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UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF CALIFORNIA

ARMANDO ZAVALA,

Plaintiff,

v.

KRUSE-WESTERN, INC., et al.,

Defendants.

No. 1:19-cv-00239-DAD-SKO

ORDER GRANTING IN PART AND
DENYING IN PART DEFENDANTS’
MOTIONS TO DISMISS

(Doc. Nos. 38, 46)

This matter is before the court on the separate motions brought on behalf of defendant Kevin Kruse and defendants the Kruse-Western, Inc. Board of Directors and Administration Committee (collectively, “defendants”), filed on August 30, 2019 and September 24, 2019, to dismiss plaintiff’s first amended complaint.¹ (Doc. Nos. 38-1, 46-1.)

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¹ The undersigned apologizes to the parties for the excessive delay in the issuance of this order. This court’s overwhelming caseload has been well publicized and the long-standing lack of judicial resources in this district long-ago reached crisis proportion. That situation, which has continued unabated for twenty-two months now, has left the undersigned presiding over approximately 1,300 civil cases and criminal matters involving 732 defendants at last count. Unfortunately, that situation sometimes results in the court not being able to issue orders in submitted civil matters within an acceptable period of time. This situation is frustrating to the court, which fully realizes how incredibly frustrating it is to the parties and their counsel.

1 addition, the California Department of Food and Agriculture fined Western Milling \$726,000.00
2 and revoked their commercial feed license “for repeated and multiple violations.” (*Id.* at ¶ 35.)
3 Western Milling separately paid over \$2 million to settle claims brought by the owners of cattle
4 that consumed excessively high levels of monensin in 2014, including more than 850 cattle that
5 died as a result of consuming Western Milling feed.² (*Id.* at ¶ 36.)

6 In September 2016, an additional 87 calves died and others became sick after consuming
7 monensin-contaminated feed produced by Western Milling. (*Id.* at ¶ 37.) Western Milling
8 discontinued the manufacture of horse and specialty feeds at its Goshen, California plant and
9 contracted out the manufacture of its horse feed. (*Id.* at ¶ 39.) Western Milling subsequently
10 spent approximately \$5.5 million to construct a new horse feed manufacturing plant separate from
11 its cattle feed plant. (*Id.*) In addition to the liabilities noted above, Western Milling and its
12 operating companies faced significant liability due to wage and hour violations at its California
13 facilities. (*Id.* at ¶ 41.)

14 According to the Articles of Incorporation obtained from the California Secretary of State,
15 Kruse-Western was incorporated on September 11, 2015. (*Id.* at ¶ 42.) Kruse-Western, in turn,
16 operates various companies including Western Milling, OHK Transport LLC, OHK Logistics,
17 LLC, and Winema Elevators, LLC. (*Id.* at ¶ 26.) The ESOP, created on November 4, 2015, is a
18 pension plan under the Employee Retirement Income Security Act (“ERISA”) that is primarily
19 invested in the stock of Kruse-Western. (*Id.* at ¶¶ 1–2, 44.) On the same day the ESOP was
20 created, GreatBanc Trust Company (“GreatBanc”) caused the ESOP to purchase 100 percent of
21 the outstanding shares of Kruse-Western stock. (*Id.* at ¶ 57.) GreatBanc was appointed trustee of
22 the ESOP by defendant Kruse-Western Board of Directors, including defendant Kruse and
23 defendants John and Jane Doe 10–20, the individual members of Board of Directors (the “Board
24 defendants”). (*Id.* at ¶¶ 15, 17.) The Board defendants also appointed the members of the
25 Administration Committee (“Administration Committee” or “Administrator”) as the designated
26

27 ² The undersigned has previously addressed these facts in the context of an insurance dispute.
28 See generally *Praetorian Ins. v. W. Milling, LLC*, No. 1:15-cv-00557-DAD-EPG, 2017 WL
4284717 (E.D. Cal. Sept. 27, 2017).

1 plan administrator of the ESOP. (*Id.* at ¶¶ 18, 21.) The ESOP purchased the outstanding shares
2 from defendant Kruse and John and Jane Doe 20–30 (the “selling shareholders”), which the
3 ESOP financed by borrowing the entire purchase price of \$244 million from Kruse-Western. (*Id.*
4 at ¶¶ 24, 57.) Kruse-Western, in turn, borrowed the \$244 million from the selling shareholders.
5 (*Id.* at ¶ 57.) The ESOP’s purchase of the Kruse-Western shares occurred on November 4, 2015,
6 after the illnesses and deaths of horses in Clovis, California due to monensin poisoning from
7 Western Blend Horse Feed and the recall of the Western Blend Horse Feed in September 2015,
8 but before the filing of the 2016 lawsuit, fines being imposed by the Department of Agriculture,
9 and additional cases of monensin poisoning coming to light. (*Id.* at ¶¶ 1–2, 31–37, 44.)

10 Less than two months after the ESOP’s purchase of those shares, on December 31, 2015,
11 the value of Kruse-Western had dropped dramatically to \$26.6 million. (*Id.* at ¶ 63.)
12 Subsequently, Kruse-Western was converted to an “S” corporation on January 1, 2016. (*Id.* at
13 ¶ 43.) By the end of 2016, that value had fallen still further to \$24.8 million. (*Id.* at ¶ 64.) By the
14 end of 2017, the value had recovered only marginally to \$27.4 million. (*Id.* at ¶ 65.) Thus, as of
15 December 31, 2017, the ESOP had purchased Kruse-Western’s outstanding stock for almost ten
16 times its actual value.

17 In his FAC plaintiff alleges that the sale to the ESOP did not adequately reflect the future
18 revenue and earnings of Kruse Western given the recurring monensin contamination of Western
19 Milling’s animal feed, nor did it reflect Kruse-Western’s potential liability for its wage and hour
20 law violations. (*Id.* at ¶¶ 69, 72.) It is also alleged that defendant Kruse, the members of the
21 Administration Committee, and the Board defendants knew of these problems at the time of the
22 sale, but the financial projections used to value Kruse-Western’s stock for purposes of the sale did
23 not account for them. (*Id.* at ¶¶ 56, 70, 71.)

24 **B. Procedural Background**

25 On February 19, 2019, plaintiff filed this action against defendants Kruse-Western, Inc.,
26 Kevin Kruse, GreatBanc Trust Company, and Does 1 through 30, inclusive. (Doc. No. 1.) On
27 July 26, 2019, following briefing and oral argument by the parties, this court issued an order
28 granting in part defendants’ prior motion to dismiss filed on April 15, 2019. (Doc. Nos. 17, 31.)

1 Pursuant to that order, this court dismissed plaintiff’s first cause of action as to the selling
2 shareholder defendants, including defendant Kruse, and dismissed plaintiff’s second cause of
3 action for in its entirety. (Doc. No. 31 at 17–18.)

4 On August 16, 2019, plaintiff filed his FAC, in which he added the Kruse-Western Board
5 of Directors and the Administration Committee as defendants, and removed Kruse-Western, Inc.
6 as a defendant. (See Doc. No. 34 at ¶¶ 13–16, 21–24.) In his FAC, plaintiff asserts five claims
7 against defendants under the Employee Retirement Income Security Act (“ERISA”) related to the
8 defendants’ management and administration of the Western Milling Employee Stock Ownership
9 Plan (the “ESOP”). (*Id.* at 17–25.) Count one alleges a violation of 29 U.S.C. § 1106(a) against
10 the selling shareholders defendants, defendant Kruse, and defendant GreatBanc, alleging that they
11 engaged in a transaction prohibited by ERISA. (*Id.* at ¶¶ 98–109.) Count two alleges a violation
12 of 29 U.S.C. § 1106(b) against the Administration Committee defendants who sold Kruse-
13 Western stock to the ESOP, and also asserts that these individuals engaged in a transaction
14 prohibited by ERISA. (*Id.* at ¶¶ 110–20.) Count three alleges that defendant GreatBanc violated
15 29 U.S.C. § 1104(a)(1)(A) and (B) by breaching its fiduciary duties to the ESOP. (*Id.* at ¶¶ 121–
16 131.) Count four alleges that the Board defendants and defendant Kruse violated 29 U.S.C.
17 § 1104(a)(1)(A) and (B) by failing to monitor GreatBanc and ensure that the ESOP paid no more
18 than fair market value for the Kruse-Western stock. (*Id.* at ¶¶ 132–38.) Count five alleges a
19 claim for co-fiduciary liability in violation of 29 U.S.C. §§ 1105(a)(1), (a)(3) against defendants
20 Kruse, the Administration Committee, the Board of Directors, and the selling shareholders. (*Id.*
21 at ¶¶ 139–57.)

22 On August 30, 2019, defendant Kruse moved to dismiss the FAC as to the three claims
23 brought against him. (Doc. No. 38.) On September 24, 2019, the Board defendants and the
24 Administration Committee moved to dismiss counts two and five of the FAC. (Doc. No. 46.)
25 Plaintiff filed an opposition to both motions on October 15, 2019, and defendants filed a joint
26 reply thereto on October 22, 2019. (Doc. Nos. 49, 50.) On October 29, 2019, plaintiff filed a
27 request for the court to consider a surreply or, in the alternative, to strike arguments defendants

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1 had raised for the first time in their reply brief, and attached the surreply to the request. (Doc.
2 Nos. 51, 51-1.)

3 “While [a party] may not raise issues for the first time in her reply brief,” a court may
4 remedy the issue by permitting the opposing party to file a surreply to “allow all issues to be
5 determined on the merits.” *Garrett v. Astrue*, No. 1:08-cv-1626-DLB, 2009 WL 2905793, at *1
6 (E.D. Cal. Sept. 4, 2009) (citing *Indep. Towers of Washington v. Washington*, 350 F.3d 925, 929
7 (9th Cir.2003)). In the interests of justice and the efficient administration of justice, the court will
8 grant plaintiff’s request to consider its surreply addressing the arguments defendants asserted for
9 the first time in their reply brief.

10 LEGAL STANDARD

11 The purpose of a motion to dismiss pursuant to Rule 12(b)(6) is to test the legal
12 sufficiency of the complaint. *N. Star Int’l v. Ariz. Corp. Comm’n*, 720 F.2d 578, 581 (9th Cir.
13 1983); Fed. R. Civ. Pro. 12(b)(6). “Dismissal can be based on the lack of a cognizable legal
14 theory or the absence of sufficient facts alleged under a cognizable legal theory.” *Balistreri v.*
15 *Pacifica Police Dep’t*, 901 F.2d 696, 699 (9th Cir. 1990). A plaintiff is required to allege
16 “enough facts to state a claim to relief that is plausible on its face.” *Bell Atl. Corp. v. Twombly*,
17 550 U.S. 544, 570 (2007). “A claim has facial plausibility when the plaintiff pleads factual
18 content that allows the court to draw the reasonable inference that the defendant is liable for the
19 misconduct alleged.” *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009).

20 In determining whether a complaint states a claim upon which relief may be granted, the
21 court accepts as true the allegations in the complaint and construes the allegations in the light
22 most favorable to the plaintiff. *Hishon v. King & Spalding*, 467 U.S. 69, 73 (1984); *Love v.*
23 *United States*, 915 F.2d 1242, 1245 (9th Cir. 1989). However, the court need not assume the truth
24 of legal conclusions cast in the form of factual allegations. *U.S. ex rel. Chunie v. Ringrose*, 788
25 F.2d 638, 643 n.2 (9th Cir. 1986). While Rule 8(a) does not require detailed factual allegations,
26 “it demands more than an unadorned, the defendant-unlawfully-harmed-me accusation.” *Iqbal*,
27 556 U.S. at 678. A pleading is insufficient if it offers mere “labels and conclusions” or “a
28 formulaic recitation of the elements of a cause of action.” *Twombly*, 550 U.S. at 555; *see also*

1 *Iqbal*, 556 U.S. at 676 (“Threadbare recitals of the elements of a cause of action, supported by
2 mere conclusory statements, do not suffice.”). Moreover, it is inappropriate to assume that the
3 plaintiff “can prove facts which it has not alleged or that the defendants have violated the . . . laws
4 in ways that have not been alleged.” *Associated Gen. Contractors of Cal., Inc. v. Cal. State*
5 *Council of Carpenters*, 459 U.S. 519, 526 (1983).

6 ANALYSIS

7 Although defendant Kruse and the Board and Administration Committee defendants filed
8 separate motions to dismiss, all defendants contend that the allegations of plaintiff’s first
9 amended complaint are insufficient to state a plausible claim as to counts two and five. (Doc.
10 Nos. 38-1 at 8; 46-1 at 2, 5.) Defendant Kruse additionally asserts that count one is insufficiently
11 pleaded to state a plausible ERISA claim. (Doc. No. 38-1 at 4.) Each of these arguments is
12 addressed in turn below.

13 A. First Cause of Action

14 In his first cause of action plaintiff alleges that defendants selling shareholders, Kruse, and
15 GreatBanc engaged in a prohibited transaction in violation of 29 U.S.C. § 1106(a). Defendant
16 Kruse argues that this cause of action must be dismissed because, as was the case with plaintiff’s
17 original complaint, (1) it fails to assert that defendant Kruse and the selling shareholders were
18 fiduciaries to the ESOP; (2) it fails to identify specific, traceable funds as required to seek
19 equitable relief; and (3) the remedies sought in the amended complaint are legal in nature, not
20 equitable. (*Id.* at 4–7.)

21 The court first addresses whether plaintiff’s FAC contains allegations indicating that
22 defendants Kruse and the selling shareholders are themselves fiduciaries to the ESOP. (Doc. No.
23 38-1 at 5.) There are two types of fiduciaries under ERISA. *See Depot*, 915 F.3d at 653. First, a
24 party is considered a “named fiduciary” if they are designated as such “in the plan instrument.”
25 29 U.S.C. § 1102(a)(2); *Depot*, 915 F.3d at 653. The second type of fiduciary, commonly
26 referred to as a “functional fiduciary” (*Depot*, 915 F.3d at 653), is defined under ERISA as
27 follows:

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1 [A] person is a fiduciary with respect to a plan to the extent (i) he
2 exercises any discretionary authority or discretionary control
3 respecting management of such plan or exercises any authority or
4 control respecting management or disposition of its assets, (ii) he
5 renders investment advice for a fee or other compensation, direct or
6 indirect, with respect to any moneys or other property of such plan,
7 or has any authority or responsibility to do so, or (iii) he has any
8 discretionary authority or discretionary responsibility in the
9 administration of such plan.

10 29 U.S.C. § 1002(21)(A). Of particular relevance to this case, the Ninth Circuit has recognized
11 that under this definition of a fiduciary, “where members of an employer’s board of directors
12 have responsibility for the appointment and removal of ERISA trustees, those directors are
13 themselves subject to ERISA fiduciary duties, albeit only with respect to trustee selection and
14 retention.” *Johnson v. Couturier*, 572 F.3d 1067, 1076 (9th Cir. 2009). Thus, where a board
15 member is not a “named fiduciary,” that board member’s fiduciary duties under ERISA are
16 limited.

17 Here, plaintiff’s FAC alleges that “[a]s a result of his membership on the Board of
18 Directors, Mr. Kruse is and has been at all relevant times a fiduciary of the ESOP within the
19 meaning of ERISA § 3(21)(A), 29 U.S.C. § 1002(21), and a ‘party in interest’ as to the ESOP as
20 defined in ERISA § 3(14), 29 U.S.C. § 1002(14).” (FAC at ¶ 14.) Plaintiff’s counsel asserted at
21 oral argument on the pending motions that the FAC alleges the selling shareholders are both
22 named and functional fiduciaries to the ESOP. However, rather than alleging that the selling
23 shareholders are fiduciaries, the FAC—as in plaintiff’s original complaint—instead defines the
24 selling shareholders only as “parties in interest” within the meaning of 29 U.S.C. § 1002(14).
25 (FAC at ¶ 25.) The FAC does, however, allege that the Administration Committee itself is a
26 named fiduciary of the ESOP with authority over the management and disposition of the ESOP’s
27 assets. (FAC at ¶¶ 21, 55.) Plaintiff contends both that the Administration Committee and the
28 individual committee members were named fiduciaries, and that the Administration Committee
defendants are also functional fiduciaries because they “ha[ve] exercised ‘discretionary authority
and control’ over ESOP management[.]” (Doc. No. 49 at 14, 17–18.) By asserting that the
selling shareholders are “the persons serving on the Administration Committee of the ESOP” (the
“Administration Committee defendants”), plaintiff has sufficiently alleged that the

1 Administration Committee defendants are at least functional fiduciaries of the ESOP. The FAC
2 therefore contains sufficient allegations that defendant Kruse is a named fiduciary and the
3 Administration Committee defendants are functional fiduciaries of the ESOP with limited
4 fiduciary duties. *See Johnson*, 572 F.3d at 1076 (holding that where the board of directors of an
5 ERISA plan has limited control over the plan, its fiduciary duties are likewise limited).

6 As discussed in this court’s prior order, Title 29 U.S.C. § 1332(a)(3) provides “a cause of
7 action to remedy plan or ERISA violations—including prohibited interested-party transactions—
8 with ‘appropriate equitable relief.’” *Depot, Inc. v. Caring for Montanans, Inc.*, 915 F.3d 643, 653
9 (9th Cir. 2019), *cert. denied*, ___U.S.___, 140 S. Ct. 223 (2019). To state such a claim, however,
10 the complaint must contain allegations that the relief sought is equitable rather than legal. The
11 failure by a plaintiff to seek appropriate equitable relief therefore will warrant dismissal of such a
12 claim. *See id.* at 659 (“We conclude that the relief plaintiffs seek is not equitable and accordingly
13 affirm the district court’s dismissal of plaintiffs’ prohibited transaction claim.”). Thus, whether
14 plaintiff here has stated a cognizable cause of action against the selling defendants turns on
15 whether plaintiff’s operative complaint seeks equitable relief.

16 “[T]he term ‘equitable relief’ . . . is limited to ‘those categories of relief that were *typically*
17 available in equity’ during the days of the divided bench (meaning, the period before 1938 when
18 courts of law and equity were separate).” *Montanile v. Bd. of Trs.*, 577 U.S. 136, 142, (2016)
19 (quoting *Mertens v. Hewitt Assocs.*, 508 U.S. 248, 256 (1993)). The label a plaintiff attaches to a
20 particular form of relief is not dispositive; rather, whether a remedy is legal or equitable “depends
21 on the basis for the plaintiff’s claim and the nature of the underlying remedies sought.” *Sereboff*
22 *v. Mid Atl. Med. Servs., Inc.*, 547 U.S. 356, 363 (2006) (internal quotation marks and brackets
23 omitted); *see also Mathews v. Chevron Corp.*, 362 F.3d 1172, 1185 (9th Cir. 2004) (“In
24 determining whether an action for equitable relief is properly brought under ERISA, we look to
25 the substance of the remedy sought.”).

26 In the specific context of ERISA claims, whether the relief sought can be characterized as
27 legal or equitable turns on whether the money or property sought is “in the defendants’
28 possession.” *See Depot*, 915 F.3d at 661. To that end, the Ninth Circuit in *Depot* set forth three

1 methods by which a plaintiff could allege that the money or property is in the possession of
2 defendants and therefore state a claim under § 1132(a)(3). First, a plaintiff may “identif[y] a
3 specific fund to which they are entitled.” *Id.* at 662. Second, a complaint may allege “the
4 existence of a general account in which the ill-gotten funds . . . were commingled, such that the
5 product of those funds would be traceable.” *Id.* at 663. And third, a plaintiff may allege that
6 defendants’ account balance remained above the surcharge amounts for purposes of the “lowest
7 intermediate balance” theory.³ *Id.* The Ninth Circuit in *Depot* reasoned that absent such
8 allegations, “a judgment in plaintiffs’ favor would have no connection to any particular fund
9 whatsoever. Defendants would simply be required to pay a certain amount of money, and they
10 could satisfy that obligation by dipping into any pot they like.” *Id.* at 662 (internal quotation
11 marks omitted); *see also Montanile*, 136 S. Ct. at 658–59 (noting that “[e]quitable remedies are,
12 as a general rule, directed against some specific thing; they give or enforce a right to or over some
13 particular thing rather than a right to recover a sum of money generally out of the defendant’s
14 assets”) (internal quotation marks and ellipses omitted).

15 In this case plaintiff’s FAC sufficiently alleges that the money is in the possession of
16 defendants and therefore adequately states a claim under § 1132(a)(3). In this regard, the FAC
17 alleges that each of the selling shareholders, including defendant Kruse, “deposited his/her share
18 of the proceeds from the ESOP Transaction in his/her personal account and each such account
19 continues to exist in the possession of the Selling Shareholders” and that “the balance of each of
20 the personal accounts into which the ESOP Transaction proceeds were deposited have remained
21 above the amount of the total proceeds deposited therein.” (FAC at ¶¶ 59–60, 109.) Plaintiff

22 ³ The Ninth Circuit has explained this “lowest intermediate balance” theory as follows:

23
24 Where a wrongdoer mingles another’s money with his own, from
25 which commingled account withdrawals are from time to time made,
26 there is a presumption of law that the sums first withdrawn were
27 moneys of the tortfeasor. If the amount on deposit is depleted below
the amount of the trust, however, the amount withdrawn is treated as
lost, and subsequent deposits do not replenish the trust. Thus, the
beneficiary is entitled to the lowest intermediate balance between the
date of the commingling and the date of payment.

28 *In re R & T Roofing Structures & Commercial Framing, Inc.*, 887 F.2d 981, 987 (9th Cir. 1989).

1 seeks disgorgement “of any ill-gotten gains [defendants] received in connection with the ESOP
2 Transaction” that were allegedly “deposited in the personal accounts of the Selling Shareholders
3 and remain in their possession.” (*Id.* at ¶ 109.)

4 Defendant Kruse urges the court to find that these allegations are insufficient to “identify
5 a specific, traceable fund” and are thus insufficient to state a claim under *Depot*. (Doc. No. 38-1
6 at 6 n.4.) Citing to several district court decisions, defendant Kruse also argues that because
7 plaintiff’s allegations on this issue are made only on information and belief, plaintiff “lacks ‘a
8 good faith basis for his allegations[.]’” (*Id.* at 6.) Furthermore, in his reply brief, defendant
9 Kruse emphasizes that the FAC alleges the ESOP borrowed the entire amount needed to fund the
10 stock purchase price from Kruse-Western, “which, in turn, borrowed that amount from the Selling
11 Shareholders,” such that there now exists no specific, traceable fund in which the purchase price
12 of the Kruse-Western shares was deposited. (Doc. No. 50 at 5–6; FAC ¶¶ 57–58.) The court
13 finds these arguments unpersuasive.

14 As this court previously noted, the following information is likely to be unavailable to
15 plaintiff in the absence of discovery: the identity of a specific fund, whether particular assets
16 were commingled in a general account, and whether defendants’ account balances remained
17 above a specific dollar amount. (*See* Doc. No. 31 at 10 n.3.) Here, in accordance with the Ninth
18 Circuit’s decision in *Depot*, the FAC alleges that the money sought is contained in accounts in the
19 possession of the defendants. *See Depot*, 915 F.3d at 661. Although the FAC does allege that the
20 purchase price amount was borrowed by the ESOP from the selling shareholders through Kruse-
21 Western, it does not necessarily follow that the lending resulted in the selling shareholders
22 “receiv[ing] no cash” for the sale of their stock as defendant contends. (*See* Doc. No. 50 at 5–6;
23 FAC at ¶¶ 58–59.) There are no allegations that the only compensation that the selling
24 shareholders received were promissory notes or that each selling shareholder loaned the exact
25 value of the purchase price for their shares, as would be necessary for none of the selling
26 shareholders to have received money deposited into their accounts. Rather, the FAC explicitly
27 alleges that the proceeds of the sale were deposited into the selling shareholders’ individual
28 accounts. (FAC at ¶¶ 58–59, 109.)

1 Nor does defendant’s argument that pleading upon information and belief is insufficient to
2 state a claim entitle them to prevail on the pending motion to dismiss. “The *Twombly* plausibility
3 standard . . . does not prevent a plaintiff from pleading facts alleged upon information and belief
4 where the facts are peculiarly within the possession and control of the defendant or where the
5 belief is based on factual information that makes the inference of culpability plausible.” *Soo Park*
6 *v. Thompson*, 851 F.3d 910, 928 (9th Cir. 2017), *cert. denied*, ___U.S.___, 138 S. Ct. 642 (2018).
7 Here, the specific identity of defendants’ accounts and their account balances are “peculiarly
8 within the possession and control of the defendant[s]” and can likely be ascertained through
9 discovery. *Id.*

10 Defendant Kruse’s motion to dismiss plaintiff’s first cause of action will therefore be
11 denied.

12 **B. Second Cause of Action**

13 Plaintiff’s second cause of action, alleged under 29 U.S.C. § 1106(b), is brought against
14 all Administration Committee defendants who sold Kruse-Western stock to the ESOP. As with
15 his first cause of action, in the second cause of action plaintiff alleges a prohibited transaction in
16 violation of ERISA. Title 29 U.S.C. § 1106(b) contains various prohibitions on transactions
17 between a plan and a fiduciary of that plan, including transactions that involve acts of self-dealing
18 by the fiduciary. The parties agree that a cause of action alleging a violation of that provision
19 must allege that the defendants are themselves fiduciaries. They disagree, however, as to whether
20 the allegations of the first amended complaint plausibly allege that the Administration Committee
21 defendants are fiduciaries. (*See* Doc. Nos. 38-1 at 8; 46-1 at 2–3; 49 at 14.) Defendants also
22 assert that any allegation that the Administration Committee defendants sold Kruse-Western stock
23 to the ESOP at all is speculative, such that this cause of action must therefore be dismissed. (Doc.
24 No. 46-1 at 3.)

25 As discussed above, there are two types of fiduciaries under ERISA: named fiduciaries
26 designated as such in the plan instrument, and functional fiduciaries defined as follows:

27 [A] person is a fiduciary with respect to a plan to the extent (i) he
28 exercises any discretionary authority or discretionary control
respecting management of such plan or exercises any authority or

1 control respecting management or disposition of its assets, (ii) he
2 renders investment advice for a fee or other compensation, direct or
3 indirect, with respect to any moneys or other property of such plan,
4 or has any authority or responsibility to do so, or (iii) he has any
5 discretionary authority or discretionary responsibility in the
6 administration of such plan.

7 29 U.S.C. § 1002(21)(A); *see also* 29 U.S.C. § 1102(a)(2); *Depot*, 915 F.3d at 653. Thus, where
8 a board member is not a “named fiduciary,” and his or her discretionary authority or discretionary
9 control over the management of the plan is limited, that board member’s fiduciary duties under
10 ERISA are limited. *Johnson*, 572 F.3d at 1076.

11 Defendants argue that plaintiff has “failed to offer any factual allegations that demonstrate
12 that any [Administration Committee] member who sold stock was acting in the capacity of a
13 ‘functional fiduciary’ at the time” of the sale of shares to the ESOP. (Doc. Nos. 38-1 at 10; 46-1
14 at 3.) Defendants contend that in amending his complaint plaintiff merely substituted the
15 Administration Committee defendants in place of the Board defendants from plaintiff’s original
16 complaint, which was dismissed in this court’s prior order because the original complaint gave
17 “the reader no indication of what it is the Board defendants did that caused the transaction to
18 occur.” (Doc. Nos. 38-1 at 10; 46-1 at 4; 31 at 13.)

19 In his FAC plaintiff alleges that the Administration Committee itself is a named fiduciary
20 of the ESOP with authority over the management and disposition of the ESOP’s assets. (FAC at
21 ¶¶ 21, 55.) In opposing dismissal, plaintiff argues both that the Administration Committee and
22 the individual committee members were named fiduciaries and that the Administration
23 Committee defendants are also functional fiduciaries because they “ha[ve] exercised
24 ‘discretionary authority and control’ over ESOP management[.]” (Doc. No. 49 at 14, 17–18.)
25 Plaintiff contends that his second cause of action “plausibly pleads that the Selling Committee
26 Members had the power to direct GreatBanc in its decision-making for the ESOP” and
27 “effectively controlled the Trustee at all relevant times.” (*Id.* at 18–19.) Plaintiff asserts that the
28 Administration Committee defendants engaged in self-dealing in violation of 29 U.S.C. § 1106(b)
because they “us[ed] their discretion to provide themselves accelerated payments on the ESOP
Transaction debt.” (*Id.* at 19.)

1 In their reply, defendants contend for the first time that plaintiff’s second cause of action
2 should be dismissed because the Trust Agreement specifies that the Trustee may only purchase
3 company stock at fair market values “as determined by the Trustee based upon a valuation by an
4 independent appraiser,” and that the Administration Committee defendants therefore held no
5 decision-making power or control as to the purchase price of the Kruse-Western shares and thus
6 no fiduciary duty related to the valuation of the purchase price for those shares. (Doc. No. 50 at
7 10.) Defendants thus advance the argument that the Administration Committee defendants could
8 not act in a fiduciary capacity regarding repayments of the ESOP’s loan because the ESOP Plan
9 Document directs that *only* the Trustee, and not the Administration Committee, may decide
10 whether to use stock dividends to repay the loan the ESOP used to purchase Kruse-Western stock.
11 (*Id.* at 7–8.)

12 In his sur-reply, plaintiff counters that although the Trust Agreement constitutes improper
13 extrinsic material, the Trust Agreement has no bearing on the Administration Committee’s
14 “power to direct GreatBanc to purchase Company Stock using ESOP assets.” (Doc. No. 51-1 at
15 3.) Plaintiff also argues that the Plan Document grants the Administrator the authority to “direct
16 the Trustee as respects payments or distributions from the Trust in accordance with the provisions
17 of the Plan” and that, in general, the Trustee must first receive authorization from the
18 Administrator in order to act without direction in any aspect except payments to acquisition loans
19 from cash dividends held in the Loan Suspense Account or cash dividends credited to
20 Participants’ ESOP Accounts. (*Id.* at 4–5.)

21 It is important to keep in mind that in determining whether a complaint contains sufficient
22 allegations to survive a motion to dismiss brought under Rule 12(b)(6), “a court *may not* look
23 beyond the complaint to a plaintiff’s moving papers, such as a memorandum in opposition to a
24 defendant’s motion to dismiss.” *Schneider v. Cal. Dep’t of Corr.*, 151 F.3d 1194, 1197 n.1 (9th
25 Cir. 1998). Reliance by the court on the Trust Agreement and the ESOP Plan Document in ruling
26 on the pending motions would therefore be inappropriate because those documents were not
27 attached to or incorporated into the FAC, and were attached only to defendants’ reply brief in
28 support of the pending motions to dismiss. The FAC alleges that “for the Trustee to act without

1 direction from the Administrator, it must be authorized to do so by the Administrator in advance”
2 and that Administration Committee members determine “what portion of the participants’ stock
3 dividends and employer contributions, held in the ESOP, are used to provide accelerated loan
4 payments to themselves given that they are also the note holders on the ESOP’s transaction debt.”
5 (FAC at ¶¶ 54, 114, 119.) Nevertheless, even if the Administration Committee individual
6 defendants were functional fiduciaries of the ESOP, the FAC’s allegations do not address or
7 explain how the Administration Committee defendants *caused* the purchase of Kruse-Western
8 stock to occur such that the purchase of the stock constituted an act of self-interest by the ESOP
9 fiduciaries. An allegation of causation is essential to support plaintiff’s claim that the
10 Administration Committee subsequently engaged in self-dealing by fulfilling their duties laid out
11 in the Plan documents to determine what portion of stock dividends and employer contributions
12 are directed to loan repayments. Because no such allegation of facts to, if proven, establish
13 causation appears in the FAC, plaintiff has failed to sufficiently allege facts stating a claim
14 against the Administration Committee defendants for violation of 29 U.S.C. § 1106(b).
15 Therefore, defendants’ motion to dismiss will be granted as to plaintiff’s second cause of action.
16 Below, the court turns to the question of whether plaintiff should be granted further leave to
17 amend.

18 The court is to “freely give” leave to amend “when justice so requires.” Fed. R. Civ. P.
19 15(a)(2). “[L]eave to amend should be granted unless the district court ‘determines that the
20 pleading could not possibly be cured by the allegation of other facts.’” *United States ex rel. Lee*
21 *v. SmithKline Beecham, Inc.*, 245 F.3d 1048, 1052 (9th Cir. 2001) (quoting *Lopez v. Smith*, 203
22 F.3d 1122 (9th Cir. 2000)). The Ninth Circuit has “repeatedly stressed that the court must remain
23 guided by the underlying purpose of Rule 15 to facilitate decision on the merits, rather than on the
24 pleadings or technicalities.” *Nunes v. Ashcroft*, 375 F.3d 805, 808 (9th Cir. 2003) (internal
25 quotations and changes omitted). In evaluating whether leave to amend should be given, the
26 following factors should be considered: “bad faith, undue delay, prejudice to the opposing party,
27 futility of the amendment, and whether the party has previously amended his pleadings.” *Bonin*
28 *v. Calderon*, 59 F.3d 815, 845 (9th Cir. 1995). “Futility alone can justify the denial of a motion

1 for leave to amend.” *Nunes*, 375 F.3d at 808. *See also Lockheed Martin Corp. v. Network Sols.,*
2 *Inc.*, 194 F.3d 980, 986 (9th Cir. 1999) (“Where the legal basis for a cause of action is tenuous,
3 futility supports the refusal to grant leave to amend.”) Here, it appears plaintiff may be able to
4 address the deficiencies in their allegations in support of their second cause of action identified in
5 this order. The FAC does not contain allegations as to how the Administration Committee
6 defendants caused the purchase of Kruse-Western stock to occur such that the purchase of the
7 stock constituted an act of self-interest by the ESOP fiduciaries. However, nothing in the FAC or
8 in the briefing for the pending motions suggests to the court that plaintiff cannot plead additional
9 facts to allege such causation and that would be sufficient to support a claim of self-dealing in
10 violation of ERISA. Plaintiff’s second cause of action of the FAC will therefore be dismissed
11 with further leave to amend being granted.

12 **C. Fifth Cause of Action**

13 Finally, defendants move to dismiss plaintiff’s fifth cause of action in which he asserts
14 that the Board defendants, the Administration Committee defendants, and defendant Kruse
15 violated 29 U.S.C. §§ 1105(a)(1), (a)(3) by knowingly participating in the breach of fiduciary
16 duties (as alleged against GreatBanc in plaintiff’s fourth cause of action) and by failing to take
17 reasonable steps to remedy GreatBanc’s alleged breach of those duties. (FAC at ¶¶ 142, 144,
18 148, 155.)

19 A fiduciary is “liable for a breach of fiduciary responsibility of another fiduciary with
20 respect to the same plan” if he “participates knowingly in or knowingly undertakes to conceal, an
21 act or omission of such other fiduciary, knowing such act or omission is a breach,” or “if he has
22 knowledge of a breach by such other fiduciary, unless he makes reasonable efforts under the
23 circumstances to remedy the breach.” 29 U.S.C. §§ 1105(a)(1), (3). Sections 1105(a)(1) and
24 1105(a)(3) “require actual knowledge of the breach.” *Renfro v. Unisys Corp.*, 671 F.3d 314, 324
25 (3d Cir. 2011). The defendant fiduciary “must know the other person is a fiduciary with respect
26 to the plan, must know that he participated in the act that constituted a breach, and must know
27 that it was a breach.” *Id.* (quoting *Donovan v. Cunningham*, 716 F.2d 1445, 1475 (5th Cir.
28 1983)).

1 Specifically, plaintiff's fifth cause of action alleges that the defendants were involved in
2 preparing the financial projections that GreatBanc relied upon, that defendants knew the financial
3 projections failed to reflect Kruse-Western's monensin contamination issues and wage and hour
4 violations, and that defendants knew the financial projections "would be used to determine the
5 value the ESOP would pay for Company stock and thus cause the ESOP to overpay." (*Id.* at
6 ¶ 141.) Defendants argue in their motion that the FAC fails to sufficiently allege that (1)
7 defendants' alleged actions constitute fiduciary actions sufficient to support a claim of an ERISA
8 violation, and that (2) defendants had actual knowledge of how the financial projections factored
9 into the analysis and knew that GreatBanc breached a fiduciary duty. (Doc. Nos. 38-1 at 11, 46-1
10 at 5-6.)

11 Plaintiff counters that co-fiduciary liability under 29 U.S.C. § 1105 requires only that each
12 of the defendants was a fiduciary to the ESOP in some capacity at the time of GreatBanc's
13 alleged breaches, and that defendants' actions or omissions need not themselves be fiduciary
14 functions. (Doc. No. 49 at 23.) Plaintiff asserts that "the fiduciary duty to monitor is sufficient to
15 give rise to co-fiduciary liability" against the Board Defendants and defendant Kruse because this
16 court previously found that plaintiff adequately pled a failure to monitor claim against those
17 defendants. (*Id.* at 24.) Plaintiff further points out that in his FAC he has alleged that the
18 Administration Committee members were fiduciaries because the Plan Document expressly gives
19 the Administration Committee fiduciary responsibilities, and that in this way they satisfy the
20 threshold requirement for co-fiduciary liability. (*Id.*) Plaintiff also contends that the FAC
21 explicitly alleges that defendants had actual knowledge of GreatBanc's fiduciary violations. (*Id.*
22 at 21.)

23 In reply, defendants argue that plaintiff's conclusory allegations that defendants had actual
24 knowledge of GreatBanc's fiduciary violations cannot survive a motion to dismiss. (Doc. No. 50
25 at 12.) Defendants contend that co-fiduciary liability would require allegations that defendants
26 "*knew* how the projections factored into GreatBanc's analysis about the purchase price of the
27 transaction or *knew* that GreatBanc's treatment of them breached any fiduciary duty." (*Id.* at 13.)
28 Defendants also argue that holding them liable as co-fiduciaries for conduct not within the scope

1 of their fiduciary functions would violate the two-hat distinction made in *Pegram v. Herdrich*,
2 530 U.S. 211, 225 (2000), in which the court held that fiduciaries “may wear different hats” and
3 “still take actions to the disadvantage of . . . beneficiaries” when acting in a non-fiduciary role
4 without violating ERISA.

5 In his FAC plaintiff alleges that defendant Kruse, the Board defendants, and the
6 Administration Committee are fiduciaries of the ESOP. (FAC ¶¶ 14, 15, 21.) Although the FAC
7 does not allege that the Administration Committee defendants were individually named
8 fiduciaries of the ESOP, it does sufficiently allege that the Administration Committee defendants,
9 by virtue of serving on the Administration Committee, are “functional fiduciar[ies]” pursuant to
10 ERISA by exercising some “discretionary authority or discretionary control over plan
11 management.” 29 U.S.C. § 1002(21)(A) (defining functional fiduciaries as individuals who
12 exercise “any discretionary authority or control over plan management” or any control over plan
13 assets). Despite defendants’ arguments to the contrary, a review of the applicable caselaw does
14 not establish that co-fiduciary liability is limited only to instances when the actions underlying the
15 fiduciary’s participation in or concealing of the breach or the inaction to remedy the breach
16 themselves amount to fiduciary conduct. *See, e.g., In re Polaroid ERISA Litig.*, 362 F. Supp. 2d
17 461, 479 (S.D.N.Y. 2005) (holding that “fiduciaries may be liable under § 1105(a) even if their
18 co-fiduciary’s breach is beyond the scope of their own discretionary authority”) (citing *In re*
19 *WorldCom, Inc. ERISA Litig.*, 354 F.Supp.2d 423, 445 (S.D.N.Y. 2005)); *see also Silverman v.*
20 *Mut. Benefit Life Ins. Co.*, 138 F.3d 98, 106 (2d Cir.1998) (Jacobs, J., concurring) (“Section
21 1105(a)(3) provides for extraordinarily broad liability for co-fiduciaries because it requires only
22 that the defendant be a fiduciary of the same plan as the breaching fiduciary”); *Pizzella v.*
23 *Vinoskey*, 409 F. Supp. 3d 473, 529–30 (W.D. Va. 2019) (finding the defendant liable for a co-
24 fiduciary’s breach because he was a fiduciary of the ESOP at the time of the transaction and had
25 actual knowledge that the price he received for selling his shares exceeded fair market value);
26 *Hurtado v. Rainbow Disposal Co.*, No. 8:17-cv-01605-JLS-DFM, 2018 WL 3372752, at *14
27 (C.D. Cal. July 9, 2018) (finding that the co-fiduciary liability claim survived a motion to dismiss
28 “[b]ecause the Court finds that Plaintiffs have stated claims for breach of fiduciary duty as to all

1 Defendants”). Further, defendants’ reliance on the decision in *Parsons v. Bd. of Trustees of the*
2 *Nevada Resort Ass’n - I.A.T.S.E. Loc. 702 Ret. Plan*, No. 2:12-CV-00299-LDG, 2013 WL
3 5324946 (D. Nev. Sept. 20, 2013) for the proposition that co-fiduciary liability may only apply to
4 conduct within the scope of a fiduciary’s own fiduciary functions is misplaced. The district court
5 in *Parsons* held only that in order to allege co-fiduciary liability against the trustee defendants, a
6 plaintiff must allege an underlying breach of fiduciary duty by other fiduciaries. *Id.* at *8. That
7 court did not, as defendants argue, hold that a defendant fiduciary may only be liable for a co-
8 fiduciary’s breach if the defendant fiduciary engaged in fiduciary conduct to participate in or
9 conceal the co-fiduciary’s breach. *See id.*

10 Here, plaintiff has sufficiently alleged that defendant GreatBanc breached its fiduciary
11 duties as the ESOP’s trustee (*see* Doc. No. 31 at 17), and plaintiff brings the co-fiduciary liability
12 claim against the remaining defendants for GreatBanc’s underlying breach of duty. (FAC at
13 ¶¶ 140, 142.) Moreover, the court concludes that the FAC sufficiently alleges that defendants
14 knowingly participated in GreatBanc’s breach of its fiduciary duty and had actual knowledge of
15 that breach but failed to take reasonable steps to remedy it. In this regard, plaintiff in his FAC
16 alleges that: (1) defendant Kruse, the Board defendants, and the Administration Committee
17 defendants were involved in or directed the preparation of the financial projections used by
18 GreatBanc to appraise the value of Kruse-Western stock; (2) defendants knew about Kruse-
19 Western’s monensin contamination problems and wage and hour liabilities; (3) defendants also
20 knew that the monensin contamination was not incorporated in the financial projections and that
21 the projections underlying the ESOP’s purchase price were therefore clearly inaccurate. (FAC
22 ¶¶ 56, 70, 141, 143, 146, 152–53.) Plaintiff claims that defendants’ actively engaged in preparing
23 inaccurate financial projections that they knew were to be used by GreatBanc in the valuation of
24 the ESOP purchase price. This, plaintiff avers, constitutes participation in and actual knowledge
25 of GreatBanc’s breach of duty, yet defendants allegedly failed to take any action to remedy that
26 breach. (*Id.* at ¶¶ 142, 144, 147–51, 154–57.)

27 These allegations support a claim of co-fiduciary liability against defendant Kruse and the
28 Administration Committee defendants. *See Pizzella*, 409 F. Supp. 3d at 529–30 (finding that a

1 fiduciary's actual knowledge that the price received for selling his shares in the ESOP's exceeded
2 the fair market value of those shares was sufficient to hold him liable as a co-fiduciary).

3 Defendants do not dispute that plaintiff alleges that defendants knew GreatBanc would and did
4 use the allegedly inaccurate financial projections in its valuation, only arguing that they did not
5 know how exactly the projections would be used. (*See* Doc. No. 50 at 13.) But plaintiff's
6 allegations that defendants knew of GreatBanc's reliance on the inaccurate projections they had
7 prepared is sufficient to state a cognizable claim. Although a co-fiduciary liability claim must
8 allege actual knowledge of a co-fiduciary's breach, it "need not allege specific facts buttressing
9 those claims of knowledge to survive a motion to dismiss." *In re Polaroid ERISA Litig.*, 362 F.
10 Supp. 2d at 479–80 (citing *In re WorldCom, Inc.*, 263 F. Supp. 2d 745, 767 n. 15 (S.D.N.Y.
11 2003)); *cf. Renfro*, 671 F.3d at 324 (finding that plaintiff's co-fiduciary liability claims failed
12 because they did not contend that defendant had knowledge about the co-fiduciary's "flawed
13 decision-making process regarding investment options to be included in the plan"). Defendants'
14 arguments as to whether plaintiff has "adequately shown sufficient knowledge to sustain this
15 Count [of co-fiduciary liability] are not appropriate for resolution at the pleading stage."
16 *Hurtado*, 2018 WL 3372752 at *14.

17 Accordingly, defendants' motions to dismiss plaintiff's fifth cause of action will be
18 denied.

19 CONCLUSION

20 For the reasons explained above:

- 21 1. Defendants' motions to dismiss (Doc. Nos. 38, 46) are granted in part and denied
22 in part as follows:
 - 23 a. Plaintiff's second cause of action is dismissed with leave to amend;
 - 24 b. Defendants' motions are denied in all other aspects; and

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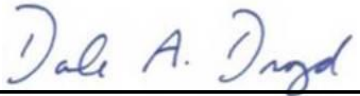
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2. Within twenty-one days from the date of service of this order, plaintiff is directed to either file a second amended complaint or notify the court that he intends to proceed only on the his claims other than the second cause of action asserted in his FAC.

IT IS SO ORDERED.

Dated: December 13, 2021


UNITED STATES DISTRICT JUDGE