20-4117

In the United States Court of Appeals for the Second Circuit

MELISSA HALEY, *individually and on behalf of others similarly situated*,

Plaintiff-Respondent.

v.

TEACHERS INSURANCE AND ANNUITY ASSOCIATION OF AMERICA,

Defendant-Petitioner,

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

BRIEF OF *AMICI CURIAE* THE SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION, AMERICAN BENEFITS COUNCIL, AND SOCIETY OF PROFESSIONAL ASSET MANAGERS AND RECORDKEEPERS IN SUPPORT OF DEFENDANT-PETITIONER

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CORPORATE DISCLOSURE STATEMENT

Amici curiae the Securities Industry and Financial Markets Association ("SIFMA"), the American Benefits Council (the "Council"), and the Society of Professional Asset Managers and Recordkeepers (the "SPARK Institute") are all not-for-profit organizations. Each certifies that it has no parent corporation and no publicly-held corporation owns ten percent or more of its stock.

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INTERESTS OF THE *AMICI CURIAE*[1]

Amici SIFMA, the Council, and the SPARK Institute are national nonprofit organizations representing retirement-plan sponsors and service providers. *See* Mot. for Leave to File *Amicus* Br. in Supp. of Def.-Pet'r 1-2. They urge the Court to review the district court's unprecedented order, which permits a participant in a single retirement plan to broadly litigate the fiduciary judgments of thousands of absent plans through an action against a non-fiduciary service provider. *Amici* frequently participate in ERISA lawsuits, like this one, raising issues of concern to plan sponsors and service providers. *Id.* at 2.

INTRODUCTION

As ERISA class actions go, this one is unusual in several respects that make it worthy of this Court's immediate attention. The plaintiff, a single individual participant in a single 403(b) retirement plan, alleges that her plan's fiduciaries violated their duties by enlisting the plan in TIAA's participant loan program. But the plaintiff did not sue the fiduciaries who made that choice; instead, she seeks to hold TIAA liable as a nonfiduciary for knowingly participating in a prohibited transaction. She convinced the district court to certify a class of every other retirement plan in the country similarly using these TIAA services. That litigation

[1] Pursuant to Fed. R. App. P. 29(a)(4)(E) and L.R. 29.1(b), counsel for *amici curiae* state that no party's counsel authored this brief in whole or in part, and that no person other than *amici*, their non-party members, or their counsel contributed money that was intended for preparing or submitting this brief.

juggernaut purports to evaluate the independent decisions of thousands of plan fiduciaries without any consideration of the plan-specific facts that motivated those decisions and, apparently, without any participation by the fiduciaries themselves. Neither ERISA nor Rule 23 condones this novel approach.

The central questions driving a nonfiduciary claim premised on a prohibited transaction are all individualized, yet the district court swept those concerns aside and certified a Rule 23(b)(3) class based on the presence of other, collateral, common issues. ERISA prohibited-transaction claims hinge on highly context-driven exemptions that depend on factual questions like the reasonableness of the transaction. The answers to those questions will vary from one plan to the next depending on the plan's unique characteristics and market options. The district court's conclusion that it could adopt a one-size-fits-all approach through a single action against a nonfiduciary service provider subverts ERISA's basic design: to entrust plan fiduciaries to make informed decisions in *their* plan's best interest.

The court compounded that error by certifying a class that apparently does not contemplate any notice to, or participation by, plan fiduciaries, even though those fiduciaries have the best access to information about their decisions and face personal liability if the district court finds their decisions improper. This Court should grant interlocutory review to protect the interests of fiduciaries and the plans and participants they serve, none of whom benefit from this unwarranted expansion of the class device.

ARGUMENT

The district court's certification of a nationwide multi-plan class of nonfiduciary claims pushes the boundaries of class-action law well beyond what Rule 23 permits. Although interlocutory review is discretionary, this Court has not hesitated to grant review of important legal questions in need of immediate resolution, or errors that may frustrate post-judgment review. *See In re Sumitomo Copper Litig.*, 262 F.3d 134, 139 (2d Cir. 2001).

The district court's order implicates important legal questions about whether a single individual can represent thousands of employee retirement plans to which she has no connection, to pursue a liability theory that ordinarily requires proof that each plan's fiduciaries breached their obligations by engaging in unlawful transactions, without those fiduciaries' participation. The fiduciaries whose decisions will be on trial will have no avenue to defend them—and no say in whether the defendant will cave to the extraordinary settlement pressure a certified class of this scale exerts, precluding this Court's post-judgment review.

I. A Nonfiduciary's "Knowing Participation" in ERISA Violations Cannot Feasibly Be Adjudicated in a Multi-Plan Class Action

The district court brushed aside the individual questions that will drive this litigation: (1) whether the fiduciaries of TIAA's client plans caused non-exempt prohibited transactions, and (2) whether TIAA knowingly participated in those violations. Those questions lie at the heart of the claims asserted in this lawsuit, and their proper consideration would require thousands of individualized evidentiary proceedings in total conflict with the class device. Ignoring these concerns was an abuse of discretion.

All fiduciaries of ERISA-governed retirement plans are obligated to act prudently and diligently in the sole interests of their plan's participants and beneficiaries. 29 U.S.C. § 1104(a)(1)(B); *see Henry v. Champlain Enters., Inc.*, 445 F.3d 610, 618 (2d Cir. 2006) (Sotomayor, J.). ERISA § 406 supplements those general fiduciary obligations by prohibiting fiduciaries from engaging in virtually any transaction with an interested party unless covered by an enumerated exemption. *Id.*; *see, e.g.*, 29 U.S.C. § 1108. Because § 406's general prohibition sweeps so broadly that it "might impede a plan from entering into reasonable contracts for necessary services," the central focus in the litigation of an ERISA prohibited-transaction claim is whether the engagement falls within an available exemption. *See L.I. Head Start Child Dev. Servs., Inc. v. Frank*, 165 F. Supp. 2d 367, 370 (E.D.N.Y. 2001).

The district court concluded that the existence of a violation could be determined on a classwide basis because all of the plans in the class subscribed to the same basic TIAA loan program. Op. at 10-12. But the court's opinion ignores that liability in a prohibited-transaction suit ultimately centers on the *context* of the fiduciary's decision, which will vary across plans. For example, ERISA § 408(b)(1) exempts loans made to plan participants so long as they bear a "reasonable rate of interest," are made to all participants on a "reasonably equivalent basis," and are "adequately capitalized," among other things. 29 U.S.C. § 1108(b)(1). Those determinations inherently depend on facts particular to the plan, including the terms the fiduciaries negotiated based on their plan's individual needs and bargaining power and the alternatives available to the plan in the marketplace at the time of the transaction. *See Pension Ben. Guar. Corp. ex rel. St. Vincent Catholic Med. Ctrs. Ret. Plan v. Morgan Stanley Inv. Mgmt. Inc.*, 712 F.3d 705, 716 (2d Cir. 2013); *Bunch v. W.R. Grace & Co.*, 555 F.3d 1, 7-10 (1st Cir. 2009).

The district court dismissed the individualized application of § 408 exemptions as mere "affirmative defenses" outweighed by the "number of questions that can be resolved with common proof." Op. 23. But unlike one-off affirmative defenses that may affect only a handful of class members, the context-dependent availability of an exemption for each plan will be outcome-determinative for *every plan* in the class. Given the "nature and significance" of the exemption questions, *In re Petrobras Sec.*, 862 F.3d 250, 271 (2d Cir. 2017), the class is insufficiently "cohesive to warrant adjudication by representation," *Amchem Prods., Inc. v. Windsor*, 521 U.S. 591, 623 (1997).

Evaluating whether a *nonfiduciary* is liable for participating in a prohibited transaction only multiplies the plan-specific evidence needed to resolve a multi-plan lawsuit. In addition to showing "that the *plan fiduciary*, with actual or constructive knowledge of the facts satisfying the elements of a § 406(a) transaction, caused the plan to engage in the transaction," the plaintiff must prove that the *nonfiduciary* "had actual or constructive knowledge of the circumstances that rendered the transaction unlawful." *Harris Tr. & Sav. Bank v. Salomon Smith Barney, Inc.*, 530 U.S. 238, 251 (2000). The "critical element" of this type of claim is evidence that the nonfiduciary "knew that the primary violator's conduct violated a fiduciary duty." *Leber v. Citigroup, Inc.*, No. 07 Civ. 9329, 2010 WL 935442, at *14 (S.D.N.Y. Mar. 16, 2010). That further determination will depend on the circumstances surrounding the service provider's engagement by each of its client plans.

Because nonfiduciary prohibited-transaction claims implicate multiple layers of plan-level individualized determinations, they are not amenable to multi-plan damages class actions like this one. A challenge to the decisions of independent plan fiduciaries with respect to thousands of different employee benefit plans does not turn on "questions of law or fact common to the class," Fed. R. Civ. P.

23(a)(2), and any common questions that exist certainly don't "predominate" over individualized ones, Fed. R. Civ. P. 23(b)(3). *Wal-Mart Stores, Inc. v. Dukes*, 564 U.S. 338, 350-52 (2011) (explaining that the common question must be "the crux of the inquiry" to ensure that the class proceeding will "generate common *answers* apt to drive the resolution of the litigation"). In a multi-plan prohibited-transaction suit against a nonfiduciary, the central questions determining liability are particularized, not common. The determination of these claims across thousands of plans would be both unprecedented and contrary to law.

II. The Class Device Is Unsuited to Evaluating the Fiduciary Decisions of Non-Party Plans

A multi-plan class proceeding against a service provider cannot be used to decide the sufficiency of the decisionmaking of individual fiduciaries that approved the terms of the service provider's engagement, not least because those independent fiduciaries have no opportunity to participate. Plaintiffs' proposal to effectively adjudicate the personal liability of thousands of individual fiduciaries through a proceeding that excludes them violates due process as well as Rule 23(b)(3)'s requirement that class resolution be superior to other adjudication methods. Fed. R. Civ. P. 23(b)(3); *Amchem*, 521 U.S. at 615.

If the plaintiff succeeds in making TIAA liable for participating in prohibited transactions caused by thousands of independent plan fiduciaries, the affected plans' service arrangements with TIAA will be disrupted and the plans' fiduciaries will face personal liability for the violations. *See* ERISA § 409, 29 U.S.C. § 1109. But the court will not hear from those non-party fiduciaries in this proceeding, and will not see the grounds that led each to conclude that their arrangement with TIAA was appropriate. Exposing non-parties to liability with no process whatsoever contravenes the most "elementary and fundamental requirement" of due process: notice apprising "interested parties of the pendency of the action and afford[ing] them an opportunity to present their objections." *Mullane v. Cent. Hanover Bank & Tr. Co.*, 339 U.S. 306, 314 (1950). The only way around the due process problem would be to recognize that those fiduciaries are necessary parties entitled to participate, Fed. R. Civ. P. 24(a), but that would overwhelm the very functioning of the multi-plan class proceeding. Claims like the plaintiff's can and should be adjudicated through individual plan lawsuits involving all necessary parties. Indeed, exactly such a lawsuit involving plaintiff's own plan was already adjudicated, in the fiduciaries' favor. *See* Pet. 8.

Moreover, nonfiduciaries often lack the evidence that would establish the reasonableness of the arrangement each fiduciary struck for their particular plan. The rationale for placing the burden of proof on fiduciaries to prove the propriety of an otherwise prohibited transaction is that "the fiduciary has a virtual monopoly of information concerning the transaction in question," and therefore "is in the best position to demonstrate the absence of self-dealing." *Lowen v. Tower Asset Mgmt.,* *Inc.*, 829 F.2d 1209, 1215 (2d Cir. 1987). That information monopoly does not extend to service providers like TIAA, who lack direct knowledge about the competitive offerings any given fiduciary considered in selecting them, and must rely on the market to establish the reasonableness of their terms. The order below necessarily contemplates that this action will proceed without that evidence at all.

This evidentiary gap highlights the impropriety of permitting a participant in one plan to challenge the fiduciary process of other, stranger plans. The plaintiff has no factual basis to question the sufficiency of that process—yet her action, if successful, would have the effect of disrupting fiduciary choices with which those third-party plans and their participants may be entirely satisfied. With the precedent set by this certified class action, fiduciaries' carefully negotiated service arrangements will be subject to challenge by individuals who are wholly unrelated to their plans, disturbing service provider arrangements that the fiduciaries have determined best serve the interests of their participants. Unitary classwide adjudication of these claims would frustrate, not advance, ERISA's goals.

It should go without saying that the plaintiff, lacking any connection to the stranger plans, cannot articulate any Article III injury affecting her "in a personal and individual way" that is fairly traceable to those plans' independent service arrangements. *Connecticut v. Physicians Health Servs. of Conn., Inc.*, 287 F.3d 110, 118 (2d Cir. 2002) (quotation omitted); *see La Mar v. H & B Novelty & Loan*

Co., 489 F.2d 461, 462 (9th Cir. 1973) (a class representative "cannot represent those having causes of action against other defendants against whom the plaintiff has no cause of action and from whose hands [s]he suffered no injury"). But she also lacks a cause of action under ERISA to press claims on behalf of unrelated plans. *See* ERISA § 502(a)(2), 29 U.S.C. § 1132(a)(2) (limiting cause of action to Secretary of Labor, plan fiduciaries, participants, and beneficiaries); *see Acosta v. Pac. Enters.*, 950 F.2d 611, 617 (9th Cir. 1991), *as amended on reh'g* (Jan. 23, 1992); *Chemung Canal Tr. Co. v. Sovran Bank/Maryland*, 939 F.2d 12, 14 (2d Cir. 1991). A participant in one plan cannot derivatively represent another plan any more than a shareholder in one company can represent the interests of an unrelated corporation in which she does not own shares. *See* Debra A. Demott, Shareholder Derivative Actions: Law & Practice § 2:2 (2011). And such a participant certainly cannot adequately represent the interests of those other plans' participants and beneficiaries. *See Gen. Tel. Co. of Sw. v. Falcon*, 457 U.S. 147, 156 (1982) ("[A] class representative must be part of the class and possess the same interest and suffer the same injury as the class members." (quotation omitted)).

The district court's certification of an opt-out class under Rule 23(b)(3) does not resolve these concerns, and the court's order does not clarify how the notice required by Rule 23(c)(2)(B) would operate. If the opt-out decision is given to plan fiduciaries, they will face an untenable dilemma: to preserve their plan service arrangements (and incidentally favor their own interests) or cede their plans' fates to this litigation, with no ability to influence how it affects those arrangements. If the notice goes to individual plan participants, the fiduciaries will be powerless to exclude their plans from this litigation, and the opt-out decisions may conflict. Should a single one of a plan's participants remain in the action, the propriety of the plan's fiduciary decisions may be determined for the entire plan because fiduciaries generally must treat participants in a uniform manner. *See Coan v. Kaufman*, 457 F.3d 250, 259-61 (2d Cir. 2006).

This litigation threatens to upend thousands of fiduciary-negotiated service-provider arrangements and replace them with the generic approach favored by a single individual with no legal connection to those plans. The plaintiff is not equipped to question the considered judgment of the fiduciaries who initially selected, and continuously monitor the prudence of, their plans' arrangements and investments. Nor is TIAA best positioned to defend those decisions. This Court should not permit the class device to undermine the goals and fundamental structure of ERISA.

CONCLUSION

Amici curiae respectfully urge this Court to grant TIAA's Rule 23(f) petition.

Dated: December 16, 2020

Respectfully submitted,

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<u>CERTIFICATE OF COMPLIANCE</u>

This brief complies with the type-volume limitations of Second Circuit Local Rule 29.1(c) because the brief contains 2,526 words, excluding the items listed in Federal Rule of Appellate Procedure 32(f). This brief complies with the typeface requirements of Federal Rule of Appellate Procedure 32(a)(5) and the type styles requirements of Federal Rule of Appellate Procedure 32(a)(6) because this brief has been prepared in a proportionally spaced typeface using Microsoft Word 2016 in Times New Roman 14-point font (14-point for footnotes).

Date: December 16, 2020 *<u>/s/ Meaghan VerGow</u>*

Meaghan VerGow