets and discretionary authority over the management and administration of the Plans; and (2) these Plans are covered by ERISA, the Koresko Defendants are bound by the exacting standards expected of ERISA fiduciaries when dealing with these Plans. In accordance with those standards, assets belonging to the Plans must remain in the trust for the Plans.

The issue presented by this Motion is not whether any one particular Plan beneficiary was entitled to death benefit proceeds, nor is it the amount of death benefit proceeds to which any one beneficiary was entitled. The issue, rather, is whether the Koresko Defendants were entitled by law to take death benefit proceeds out of the Plans. The Secretary argues that by taking this money, the Koresko Defendants violated ERISA and caused losses to the Plans.

Through this Motion, the Secretary seeks an Order requiring the Koresko Defendants to restore the losses to these Plans caused by their fiduciary breaches, including lost opportunity costs; an Order enjoining the Koresko Defendants from serving as fiduciaries or service providers to the Décor Coordinates, Cetylite, and Castellano Plans referenced below; an Order appointing a special master to perform an accounting of these three Plans at the Koresko Defendants' expense; an Order directing the appointment of new fiduciaries selected by the Plan Sponsors of these Plans; and an Order requiring the Koresko Defendants to cooperate with and provide all necessary documents and information required or requested by the special master or new fiduciaries.

[7] III. FACTS

PennMont Benefit Services, Inc. ("PennMont") is the Plan Administrator for the Décor Coordinates Health and Welfare Benefit Plan, the Cetylite Industries, Inc. Health and Welfare Benefit Plan, and the Domenic Castellano D.D.S., P.A. Health and Welfare Benefit Plan. (Statement of Material Facts No. 7, hereafter "SMF")[1] John J. Koresko, V ("Mr. Koresko") is the president of PennMont. (SMF No. 3) PennMont has no employees. (SMF No. 6) PennMont's duties as

[1] "Statement of Material Facts" refers to the "Plaintiff's Statement of Undisputed Material Facts," filed in support of her Partial Motion for Summary Judgment.

Plan Administrator were performed by the law firm Koresko and Associates, P.C. ("KAPC") and the Koresko Law Firm, P.C. ("KLF") and the employees of those firms. (SMF No. 6)

Mr. Koresko is the president and sole shareholder of KLF and KAPC. (SMF No. 2) Jeanne Bonney ("Ms. Bonney") was an attorney at KLF and KAPC. (SMF No. 4)

Community Trust Company ("CTC") was the named Trustee of the Plans as of March 2002. (SMF No. 10) As CTC was the sole Trustee, none of the Koresko Defendants were Trustees of the Plans in the time period 2002 to 2003, when the death benefits at issue were diverted out of the Trust to the Koresko Defendants. (SMF No. 9-11) The assets of the Plans were held in the commingled REAL VEBA Trust, which CTC served as Trustee. (SMF No. 9-10)

As employers, Décor Coordinates, Inc. ("Décor Coordinates"), Cetylite Industries, Inc. ("Cetylite"), and Domenic M. Castellano, D.D.S., P.A. ("Castellano") each signed an adoption agreement establishing its own plan, respectively, the Décor Coordinates, Inc. Health and Welfare Benefit Plan ("Décor Plan"), the Cetylite Industries, Inc. Health and Welfare Benefit Plan ("Cetylite Plan"), and the Domenic M. Castellano, D.D.S., P.A. [8] Health and Welfare Benefit Plan ("Castellano Plan"). (SMF No. 12-13, 30-31, 49-50) Each of these employers established the qualifications for participation in the employer's Plan, the type of benefits available through the Plan, (namely, "death benefits") and the amount of benefits. (SMF No. 14-16, 32-34, 36, 50) Each employer contributed to its own Plan by executing checks payable to the Trustee. (SMF No. 15, 35, 51-52) These three Plans had at least one participating common law employee in addition to the owner and/or the owner's spouse. (SMF No. 17, 37, 53)

The REAL VEBA Trust purchased insurance policies on the lives of the employee participants with the remitted funds from employers. (SMF No. 17, 35, 37, 53) The policies were issued in the name of the Trustee "f/b/o" or "for the benefit of" the Plans. (SMF No. 19, 53) When a participant in a Plan died, a claim was made for benefits, and the claim was adjudicated by PennMont. (SMF No. 16, 36, 52)

The REAL VEBA Trust received death benefit proceeds from insurance companies following the deaths of Angelo Ferraro, Dale Kelling and Domenic Castellano, who were participating employees in the Plans. (SMF No. 18-20, 38-40, 54-57, 59) The insurance policy proceeds that were paid by the insurance carriers following the deaths of Mr. Ferraro, Mr. Kelling and Dr. Castellano were checks payable to the Trust established to hold the assets of the Plans. (SMF No. 20, 40, 59)

Rather than keep the money in the REAL VEBA Trust for the benefit of the Plans, however, the Koresko Defendants directed CTC to transfer the insurance proceeds out of the REAL VEBA Trust to accounts solely controlled by Mr. Koresko and Ms.

Bonney. (SMF No. 22-28, 45-48, 58-63). In an apparent attempt to conceal the impropriety of these transactions, Mr. Koresko and Ms. Bonney initially transferred these [9] Plan assets into so-called "trust" accounts. (SMF No. 24, 43-44, 58-59)[2] Mr. Koresko then transferred the Plan assets from the intermediary "trust" accounts to his law firm's account. (SMF No. 25, 47, 61) Mr. Koresko and Ms. Bonney transferred not less than $1,261,430.10 of the assets of the Décor, Cetylite and Castellano Plans to non-trust accounts under their sole control.

IV. ARGUMENT

A. ERISA: An Overview

ERISA is a comprehensive remedial statute designed to promote and protect the interests of participants and the beneficiaries in employee benefit plans. *Shaw v. Delta Air Lines, Inc.*, 463 U.S. 85, 90 (1983); *Nachman Corp. v. Pension Ben. Guaranty Corp.*, 446 U.S. 359, 361-62 (1980). Congress intended to ensure the financial soundness of employee benefit plans "by establishing standards of conduct, responsibility, and

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[2] Indeed, Mr. Koresko has admitted "that particular designation [of these new accounts as "trust" accounts] seemed to create more problems than it was meant to – that was an accounting designation by the plan administrator. There was no legal – there was no legal substance to that original designation." May 27, 2011 hearing on Defendant's Motion for a Temporary Restraining Order in *REAL VEBA v. Castellano*, Case No. 2:03- cv-06903 (MAM), Tr. 22: 4-8.

obligation for fiduciaries of employee benefit plans, and by providing for appropriate remedies, sanctions, and ready access to the Federal courts." ERISA Section 2(b), 29 U.S.C. § 1001(b). Those fiduciary standards of conduct are codified in ERISA Section 404(a), 29 U.S.C. § 1104(a). The fiduciary obligations imposed by ERISA are "the highest known to the law." *Donovan v. Bierwirth*, 680 F.2d 263, 272 n.8 (2d Cir. 1981), *cert. denied*, 459 U.S. 1069 (1982), and are to be interpreted and applied "bearing in mind the special nature and purpose of employee benefit plans." *Donovan v. Cunningham*, 716 F.2d 1455, 1464 (5th Cir. 1983), *cert. denied*, 467 U.S. 1251 (1984).

[10] These fiduciary standards are greater than those that apply to mere entrepreneurs. "Many forms of conduct permissible in a workaday world for those acting at arm's length, are forbidden to those bound by fiduciary ties. *A trustee is held to something stricter than the morals of the market place*. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior." *Pegram v. Herdrich*, 530 U.S. 211, 224-25 (2000), citing *Meinhard v. Salmon,* 249 N.Y. 458, 464, 164 N.E. 545, 546 (1928) (Cardozo, J.) (emphasis supplied).

Fiduciaries of ERISA-covered plans must comport their actions and conduct to the standards enunciated in Sections 403, 404(a) and 406 of the Act. The fiduciary duties relevant to the instant motion are the duty to keep plan assets in a trust account, Section 403 of ERISA, 29 U.S.C. §1103; the duty to act solely in the interest of the plan participants, and their beneficiaries, for the exclusive purpose of providing benefits and defraying reasonable expenses of administrating a plan, Section 404(a)(1)(A) of ERISA, 29 U.S.C. §1104(a)(1)(A); the duty to act prudently, Section 404(a)(1)(B) of ERISA, 29 U.S.C. §1104(a)(1)(B); the duty to prevent a plan from engaging in a direct or indirect transfer of plan assets for the benefit or use of a party-in-interest, Section 406(a)(1)(D) of ERISA, 29 U.S.C. §1106(a)(1)(D); and the duty to refrain from dealing with a plan's assets for the fiduciary's own interest, Section 406(b)(1)(D) of ERISA, 29 U.S.C. §1106(b)(1).

A fiduciary who, by breaching any one of the statutory duties listed in Section 404 above, enables another fiduciary's breach, is jointly and severally liable for the losses resulting from the other's breaches; Section 405(a)(2) of ERISA, 29 U.S.C. §1105(a)(2). A fiduciary is also jointly and severally liable for the losses resulting from a co-[11]fiduciary's breaches if that fiduciary knowingly participates in, or attempts to conceal, the co-fiduciary's breach or if that fiduciary has knowledge of a co-fiduciary's breach and does nothing to remedy it; Section 405(a)(1) and (3) of ERISA, 29 U.S.C. §1105(a)(1) and (3).

Under ERISA Sections 502(a)(2) and (5), 29 U.S.C. §§ 1132(a)(2) and (5), the Secretary is authorized to bring civil actions for equitable and injunctive relief, and to enforce ERISA's provisions. This Court has broad authority to grant "equitable or remedial relief as the court may deem appropriate," including removal of a fiduciary and bars on fiduciary status, Section 409(a) of ERISA, 29 U.S.C. §1109(a). *See Delgrosso v. Spang and Co.*, 769 F.2d 928, 937-38 (3d Cir. 1985); *Cigna v. Amara,* ___ U.S. ___, 131 S.Ct. 1866, 1878-80 (U.S., 2011) (recognizing the breadth of equitable remedies available against ERISA fiduciaries).

In applying ERISA's remedial provisions, the courts have a duty to fashion the remedy which is most advantageous to plan participants and beneficiaries and which best effectuates the purpose of the Act. *Donovan v. Mazzola*, 716 F.2d 1226, 1235 (9th Cir. 1983), *cert. denied*, 464 U.S. 1040 (1984). Because the Koresko Defendants have failed to adhere to those exacting ERISA standards outlined above, the Secretary is entitled to an Order granting Partial Summary Judgment and the equitable relief sought.

B. The Décor, Cetylite and Castellano Plans are subject to ERISA coverage.

1. Each of these employers established its own Plan.

The Décor Plan, the Cetylite Plan and the Castellano Plan are individual employee welfare benefit plans covered by Title I of ERISA. Section 4(a) of ERISA, 29 U.S.C. §1003(a), states that Title I of ERISA applies to: "any employee benefit plan if it [12] is established or maintained – (1) by an employer engaged in commerce or any industry or activity affecting commerce." Section 3(3) of ERISA, 29 U.S.C. §1002(3) defines an "employee benefit plan" as "an employee welfare plan or an employee pension benefit plan." Section 3(1) of ERISA in turn defines an employee welfare plan as:

> any plan, fund, or program which was heretofore or is hereafter established or maintained by an employer or an employee organization, or by both, to the extent that such plan, fund, or program was established or is maintained for the purpose of providing for its participants or their beneficiaries, through the purchase of insurance or otherwise, . . . (A) . . . benefits in the event of . . . sickness, accident, disability, death. . . . 29 U.S.C. § 1002(1).

An "employer" is "any person acting directly as an employer, or indirectly in the interest of an employer, in relation to an employee benefit plan; and includes a group or association of employers acting for an employer in such capacity." Section 3(5) of ERISA, 29 U.S.C. §1002(5). Accordingly, to establish ERISA coverage of an employee welfare plan, a court must find that an employer has established or maintained a plan offering benefits, such as death benefits, for its employees.

The term "employee benefit plan" has been construed very broadly by the courts. The Third Circuit has held a plan exists "if 'from the surrounding circumstances a reasonable person can ascertain the intended benefits, a class of beneficiaries, the sources of funding, and procedures for receiving benefits.'" "[T]he crucial factor in determining whether a "plan" has been established is whether the employer has expressed an intention to provide benefits on a regular and long-term basis." *Gruber v. Hubbard Bert Karle Weber, Inc.*, 159 F.3d 780, 789 (3d Cir. 1998), quoting *Diebler v. United Food & Commercial Workers Local Union 23,* 973 F.2d 206, 209 (3d Cir. 1992). *See also Russo v. Abingdon Mem. Hosp.*, 881 F. Supp 177, 181 (E.D. Pa. 1995) (Abington [sic] Foundation [13] created a covered welfare plan for its employees by purchasing health insurance for them).

Under these criteria, Décor Coordinates, Cetylite, and Castellano each established its own employee welfare benefit plan to provide death benefits to its employees. First, each of these employers executed an adoption agreement that created a plan in the name of its individual company using the PennMont prototype plan document. (SMF No. 12-13, 30-31, 49) Second, each Plan provides "life" or other benefits. (SMF No. 14, 34, 50) Third, the beneficiaries are the employees of these employers that have executed the adoption agreements adopting their Plans. (SMF No. 14, 34, 50) Fourth, the source of funding is employer contributions. (SMF No. 15, 35, 51) Fifth, pursuant to the Plan documents, the procedure for receiving benefits is the adjudication of claims by PennMont. (SMF No. 16, 36, 52) Further, each of the Plans had at least one employee participant who was not an owner of the sponsoring employer or the spouse of the owner.[3] (SMF No. 17, 37, 53) *See* 29 C.F.R. § 2510.3-3(b) (2006) (requiring ERISA-covered plans to have at least one eligible participant, not married to the employers); *Slamne v. Paul Revere Life Ins. Co.,* 166 F.3d 1102 (11th Cir. 1999). Hence, each of the Plans listed above is an individual employee welfare benefit plan subject to the requirements and protections of ERISA.

[14] **2. Each employer established its own Plan despite the existence of a master trust that held the commingled assets of all Plans.**

The assets of these three Plans were held in a single, commingled master trust, the REAL VEBA Trust. (SMF No. 7, 9) The REAL VEBA Trust is not a welfare plan in itself, but is a pooled, collective trust for the multiple welfare plans established by each contributing employer. (SMF No. 9)

The alleged creation of the REAL VEBA[4] and the existence of a commingled master trust for the

[3] The Koresko Defendants may argue that they amended the Plans to exclude common law employees and thus the Plans are not covered under ERISA. This argument must fail for the reasons set forth in the Secretary's Post-Hearing Brief on her Motion for Preliminary Injunction, and incorporated herein by reference. *See Secretary's Post-Hearing Brief, Section VII*, at pp. 28 to 31 (Docket No. 134).

[4] The "REAL VEBA" itself was a fictional business association as Mr. Koresko testified that it "did not exist" as an entity and that the association consisted only of Mr. Koresko and his brother Lawrence. (SMF No. 8)

supposed REAL VEBA do not change the result that each of these Plans were individual employee welfare benefit plans covered by ERISA. The Secretary and this Circuit have previously addressed a situation in which an association sells a program of benefits to unrelated employers. It is the U.S. Department of Labor's position that "if an employer adopts for its employees a program of benefits sponsored by a group or association that does not itself constitutes [sic] an employer," the employer may have "established a separate single-employer . . . employee benefit plan covered by Title I of ERISA." *U.S. Dep't of Labor, Office of Pension and Welfare Benefit Programs*, *Advisory Op. No. 96-25A,* 1981 WL 17728 at *3. This Circuit reached the same conclusion in *Gruber*, 159 F.3d at 786-87.[5]

In *Gruber*, the Court concluded that a program of benefits sponsored by an association was not covered as one plan under ERISA because the employers offering the benefits were not linked by common economic or "representation" interests beyond [15] simply a desire to share the costs of providing benefits to employees. The Court recognized that each employer could have created its own plan by adopting the program of benefits sponsored by the association and remanded the case back to the District Court for fact finding on the question of whether separate

[5] The Third Circuit in *Chao v. Community Trust Co.*, 474 F.3d 75, 87 (3d Cir. 2007), cited *Gruber* as the controlling case on coverage.

ERISA-covered plans were created for each employer. *Gruber*, 159 F.3d at 789. In remanding the case to the district court, the Third Circuit reiterated the holding of *Deibler,* 973 F.2d at 209, namely, that coverage exists when "the employer has expressed an intention to provide benefits on a regular and long-term basis." *See also Niethammer v Prudential Ins. Co.*, No. 06-cv-1664 CDD, 2007 WL 1629886 (E.D. Mo. June 4, 2007) (an employer subscribing to a non-covered multiple employer welfare arrangement can be deemed to establish its own plan).

On remand from the Third Circuit's decision in the Secretary's subpoena enforcement action against Community Trust Company, *Chao v. Community Trust Company*, 474 F.3d 75 (3d Cir. 2007), this Court addressed the question of whether plans being administered by the Defendants were covered by ERISA. *See Chao v. Community Trust Co.*, No. 05-mc-18 (E.D. Pa. Oct. 31. 2008) (Memorandum and Order). The Court found that the evidence submitted by the Secretary, which was nearly identical to the evidence presented herein with regard to coverage of the Décor, Cetylite and Castellano Plans, established ERISA coverage. Specifically, this Court concluded that "the DOL has indicated by way of affidavit that over 100 employers within the REAL VEBA Trust established benefit plans for their employees falling within the DOL's jurisdiction in the context of an ERISA investigation." *Id.* at 3-4.

[16] Each of the affected Plans is a single plan established by its respective employer. The fact that

each employer funds its particular Plan through a commingled, common trust for tax or other purposes does not remove the Plan from the protections of ERISA.[6]

3. The monies held in the master trust, including death benefit proceeds, are Plan assets.

The term "plan assets" is not defined in the Act or the applicable regulations. Absent a regulatory or statutory definition, "plan assets" are defined according to "ordinary notions of property rights under non-ERISA law," such that plan assets include "any property, tangible or intangible, in which the plan has a beneficial ownership interest." *U.S. Dep't of Labor, Advisory Op. No. 93-14A*, 1993 WL 188473, at *4 (May 5, 1993); *U.S. Dep't of Labor Advisory Op. No. 2005-08A* (May 11, 2005) (same); *In re Haplin*, 566 F.3d 286, 289 (2d. Cir. 2009) (adopting definition of plan assets laid out in Secretary's Advisory Opinions);

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[6] Indeed, in litigation in United States District Court for the Southern District of Texas, Defendants PennMont and Penn Public Trust ("PPT") have argued that a plan listed in Attachment A to the Secretary's Complaint in this proceeding, the South Texas Woodmill Inc., Plan, is covered by ERISA. *See Wilhite v. Regional Employers Assurance League VEBA Trust*, Case No. 1:11-civ-00059, Defendants' Proposed Findings of Fact and Conclusions of Law, Dkt. No. 117, at paragraph 2 ("Plaintiffs' claim for death benefits is governed by the Health and Welfare Plan Document . . . (the 'Plan'), which is an employee welfare benefit plan governed by the Employee Retirement Income Security Act ('ERISA'). . . .").

Kalda v. Sioux Valley Physician Partners, Inc., 481 F.3d 639, 647 (8th Cir. 2007) (same); *In re Luna*, 406 F.3d 1192, 1199-2000 (10th Cir. 2005) (same); *Edmonson v. Lincoln Nat. Life Ins. Co.*, 777 F.Supp.2d 869, 889, 891 (E.D.Pa. 2011) (same); *Solis v. Plan Ben. Services, Inc.*, 620 F.Supp.2d 131 (D.Mass. 2009) (same).

[17] Under ordinary notions of property law, the money forwarded by Décor Coordinates, Cetylite, and Castellano for their Plans and deposited in the REAL VEBA Trust account is clearly "property, tangible or intangible, in which each plan has a beneficial ownership interest." *Id.* The life insurance policies purchased with those funds and for the benefit of the Plans, as well as any death benefits paid on those life insurance policies, are also Plan assets because such policies were held by the Trust for the benefit of the Plans and paid for with Plan assets. (SMF No. 15, 17, 19, 35, 38, 51, 53) *See DOL Advisory Opinion No. 2005-08A* (May 11, 2005) ("Generally, a distribution such as the [death benefit payment], will be a plan asset if a plan has a beneficial interest in the distribution under ordinary notions of property rights . . . In the case where any type of plan or trust is the policyholder, or where the premium is paid entirely out of trust assets, it is the view of the Department that the entire distribution amount received by such policyholder constitutes plan assets.")

Until the beneficiary has effective control over these death benefit proceeds, those funds remain plan assets, whether or not they remain in the Plans' trust account. *Id.*; *accord Edmonson* v. *Lincoln Nat. Life,* 777 F.Supp.2d at 891 (assuming all facts alleged by plaintiff were true, death benefit proceeds were "plan assets");[7] *Mogel v. Unum Life Ins. Co. of America*, 547 F. 3d 23, 26 (1st Cir. 2008) (death benefit proceeds remain plan assets of group death benefit plan subject to fiduciary obligations until actual payment of [18] proceeds to beneficiary); *compare Faber v. Metropolitan Life Ins. Co.,* 648 F.3d 98 (2d. Cir. 2011) (death benefit proceeds were no longer plan assets once the beneficiary received checkbook from plan because the beneficiary's receipt of such checkbook constituted effective receipt of the plan assets). Therefore, the death benefit proceeds discussed below remained plan assets, even when the Koresko Defendants unlawfully removed them from the REAL VEBA Trust. Only the portion of the proceeds actually forwarded to beneficiaries lost their character as plan assets.

The terms of the Plans' governing documents here further support that the life insurance proceeds

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[7] In *Edmonson*, this District's Judge Baylson concluded that the plaintiff beneficiary of a group death benefit plan had alleged facts sufficient to establish that defendant life insurance company was an ERISA fiduciary, for the purposes of the defendants' motion to dismiss, by alleging that the defendant insurance company controlled the proceeds of her death benefit policy and thus that it had authority or control over "plan assets". *Id.* at 891. It made no difference to the Court that the defendant attempted to segregate the proceeds by establishing an individual "SecureLine" account for the beneficiary. *Id.*

are plan assets. For example, the Cetylite Summary Plan Description expressly provided that any "unclaimed death benefit payment shall remain part of Plan." (SMF No. 33) *See also Bottle Beer Drivers, Warehouseman & Helpers Teamsters Local 843 v. Anheuser Busch Inc.*, 96 Fed.Appx. 831 (3d Cir. 2004) (terms of plan documents can help determine whether certain assets are plan assets according to ordinary notions of property law).

C. The Koresko Defendants are Fiduciaries and Parties in Interest.

1. Defendant PennMont is a named fiduciary under ERISA.

Plan Administrators are automatically fiduciaries under ERISA because of the nature of the positions they occupy. *See* 29 C.F.R. § 2509.75-8, D-3. PennMont is the Plan Administrator of the Plans and a named fiduciary in the governing Plan documents. (SMF No. 7) PennMont is therefore a named fiduciary responsible for compliance with ERISA.

[19] **2. Defendants John Koresko, Jeanne Bonney, Koresko & Associates, P.C., and the Koresko Law Firm are also fiduciaries under ERISA.**

Section 3(21)(A)(i) of ERISA, 29 U.S.C. § 1002(21)(a)(i), states that a person is an ERISA fiduciary to the extent "he exercises any discretionary authority or discretionary control respecting management of such plan or exercises any authority or control respecting management or disposition of its assets." Hence, under ERISA, even if not named in a plan document, a person may become a fiduciary if he or she exercises control over a plan or its assets. In determining whether a party is a fiduciary, courts do not focus on formal titles or designations, but whether that party exercises discretionary authority or control over a plan's management or administration, or exercises any control of a plan's assets. *Confer v. Custom Eng'g Co.,* 952 F.2d 34, 36 (3rd Cir. 1991); *see also Yeseta v. Baima*, 837 F.2d 380, 385-86 (9th Cir. 1988) (power over withdrawals from plan confers fiduciary status on person not designated as fiduciary by plan).

Various Federal Circuit Courts have held that the second clause of Section 3(21)(A)(i) regarding authority or control over plan assets establishes a "lower" threshold for establishing fiduciary status. To be a fiduciary under this clause, a person does not need to have discretionary authority or control respecting management of a plan, as long as he or she exercises control over the disposition of plan assets. *See Bricklayers and Allied Craftsmen Local 6 of New Jersey v. Wettlin Assoc.*, 237 F.3d 270, 273 (3d Cir. 2001); *FirsTier Bank v. Zeller*, 16 F.3d 907, 911 (8th Cir. 1993). As the Eighth Circuit stated in *FirsTier*, "[ERISA] imposes fiduciary duties only if one exercises *discretionary* authority or control over Plan *management*, but imposes those duties *whenever* one deals with Plan assets." 16 F.3d at 711 (emphasis in original). *See also Srein v. Frankford* [20] *Trust*, 323 F.3d 214, 220-22 (3d Cir. 2003) (authority and control over assets confers fiduciary status).

Ms. Bonney exercised authority and control respecting the management and disposition of the insurance policy proceeds, which were plan assets. She was a signatory on the Wachovia Account No. 1, Wachovia Account No. 2 and the FUNB Account into which the Ferraro, Kelling and Castellano insurance policy proceeds were transferred. (SMF No. 22, 28, 43, 48, 58, 63) Ms. Bonney directed transfer of these funds to the Wachovia Account No. 1, which she and Mr. Koresko named "The Kelling Family Death Benefit Trust." (SMF No. 41) She controlled the disposition of those plan assets and therefore functioned as a fiduciary under ERISA.

Mr. Koresko controlled the plan assets transferred from the REAL VEBA Trust to the three accounts that Ms. Bonney and he established at Wachovia and First Union National Bank. He was a signatory on the Wachovia Accounts Nos. 1 and 2 and the FUNB account into which the plan assets were transferred. (SMF No. 22, 28, 43, 48, 58, 63) He wrote checks from those accounts further diverting those plan assets, including diverting the assets to his own law firm. (SMF No. 47, 48, 61, 62) Mr. Koresko was, therefore, a fiduciary to the Plans in regard to those assets he controlled. *See, e.g., Chao v. Day*, 436 F.3d 234, 237-38 (D.C. Cir. 2006) (insurance broker who "solicited, accepted, and then pilfered the plans' assets by reneging on his promise to purchase insurance" exercised sufficient "authority or control" over the "disposition" of the plans' assets to qualify as a "fiduciary"); *Srein v. Frankford Trust Co.*, 323 F.3d 214, 221-22 (3d Cir. 2003) (trust company exercised undirected "authority and control" over plan's interests in [21] life insurance policy and therefore functioned as a fiduciary with respect to those interests).

KLF and KAPC (Mr. Koresko's law firms) performed all the work for the Plans and had full responsibility for plan administration. (SMF No. 6) This work included handling and managing benefit claims and all the life insurance proceeds issued by the insurance carriers following the deaths of Mr. Ferraro, Mr. Kelling and Dr. Castellano. (SMF No. 24, 41, 43, 59, 61) Ms. Bonney performed her plan administration work as an employee of the law firms. (SMF No. 4) Mr. Koresko likewise acted as an agent of his firms when he exercised authority and control over the insurance proceeds. (SMF No. 2) These firms exercised authority and control respecting management and administration of the Plans, as well as control over the disposition of these plan assets and they are therefore fiduciaries.

3. Defendants Koresko, Bonney, PennMont, Koresko & Associates, and Koresko Law Firm are Parties in Interest.

Mr. Koresko, Ms. Bonney, PennMont, KLF and KAPC are all parties in interest. A "party-in-interest" is defined at Sections (3)(14)(A) and (B) of ERISA, 29 U.S.C. § 1002(14)(A) and (B), to include any fiduciary, counsel, or person providing services to an employee benefit plan. The Koresko Defendants are fiduciaries to the affected Plans. Therefore, they are also parties-in-interest. Mr. Koresko, Ms. Bonney and the law firms also acted as counsel to the affected plans; they are parties-in-interest on that basis as well.

[22] **D. The Koresko Defendants have violated ERISA.**

1. The Koresko Defendants violated ERISA Section 403(a) by failing to maintain all of the Plans assets in the Plans' trust account.

Section 403(a) of ERISA, 29 U.S.C. §1103, requires that "all assets of an employee benefit plan shall be held in trust by one or more trustees." ERISA's requirements are reinforced by those of common trust law. Under common law, a fiduciary must keep an individual trust's property separate from other property, including the trustees' own property and "property held upon other trusts." Restatement (Second) of Trusts § 179*, Duty To Keep Trust Property Separate* ("The trustee is under a duty to the beneficiary to keep the trust property separate from his individual property, and, so far as it is reasonable that he should do so, to keep it separate from other property not subject to the trust, and to see that the property is designated as property of the trust.")

The Koresko Defendants' unlawful conduct is identical with regard to the Décor Coordinates, Cetylite and Castellano Plans: PennMont and Ms. Bonney, through Mr. Koresko's law firm, directed the Plans' Trustee CTC to transfer the death benefit proceeds into non-trust accounts controlled by Mr. Koresko and Ms. Bonney. Mr. Koresko then transferred some of these proceeds to non-trust accounts in the name of Mr. Koresko's law firms. Because the Koresko Defendants removed plan assets, including death benefit proceeds, from the Plans' trust account and placed them in non-trust accounts outside the reach of CTC, the Plan's Trustee, the Koresko Defendants violated ERISA Sections 403(a). *See Chao v. Crouse*, 346 F.Supp.2d 975, 986 (S.D.Ind. 2004) (finding that named fiduciary administrator of multi-employer welfare plan violated [23] Section 403(a) by, *inter alia,* failing to maintain the participating employers' health premium contributions in a segregated trust).

2. The Koresko Defendants violated ERISA Section 404(a)(1)(A) when they transferred death benefit plan proceeds out of the REAL VEBA Trust to non-trust accounts they alone controlled.

Section 404(a)(1)(A) of ERISA requires a fiduciary to act solely in the interest of the plan's participants for the exclusive purpose of providing benefits and defraying expenses. 29 U.S.C. § 1104(a)(1)(A).[8] Under Section 404(a)(1)(A), fiduciaries must act "with an eye single to the interests of the participants and beneficiaries" of the plan. *Bierwirth*, *supra*, 680 F.2d at 271; *Leigh v. Engle*, 727 F.2d 113, 125 (7th Cir. 1984).

A fiduciary who directs plan assets to his or her own use fails to act solely in the interest of plan participants and beneficiaries in violation of Section 404(a)(1)(A). This misdirection is a violation regardless of whether the fiduciary's "own use" is commercial or personal. Thus, in *Yeseta v. Baima, supra*, the Ninth Circuit held that an employee with control over plan assets breached his duty of loyalty to the plan participants when he withdrew $25,000 from the plan trust and placed those funds into a company account to pay the company's "necessary operating expenses." 837 F.2d at 386. Similarly, in *Leigh v. Engle*, *supra*, the Seventh Circuit held that a fiduciary had breached its duty of loyalty when it used plan assets to aid a party-in-interest in corporate takeover activities. [24] 727 F.2d at 126-27 (noting that "[g]ood faith

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[8] . . . a fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and –

(A) for the exclusive purpose of:

(i) providing benefits to participants and their beneficiaries; and

(ii) defraying reasonable expenses of administering the plan. . . .

is not a defense to an ERISA fiduciary's breach of duty of loyalty").

Plan assets are not available to ERISA fiduciaries for *any* personal or corporate use. *See Pell v. E.I. DuPont de Nemours & Co. Inc.*, 539 F.3d 292, 309 (3rd Cir. 2008) ("ERISA plan funds are, as a matter of law, held in trust and are not available to the employer for general use"); *Frahm v. Equitable Life Assurance Soc. of the United States*, 137 F.3d 955, 959 (7th Cir. 1998) ("deliberately favoring the corporate treasury when administering . . . a plan is inconsistent with [ERISA's duty of loyalty]."); *Chao v. Crouse*, *supra,* 346 at 975 (just as ERISA prohibits fiduciaries from favoring the corporate treasury when administering a plan, so too does it prohibit fiduciaries from treating plan assets as the corporate treasury); *Chao v. Johnson*, No. Civ. A. H-03-5394, 2005 WL 2095109 (S.D.Tex., Aug. 30, 2005) (employer breached duty of loyalty by diverting plan assets to corporate accounts); *Connors v. Paybra Mining Co.,* 807 F. Supp. 1242, 1246, (S.D.W.V. 1992) (corporate directors and officers violated fiduciary duty of loyalty by diverting plan assets to cover company expenses); *Wright v. Nimmons,* 641 F.Supp. 1391, 1402 (S.D.Tex.1986) (fiduciary "blatantly disregarded his duty of loyalty by consistently treating the trust assets as if they were his own property"); *Greenblatt v. Prescription Plan Serv. Corp.,* 783 F. Supp. 814, 822 (S.D. N.Y 1984) (fiduciary's failure to return cash reserve to plan constitutes violation of duty of loyalty).

A fiduciary's duty to refrain from diverting plan assets to his or her own use applies just as strongly to administrators of multiemployer welfare arrangements that receive "assets from . . . individual plans of . . . subscribing employers which themselves qualify as . . . employee welfare benefit plans" as it does to single employer retirement [25] plans. *Crouse*, 346 F.Supp.2d at 982. In *Crouse*, for example, the District Court held that the fiduciaries of a multi-employer health plan breached their duty of loyalty by depositing plan assets (employer health-insurance premium payments) into the administrator's corporate accounts. *Id.* at 986-88.

Much like the defendants in *Crouse*, the Koresko Defendants diverted plan assets, which pursuant to ERISA Section 403(a) must be held in a segregated trust and used exclusively for the benefit of the plan participants. They deposited those assets into various accounts subject to their sole control, including Mr. Koresko's wholly-owned law firm account. As in *Crouse*, these actions establish that the Koresko Defendants violated their ERISA duty of loyalty to the plan participants. *Crouse*, 346 F.Supp.2d at 987; *accord Yeseta*, 837 F.2d at 386.

3. The Koresko Defendants also violated ERISA Section 404(a)(1)(B) when they transferred death benefit plan proceeds out of the REAL VEBA Trust to non-trust accounts they alone controlled.

Section 404(a)(1)(B) of ERISA requires a fiduciary to discharge his or her duties "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). This section of the Act " . . . imposes an unwavering duty on an ERISA [fiduciary] to make decisions with single-minded devotion to a plan's participants and beneficiaries and, in so doing, to act as a prudent person would act in a similar situation." *Morse v. Stanley*, 732 F.2d 1139, 1145 (2d Cir. 1984).

A fiduciary breaches his or her duty of prudence when, regardless of intent, he or she fails to maintain plan assets in trust. *Chao v. Johnson*, *supra*, 2005 WL 2095109 at [26] *5-6 (citing *Prof'l Helicopter Pilots Ass'n v. Denison*, 804 F.Supp. 1447, 1452-54 (M.D. Ala. 1992). Thus, for example, in *Brock v. Ardito*, Civil Action File No. 86-0582-G, 1987 U.S. Dist LEXIS 14184 (E.D. N.Y. May 28, 1987) (no Westlaw cite), the trustee's transfer of $175,000 in plan assets to several bank accounts, including his personal checking account and the corporate bank account of the company of which he was both the president and majority stockholder, "was the pinnacle of imprudence." *Id.* at *11. Likewise, in *Marshall v. Kelly*, 465 F. Supp. 341 (W.D. Okla. 1978), where the trustee caused the plan to transfer $9,000 of its assets to himself as a six percent "sales commission" for the sale of plan real estate, in the absence of any written or oral contract providing for the payment of such a commission, the Court found a violation of Section 404(a)(1)(B).

A fiduciary with reason to suspect that another party may be diverting plan assets from the trust also breaches its duty of prudence if it takes no affirmative steps to determine whether the suspected fiduciary misconduct is in fact occurring. For example, in *Chao v. Johnson*, a fiduciary CEO of a healthcare company breached his duty of prudence when, upon learning that his company may not have been remitting employee contributions to its 401(k) Plan, he took no affirmative steps to determine whether the contributions were in fact being properly remitted. *Chao v. Johnson*, 2005 WL 2095109 at *5-6.

A fiduciary also breaches his or her duty of prudence when he or she takes no affirmative steps to remove conflicts of interest or to step aside, at least temporarily, from the management of plan assets when such conflicts of interest arise. *Bierwirth*, 680 F.2d at 274 (prudence requires fiduciaries will avoid placing themselves in a position where [27] "their acts as officers or directors of a corporation will prevent their functioning with the complete loyalty to participants demanded of them as trustees of an [ERISA plan]"); *Leigh v. Engle*, 727 F.2d at 125 ("Where the potential for conflicts [of interest between the fiduciaries and the plan beneficiaries] is substantial, it may be virtually impossible for fiduciaries to discharge their duties with an 'eye single' to the interests of the beneficiaries, and the fiduciaries may need to step aside, at least temporarily, from the management of assets where they face potentially conflicting interests"); *Corley v. Hecht Co.*, 530 F. Supp. 1155, 1163 (D. D.C. 1982) (fiduciary "violated its duty of care, prudence and diligence under section 404 in failing to clearly differentiate between its own money and that belonging to the Plan").

Like the fiduciaries in *Ardito*, *Kelly*, and *Corley*, the Koresko Defendants transferred plan assets out of the Plans' Trust and into accounts subject to their exclusive control. This conduct not only violated the fiduciary's duty of loyalty to plan participants, it also represents "the pinnacle of imprudence." Like the fiduciaries in *Bierwirth* and *Leigh*, the Koresko Defendants also breached their duties of prudence by voluntarily placing themselves in a significantly conflicted position as to the management of plan assets. By transferring plan assets from the custody of CTC, the Plans' trustee, to Mr. Koresko's law firm and other accounts subject to their sole control, the Koresko Defendants voluntarily and imprudently subjected themselves to a blatant conflict of interest. The Koresko Defendants violated Section 404(a)(1)(B).

[28] **4. The Koresko Defendants violated ERISA Section 406(a)(1)(D) when they transferred death benefit plan proceeds out of the REAL VEBA Trust to non-trust accounts they alone controlled.**

Section 406(a)(1)(D) of ERISA provides that a plan fiduciary shall not cause the plan to engage in a transaction if he knows or should know that such transaction constitutes a direct or indirect "transfer to, or use by or for the benefit of a party in interest, of any assets of the plan." 29 U.S.C. § 1106(a)(1)(D).

Congress enacted Section 406(a)(1) in order to "categorically bar certain transactions deemed 'likely to injure a pension plan.'" *Harris Trust and Sav. Bank v. Salomon Smith Barney, Inc.*, 530 U.S. 238, 241-42 (2000); *Reich v. Compton*, 57 F.3d 270, 275 (3d. Cir. 1995). To establish that a fiduciary "knew or should have known" of a prohibited transaction, it is not necessary to prove that the fiduciary knew or should have known that the transaction was illegal; it need only be established that the fiduciary knew or should have known that the transaction involved the transfer of plan assets to a party-in-interest. *Marshall v. Kelly*, 465 F. at 351; *Freund v. Marshall & Illsley Bank*, 485 F. Supp. 629, 637 (D.C. Wis. 1979); *Dimond v. Retirement Plan for Employees of Michael Baker Corp.*, 582 F.Supp. 892, 899 (W.D. Pa. 1983).

Where, as here, a fiduciary exercises control over plan assets and knowingly transfers them to a party-in-interest, that fiduciary has violated Section 406(a)(1)(D). For example, in *Pension Benefit Guar. Corp. v. Morin*, Civ. Act. No. 99-246-PC, 2000 WL 760737, (D. Maine, April 24, 2000), the plan trustee violated Section 406(a)(1)(D) by transferring plan monies to himself and also to his wholly-owned corporation. *Id.* at *5. Also, in *Marshall v. Kelly,* 465 F. Supp. at 341, the plan trustee violated Section 406(a)(1)(D) by causing the plan to pay him a sales commission and by causing the plan [29] to pay the plan sponsor, in which the trustee owned a controlling interest and of which he was an officer, $45,000 in alleged construction costs. *Id.* at 351. *See also Brock v. Ardito, supra*, 1987 U.S. Dist. LEXIS 14184, at *12 (fiduciary engaged in *per se* violations of ERISA when he caused the plan to transfer plan assets to himself and [the plan administrator], both parties-in-interest, for use by or for their own benefit);

Transfers of plan assets covered by ERISA Section 406(a)(1) are *per se* violations of ERISA, regardless of the motivation of the party initiating the transaction, the prudence of the transaction, or the absence of any harm arising from the transaction. *Chao v Hall Holding*, 285 F.3d 413, 441-42 (6th Cir. 2002); *compare Reich v. Compton*, 57 F. 3d 270, 278-81 (3d Cir. 1995) (examining whether a union's *use* – without any formal lease agreement – of real property owned by the union's retirement plans violated §406(a)(1)(D)). In *Compton*, the Third Circuit held that a union fiduciary could not be found to have "used" plan assets "for the benefit of" a party-in-interest in violation of Section 406(a)(1)(D), unless the plaintiff established that at least one of the parties subjectively intended for such use to benefit the party-in-interest. *Id*. at 280. The Court did not hold, however – and the statutory language does not support – that a *transfer* of plan assets to a party-in-interest requires a showing of subjective intent to benefit the transferee party-in-interest. *See* Section

406(a)(1)(D) (barring a "transfer to, *or* use by *or* for the benefit of a party in interest, of any assets of the plan.") (emphasis added).

The Koresko Defendants transferred plan assets to parties in interest. PennMont removed the remaining proceeds out of the trust account maintained by CTC, the Trustee for the Plans. After paying only a portion of the death benefit proceeds to the beneficiaries, PennMont then deposited the removed plan assets into accounts to which [30] *only* Mr. Koresko and Ms. Bonney were signatories. In so transferring plan assets to parties-in-interest, the Koresko Defendants violated Section 406(a)(1) of ERISA.

As noted, neither Section 406(a)(1)(D) nor *Compton* require a showing that a party-in-interest actually benefited from its receipt of plan assets nor that a fiduciary subjectively intended such a benefit to result from the transfer. Even if such a showing is necessary, however, it is easily made here. PennMont transferred death benefit proceeds, which are as a matter of law Plan assets, out of the trust into accounts to which *only* Mr. Koresko and Ms. Bonney were signatories. Mr. Koresko eventually transferred these proceeds to his law firm's accounts. These intentional transfers to accounts solely under the control of the Koresko Defendants clearly could benefit no one other than the Koresko Defendants. Thus, regardless of whether *Compton's* "subjective intent" showing is necessary here, PennMont, Mr. Koresko, Ms. Bonney, KLF and KAPC violated Section 406(a)(1)(D) of ERISA. *See Compton*, 57 F. 3d at

279 (reversing the District Court's finding that the defendants had not violated §406(a)(1)(D) and noting that the record contained strong circumstantial evidence of the fiduciary's subjective intent to benefit a party-in-interest by allowing it to use the plan's real property because "a reasonable fact finder could easily find that the two transactions had the effect of benefitting [the party in interest], and *a reasonable factfinder could infer that the trustees intended to bring about this effect*.") (emphasis added).

5. The Koresko Defendants violated ERISA Section 406(b)(1) by transferring death benefit plan proceeds out of the REAL VEBA Trust to non-trust accounts they alone controlled.

Section 406(b)(1) of ERISA specifically forbids fiduciaries from dealing with plan assets for their account. 29 U.S.C. § 1106(b)(1). The purpose of Section 406(b) "is [31] to 'prevent a fiduciary from being put in a position where he has dual loyalties, and therefore, he cannot act exclusively for the benefit of a plan's participants and beneficiaries.'" *Reich v. Compton*, *supra*, *57* F.3d at 287 (citing H.R. Rep. No. 93-1280, 93d Cong., 2d Session (1974), *reprinted in* 1974 U.S. Code Cong. & Admin. News. 5038, 5039).

Section 406(b) creates a *per se* ERISA violation. Even in the absence of bad faith, or in the presence of a fair and reasonable transaction, Section 406(b)(1) establishes a "blanket prohibition of certain acts, easily applied, in order to facilitate Congress' remedial interest in protecting employee benefit plans." *Gilliam v Edwards*, 492 F. Supp. 1255, 1263 (D.N.J. 1980).

Courts have found violations of Section 406(b)(1) based on fiduciary conduct similar to that exhibited by the Koresko Defendants. For example, in *Patelco v. Sahni*, *supra*, the defendant fiduciary administered a health and welfare plan. He collected money from an employer to pay premiums for "stop-loss" insurance. When the insurance company issued two benefits checks based on this insurance, in the name of the employer, the fiduciary deposited those checks into his own account. The Ninth Circuit found that by making these deposits into his own account, the defendant "breached his fiduciary duties by engaging in prohibited self-dealing." 262 F.3d at 911.

Courts have also granted summary judgment for violations of Section 406(b)(1) based on similar fiduciary misconduct. *See Chao v. Day*, Civ. Act. No. 02-1516 (LFO) (December 17, 2004 D.D.C.), copy attached as Exhibit A, *aff'd* 436 F.3d 234 (D.C.Cir. 2006) (granting summary judgment based on finding that fiduciary violated ERISA Section 406(b)(1) when he deposited plan assets from health and welfare benefit plans in [32] his own checking account); *Chao v. Linder*, Civ. Act. No. 05 C 3812, 2007 WL 1655254 (N.D. Ill. May 31, 2007) (granting partial summary judgment based on finding that fiduciaries violated Section 406(b)(1) when they took money from accounts holding money to pay premiums on life insurance policies); *NYSA-ILA Med. & Clinical Servs. Fund v. Catucci*, 60 F.Supp.2d 194, 203 (S.D.N.Y. 1999) (granting summary judgment based on finding that fiduciary violated ERISA Section 406(b)(1) by using health and welfare benefit plan assets to pay corporate expenses); *Pension Benefit Guar. Corp. v. Morin*, *supra*, 2000 WL 760737 at *5 (granting partial summary judgment finding that a fiduciary violated ERISA Section 406(b)(1) when he transferred funds to himself from the plan's account).

The Koresko Defendants took Plan assets out of the REAL VEBA Trust, transferred them into non-trust accounts controlled solely by Mr. Koresko and Ms. Bonney, and eventually transferred them to Mr. Koresko's law firm account. This conduct is a blatant prohibited transaction and violates Section 406(b)(1) of ERISA.

E. As a result of their violations of ERISA, the Koresko Defendants must be removed as fiduciaries and service providers to the affected Plans and ordered to make the Plans whole.

1. The Koresko Defendants should be permanently barred from serving as ERISA fiduciaries and service providers to the affected Plans.

Section 502(a)(5) of ERISA authorizes the Secretary to seek an order enjoining "any act or practice which violates any provision of this title or the terms of the plan" or granting "other appropriate equitable relief", 29 U.S.C. § 1132(a)(5). The Court has broad discretion under Section 409 of ERISA to fashion such "equitable or remedial relief as the court may deem appropriate", 29 U.S.C. § 1109(a). *See Delgrosso*, *supra*, [33] 769 F.2d at 937-38 ("A federal court enforcing fiduciary obligations under ERISA is . . . given broad equitable powers to implement its remedial decrees."). This broad grant of authority permits courts to bar serious ERISA violators from serving as fiduciaries or service providers to ERISA-covered plans. *Id.* ("Removal and replacement of a fund administrator under ERISA [is] appropriate where the administrator has been in substantial violation of his fiduciary duties.").

Serious misconduct is grounds for a permanent injunction without a showing of future harm. *See Beck v. Levering*, 947 F.2d 639, 641 (2d Cir. 1991); *Reich v. Lancaster*, 55 F.3d 1034, 1054 (5th Cir. 1995); *Brock v. Ardito*, *supra*, 1987 U.S. Dist. LEXIS 14184 at *17 (defendant trustee permanently barred from serving as a fiduciary for an ERISA-covered plan where the trustee transferred money from plan accounts to his own account); *Martin v. Harline*, Civil Action No. 87-NC-115J, 0092 WL 12151138 at *17 (D. Utah March 30, 1992) (fiduciary permanently barred when his failure to oversee and review the conduct of other fiduciaries enabled those other fiduciaries to violate ERISA).

As demonstrated herein, the Koresko Defendants engaged in blatant self-dealing and unauthorized transfers of the Décor Coordinates, Cetylite and Castellano Plans' assets out of the REAL VEBA Trust and into accounts they controlled. These serious violations of ERISA justify a permanent injunction barring them from serving as fiduciaries and service providers and from exercising any custody, authority or control with respect to these Plans.

2. A Special Master should be appointed to make an accounting and marshal the assets of the Plans.

As the affected Plans' assets are commingled with the assets of other plans participating in the REAL VEBA Trust, including the assets of the other ERISA-covered [34] plans set forth in Exhibit A in the Secretary's Complaint, an accounting will be necessary to determine the assets of each Plan. The Secretary sought such an accounting from the Koresko Defendants in her discovery requests.[9] However, to date, the Koresko defendants have failed to produce any such accounting. *Leigh v. Engle*, *supra*, 727 F.2d at 138-9 ("[T]he burden is on the defendants who are found to have breached their fiduciary duties to show which profits are attributable to their own investments apart from their control of [plan] assets.") Accordingly, a special master should be appointed

[9] See letter from Plaintiff's Counsel to the Honorable Mary A. McLaughlin, dated February 13, 2012, Attachement [sic] B, Request for Production No. 6.

pursuant to Rule 53, F.R.Civ.Pr.,[10] to perform an accounting of these Plans.

The Koresko Defendants should bear the expense of the special master. Rule 53 allows courts to allocate payment for the services of a master as the judge sees fit, taking into account "the nature and amount of the controversy, the means of the parties, and the extent to which any party is more responsible than other parties for the reference to a master." Fed. R. Civ. Proc. 53(g)(3). Courts have wide latitude to make awards of costs that favor the prevailing party. *See, e.g.*, *Teradyne, Inc. v. Teledyne Indus., Inc.*, 676 F.2d 865, 871 (1st Cir. 1982).

The Court should further order the Koresko Defendants to transfer all of the assets of the Cetylite, Castellano, and Décor Coordinates Plans, as determined by the special master, to new fiduciaries selected by these Plans' sponsors. In the event that the plan [35] sponsors do not select new fiduciaries to exercise authority and control over the recovered plan assets, the Court should appoint an independent fiduciary to do so.

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[10] Rule 53 allows courts to appoint masters to make or recommend findings of fact on issues to be decided by the court "if appointment is warranted by . . . the need to perform an accounting or resolve a difficult computation of damages." Fed. R. Civ. Proc. 53(a)(1)(B)-(C).

3. The Koresko Defendants must be ordered to make the Plans whole.

Section 409(a) of ERISA, 29 U.S.C. § 1109(a), provides:

> any person who is a fiduciary with respect to a plan who breaches any of the responsibilities, obligations, or duties imposed upon fiduciaries by this title shall be personally liable to make good to such plan any losses to the plan resulting from each such breach, and to restore to such plan any profits of such fiduciary which have been made through use of assets of the plan by the fiduciary, and shall be subject to such other equitable or remedial relief as the court may deem appropriate, including removal of such fiduciary.

Accordingly, ERISA requires a breaching fiduciary to restore a plan to the position it would have been in but for that fiduciary's illegal conduct. *See Bierwirth*, *supra*, 754 F.2d at 1056 (quoting Restatement (2nd) of Trusts § 205(c) (1959) and holding, a breaching fiduciary must "restor[e] the trust beneficiaries to the position they would have occupied but for the breach of trust."); *Chao v. Trust Fund Advisors*, Civ. Act No. 02-559 (GK), 2004 WL 444029 (D. D.C. January 20, 2004) (applying "make whole" standard to fiduciaries' liability for losses resulting from imprudence).

ERISA also requires a fiduciary to restore a plan to the position it would have been in but for *another* fiduciary's breach, if a fiduciary: (a) participates "knowingly in, or knowingly undertakes to conceal . . . [a breach] of another fiduciary knowing [it] is a breach"; (b) fails to comply with his own duties under section 404(a)(1) and thus enables another fiduciary to commit a breach; or (c) knows that a breach has occurred but fails to make reasonable efforts to remedy it. Sections 405(a)(1)-(3) of ERISA, 29 U.S.C. § 1105(a); *see, e.g., In re Enron Corp. Securities, Derivative & ERISA Litigation*, 284 F.Supp.2d 511, 581 (S.D.Tx. 2003) (reviewing in detail ERISA co-fiduciary case law).

[36] **a. As each Koresko Defendant has committed fiduciary breaches that diverted monies from the Plans, the Koresko Defendants are jointly and severally liable to restore these monies to the Plans.**

Where a plan has lost assets through a defendant's violations of ERISA, the defendant is required to make the plan whole through restitution. For example, in *Pension Benefit Guar. Corp. v. Morin, supra,* 2000 WL 760737 at * 5, where the plan trustee violated ERISA by transferring plan monies to himself and also to his wholly-owned corporation, the District Court in Maine ordered that the trustee return all misappropriated monies to the plan. *See also Chao v. Constable,* Civ. Act No. 04-1002 GLL, 2006 WL 3759749 at *9 (W.D. Pa. Dec. 19, 2006) (six breaching fiduciaries ordered to restore losses from monies taken from a death benefit fund to pay for one of the fiduciaries' personal expenses); *Harline*, *supra*, 1992 WL 2151138 at *16 (fiduciary liable to make restitution for all losses to plan resulting from his breach of fiduciary duty); *Crouse*, *supra*, 346 F.Supp.2d at 989 (same); *Johnson*, *supra*, 2005 WL 2095109 at * 8 (same).

The Koresko Defendants have violated ERISA by taking $214,692.21 from the Cetylite Plan, $485,471.14 from the Décor Plan and $751,266.76 from the Castellano Plan for their own use or for the use of a party-in-interest, by imprudently transferring these Plans' assets out of the Trust, and by failing to act solely in the interest of the Plans' participants in transferring these assets out of the Trust. Each of the Defendants is directly liable for the losses to the Plans resulting from these illegal appropriations of the Plans' assets because: (1) as discussed in section C, each of the Defendants is an ERISA fiduciary; (2) as discussed in Section D, each breached its fiduciary duties by [37] participating in the diversion of plan assets;[11] and (3) these breaches directly

[11] As noted above, the Koresko Defendants' unlawful conduct was identical with regard to the Décor Coordinates, Cetylite and Castellano Plans. PennMont – an entity under the control of Mr. Koresko – and Ms. Bonney, through KAPC and KLF, directed the Plans' Trustee CTC to transfer the death benefit into non-trust accounts controlled by Mr. Koresko and Ms. Bonney. (SMF No. 22-28, 45-48, 58-63). Mr. Koresko then transferred some of these proceeds to his law firm's non-trust accounts. (SMF No. 25, 47, 61)

resulted in the removal of the Plans' assets from the Plans' trust account and therefore losses to the Plans. As a result of their direct violations of ERISA, the Koresko Defendants are liable for restitution to the Plans.

b. As co-fiduciaries under ERISA, each of the Koresko Defendants is jointly and severally liable to restore to the Plan all monies illegally diverted from the Plans by the other Defendants.

Assuming *arguendo* that the Court finds that any one of the Koresko Defendants is not liable for restitution because that Defendant had not violated ERISA, each such Defendant is nonetheless still liable as a co-fiduciary for the other Defendants' violations of ERISA. The Act imposes co-fiduciary liability on PennMont, Mr. Koresko, Ms. Bonney, KAPC and KLF to restore the losses to the Plans under Sections 405(a)(1) and (3).

Each of these Defendants actually knew of the transfers of plan assets out of the Plans' Trust. They knew that the death benefit proceeds had been transferred out of the REAL VEBA Trust into non-trust accounts controlled by Mr. Koresko and Ms. Bonney, neither of whom was the Plans' trustee. Mr. Koresko, Ms. Bonney and the law firms knew that those proceeds were then transferred to Mr. Koresko's law firm accounts. (SMF Nos. 21-29, 42-48, 58-63)

PennMont, Mr. Koresko, Ms. Bonney and the law firms knowingly participated in the transfer of Plan assets out of trust, and they failed to make reasonable efforts to [38] remedy these breaches. *See* 29 C.F.R. § 2509.75-5FR-10 (codified DOL Interpretative Bulletin) (once a fiduciary knows that a co-fiduciary is considering imprudent action, that fiduciary must take all legal and reasonable steps to prevent or remedy a breach by a co-fiduciary, including taking legal action against the co-fiduciary or informing the Department of Labor or the plan sponsor). Therefore, they are liable as co-fiduciaries under Sections 405(a) and (c).

PennMont also failed to perform its duties as Plan Administrator and as the party that directed the Trustee of the Plans. Had it been fulfilling its duty of loyalty under Section 404(a)(1), it would not have allowed the transfer of these Plan assets out of the Trust. PennMont's failure to comply with its fiduciary duties enabled the other fiduciaries to violate ERISA. PennMont thus violated Section 405(a)(2) by enabling the breaches of Mr. Koresko, Ms. Bonney and the law firms.

c. The Koresko Defendants must be ordered to pay prejudgment interest.

The Koresko Defendants should also be required to pay prejudgment interest. Such prejudgment interest is awarded to restore a plan to the position it would have been in, but for the violations of ERISA.

See Russo v. Unger, 845 F. Supp. 124, 128-29 (S.D. N.Y. 1994) (self-dealing fiduciary and fiduciary who turned a "blind eye" to self-dealing ordered to pay prejudgment interest at "overpayment rate"); *Harline*, 1992 WL 2151138 at *16 (prejudgment interest awarded to place plan in same position that it would have occupied if losses had not occurred); *Tomasso,* 682 F. Supp. 1287, 1306 (E.D.N.Y. 1988) (awarding prejudgment interest where plan was denied use of wrongfully expended funds); *Cohen,* 686 F. Supp. 454, 458 (S.D. N.Y. 1988) (award of prejudgment interest to make plans whole for "time value of money during particular periods"); *Constable,* 2006 [39] WL 3759749 at *10 (prejudgment interest appropriate as means of making Plan whole for violations).

Several courts have held that the appropriate rate for prejudgment interest on restitution from violations of ERISA is the rate that the Internal Revenue Service charges taxpayers who underpay their taxes. This rate, found at 26 U.S.C. §§ 6621, 6622, is compounded daily. *Harline*, 1992 WL 2151138 at *16; *Cohen*, 686 F. Supp. at 458; *Whitfield v. Tomasso*, 682 F. Supp. at 1306. Using this rate, Plaintiff has calculated that the Koresko Defendants owe $92,993.23 to the Cetylite Plan, $243,349.38 to the Décor Plan, and $339,690.21 to the Castellano Plan in prejudgment interest on the losses to these Plans.

V. CONCLUSION

For the reasons set forth herein, the Secretary requests that this Court grant the Secretary's Motion for Partial Summary Judgment and enter an Order directing Mr. Koresko, Ms. Bonney, PennMont, and KLF and KAPC to restore a total of $1,261,439.10 to the Décor Coordinates, Cetylite and Castellano Plans, plus $676,032.82 in prejudgment interest, for a total of $1,937,462.90, and permanently enjoining them from acting as fiduciaries and service providers and from exercising custody, authority or control with respect to the Décor Coordinates, Cetylite and Castellano Plans. The Secretary also requests that the Court appoint a Special Master at the Koresko Defendants' expense to determine the assets of these Plans and that the Court enter an [40] Order transferring the assets of these Plans to new fiduciaries selected by Plan sponsors or to an independent fiduciary if a new fiduciary is not so selected.

Respectfully submitted,

M. Patricia Smith
Solicitor of Labor

Catherine Oliver Murphy
Regional Solicitor

Joanne Jarquin
Counsel for ERISA

/s/ *Linda M. Henry*
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U.S. Department of Labor [SEAL]

Employee Benefits Security Administration
Washington, D.C. 20210

JUL – 3 2013

2013-03A
29 CFR 2510.3-101
404 & 406

Stephen M. Saxon
Andree M. St. Martin
Groom Law Group, Chartered
1701 Pennsylvania Ave., NW
Washington, DC 20006-5811

Dear Mr. Saxon and Ms. St. Martin:

This is in response to your request on behalf of the Principal Life Insurance Company ("Principal") for an advisory opinion regarding the status of certain revenue sharing payments Principal receives from third parties. Principal receives these payments in connection with investments by employee benefit plans for which Principal provides certain services. In particular, you ask whether the revenue sharing payments constitute "plan assets" of the client plans under ERISA.[1]

You state that Principal, a life insurance company, provides recordkeeping and related administrative

[1] You have not asked for an opinion on, and this letter does not address, any fiduciary issues involved in selecting investment options that include revenue sharing expenses versus those that do not. This letter also does not address any fiduciary issues that may arise from the allocation of revenue sharing among plan expenses or individual participant accounts or where the employer has the obligation to pay plan expenses.

services to retirement plans subject to Title I of ERISA, including 401(k) and other participant-directed defined contribution plans. Principal also makes available to plans a variety of investment options, including its own insurance company separate accounts and affiliated and unaffiliated mutual funds. Principal receives revenue sharing payments from these investments in the form of Securities and Exchange Commission Rule 12b-1 fees, shareholder and administrative services fees or similar payments. You state that although Principal retains all of the payments, it may agree with a client plan to maintain a bookkeeping record of revenue sharing received in connection with the plan's investments. The bookkeeping account reflects credits to the plan calculated by reference to the estimated revenue sharing payments. For example, in accordance with terms in the agreement or directions from a plan fiduciary, Principal will apply the credits to pay certain plan expenses, such as for the services of accountants, consultants, actuaries or attorneys to the plan. Alternatively, Principal may agree to deposit an amount equal to the credits directly into a plan account, periodically or on specified dates.

You state that Principal deposits the revenue sharing payments into its general asset accounts and does not establish a special bank or custodial account to hold the revenue sharing payments. None of its agreements with the client plans call for Principal to segregate any portion of the revenue sharing payments for the benefit of any plan. You state also that

Principal makes no representations to the plan fiduciaries or to any plan participants or beneficiaries that revenue sharing amounts it receives will be set aside for the benefit of the plan or represent a separate fund for payment of benefits or expenses under the plan.

Title I of ERISA does not expressly describe what constitutes assets of an employee benefit plan. The Department has promulgated regulations identifying plan assets when a plan invests in other entities (*see* 29 CFR 2510.3-101) and when a participant pays or has amounts withheld by an employer for contribution to a plan (*see* 29 CFR. 2510.3-102). In other situations, the Department has indicated that the assets of an employee benefit plan generally are to be identified on the basis of ordinary notions of property rights. *See, e.g.,* Advisory Opinion 94-31A (Sept. 9, 1994).

Applying ordinary notions of property rights, the assets of a plan generally include any property, tangible or intangible, in which the plan has a beneficial ownership interest. The identification of plan assets therefore requires consideration of any contract or other legal instrument involving the plan, as well as the actions and representations of the parties involved. For example, a plan generally will have a beneficial interest in particular assets if the assets are held in a trust on behalf of the plan, or in a separate account with a bank or other third party in the name of the plan, or if it is specifically indicated in documents or instruments governing the arrangement that separately maintained funds belong to the plan. *See* Advisory Opinion 92-24A (Nov. 6, 1992). Similarly, whether a plan has acquired a beneficial interest in specific assets also depends on whether an intent has been expressed to grant such a beneficial interest or a representation has been made sufficient to lead participants and beneficiaries of the plan reasonably to believe that such funds separately secure the promised benefits or are otherwise plan assets. *See* Advisory Opinion 99-08A (May 20, 1999). On the other hand, the mere segregation of a service provider's funds to facilitate administration of its contract or arrangement with a plan would not in itself create a beneficial interest in those assets on behalf of the plan.[2]

Due to the inherently factual nature of the inquiry, it is possible that revenue sharing amounts received by Principal in connection with a particular plant's investments are assets of the plan, depending on Principal's arrangements and communications with that plan.[3] Nothing in the circumstances described above, however, would lead us to conclude that

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[2] *See, e.g.,* Advisory Opinion 92-2.4A (Nov. 6, 1992) (in the absence of any other actions or representations by an employer which manifest an intent to contribute assets to a plan, the mere establishment of an account in the name of the employer to be used exclusively in administering the plan would not create a beneficial interest in the plan).

[3] *See* Revision of Annual Information Return/Reports, 72 FR 64731, 64744 (Nov. 16, 2007).

amounts recorded in the bookkeeping account as representing revenue sharing payments are assets of a client plan before the plan actually receives them. As noted above, however, the assets of a plan may include any type of property, tangible or intangible. Thus, the client plan's contractual right to receive the amounts agreed to with Principal, or to have them applied to plan expenses, would be an asset of the plan. Similarly, if Principal should fail to pay amounts as required by the contract or arrangement with the plan, the plan would have a claim against Principal for the amount owed and the claim itself would be an asset of the plan.[4]

Regardless of whether the revenue sharing payments are plan assets, the arrangement between Principal and its client plans would be subject to certain provisions of ERISA. As a provider of services to a plan, Principal would be a party in interest with respect to the plan pursuant to section 3(14)(B) of ERISA. The furnishing of goods, services or facilities between a plan and a party in interest is generally prohibited under section 406(a)(1)(C) of ERISA. However, section 408(b)(2) of ERISA exempts certain arrangements between plans and service providers that otherwise would be prohibited transactions under section 406(a)(1)(C) of ERISA. Specifically, section 408(b)(2)

[4] This analysis is similar to the position of the Department described in Field Assistance Bulletin 2008-01 with respect to the plan asset status of a plan's claim against an employer for delinquent employer contributions.

provides relief from ERISA's prohibited transaction rules for service contracts or arrangements between a plan and a party in interest if the contract or arrangement is reasonable, the services are necessary for the establishment and operation of the plan, and no more than reasonable compensation is paid for the services. Regulations issued by the Department clarify each of these conditions to the exemption.[5]

The Department's regulations provide that section 408(b)(2) of ERISA does not extend to acts described in section 406(b). *See* 29 CFR 2550.408b-2(a). As explained in 29 CFR 2550.408b-2(e)(1), if a fiduciary uses the authority, control, or responsibility which makes it a fiduciary to cause the plan to enter into a transaction involving the provision of services when such fiduciary has an interest in the transaction which may affect the exercise of its best judgment as a fiduciary, a transaction described in section 406(b)(1) would occur. Section 408(b)(2) does not provide an exemption for a fiduciary's use of its authority to affect its own compensation.

The regulation explains, however, that a fiduciary does not engage in an act described in section 406(b)(1) if the fiduciary does not use any of the

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[5] *See* 29 CPR 2550.408b-2. Recent amendments to this regulation requiring expanded disclosures regarding the contract or arrangement, including disclosures regarding direct and indirect compensation received by covered service providers, became effective on July 1, 2012. See 77 Fed. Reg. 5632 (Feb. 3, 2012) for more information.

authority, control, or responsibility which makes such person a fiduciary to cause a plan to pay additional fees for a service furnished by such fiduciary or to pay a fee for a service furnished by a person in which such fiduciary has an interest which may affect the exercise of such fiduciary's best judgment as a fiduciary. For example, if Principal, in its provision of services to a client plan, is a fiduciary within the meaning of section 3(21)(A) of ERISA, including by virtue of providing investment advice for a fee as described under section 3(21)(A)(ii) of ERISA, and uses any of the authority, control or responsibility which makes it a fiduciary to cause a plan to invest in funds which pay Principal revenue sharing or other fees, a violation of section 406(b) of ERISA would occur which would not be exempted by section 408(b)(2).[6] In that case, the responsible plan fiduciaries would have to evaluate whether Principal's revenue sharing or other fee arrangements involving the plan give rise to any non-exempted prohibited transactions under section 406(b) of ERISA.

ERISA's general standards of fiduciary conduct also apply to the proposed arrangement. Under section 404(a)(1) of ERISA, the responsible plan fiduciaries must act prudently and solely in the interest of the plan participants and beneficiaries both in deciding whether to enter into, or continue, the

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[6] *See* Advisory Opinion 97-15A (May 22, 1997); Advisory Opinion 97-16A (May 22, 1997); and Advisory Opinion 2003-09A (June 25, 2003).

above-described arrangement with Principal, and in determining which investment options to utilize or make available to plan participants or beneficiaries. In this regard, the responsible plan fiduciaries must assure that the compensation the plan pays directly or indirectly to Principal for services is reasonable, taking into account the services provided to the plan as well as all fees or compensation received by Principal in connection with the investment of plan assets, including any revenue sharing. It is the view of the Department that the responsible plan fiduciaries must obtain sufficient information regarding all fees and other compensation that Principal receives with respect to the plan's investments to make an informed decision as to whether Principal's compensation for services is no more than reasonable.

The plan fiduciaries must also act prudently and in the best interests of plan participants and beneficiaries in the negotiation of the specific formula and methodology under which revenue sharing will be credited to the plan and paid back to the plan or to plan service providers. Prudence requires that a plan fiduciary, prior to entering into such an arrangement, will understand the formula, methodology and assumptions used by Principal in arriving at the amounts to be returned to the plan or used to pay plan service providers following disclosure by Principal of all relevant information pertaining to the proposed arrangement. The plan fiduciaries also must be capable of periodically monitoring the actions taken by Principal in the performance of its duties to assure, among other things, that any amounts to which the plan may be entitled under the terms of the arrangement are correctly calculated and applied for the benefit, of the plan. Thus, in considering whether to enter into an arrangement of this kind, the fiduciary should take into account its ability to oversee the service provider, including its ability to oversee and monitor the service provider's determinations under the formula. In addition, plan fiduciaries must obtain sufficient information to assure that any service providers to the plan who are paid directly by Principal are paid no more than reasonable compensation for the services provided by them to the plan.

Whether the actions of plan fiduciaries satisfy these general fiduciary standard requirements is an inherently factual question, and the Department generally will not issue advisory opinions on such questions. The appropriate plan fiduciaries must make such determinations based on all the facts and circumstances of the individual situation.

This letter constitutes an advisory opinion under ERISA Procedure 76-1 and is issued subject to the provisions of that procedure, including section 10 thereof relating to the effect of advisory opinions.

Sincerely,

Louis J. Campagna
Chief, Division of Fiduciary Interpretations
Office. of Regulations and Interpretations

Field Assistance Bulletin 2002-3

November 5, 2002

Memorandum for: Virginia C. Smith
Director of Enforcement Regional Directors

From: Robert J. Doyle
Director of Regulations and Interpretations

Subject: Disclosure and other Obligations Relating to "Float"

Issue

What does a fiduciary need to consider in evaluating the reasonableness of an agreement under which the service provider will be retaining "float" and what information is a service provider required to disclose to plan fiduciaries with respect to such arrangements in order to avoid engaging in a prohibited transaction?

Background

A number of financial services providers, such as banks and trust companies, acting as non-discretionary directed trustees or custodians maintain general or "omnibus" accounts to facilitate the transactions of employee benefit plans. The service provider may retain earnings ("float") resulting from the anticipated short-term investment of funds held in such accounts. Typically, these accounts hold contributions and other assets pending investment directions from plan fiduciaries. In addition, fiduciaries transfer funds to a general account of the financial institution in connection with issuance of a check to make a plan distribution or other disbursement. Funds are then held in the account earning interest until checks are presented for payment.

In Advisory Opinion 93-24A, the Department expressed the view that a trustee's exercise of discretion to earn income for its own account from the float attributable to outstanding benefit checks constitutes prohibited fiduciary self-dealing under section 406(b)(I) of ERISA. Advisory Opinion 93-24A dealt with a situation where there was no disclosure of the float to employee benefit plan customers. In a subsequent information letter to the American Bankers Association (August 11, 1994), the Department indicated that " . . . if a bank fiduciary has **openly negotiated** with an independent plan fiduciary to retain float attributable to outstanding benefit checks as part of its overall compensation, then the bank's use of the float would not be self-dealing because the bank would not be exercising its fiduciary authority or control for its own benefit. Therefore, to avoid problems, banks should, **as part of their fee negotiations, provide full and fair disclosure regarding the use of float** on outstanding benefit checks." (Emphasis supplied).

In general, the concepts of open **negotiation and full and fair disclosure**, as used in the 1994 letter, are intended to ensure that service providers provide sufficient information concerning such arrangements so that plan fiduciaries can make informed assessments concerning the prudence of the arrangements. Further, those concepts are intended to ensure that the amount of the service provider's compensation is determined and approved by a fiduciary independent of the service provider so that prohibited self-dealing is avoided.[1] Since the issuance of the letter, Field offices have found, as part of their investigations, a variety of methods by which plan fiduciaries are informed of, and or approve, the practice of plan service providers retaining float as part of their overall compensation. Typically, a service agreement will provide that, in addition to other specifically identified or scheduled fees, the service provider may also receive compensation in the form of earnings on funds awaiting investment or reinvestment or funds pending distribution. According to the investigations, however, there is little or no disclosure of specific information regarding compensation earned in the form of float.

Further guidance, therefore, has been requested concerning the obligations of plan fiduciaries and service providers regarding float arrangements and disclosures.

[1] What constitutes an approval by an appropriate plan fiduciary will depend on the facts and circumstances of each case. See Advisory Opinion Nos. 97-16A and 2001-02A.

Analysis

Obligations of Plan Fiduciary – In selecting a service provider, plan fiduciaries must, consistent with the requirements of section 404(a), act prudently and solely in the interest of the plan's participants and beneficiaries and for the exclusive purpose of providing benefits and defraying reasonable expenses of administering the plan. Except as provided in section 408, plan fiduciaries also have an obligation under section 406(a) not to cause the plan to engage in certain transactions, including a direct or indirect furnishing of goods, services or facilities between the plan and a party in interest. Section 408(b)(2) exempts from the prohibitions of section 406(a) any contract or reasonable arrangement with a party in interest, including a fiduciary, for office space, or legal, accounting or other services necessary for the establishment or operation of the plan, if no more than reasonable compensation is paid therefor,[(2)] In carrying out these responsibilities, the Department has indicated that a plan fiduciary must engage in an

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[(2)] As interpreted by the Department, section 408(b)(2) exempts from the prohibitions of section 406(a) payment by a plan to a party in interest, including a fiduciary, for any service (or combination of services) if (1) such service is necessary for the establishment or operation of the plan; (2) such service is furnished under a contract or arrangement which is reasonable; (3) no more than reasonable compensation is paid for such service. However, section 408(b)(2) does not provide an exemption for an act described in section 406(b) of ERISA, even if such act occurs in connection with a provision of services that is exempt under section 408(b)(2). See 29 C.F.R. § 2550.408b-2.

objective process designed to elicit information necessary to assess the qualifications of the provider, the quality of services offered, and the reasonableness of the fees charged in light of the services provided. In addition, such process should be designed to avoid self-dealing, conflicts of interest or other improper influence.

In circumstances where a service provider may receive compensation in the form of float, we believe the selection and monitoring process engaged in by the responsible fiduciary should include:

1. A review of comparable providers and service arrangements (e.g., quality and costs) to determine whether such providers may credit float to the provider's own account, rather than the plan.

2. A review of the circumstances under which float may be earned by the service provider. For example, in the case of float on cash awaiting investment, fiduciaries should ensure that their service agreements include time limits within which the provider will implement investment instructions following receipt of cash from the plan. Fiduciaries also should understand that delays in the plan providing investment instruction or delays in implementing investment direction by the service provider would result in increased compensation in the form of float. In the case of float on funds awaiting disbursement, fiduciaries should ensure that their service agreements specify the time at which assets are transferred from the plan to the general account (e.g., the date the check is requested, the date the check is written,

or the date the check is mailed). Inasmuch as timing of mailing or distribution of a check may also affect the amount of float, service agreements should provide, if relevant, an indication as to when checks are mailed following a direction to distribute funds. Fiduciaries also should understand that float will be earned on such disbursements until checks are presented for payment by the payee, the timing of which is beyond the control of the plan and service provider. In this regard, fiduciaries should review periodic statements or reports of distribution checks to determine the extent to which checks tend to remain outstanding for unusually long periods of time (e.g., 90 or more days).

3. A review of sufficient information to enable the plan fiduciary to evaluate the float as part of the total compensation to be paid for the services to be rendered under the agreement. In this regard, fiduciaries should request and review the rates the provider generally expects to earn. For example, the provider might indicate that earnings on uncashed checks are generally at money market interest rates. Given the uncertainties with respect to both actual interest rates and the length of the periods during which any given funds may be pending investment or pending disbursement, it is anticipated that any projections by the fiduciary will result in only a rough approximation of the potential float. However, the information on which the approximation is based (e.g., basis for earnings rates and agreement terms relating to maximum periods within which funds will be invested following investment direction, timing of transfers of cash from

> the plan to the provider's general account following direction to distribute funds, period for mailing checks, extent to which experience shows that distribution checks remain outstanding for unusually long periods of time, etc.) and the approximation itself, will enable a fiduciary both to compare service provider float practices and assess the extent to which float is a significant component of the overall compensation arrangement.

Additionally, a plan fiduciary must periodically monitor compliance by the service provider with the terms of the agreement and the reasonableness of compensation under the agreement in order to ensure continuation of the agreement meets the requirements of sections 404(a)(1), 406 and 408(b)(2).

Obligations of Service Providers – The primary issue for service providers with float arrangements is whether the provider has disclosed to its employee benefit plan customers sufficient information concerning the administration of its accounts holding float so that the customer can reasonably approve the arrangement based on an understanding of the service provider's compensation. Moreover, the arrangement must not permit the service provider to affect the amount of its compensation in violation of section 406(b)(1) (e.g., by giving the service provider broad discretion over the duration of the float). For example, even where a service provider discloses in its service agreement that additional compensation may be paid to the service provider as a result of float, a prohibited transaction may nonetheless result to the extent that the service provider exercises discretionary authority or control sufficient to cause a plan to pay additional fees to the provider. As noted in Advisory Opinion 93-24A, a fiduciary's decision to handle plan assets in such a way as to benefit itself constitutes prohibited self-dealing, without regard to the status of the funds after they are placed in a disbursement or other account.

It is the view of this Office that, in connection with a service agreement pursuant to which the service provider may be retaining float as part of its compensation, the service provider can avoid self-dealing with respect to such earnings by taking the following steps:

1. Disclose the specific circumstances under which float will be earned and retained.

2. In the case of float on contributions pending investment direction, establish, disclose and adhere to specific time frames within which cash pending investment direction will be invested following direction from the plan fiduciary, as well as any exceptions that might apply.

3. In the case of float on distributions, disclose when the float period commences (e.g., the date check is requested, the date the check is written, the date the check is mailed) and ends (the date on which the check is presented for payment). Also disclose, and adhere to, time frames for mailing and any other administrative practices that might affect the duration of the float period.

4. Disclose the rate of the float or the specific manner in which such rate will be determined. For example, earnings on cash pending investment and earnings on uncashed checks are generally at a money market interest rate.

We note that the disclosure of and adherence to the foregoing by service providers will not only reduce the likelihood of prohibited self-dealing, but also will assist plan fiduciaries in discharging their obligations under sections 404(a)(1), 406 and 408(b)(2).

Conclusion

Float should he regarded by plan fiduciaries and service providers as part of the service provider's compensation for services to the plan. As such, the plan fiduciary must have an adequate understanding of how the service provider will earn float, and how it contributes to the service provider's compensation. The service provider must make disclosures sufficient to permit the fiduciary to make an informed decision regarding the proposed float arrangement, In addition, to avoid having the arrangement give rise to self-dealing violations of section 406(b), both parties must avoid giving the service provider discretion to affect the amount of compensation it receives from float.

Questions concerning this matter may be directed to Louis Campagna or Fred Wong, Division of Fiduciary Interpretations at 202.693.8510.

U.S. DOL

PWBA Office of Regulations and Interpretations

Advisory Opinion

September13, 1993

93-24A
ERISA SEC. 406(b)(1), 406(b)(3)

Roger W. Thomas
Staff Attorney
Department of Financial Institutions
Fourth Floor, The John Sevier Building
500 Charlotte Avenue
Nashville, TN 37243-0705

Dear Mr. Thomas:

This is in response to your inquiry whether certain transactions engaged in by a Tennessee bank are consistent with the Employee Retirement Income Security Act of 1974 (ERISA). In particular, you call attention to an asserted "common industry practice" whereby banks acting as agents or trustees for employee benefit plans earn interest for their own accounts from the "float" when a benefit check is written to a participant until the check is presented for payment.

You indicate that a company (Trust Company), which is chartered under Tennessee law as a non-depository bank limited to trust powers, acts as an agent or trustee for various employee benefit plans. It also offers various collective investment funds in which plans invest. A national bank (National Bank) located in Tennessee serves as custodian for some of these plans.

In connection with the administration of the plans, Trust Company maintains accounts at National Bank, including a "General Account" and a "Disbursement Account." When Trust Company is directed to liquidate pooled fund assets to pay benefits, unless it is specifically directed to wire the funds to the participant, it transfers the funds to the General Account and simultaneously issues a check payable to the participant from the Disbursement Account. When checks are presented for payment, funds are wired from the General to the Disbursement Account. In the interim, Trust Company earns income on such funds for its own account, pursuant to a retail repurchase agreement with National Bank.

You question whether the payment of this income to Trust Company is a prohibited receipt by a fiduciary of consideration from a party dealing with the plan in connection with a transaction involving the assets of the plan under section 406(b)(3) of ERISA. You also express concern that the Trust Company may be violating ERISA by dealing with National Bank, given National Bank's relationship to the plans.

Trust Company, through its attorney, contends that once a check is written to a participant, corresponding amounts in the General Account cease to be plan assets. In support of this argument Trust Company relies upon the first example of the participant contribution regulation in 29 C.F.R. 2510.3-102, which addresses when amounts that an employer withholds from a participant's pay for contribution to a plan can reasonably be segregated from the employer's general assets, and thus become assets of the plan for certain purposes. These special rules concerning segregation of participant contributions from an employer's general assets, however, have no application to the question of whether a plan has an interest in an administrative account when plan assets are transferred to the account in support of an outstanding benefit check.[1]

Turning to an analysis of the issues presented, section 406(b)(1) of ERISA states that a fiduciary with respect to a plan shall not deal with the assets of the plan in his or her own interest or for his or her own account. Section 3(21)(A) of ERISA defines a fiduciary, in part, as one who exercises any discretionary authority with respect to the assets of a plan. As explained in 29 C.F.R. 2509.75-8, persons serving as plan trustees (and certain other plan officials) will be fiduciaries due to the very nature of their positions. Other persons will be fiduciaries to the extent that

[1] It is commonly understood that a check does not of itself operate as an assignment of any funds in the hands of the drawee bank available for its payment and the bank is not liable on the instrument until it accepts it. U.C.C. §3-409(1). A bank which properly pays checks drawn on it extinguishes its liability to the depositor to the extent of the amount so paid, so that it may charge the depositor's account with the amount of such payment.

9 C.J.S. Banks and Banking § 353 (1938).

they perform any of the functions described in section 3(21)(A) of ERISA.

Accordingly, it is the view of the Department that, based on the facts described above, where a fiduciary (e.g. Trust Company) exercises discretion with regard to plan assets, its receipt of income from the "float" on benefit checks under a repurchase agreement with a national bank in connection with the investment of such, plan assets would result in a transaction described in ERISA section 406(b)(1).[2]

Moreover, even if all income earned under the repurchase agreements were allocated to the plans, the repurchase agreements themselves may be prohibited where the national bank is a party in interest with respect to the plans. Section 406(a)(1)(A) and (B) of ERISA, in part, prohibit sales or extensions of credit between plans and parties in interest. The term "party in interest" is defined in section 3(14) of ERISA to include a person providing services to a plan. From the information provided, it appears that National Bank, as the custodian of plan assets for some of the plans, is a service provider to such plans.

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[2] Although you asked if this arrangement would be prohibited under section 406(b)(3), due to the limited information provided we are unable to conclude that the arrangement described herein gives rise to a violation of this section. Specifically, we are unable to conclude that the bank knew, or should have known, the circumstances under which plan assets were invested pursuant to the repurchase agreements. Thus, we are restricting our analysis to the potential violation of section 406(b)(1).

As we understand it, repurchase agreements essentially involve debt transactions structured as sales of securities. Therefore, absent exemptive relief, it appears that the repurchase agreements in question would involve prohibited extensions of credit, as well as prohibited sales between National Bank and plans that it serves. The Department has issued an administrative exemption, Prohibited Transaction Exemption 81-8 (copy enclosed), which provides conditional relief for investments in repurchase agreements, by or on behalf of an employee benefit plan. Whether this class exemption would grant relief to the parties involved in the subject retail repurchase agreement cannot be determined from the information provided.

This letter constitutes an advisory opinion under *ERISA Procedure 76-1.* Accordingly, it is issued subject to the provisions of that procedure, including section 10 thereof relating to the effect of advisory opinions.

Sincerely,

Robert J. Doyle
Director of Regulations
and Interpretations

Enclosure