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UNITED STATES DISTRICT COURT

CENTRAL DISTRICT OF CALIFORNIA

JACLYN SANTOMENNO; KAREN POLEY; BARBARA POLEY, Plaintiffs, v. TRANSAMERICA LIFE INSURANCE COMPANY; TRANSAMERICA INVESTMENT MANAGEMENT, LLC; TRANSAMERICA ASSET MANAGEMENT INC., Defendants.	)	Case No. CV 12-02782 DDP (MANx) **ORDER GRANTING IN PART AND DENYING IN PART DEFENDANTS' MOTIONS TO DISMISS** [Dkt. Nos. 103 & 104]

Presently before the court are Defendants Transamerica Life Insurance Company ("TLIC"), Transamerica Asset Management, Inc. ("TAM"), and Transamerica Investment Management, LLC ("TIM")'s Motions to Dismiss. Having considered the parties' submissions and heard oral argument, the court adopts the following order.

I. BACKGROUND

A. The Transamerica System

Transamerica Life Insurance Company ("TLIC") sells a 401(k) plan product targeted at small and mid-size employers. (Compl. ¶¶

62, 94.) The product consists of a bundle of investment options and administrative services that an employer can purchase. (Id. ¶ 7.) As of December 31, 2010, TLIC was operating approximately 15,500 401(k) plans through its group annuity product and was managing approximately $19.5 billion in employee assets. (Id. ¶ 8.)

Employers who purchase the 401(k) plan product enter into two separate agreements with TLIC. First, they enter into an "Application and Agreement for Services" ("Services Agreement"), which sets out the various services TLIC agrees to provide for the employer's plan, including recordkeeping services, enrollment services, and website hosting. (See, e.g., Decl. Darcy Hatton in Support of Defendant Transamerica Life Insurance Company's Motion to Dismiss Class Action Complaint ("Hatton Decl."), Exh. A.) The Services Agreements for the Plaintiffs' Plans contain fee schedules that are based on the number of participants or, for some services, an hourly rate. (Id., Exhs. A and C.) Plaintiffs are not challenging these fees. (See Joint Statement in Response to Court's October 19, 2012 Order for Supplemental Briefing ("Joint Statement") at 11.)

Additionally, and more relevant to this action, employers and TLIC enter into a group annuity contract ("GAC" or "the contract") which governs TLIC's provision of investment options to the Plans. (See Hatton Decl., Exhs. D-1 and D-2.) Through the GAC, TLIC provides a set of investment options to the employer. Both of Plaintiffs' employers selected the "Partner Series III" retirement package. (Compl. ¶ 243.) This package gives employers 170 investment options from which they may select 50 or 80 to offer to their employees. (Id. ¶¶ 241-42.) The 401(k) plan sponsored by the former employer of Plaintiff Santomenno, the Gain Capital Group, LLC 401(k) Plan (the "Gain Plan"), selected 46 of 170 investment options. (Id. ¶¶ 17, 206-08.) The plan sponsored by the employer of Plaintiffs Karen and Barbara Poley, QualCare Alliance Networks, Inc. Retirement Plan (the "QualCare Plan"), selected 36 of 170 investment options. (Id. ¶¶ 16, 206-08.)

One of the benefits TLIC provides to client employers is the "Fiduciary Warranty." (Id. ¶ 155.) Having entered into a GAC, an employer may pick and choose from the investment options à la carte, or it may choose one of TLIC's pre-selected "model" line-ups. (Id. ¶ 157.) If an employer chooses a model line-up, the employer qualifies for TLIC's Fiduciary Warranty, which "provides specific assurances" that the line-up will satisfy ERISA's "broad range of investments" requirement and its "prudent man standards." (Id.) TLIC warrants that if employees assert a claim for breach of those fiduciary duties against the employer, TLIC will indemnify the employer and make the plan whole. (Id. ¶ 159.) TLIC's Fiduciary Warranty applies if an employer constructs its own line-up only if the employer selects investments from specified categories. (Id. ¶ 157.)

TLIC structures its investment product under the GAC such that each investment option is considered a separate account. (Id. ¶ 132.) Each separate account corresponds to an underlying investment: a mutual fund, a collective trust, or a traditional separate account. (Id. ¶ 130.) Many of the mutual funds are publicly traded and managed by investment managers unaffiliated with TLIC such as Fidelity or Vanguard. (See e.g., id. ¶ 214.) Some of the mutual funds and collective trusts are managed by Transamerica Investment Management, LLC ("TIM") or Transamerica Asset Management, Inc. ("TAM"), affiliates of TLIC. (Id. ¶ 340.)

In each separate account, TLIC pools together the retirement assets of all employees who choose a certain investment option, regardless of their employer. (Id. at 130.) For example, if Plaintiff Santomenno and Plaintiffs Karen and Barbara Polley each selected the Vanguard Total Stock Market Index Ret Opt as one of their investment options, the funds that they choose to invest in that option would be channeled to and pooled in the same account, despite the fact that Santomenno and the Polleys have different employers. (Id. ¶ 133.)

B. Fees

TLIC assesses fees for most separate accounts. The GAC specifies that Investment Management Charges and Administrative Management Charges associated with each separate account "may be withdrawn daily and will belong to [TLIC]." (Hatton Decl., Exh. D-1.) These fees are a percentage of the assets in the separate account, and the rate varies depending on which separate account is in question. (Hatton Decl., Exhs. D-1 and D-2.) The GAC provides a schedule of fees for each of the separate accounts but reserves the "right to change the Investment Management Charge or the Administrative Charge upon advance written notice to the Contractholder of at least 30 days." (Hatton Decl., Exh. D-1.)

The TLIC fees are not the only fees withdrawn from employees' retirement assets. As discussed above, many of the separate accounts overlie mutual funds that are administered by third parties such as Vanguard or Fidelity. (Compl. ¶¶ 214-15.) These mutual funds charge their own management fees, also calculated as a percentage of the assets in the account. (<u>See e.g.</u> <u>id.</u> ¶¶ 229, 245.) Any fees charged by the underlying investments are also withdrawn from the retirement assets.

TLIC's fees are frequently higher than the fees of the underlying mutual fund. (<u>Id.</u> ¶ 245.) For separate account investment options invested in mutual funds, TLIC's fees are approximately 75 basis points, or 0.75% of the Plan assets invested in each option. (<u>Id.</u> ¶ 271.) For at least 28 of the mutual fund options, plan participants pay the fee charged by the mutual fund in addition to a higher fee charged by TLIC. (<u>Id.</u> ¶¶ 245, 248.) For instance, for the separate account that invests in the Vanguard Total Stock Market Index Ret Opt, the underlying mutual fund charged a fee of 18 basis points and TLIC charged an additional account fee of 93 basis points, for a total fee of 111 basis points or 1.11% of the separate account assets. (<u>Id.</u> ¶ 246.) For separate account investment options invested in collective trusts, TLIC charged a fee ranging from 79 basis points to 150 basis points. (<u>Id.</u> ¶¶ 331, 333-34.)

C. Plaintiffs' Allegations

Plaintiffs allege that Defendants' fees are excessive and are a breach of their fiduciary duty to Plaintiffs under ERISA. More specifically, Plaintiffs allege that TLIC's fees on separate accounts that invest in publicly available mutual funds are excessive because TLIC provides no services on such accounts: the underlying mutual funds' investment management fees covered "all of the necessary investment management/advisory services needed for the mutual fund," and thus "the alleged management services performed by TLIC were unnecessary or simply not performed." (Compl. ¶ 276.) As a result, Plaintiffs argue, the fees they paid to TLIC were "excessive and unnecessary." (Id.) "The charging of any fees by TLIC to Plaintiffs that are in excess of the fees charged by each of the mutual funds that underlie the overlaying separate account is impermissible." (Id. ¶ 293.) As a corollary to this claim, Plaintiffs allege that revenue sharing payments paid by mutual funds to TLIC benefitted only TLIC and not Plaintiffs, even when they were used to offset TLIC's fees. This is because TLIC's fees did not correlate to any benefits or services to Plaintiffs, such that any offset of such fees was not a benefit to Plaintiffs but a diversion to TLIC of funds that should have gone to Plaintiffs. (Id., Count III, ¶ 3.)

Another set of Plaintiffs' allegations concern TLIC's failure to use its leverage to provide them with low-fee investments. With respect to collective trust separate accounts, Plaintiffs allege that the fees are excessive because collective investment trusts "generally charge less in fees" than comparable mutual funds with the same investment strategy, but the fees TLIC charged were higher than a comparable mutual fund. (Id. ¶¶ 328, 330-33.) Similarly, Plaintiffs allege that Defendants failed to invest in the lowest price share class of mutual funds despite their leverage to do so. (Id. ¶ 314.)

Plaintiffs also make allegations against affiliates TIM and TAM for committing prohibited transactions under ERISA and for knowingly participating in TLIC's fiduciary violations. (Id., Count IV.)

Finally, Plaintiffs allege violations of the Investment Advisers Act ("IAA"). (Id., Counts VIII & IX.)

Defendant TLIC moves to dismiss the ERISA claims on the grounds that TLIC does not have a fiduciary duty to Plaintiffs with respect to the fees charged. Without a fiduciary duty, none of the ERISA claims survive. Defendants TIM and TAM separately move to dismiss on the grounds that their acts do not constitute prohibited transactions.

Defendant TLIC moves to dismiss the IAA claims on the grounds that Plaintiffs were not parties to any investment advisory contracts with TLIC and that there is nothing to rescind.

II. LEGAL STANDARD

A complaint will survive a motion to dismiss when it contains "sufficient factual matter, accepted as true, to state a claim to relief that is plausible on its face." Ashcroft v. Iqbal, 556 U.S. 662, 663 (2009) (quoting Bell Atl. Corp. v. Twombly, 550 U.S. 544, 570 (2007)). When considering a Rule 12(b)(6) motion, a court must "accept as true all allegations of material fact and must construe those facts in the light most favorable to the plaintiff." Resnick v. Hayes, 213 F.3d 443, 447 (9th Cir. 2000). Although a complaint need not include "detailed factual allegations," it must offer "more than an unadorned, the-defendant-unlawfully-harmed-me accusation." Iqbal, 556 U.S. at 678. Conclusory allegations or allegations that are no more than a statement of a legal conclusion "are not entitled to the assumption of truth." Id. at 679. In other words, a pleading that merely offers "labels and conclusions," a "formulaic recitation of the elements," or "naked assertions" will not be sufficient to state a claim upon which relief can be granted. Id. at 678 (citations and internal quotation marks omitted).

"When there are well-pleaded factual allegations, a court should assume their veracity and then determine whether they plausibly give rise to an entitlement of relief." Id. at 664. Plaintiffs must allege "plausible grounds to infer" that their claims rise "above the speculative level." Twombly, 550 U.S. at 555-56. "Determining whether a complaint states a plausible claim for relief" is a "context-specific" task, "requiring the reviewing court to draw on its judicial experience and common sense." Iqbal, 556 U.S. at 663-64.

III. DISCUSSION

A. ERISA Claims

This case presents the question of when a fiduciary duty attaches to a company such as TLIC that negotiates with an employer to provide services to a retirement plan. TLIC argues that it is not a fiduciary with respect to the terms of its own compensation because those terms were negotiated before it became a fiduciary. The court disagrees. Basic fiduciary principles and ERISA's functional definition of fiduciary duty require that TLIC be held accountable for the fees it assesses on employees' retirement assets.

1. Fiduciary Principles

In assessing TLIC's fiduciary duty, it is essential to bear in mind that a fiduciary relationship is governed by principles of trust and confidence, not by contract. "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." Meinhard v. Salmon, 249 N.Y. 458, 464 (1928)(Cardozo, J.). ERISA fiduciaries are entrusted with protecting "the continued well-being and security of millions of employees and their dependents [which] are directly affected" by employee benefit plans. John Hancock Mut. Life Ins. Co. v. Harris Trust & Sav. Bank, 510 U.S. 86, 96 n.5 (1993)(quoting the statement of purpose of 29 U.S.C. § 1001(a)). Congress directed courts to interpret ERISA's fiduciary requirements "bearing in mind the special nature and purpose of employee benefit plans." Varity Corp. v. Howe, 516 U.S. 489, 497 (1996)(quoting H.R. Rep. 93-533, 4650). Indeed, ERISA's fiduciary obligations are the "highest known to the law." Donovan v. Bierwirth, 680 F.2d 263, 272 n.8 (2d Cir. 1982).

These broad principles do not answer the question of when TLIC becomes a fiduciary, but they must frame the inquiry into any question concerning fiduciary duty under ERISA.

2. ERISA's Functional Definition of Fiduciary

"Under traditional trust law . . . only the trustee had fiduciary duties. ERISA, however, defines 'fiduciary' not in terms of formal trusteeship, but in functional terms of control and authority over the plan, see 29 U.S.C. § 1002(21)(A), thus expanding the universe of persons subject to fiduciary duties—and to damages—under § 409(a)." Mertens v. Hewitt Assoc., 508 U.S. 248, 262 (1993)(emphasis in original)(internal citations omitted). See also Arizona State Carpenters Pension Trust Fund v. Citibank, 125 F.3d 715, 720 (9th Cir. 1997). Under ERISA, not only named trustees but those assuming fiduciary functions are deemed to have a fiduciary duty. The statute describes those functions. A person is an ERISA fiduciary

> 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.

29 U.S.C.A. § 1002(21)(A).[1]

The purpose of a functional standard was to supplement traditional trust law, which was deemed "insufficient to adequately protect the interests of plan participants and beneficiaries." H.R. Rep. 93-533 at 4650. Congress in enacting ERISA made "more exacting the requirements of the common law of trusts relating to employee benefit trust funds." Donovan v. Mazzola, 716 F.2d 1226,

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[1]Federal regulations elaborate on the fiduciary function of insurers, like TLIC:

> [A]n insurer is subject to ERISA's fiduciary responsibility provisions with respect to the assets of a separate account . . . to the extent that the investment performance of such assets is passed directly through to the plan policyholders. ERISA requires insurers, in administering separate account assets, to act solely in the interest of the plan's participants and beneficiaries; prohibits self-dealing and conflicts of interest; and requires insurers to adhere to a prudent standard of care.

29 CFR § 2550.401c.

1231-32 (9th Cir. 1983). The functional definition of fiduciary was central to expanding the protection of employees' retirement benefits. "To help fulfill ERISA's broadly protective purposes, Congress commodiously imposed fiduciary standards on persons whose actions affect the amount of benefits retirement plan participants will receive." John Hancock Mut. Life Ins. Co., 510 U.S. at 96.

To say that ERISA defines fiduciary duty in functional terms is to say that such duty is determined not by a party's status but by particular actions taken with respect to plan. The same party can be both a fiduciary and a non-fiduciary, depending on the action it is taking. For instance, "[p]rofessional service providers such as actuaries become liable for damages when they cross the line from advisor to fiduciary." Mertens, 508 U.S. at 262. Likewise, fiduciaries such as employers can take certain non-fiduciary actions not comprised in their duty. In other words, "the trustee under ERISA may wear different hats." Pegram v. Herdrich, 530 U.S. 211, 225 (2000). However, ERISA requires

> that the fiduciary with two hats wear only one at a time, and wear the fiduciary hat when making fiduciary decisions. Thus, the statute does not describe fiduciaries simply as administrators of the plan, or managers or advisers. Instead it defines an administrator, for example, as a fiduciary only "to the extent" that he acts in such a capacity in relation to a plan. In every case charging breach of ERISA fiduciary duty, then, the threshold question is not whether the actions of some person employed to provide services under a plan adversely affected a plan beneficiary's

interest, but whether that person was acting as a fiduciary (that is, was performing a fiduciary function) when taking the action subject to complaint.

Id. at 225-26 (citations omitted).

TLIC does not contest that under the GAC it has fiduciary responsibility for the separate accounts. It concedes that it has "limited fiduciary responsibilities[2] for monitoring the investment performance within its separate account investment products." (TLIC Mot. at 12.) But TLIC disavows any fiduciary duty with respect to its fees because they were set by contract before TLIC assumed its fiduciary responsibilities as defined in the same contract. Thus TLIC contends that it wore a non-fiduciary hat when negotiating the contract with the employer, even if the contract allowed it to put on a fiduciary hat once it was in effect.

In support of this argument, TLIC cites cases from other Circuits supporting the proposition that "a service provider does not act as a fiduciary with respect to the terms in the service agreement if it does not control the named fiduciary's negotiation and approval of those terms." Hecker v. Deere & Co., 556 F.3d 575, 583 (7th Cir. 2009). TLIC argues that because it does not have final authority over the contract – only the employer can enter into the contract on behalf of the plan - it also lacks the requisite control over its compensation that would make it a fiduciary with respect to its own fees.

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[2] Without addressing the issue further, the court notes that characterizing some fiduciary responsibilities as "limited" seems oxymoronic.

The court rejects this formalistic line-drawing. TLIC is negotiating to become a fiduciary and negotiating for the fees that, as a fiduciary, it will assess on the employees' retirement accounts. The reductio ad absurdum of the principle that a future fiduciary is not responsible for the terms of its own compensation is that the fiduciary could negotiate for a fee of 99% of each separate account and still be considered to be fulfilling its fiduciary duty of managing the separate account simply because it negotiated this fee by contract. The contract can immunize the future fiduciary TLIC from fiduciary breach no more than it can immunize the employer. To hold otherwise would allow fiduciaries to contract themselves out of their duties, so long as it was done prior to the assumption of those duties.

TLIC is entitled to reasonable fees and profits for the services that it provides to the plans, but as a fiduciary TLIC is accountable for the reasonableness of those fees. This conclusion does no damage to the sanctity of contracts; it simply acknowledges that where fiduciary duties are involved, the fiduciary rules apply. Because TLIC is negotiating to assume the high duties of an ERISA fiduciary, it must be accountable to the beneficiaries of the plan for the reasonableness of its compensation.

3. Arm's Length Negotiations

TLIC also argues that it has no control over the fees because they were the terms of a contract that was negotiated at arm's length. TLIC asserts that where a specific term "is bargained for at arm's length, adherence to that term is not a breach of fiduciary duty." Ed Miniat, Inc. v. Globe Life Ins. Grp., Inc., 805 F.2d 732, 737 (7th Cir. 1986).

The court has found no precise definition of an arm’s length transaction in the ERISA context. In other areas of the law, arm’s length negotiations or transactions are characterized as adversarial negotiations between parties that are each pursuing independent interests.[3] The contract negotiations at issue here depart from the typical arm’s length negotiation in several respects. First, the subject matter of the contract is fiduciary duty: the duty the employer has and the duty TLIC will assume. Importantly, these duties do not extend between the parties who are negotiating the contract. Instead, the duty is owed to the Plan and its beneficiaries, who are absent and vulnerable.

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[3] The typical arm’s length transaction involves an adversarial negotiation in which the parties have independent interests and each tries to obtain the best deal for itself. See, e.g., Black’s Law 6th Ed., 109 (defining an arm’s length transaction as “a transaction negotiated by unrelated parties, each acting in his or her own self interest . . . . A transaction in good faith in the ordinary course of business by parties with independent interests”); 30 C.F.R. 206.151 (defining arm’s length contract in the minerals context as an agreement between “independent persons who are not affiliates and who have opposing economic interests regarding that contract”); A.T. Kearney, Inc. v. Int’l Bus. Machines Corp., 73 F. 3d 238, 242 (9th Cir. 1995)(contrasting relationships with a special duty of care to relationships involving “two adversarial parties negotiating at arm’s length to further their own economic interests,” “business adversaries in the commercial sense”); In re U.S. Med., Inc., 531 F.3d 1272, 1277 n.4 (10th Cir. 2008)(quoting Black’s Law Dictionary 109, 6th Ed. 1990)(in the bankruptcy context, “[a]n arm's-length transaction is ‘[a] transaction in good faith in the ordinary course of business by parties with independent interests.... The standard under which unrelated parties, each acting in his or her own best interest, would carry out a particular transaction”); Estate of Waters v. C.I.R., 48 F.3d 838, 849 (in the tax context, a negotiation that was adversarial in nature constituted a “bona fide arm’s length transaction”); Jeanes Hosp. v. Sec’y of Health and Human Servs., 448 Fed. Appx. 202, 206 (3rd Cir. 2011)(a party who “negotiated rigorously, selfishly and with an adequate concern for price,” and “conducted lengthy due diligence” and “extracted concessions” meant that the “merger bore the hallmark characteristics of arm’s-length bargaining”); and Oxford English Dictionary, Dec. 2012, arm, n.1(“The parties must be put so much at arm’s length that they stand in adverse relations of vendor and purchaser.”[1879]).

Additionally, the absent party will not only benefit from but will bear a burden under the contract. It appears to the court that TLIC and the employer are not bargaining for TLIC to provide services and for the employer to pay a fee, but instead for TLIC to provide services and for a fee to be assessed on the employees' retirement accounts. If this is true, it is not a traditional arm's length negotiation where the parties are adverse and pursuing independent interests; instead, the parties are collaborating to manage the employees' 401(k) plans.

One example of the non-adversarial nature of these negotiations is TLIC's Fiduciary Warranty. (See Compl. ¶¶ 157-59.) Based on the allegations before the court, it appears that the Fiduciary Warranty amounts to insurance provided by TLIC to employers against law suits by employees for breach of fiduciary duty, but this insurance is paid for by the fees assessed on the employees' assets. The court has found no indication that the employers pay TLIC separately for such insurance. Thus, instead of an insurance company bargaining with a party seeking to obtain the best rate for itself in its insurance purchase, the insurer is bargaining with a party who is not in fact bearing the financial burden of the insurance, though it will reap the benefits.

Because the contract does not appear to have been negotiated at arm's length, TLIC may not shield itself behind the contract from an alleged breach of duty.

4. TLIC's Discretion

a. Discretion over Fees

As a separate basis for TLIC's fiduciary duty, Plaintiffs allege that TLIC has sufficient discretion over its own compensation to make TLIC a fiduciary on that basis. “When a contract . . . grants an insurer discretionary authority, even though the contract itself is the product of an arm’s length bargain, the insurer may be a fiduciary.” Ed Miniat, Inc., 805 F.2d at 737. Plaintiffs allege that TLIC has discretion over its fees because it retains the right to modify those fees with 30-days' notice to the plan and by assessing termination fees. (Hatton Decl. Exh. D-1, Section B.08; Exh. E, Section B.08) ("We reserve the right to change the Investment Management or the Administrative Charge upon advance written notice to the Contractholder of at least 30 days."). Plaintiffs also point to contract termination and participant level redemption fees. (Opp. at 22; Hatton Decl., Exhs. D-1 & D-2, at Dkt. pp. 3337, 3344, 3393, 3408.)[4]

TLIC asserts that it has no discretion over the fees because employers have a 30-day period during which they can accept the fee change or reject it by terminating the contract. In making this argument, TLIC conflates an ability to change the fees with the consequences of changing the fees. TLIC could lower its fees at any time, without any approval apparently required from the employer. In such a scenario, TLIC has discretion over its fees because it has the power to modify them without approval; whether the employer chooses to terminate the contract or not is immaterial to determining whether TLIC has the discretion to change the fees.

The same logic applies to a scenario in which TLIC raises its fees. TLIC has discretion to modify its fees, and an employer has

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[4] Plaintiffs also note that a "confidential document shows applicable termination charges." (Opp. at 22 n.13.)

thirty days in which it can terminate the contract or not. The employer's decision regarding contract termination does not mean that TLIC lacks discretion over the fees.[5] This is all the more true where, as here, there are financial and logistical hurdles to prevent an employer from cancelling a contract. Thirty days is a brief period within which to secure a new service provider for an employer's ERISA plan and all it entails, including negotiating such a contract and ensuring that it allows the employer to comply with its obligations under ERISA.[6] Additionally, there appear to

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[5]TLIC contends that because it must give advance notice to the employer of the fee change and because the employer can terminate the contract, all discretion is vested exclusively with the employer. As a fiduciary, any employer would likely have the ability and indeed the duty to terminate the contract at any time if an investment administrator were to have the employees' funds in investments with excessive fees or later to transfer the funds to investments with excessive fees. This right exists regardless of any contract provision providing the same. Therefore, that the contract states that there is a "right" of termination is a slight reed from which to build the argument that it is the employer—not TLIC-that has discretion over fees.

[6] Defendants point to a Department of Labor ("DOL") advisory opinion which advised that 60 day notice period followed by a 120-day period following notice within which to reject the change to investment options and secure a new service provider meant that the original service provider was not "exercising discretionary authority or control over the management of a plan." Dep't of Labor, Advisory Op. 97-16A, 1997 WL 277979 *4 (May 22, 1997). The notice period at issue here is half as long. The DOL advisory opinion notes that the acceptable notice period is context specific, and that a period of fewer than 120 days might be sufficient in some contexts. Id. at *5 n.5("What constitutes a 'reasonable period' within which to terminate an arrangement and change service providers will depend on the particular facts and circumstances of each case. There **may** be situations in which a time period shorter than 120 days **may** constitute a 'reasonable period.'")(emphasis in original). A district court in Massachusetts found that a three months' notice requirement still gave an insurance company enough discretion to be considered an ERISA fiduciary. Charters v. John Hancock Life Ins. Co., 583 F. Supp. 2d 189, 198 (D.Mass. 2008). The court makes no holding on what an adequate notice period would be in this context, but finds only that based on the facts alleged, TLIC's contractually explicit (continued...)

be termination fees associated with terminating the contract, even if the termination is a consequence of increased fees. (See, e.g., Hatton Decl., Exh. D-2, Amendment to Contract, Dkt. p. 3392) ("Transamerica reserves the right to: . . . Assess[] a transfer fee or redemption fee for a particular Contract Account.").

The court rejects TLIC's claim that the notice period gave final authority over the fees to the employer. "[I]t is undisputed that [the service provider] retained sole discretion to change the maximum administrative maintenance charge at any time upon three-months prior written notice to [the employer]. That discretion was sufficient to make [the service provider] an ERISA fiduciary with respect to its fees." Charters v. John Hancock Life Ins. Co., 583 F. Supp. 2d 189, 197-198 (D.Mass. 2008)

Based on the facts before it, the court finds that the notice period provided here to employers does not relieve TLIC of discretion over the fees.

b. Control over investment line-up

Plaintiffs allege that TLIC has discretionary control over its fees for the additional reason that TLIC "retains the authority to unilaterally add and delete investment options at its discretion" and to "unilaterally change the share class [] of the mutual fund, in which Plaintiffs' assets are invested," thereby altering its own compensation. (Compl. ¶¶ 152-54.) TLIC contends that the ability to add or delete investment options does not give it discretion that would qualify it as an ERISA fiduciary with

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[6](...continued) discretion to change fees is not reversed by the brief notice period, all the more so when there also appears to be a termination fee.

respect to the fees for the same reasons that it asserts it does not have discretion over the Administrative and Investment Management Fees: because Plaintiffs do not allege that TLIC ever exercised its authority to change investment options, and because TLIC must give advance notice of the change.

The court finds that TLIC has a fiduciary duty that attaches from its power to add and delete investment options, such that it "exercises authority or control over plan assets by determining and altering which mutual funds are available for the Plans' and the participants' investment." Haddock v. Nationwide Fin. Servs. Inc., 419 F. Supp. 2d 156, 166 (D.Conn. 2006). The Department of Labor ("DOL") has taken the position that when the service provider gives an employer advance notice of a deletion or substitution and 120 days to reject the change and secure a new service provider, "a person would not be exercising discretionary authority or control over the management of a plan or its assets solely as a result of deleting or substituting a fund from a program of investment options and services offered to plans, provided that the appropriate plan fiduciary in fact makes the decision to accept or reject the change." Dep't of Labor, Advisory Op. 97-16A, 1997 WL 277979 *5.[7] The crucial feature barring a finding of discretion is thus the approval of such a change by a fiduciary.

The facts alleged by Plaintiffs are sufficient to state a claim for TLIC's fiduciary responsibility on this theory. Unlike

[7]The DOL has also offered the opinion that reserving the right to "add or remove mutual fund families . . . [made] available to Plans" could be considered discretionary authority such that receiving fees from those mutual funds would be subject to restrictions on fiduciaries. Dep't of Labor Advisory Op. 97-15A, 1997 WL 277980 *3.

in Hecker, where the complaint alleged that the service provider "played a role" in the choice of funds rather than exercising "final authority," Hecker, 556 F.3d at 584, here there is no indication that an employer has final authority over such changes beyond its ability to terminate the contract.[8] As discussed above, an employer's ability to terminate a contract if it does not approve of a unilateral decision to substitute or delete options does not somehow transform TLIC's decision into the employer's decision.[9]

c. Exercise or possession of discretion

TLIC argues that even if it is found to have discretionary authority over its fees and the investment line-up, it has not exercised such discretion and is therefore not a fiduciary. TLIC points out that under the ERISA statute, an entity is a fiduciary if it "exercises any discretionary authority or discretionary control respecting management of such plan or exercises any authority or control respecting management or disposition of its

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[8] Again, TLIC conflates its discretion to do an act, i.e., its election to switch to investment options with allegedly excessive fees, with the employer's possible remedy in terminating the contract. It also appears to assume again that the employer has the right to terminate the contract only because the contract so specified. But the employer may have both the right and the obligation to terminate the contract if employees' investments were placed in or moved into investment accounts with excessive fees, regardless of the terms of the contract with TLIC.

[9] TLIC contends that "Negotiated termination fees are just a mechanism for service providers to ensure reasonable compensation, including the recovery of initial costs in the event of an early termination. The mere fact that termination would entail costs or inconvenience does not give a service provider control over the sponsor's decisions." (TLIC Reply at 8-9.) The service provider need not have "control" over a sponsor's decision to make termination an unrealistic option for the sponsor. A termination fee may be so burdensome that it alone could stop a sponsor from terminating a plan.

assets," or to the extent it "has any discretionary authority or discretionary responsibility in the administration of such plan." 29 U.S.C. § 1002(21)(A)(emphasis added). TLIC asserts that Plaintiffs have alleged that TLIC possesses, but not that it has exercised, discretionary authority with respect to the management or disposition of assets. Merely having such authority, TLIC argues, is insufficient to create fiduciary duty under the relevant clause of the statute.

Plaintiffs respond that while they did not allege in the Complaint that TLIC exercised its authority,[9] TLIC's conduct "should be measured by what it did or failed to do. A fiduciary has affirmative obligations to conduct itself prudently. . . . [Fiduciary duties] entail obligations to end conduct that may be self dealing or imprudent." (Opp. at 24, emphasis omitted.) Plaintiffs appear to be saying that TLIC is "exercising" its discretionary authority by not altering its fees when it should, as required by its fiduciary duty.

There is a fine line between "having" and "exercising" discretionary authority. Discretionary authority is premised on a power or a capacity. See Nat'l Ass'n of Home Builders v. Defenders of Wildlife, 551 U.S. 644, 668 (2007)(quoting Random House Dictionary of the English Language 411 (unabridged ed. 1967) ("'discretion' defined as 'the power or right to decide or act according to one's own judgment; freedom of judgment or choice'")). Discretion is the touchstone of fiduciary duty under ERISA because

[9] Plaintiffs assert that they have "uncovered evidence that TLIC altered its fees" and that "[d]iscovery will likely reveal other similar instances," but they do not claim to have pled altered fees. (Opp. at 24.)

it is precisely this power of free decision that is transferred in trust to a fiduciary. The power of free decision comprises not only the power to act but the power not to act. A person without discretionary authority has no choice with respect to acting or not acting; she is required either to act or to refrain from acting, depending on the circumstances. A person with discretionary authority, in contrast, may act or not act, as she deems best. But she exercises her discretion no less in choosing not to act than in choosing to act.

TLIC's assertion that "a party is only a fiduciary with respect to the management of a plan or the disposition of its assets when it ***exercises*** authority or control over the plan," in contrast to "plan administration, as to which a party only needs to ***have*** discretionary authority" makes little sense. (TLIC Reply at 10, emphasis in brief.) TLIC does not explain how a party can exercise authority over the plan without having such authority, the rationale behind such a distinction, or its implications, nor does it cite any authority for such an interpretation. Such an interpretation contravenes Congress's directive to construe fiduciary duty broadly in order to effect the remedial purposes of ERISA. See Varity, 516 U.S. at 497. The court therefore finds that in the ERISA context, having and exercising discretionary authority are so close as to be identical, and that under ERISA, a fiduciary duty attaches not because a party takes a discretionary action but when that party acquires the power to take a discretionary action.

5. Plaintiffs' Fiduciary Duty Claims

Because the court finds that Plaintiffs have stated a claim for TLIC's fiduciary status, all of Plaintiffs' allegations that

TLIC violated its fiduciary duty under ERISA must survive TLIC's Motion to Dismiss.[10]

Mutual Fund Excessive Fee Claims (Counts I and II):Plaintiffs allege that because TLIC has a fiduciary duty with respect to its fees, the fees it charges in excess of the fees charged by an underlying mutual fund are excessive. Likewise, they allege that TLIC's investment management fees on separate accounts are also excessive. Since Plaintiffs have stated a claim for TLIC's fiduciary status with respect to its fees, these claims survive.

Revenue Sharing Claim (Count III): Plaintiffs allege that TLIC receives "fee income" or "Revenue Sharing Payments" from Plaintiffs' investments, ranging from 15 to 25 bps. (Compl. ¶¶ 281, 283-84.) They allege that even if TLIC uses those Revenue Sharing Payments to offset the Investment Management and Administrative Charges, as TLIC claims it does, those payments are still impermissible because they are only offsetting TLIC's excessive fees, themselves impermissible. (Id. ¶¶ 288-91.)

Because the court has already found that Plaintiffs have stated a claim that TLIC is a fiduciary with respect to its fees, Plaintiffs have also stated a claim with respect to the Revenue Sharing Payments. Offsetting impermissible fees may not be a permissible use of Revenue Sharing Payments. Plaintiffs have thus stated a claim for breach of fiduciary duty and the commission of prohibited transactions with respect to these Payments.

Mutual Fund Share Class Claim (Count V) and Collective Trust/Separate Account Excessive Fee Claim (Count VI): In Count V,

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[10] Plaintiffs's claims against TIM and TAM are discussed below.

Plaintiffs allege that TLIC breached its ERISA fiduciary duties by failing to invest in the lowest cost share class of the mutual funds underlying separate account investment options, even though TLIC had the leverage to do so. (Compl. ¶¶ 302-19.) In Count VI, Plaintiffs allege that TLIC failed to use its economic leverage to negotiate lower fees for collective trusts and traditional separate accounts. (Id. ¶¶ 320-337.) Because Plaintiffs have stated a claim that TLIC is a fiduciary with respect to its fees, the fact that the employer has approved the inclusion of a particular mutual fund or the expenses of a collective trust or separate account will not get TLIC off the hook if, as a fiduciary, TLIC should have selected the cheapest share class or negotiated lower fees. Plaintiffs have thus stated a claim on these two counts.

6. Prohibited Transaction and Affiliate Claims (Counts IV and VII)

a. Claims against TLIC

ERISA's prohibited transactions rule provides that "[a] fiduciary with respect to a plan shall not – (1) deal with assets of the plan in his own interest or for his own account, . . . 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." 29 U.S.C. § 1106(b). The legislative history of ERISA demonstrates 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." Mass. Mut. Life Ins. Co. v. Russell, 473 U.S. 134, 140 n.8 (1985).

Plaintiffs allege that TLIC committed prohibited transactions under ERISA § 406(b), 29 U.S.C. § 1132(a)(3), by paying advisory fees from employees' accounts to affiliates TIM and TAM for advising or subadvising certain mutual funds, collective investment trusts, or traditional separate accounts. (Compl., Counts IV and VII.) These fees, allege Plaintiffs, were an instance of TLIC dealing with assets of the Plaintiff Plans for its own interest, because TIM and TAM were its affiliates. (Compl., Count IV, ¶ 4.) Additionally, Plaintiffs allege that TIM and TAM violated ERISA § 502(a)(3), 29 U.S.C. § 1132(a)(3), for knowingly participating in those prohibited transactions. (Compl., Count IV, ¶ 8.)

TLIC asserts that these claims fail because Plaintiffs do not identify any specific "transaction" that would trigger liability under ERISA § 406. TLIC points to <u>Wright v. Oregon Metallurgical Corp.</u>, where the Ninth Circuit found that the Corporation's decision to continue to hold a certain percentage of plan assets in employer stock was not a transaction because it was not "akin to a 'sale, exchange, or leasing of property, or the lending of money or extension of credit,' all commercial bargains defined by the Supreme Court in <u>Lockheed</u> as falling under § 1106." 360 F.3d 1090, 1101 (9th Cir. 2004), quoting <u>Lockheed Corp. v. Spink</u>, 517 U.S. 882, 893 (1996)(alterations omitted). Here, TLIC argues, the only "transaction" involving Plan assets identified in the Complaint is the selection of the original Plan investment lineup. TLIC also argues that even if collecting fees from separate accounts can be considered a transaction, doing so is not a prohibited transaction, since TLIC was "merely collecting fees from transactions that a different, independent fiduciary caused the plan to undertake." (TLIC Reply at 15.)

The court finds that Plaintiffs have stated a claim for prohibited transactions in the form of collecting fees from separate accounts and selecting the investment lineup. As discussed above, TLIC may not insulate itself from its fiduciary obligations by invoking the terms of its contract with the employers; TLIC cannot by contract permit itself transactions that would otherwise be prohibited to it as a fiduciary. Here, the employer-fiduciaries did approve the selection of TIM- and TAM-managed accounts by selecting them for the line-ups offered to the employees. Nonetheless, mere approval by another fiduciary does not relieve TLIC of potential responsibility for fees being paid to TLIC affiliates. For instance, Plaintiffs may be able to show that TLIC used the promise of the fiduciary warranty to direct employers to select TIM- and TAM-managed accounts. "[B]ecause the authority, control or responsibility which makes a person a fiduciary may be exercised 'in effect' as well as in form, mere approval of the transaction by a second fiduciary does not mean that the first fiduciary has not used any of the authority, control or responsibility which makes such person a fiduciary to cause the plan to pay the first fiduciary an additional fee for a service." 29 CFR § 2550.408b-2(e)(2).

The court finds that Plaintiffs have stated a claim for prohibited transactions by TLIC.

b. Claims against TIM and TAM

"Section 502(a)(3) authorizes a civil action: 'by a participant, beneficiary, or fiduciary (A) to enjoin any act or practice which violates . . . the terms of the plan, or (B) to obtain other appropriate equitable relief (i) to redress such violations or (ii) to enforce any such provisions of . . . the terms of the plan.'" Great-West Life & Annuity Ins. Co. v. Knudson, 534 U.S. 204, 209 (2002)(quoting 29 U.S.C. § 1132(a)(3)). "'[E]quitable relief' in § 502(a)(3) must refer to those categories of relief that were typically available in equity." Id. at 210 (citation and internal quotation marks omitted). Here, the relief requested from TIM and TAM is restitution. Restitution may be either a legal or an equitable remedy, depending on the circumstances. "[R]estitution is a legal remedy when ordered in a case at law and an equitable remedy when ordered in an equity case, and whether it is legal or equitable depends on the basis for the plaintiff's claim and the nature of the underlying remedies sought." Id. at 213 (alterations, citation, and internal quotation marks omitted). "[F]or restitution to lie in equity, the action generally must seek not to impose personal liability on the defendant, but to restore to the plaintiff particular funds or property in the defendant's possession." Id. at 214 (footnote omitted).[11] More specifically, restitution in equity is possible "where money or property identified as belonging in good conscience to the plaintiff could clearly be traced to particular funds or property in the defendant's possession." Id. at 213.

TIM and TAM argue that Plaintiffs are "not seeking recovery of specific funds in Defendants' possession that properly belong to the Plan" but "are instead seeking broad recovery of the fees"

[11]A remedy was considered to be restitution at law when a plaintiff "sought to obtain a judgment imposing a merely personal liability upon the defendant to pay a sum of money," in what was essentially a breach of contract claim. Great-West Life, 534 U.S. at 213 (citation and internal quotation marks omitted).

received by TIM and Tam. (TIM/TAM Mot. at 4.) These fees are not traceable, assert TIM and TAM, because the fees TIM and TAM received were paid out of the mutual funds, which are not considered plan assets under ERISA § 401(b)(1), 29 U.S.C. § 1101(b)(1). Under ERISA § 401(b)(1), "[i]n the case of a plan which invests in any security issued by an investment company registered under the Investment Company Act of 1940 [15 U.S.C.A. § 80a-1 et seq.][indicating a mutual fund], the assets of such plan shall be deemed to include such security but shall not, solely by reason of such investment, be deemed to include any assets of such investment company." 29 U.S.C.A. § 1101. According to the Seventh Circuit, "[o]nce the fees are collected from the mutual fund's assets and transferred to one of the Fidelity entities, they become Fidelity's assets – again, not the assets of the Plans." Hecker, 556 F.3d at 584.

Even if this is correct, it is not clear how it defeats the traceability of the fees. Plaintiffs allege that TIM and TAM knowingly participated in TLIC's alleged self-dealing by withdrawing fees from the mutual fund or collective trust accounts into which TLIC's separate accounts invested Plaintiffs' retirement funds. The fees are allegedly in the current possession of TIM, TAM, or their successors. The fees assessed appear to be a percentage of the mutual fund's value. It does not appear to be difficult to determine the fees assessed by and in the possession of TIM and TAM with respect to each Plaintiff's account.[11]

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[11] In Hecker, the court found that assessing fees on mutual funds could not be the source of fiduciary status because the mutual fund is not itself a plan asset. 556 F.3d at 584. Without (continued...)

B. Investment Advisers Act Claims

In Counts VIII and IX, Plaintiffs make claims against TLIC for violation of the Investment Advisers Act ("IAA"), which requires investment advisers to register with the Securities and Exchange Commission ("SEC"). IAA § 215(b), 15 U.S.C. § 80b-15(b), voids investment advisory contracts entered into by unregistered investment advisors and permits investors to bring actions for equitable relief. Transamerica Mortg. Advisors, Inc. (TAMA) v. Lewis, 444 U.S. 11, 18-19 (1979). "[T]here exists a limited private remedy under the Investment Advisers Act of 1940 to void an investment advisers contract, but . . . the Act confers no other private causes of action, legal or equitable." Id. at 24. Plaintiffs allege that TLIC entered into contracts with them pursuant to which TLIC rendered investment advice to them without registering with the SEC. (Compl. ¶ 38 and Count VIII, ¶ 10.) Plaintiffs seek to void the advisory contracts and recover the "Investment Management Fees" paid by Plaintiffs.

TLIC argues that Plaintiffs were not party to the contract. The contract was with the Plan, and "[n]o new, individual contracts between TLIC and the participants were required or can be reasonably inferred." (TLIC Reply at 18.) Furthermore, they claim that the Investment Management Fees were paid not by Plaintiffs, as Plaintiffs allege, but instead by the Plan.

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[11](...continued)
such a rule, all mutual fund administrators (such as Fidelity) would automatically be fiduciaries when any retirement funds are invested into the mutual funds. Here, in contrast, the issue is whether the fees assessed by TIM and TAM are traceable, and the technical distinction between plan assets and mutual fund assets has no bearing on this inquiry.

The parties disagree on what, if anything, should be considered the investment advisory contract. TLIC maintains that the contract is the GAC, while Plaintiffs point to a functional contract that developed out of the economic relationship between Plaintiffs and TLIC. Plaintiffs argue that there was a functional contract between Plaintiffs and TLIC by analogy to the Securities Act. In that context, the Supreme Court construed the term "investment contract" broadly based on its use in state laws prior to the adoption of the statute: "Form was disregarded for substance and emphasis was placed upon economic reality. An investment contract thus came to mean a contract or scheme for the placing of capital or laying out of money in a way intended to secure income or profit from its employment." S.E.C. v. W.J. Howey Co., 328 U.S. 293, 298 (1946)(internal quotation marks omitted).

Using a similar functional analysis, Plaintiffs argue, there was a contract between TLIC and each Plaintiff when that Plaintiff purchased units in the separate account, paid an Investment Management Fee, and received investment advice from TLIC in the form of advisory fact sheets. (Opp. at 46.) Plaintiffs contend that the requirements of offer, acceptance, and consideration are all met in this case. The "offer" is made by TLIC "by providing each Plaintiff with a personal electronic account and a menu of pre-selected investment options which a Plaintiff may accept," the "acceptance" by Plaintiff selecting an investment online or by mail, and "consideration" from Plaintiffs in the form of investment and management fees, and from TLIC by its "culling and analysis of available investments." (Opp. at 48.)

The court does not disagree that there could be a functional investment advice contract between Plaintiffs and TLIC even if the fees paid technically came from Plan assets rather than from a check written by each Plaintiff to TLIC; the temporary placement of the money into a Plan account does not alter the economic reality that the fees are coming out of each Plaintiff's retirement fund. However, here there is already a contract in place – the GAC – which governs the same relationship. TLIC points out that the website, which Plaintiffs construe as part of the "offer," is part of a prior separate services agreement between TLIC and the Plan which requires TLIC to provide a website allowing employees to manage their accounts. (Hatton Decl., Exh. C, Dkt. p. 3297; TLIC Reply at 18 n.11.) There is no indication that the consideration in the GAC is different from the consideration in the purported functional contract (the fees assessed by TLIC on the separate accounts and the investment services and advice provided by TLIC). Plaintiffs appear to suggest that the Investment Management Fee was not consideration for the GAC, but in that case, it is unclear what the consideration for the GAC was. Plaintiffs do not appear to be arguing that the GAC is invalid, but instead that it exists alongside a functional contract between Plaintiffs and TLIC. However, all the relevant components of a functional contract appear already to be governed by the GAC.

It is a principle of contract law that "[t]here cannot be a valid, express contract and an implied contract, each embracing the same subject matter, existing at the same time." <u>Berkla v. Corel Corp.</u>, 302 F.3d 909, 918 (9th Cir. 2002) (internal quotation marks and citation omitted). <u>See also</u> <u>Rogers v. American President</u>

Lines, Limited, 291 F.2d 740, 742 (9th Cir. 1961)("An action does not lie on an implied contract where there exists between the parties a valid express contract which covers the same subject matter.") The same principle applies in this context. This is for both conceptual and practical reasons. Conceptually, if a party is already contractually obliged to perform a certain action, that action cannot be consideration for a separate contract. Practically, rescinding an implied (or functional) contract will have no effect on the express contract. Here, Plaintiffs wish to rescind the functional contract for investment advice between themselves and TLIC. Even if they were successful in doing so, the GAC would still exist and put them back in the same position. Plaintiffs do not appear to argue that they are parties to the GAC, which is the express contract that could be rescinded, nor do they argue that as beneficiaries they may rescind that contract.

Plaintiffs argue that even if they are not a party to an investment management contract with TLIC they are still entitled to restitution under a theory of unjust enrichment, which does not require an actual contract. The court does not disagree with this, but finds that the GAC is once again a barrier to recovery under the IAA. "[U]njust enrichment is an action in quasi-contract, which does not lie when an enforceable, binding agreement exists defining the rights of the parties." Paracor Finance, Inc. v. General Elec. Capital Corp., 96 F.3d 1151, 1167 (9th Cir. 1996). Since the content of the GAC and the content of the quasi-contract claimed by Plaintiffs appear to be identical, Plaintiffs can have no claim for unjust enrichment.

Plaintiffs have failed to state a claim for violation of the IAA.

IV. CONCLUSION

For these reasons, Defendant TLIC's Motion to Dismiss is DENIED with respect to the ERISA claims (Counts I, II, III, IV, V, VI, VII) and GRANTED with respect to the IAA claims (Counts VIII and IX). Defendants TIM and TAM's Motion to Dismiss is DENIED.

IT IS SO ORDERED.

Dated: February 19, 2013

DEAN D. PREGERSON
United States District Judge