No. 23-1007

IN THE

# Supreme Court of the United States

CASEY CUNNINGHAM., ET AL.

*Petitioners*,

v.

CORNELL UNIVERSITY, ET AL.,

*Respondents.*

On Writ of Certiorari
to the United States Court of Appeals
for the Second Circuit

**BRIEF OF *AMICUS CURIAE***
**THE PENSION RIGHTS CENTER**
**IN SUPPORT OF PETITIONERS**

John Nestico
*Counsel of Record*
SCHNEIDER WALLACE
2138 Harris Rd.
Charlotte, NC 28211
(540) 740-2946
jnestico@schneiderwallace.com

Norman Stein
*Of Counsel*
Pension Rights Center
1730 M Street , N.W.
Suite 1000
Washington, D.C. 20036
(202) 296-3776
NStein@pensionrights.org

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## STATEMENT OF INTEREST

The Pension Rights Center ("Center"), is a Washington, D.C. nonprofit, nonpartisan consumer organization. [1] The Center was established in 1976, less than two years after the enactment of ERISA, with a mission largely co-extensive with that of the statute: to protect and promote the retirement security of American workers, retirees, and their families. For almost fifty years, the Center has provided legal assistance to thousands of retirement plan participants and beneficiaries seeking to understand and enforce their rights under their plans, to recover benefits under the terms of their plans, and to ensure that their plans are administered prudently and in accordance with the statutory protections embodied in the statute.

The issue presented here concerns the ability of such participants and beneficiaries to file suit when they allege that a fiduciary has caused their defined contribution plan to enter into a prohibited transaction, as defined by 29 U.S.C. § 1106(a) . The availability of such causes of action is essential not only to correct prohibited transactions that have already occurred but also to incentivize plan fiduciaries to avoid causing plans to enter into such transactions in the future.

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[1] No counsel for a party authored this brief in whole or in part. No party, no counsel for a party, and no person other than Amicus, its members, and its counsel made a monetary contribution to fund the preparation or submission of this brief.

Although the difference between a reasonable and unreasonable fee can appear small on an annual basis, the future value of the aggregate sum of such fees at retirement can be meaningful, especially for moderate- and low-income savers. The Second Circuit position, unless rejected by this Court, will result in an unjustified drain on the resources of American retirees and their families.

## INTRODUCTION

This case focuses on the dismissal of claims made by participants on behalf of the Cornell University Retirement Plan for the Employees of the Endowed Colleges at Ithaca (the "Retirement Plan") and the Cornell University Tax Deferred Annuity Plan (the "TDA Plan") (collectively, the "Plans") that the Plans' fiduciaries caused the Plans to engage in transactions with Teachers Insurance and Annuity Association of America-College Retirement Equities Fund ("TIAA") and Fidelity Investments Inc. ("Fidelity"), both service providers and parties in interest, that are prohibited by ERISA § 406(a)(1)(C), 29 U.S.C. § 1106(a)(1)(C). ERISA § 406(a)(1)(C) provides that "Except as provided in [ERISA § 408], (1) A fiduciary with respect to a plan shall not cause the plan to engage in a transaction, if he knows or should know that such transaction constitutes a direct or indirect— . . . (C) furnishing of goods, services, or facilities between the plan and a party in interest . . . ."

The complaint further alleged that the Plans' fiduciaries failed to employ adequate processes for monitoring the Plans resulting in the retention of

underperforming investment options and the payment of excessive fees. App. 5a. Petitioners also alleged that Respondents had "neglected to monitor the amount of revenue sharing received" by TIAA and Fidelity and had "paid substantially more than . . . a reasonable recordkeeping fee." App. 25a (internal quotation marks omitted). According to Petitioners, a reasonable recordkeeping fee for the Plans would have been "$35 per participant." Id. Petitioners instead paid several times that, between $115 and $183 per participant in the Retirement Plan, and between $145 and $200 per participant in the TDA Plan. App. 26a.

The district court ruled that Petitioners' allegations were sufficient to sustain their claims that Respondents had breached their duty of prudence. App. 100a–104a, 115a. But they were not sufficient to sustain the prohibited transaction claim. App. 109a. The district court held that to plead a § 1106 violation, plaintiffs must allege "some evidence of self-dealing or other disloyal conduct", App. 109a, and Petitioners had "offered only conclusory allegations". App. 140a.

Petitioners appealed, among other rulings, the dismissal of the prohibited transaction claims. App. 3a. After examining the recent Circuit Court decisions addressing the pleading requirements for prohibited transaction claims, the Second Circuit rejected the district court's requirement that a plaintiff allege "some evidence of self-dealing or other disloyal conduct." Instead, citing interpretations of criminal statutes, the court ruled that the introductory clause of ERISA § 406--"[e]xcept as provided in [ERISA § 408]"—effectively incorporated

by reference the terms of ERISA § 408 into the prohibitions of § 406, effectively making the terms of the § 408 exemptions elements of the § 406(a) offenses. Therefore, just as the prosecution in a criminal case must prove every element of the charged offense, a plaintiff alleging a prohibited transaction must plead the elements of the prohibited transaction and the failure to meet the conditions of the exemption. Limiting its holding to the specific facts of the case, the Second Circuit ruled specifically with respect to alleged prohibited transactions involving necessary plan services, "a complaint must plausibly allege that a fiduciary has caused the plan to engage in a transaction that constitutes the "furnishing of . . . services . . . between the plan and a party in interest" *where that transaction was unnecessary or involved unreasonable compensation."* App. 19a (emphasis in original).

## SUMMARY OF THE ARGUMENT

The clear and unambiguous language of ERISA § 406(a)(1)(C), prohibits a plan fiduciary from engaging a party in interest to provide services to the plan, unless the fiduciary obtains disclosures from the party in interest detailing all the services being provided and all compensation expected to be received in connection with those services, and determines that the compensation is reasonable in relation to those services, as required by ERISA § 408(b)(2) and its implementing regulation at 29 C.F.R. § 2550.408b-2(c). "In ERISA cases, 'as in any case of statutory construction, our analysis begins with the language of the statute . . . . And where the statutory language provides a clear answer, it ends

there as well.' *Hughes Aircraft,* 525 U.S. at 438 (internal citation and quotation marks omitted)." Harris Tr. & Sav. Bank v. Salomon Smith Barney, Inc., 530 U.S. 238, 254, 120 S. Ct. 2180, 2191 (2000). The federal courts have ruled consistently for decades that the intent of § 406 is to bar categorically specified transactions with a party in interest that are likely to injure the plan. *Commissioner* v. *Keystone Consol. Industries, Inc.*, 508 U.S. 152, 160, 124 L. Ed. 2d 71, 113 S. Ct. 2006 (1993). Federal courts, consistent with a categorical bar, have ruled that the exemptions provided by § 408 create an affirmative duty on the plan fiduciary and are, therefore, properly categorized as affirmative defenses. *See, Braden v. Wal-Mart*, 588 F.3d 585, 601 fn 10 (8th Cir. 2009).

Nonetheless, the Second Circuit found the need to re-interpret the statute for two apparent reasons. First, Respondents argued that plan sponsors would face a flood of meritless litigation if plaintiffs' prohibited transaction claims would survive a motion to dismiss by alleging only that a fiduciary caused the plan to engage a party in interest to provide services to the plan. Respondents fear that if the § 408 exemptions are characterized as purely affirmative defenses, fiduciaries would be forced to defend meritless prohibited transaction claims without any plausible allegations of wrongdoing.

But trust law has long held that once the beneficiaries have established their *prima facie* case by demonstrating the trustees' breach of fiduciary duty, "the burden of explanation or justification . . . shifts to the fiduciaries." *N.Y. State Teamsters Council Health & Hosp. Fund v. Estate of DePerno*, 18 F.3d 179, 182-83 (2d Cir.

1994)(citation omitted). The Seventh Circuit in *Allen v. GreatBanc Tr. Co*., 835 F.3d 670, 676 (7th Cir. 2016) has recognized that "[f]ive of our sister circuits agree with the position that section 408 exemptions are affirmative defenses, or that the defendant bears the burden of proof, or both"(citations omitted), including, since the infancy of ERISA, the Second Circuit. See, *Marshall v. Snyder*, 572 F.2d 894 (2d Cir. 1978). ,

Respondents also claimed that applying the plain language of the statute would lead to absurd results—prohibiting plan sponsors from obtaining services necessary for the operation of the plan. That erroneous reading of the statute, however, is a recent development, borne of a misreading of this Court's decision in *Lockheed Corporation v. Spink,* 517 U.S. 882 (1996) in *Sweda v. Univ. of Pa.*, 923 F.3d 320, 336–37 (3d Cir. 2019). For decades prior to *Sweda*, most federal courts ruled that § 406(a) contemplates per se violations. *See, e.g., M & R Inv. Co., Inc. v. Fitzsimmons*, 685 F.2d 283, 287 (9th Cir. 1982) ("The party-in-interest prohibitions act to insure arm's-length transactions by fiduciaries of funds subject to ERISA. A transaction with a party in interest is prohibited under the presumption that it is not arm's-length. The result is a broad per se prohibition of transactions ERISA implicitly defines as not arm's-length.") *See, also, Chao v. Hall Holding Co.*, 285 F.3d 415, 440 (6th Cir. 2002) and cases collected at fn 12. Note that this view was adopted by the Tenth Circuit in 1978 in *Eaves v. Penn*, 587 F.2d 453 (10th Cir. 1978) and reaffirmed repeatedly until the Third Circuit's ruling in *Sweda*.

These rulings confirm the intent of Congress in adopting ERISA's prohibited transactions rules "to prohibit outright questionable transactions between

the trust and parties in interest." S. Rep. 93-383, 95 (Aug. 21, 1973).

Finally, the structure of the statute is logically consistent with the view that the listed transactions are prohibited outright unless the plan fiduciary engages in a prescribed process to determine *in advance of the transaction* that the terms are reasonable and fair to the plan. Whether or not, as found by the Second Circuit, the phrase "except as provided in Section 1108" incorporates the terms and conditions of the Section 408 exemptions, the phrase expressly forewarns a plan fiduciary that if he proposes to engage in any of the transactions specified in 406(a)(1), he will breach his fiduciary duties unless he determines that the transaction meets the conditions of an exemption provided by § 408. Therefore, it should not be surprising or burdensome for the fiduciary to plead the steps taken to meet the conditions of the exemption to defeat a prohibited transaction claim; in other words, proving he did just what the statute affirmatively requires of him.

Respondents will undoubtedly protest that that is exactly what they are trying to prevent; having to prove that they satisfied their fiduciary obligation without any allegations that they failed to perform the required investigation. This case, however, does not present that scenario. Appellants expressly alleged that Respondents failed to adequately monitor plan fees, resulting in the payment of excessive and unreasonable compensation compared

to other comparable plans—allegations that directly challenge the performance of Respondents' duties detailed in § 408(b)(2).[2] As all parties and the court here have acknowledged, "§ 1106(a) 'supplements the fiduciary's general duty of loyalty . . . by categorically barring certain transactions" involving a "party in interest,' Harris Trust, 530 U.S. at 241–42", App. 15a, Opp. 10. ERISA § 404 describes in general terms a fiduciary's duties to use care, skill, prudence and diligence in the performance of his duties, solely in the best interest of participants and beneficiaries for the exclusive purpose of providing benefits. But more specifically, a fiduciary must not cause the plan to engage in any of the transactions specified in § 406 unless he determines the transaction satisfies an exemption provided by § 408. Therefore, if the facts alleged are sufficient to sustain claims for a breach of the fiduciary's duty of prudence, and the same set of facts is expressly applicable to the § 408 exemption on which Respondents rely, then that set of factual allegations should be sufficient to sustain a prohibited transaction claim.

Whatever concerns remain that defendants will be unfairly subjected to the baseless claims of the unscrupulous plaintiffs' bar should be alleviated by

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[2] The exemption set forth in ERISA § 408(b)(2), 29 U.S.C. § 1108(b)(2), is the exemption applicable to transactions involving services necessary for the establishment or operation of the plan prohibited by ERISA § 406(a)(1)(C) at issue in this case. Inexplicably, the Second Circuit deemed that the regulation implementing the 408(b)(2) exemption was "not implicated" in this case. App. 18a, fn 7.

by applying established pleading guidelines for any case involving a fiduciary breach.

> To survive a motion to dismiss, a complaint must contain sufficient factual matter, accepted as true, to state a claim to relief that is plausible on its face. A claim has facial plausibility when the plaintiff pleads factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged.

*Ashcroft v. Iqbal*, 556 U.S. 662, 662, 129 S. Ct. 1937, 1939 (2009). The terms of the 408(b)(2) exemption require that the plan fiduciary (i) obtain from the party in interest a description of all services being provided and all direct and indirect compensation the party in interest will receive in connection with those services; and (ii) determine that compensation is reasonable in relation to the services provide. 29 U.S.C. § 2550.408b-2(c). The plausible factual allegations that fees were dramatically higher than a reasonable fee support the inference that Respondents failed to act prudently and either failed to obtain the disclosures required by § 408(b)(2) or failed to determine the compensation was reasonable. In the language of *Iqbal,* the plausible inference of the plainly excessive fees is that Respondents acted imprudently in violation of § 404 and failed to perform the duties required by §§ 406 and 408. Therefore, they are liable to the Plans for fees that exceed a reasonable fee. Accordingly, no special pleading rule is needed because current standards already control the avalanche of litigation that has failed to develop for more than forty years.

Lastly, Respondents and the Second Circuit blithely dismiss the risk posed by service contracts

with parties in interest as "routine" or "ubiquitous arm's-length agreements for necessary services" that are of a different character than the other transactions prohibited by 406(a)(1). But that approach ignores the judgment of Congress to expressly include such agreements within a category of transactions that pose more obvious risks. It also ignores the judgment of the Employee Benefit Security Administration ("EBSA") of the U.S. Department of Labor ("DOL"), the agency primarily responsible for regulating the administration of employee benefit plans, which engaged in a five-year-long regulatory project culminating in the publication of the 408(b)(2) implementing regulation, *Reasonable Contract or Arrangement Under Section 408(b)(2)—Fee Disclosure*, for the very reason that compensation arrangements for plan service contracts are complicated and opaque and posed risks to plans.

## ARGUMENT

### 1. Fears of an explosion in meritless and burdensome litigation are overblown and unsupported.

Respondents' principal reason for urging this Court to adopt the Second Circuit's restrictive interpretation of the relationship between the prohibitions of 406 and the exemptions of 408 is the

fear of meritless litigation[3], claiming that "[a]ny plan participant then could bring a lawsuit in federal court and proceed all the way to summary judgment on the bare allegation that the plan was using those necessary services." Opp. at 10. But history proves otherwise.

**a. The common law of trusts has long held that a fiduciary bears the burden of proving justification.**

Trust law has long held that once beneficiaries have established their prima facie case by demonstrating the trustees' breach of fiduciary duty (in this case, by engaging in a prohibited transaction) the burden shifts to the fiduciary to plead and prove any affirmative defenses.

> In the law of trusts, however, it has been held that once the beneficiaries have established their prima facie case by demonstrating the trustees' breach of fiduciary duty, "the burden of explanation or justification . . . shifts to the fiduciaries." *Nedd v. United Mine Workers of America*, 556 F.2d 190, 210 (3d Cir. 1977), cert. denied, 434 U.S. 1013, 54 L. Ed. 2d 757, 98 S. Ct. 727 (1978); see also *Geddes v. Anaconda Copper Mining Co.*, 254 U.S. 590, 599, 65 L. Ed. 425, 41 S. Ct. 209 (1921); cf. 5 Austin W. Scott & William F. Fratcher, Law of Trusts § 515, at 609 (4th ed. 1989) ("Where a person has wrongfully mingled trust funds with his own,

[3] "Petitioners' view would make it much more expensive for employers to offer plans, because they could be sued for any routine service provider contract. Those lawsuits would discourage employers from offering benefit plans, to the ultimate detriment of plan participants." Opp. at 15.

> the burden is on him to show how much of the mingled fund is his own . . . ."). With respect to damages, the Third Circuit in *Nedd* held that once the plaintiffs established the trustees' breach of their duty of loyalty, the trustees' bore the burden of proving any "set off" to the extent of their liability.

*N.Y. State Teamsters Council,* 556 F.2d at 212-14. *See also, See, also, Fulton Nat'l Bank v. Tate,* 363 F.2d 562, 571–72 (5th Cir.1966) ("[T]he beneficiary need only show that the fiduciary allowed himself to be placed in a position where his personal interest ***might*** conflict with the interest of the beneficiary[, and] the law presumes that the fiduciary acted disloyally." (emphasis in original).

**b. Federal courts have consistently ruled that § 406 categorically prohibits the listed transactions subject to the affirmative defenses of § 408**

Prior to the Third Circuit's ruling in *Sweda*, this Court made it clear that the transactions prohibited by 406(a)(1) are those very transactions that Congress deemed to pose a risk to retirement plans.

> Section 406(a) forbids fiduciaries from engaging the plan in the "sale," "exchange," or "leasing" of property, 29 U.S.C. § 1106(a)(1)(A); the "lending of money" or "extension of credit," § 1106(a)(1)(B); ***the "furnishing of goods, services, or facilities," § 1106(a)(1)(C);*** and the "acquisition . . . of any employer security or

> employer real property," § 1106(a)(1)(E), with a party in interest. *See also* § 1106(b) (listing similar types of "transactions"). ***These are commercial bargains that present a special risk of plan underfunding because they are struck with plan insiders, presumably not at arm's length.*** *See Commissioner v. Keystone Consol. Industries, Inc., 508 U.S. at 160.* What the "transactions" identified in § 406(a) thus have in common is that they generally involve uses of plan assets that are potentially harmful to the plan.

*Lockheed v. Spink,* 517 U.S. at 893 (1996) (emphasis added). "Responding to deficiencies in prior law regulating transactions by plan fiduciaries, Congress enacted ERISA § 406(a)(1), which supplements the fiduciary's general duty of loyalty to the plan's beneficiaries, § 404(a), by categorically barring certain transactions deemed "likely to injure the pension plan," (quoting *Commissioner v. Keystone Consol. Industries, Inc.,*). *Harris Trust & Savings Bank v. Salomon Smith Barney Inc*., 530 U.S. 238, 241–42 (2000). As the Sixth Circuit noted in 2002, "Most courts and commentators have found that § 406(a) contemplates per se violations" under the presumption that the transactions listed in ERISA § 406(a)(1) are not at arm's-length and that experience had shown to entail a high potential for abuse.[4]" *Chao v. Hall Holding*

[4] *See Etter v. J. Pease Const. Co., Inc.*, 963 F.2d 1005, 1010 (7th Cir. 1992) (stating that no injury was required "for a court to find a transaction prohibited or otherwise impermissible"); *Brock v. Citizens Bank of Clovis*, 841 F.2d 344, 347 (10th Cir.

1988) (referring to the transactions listed in § 406 as per se violations); *Leigh v. Engle*, 727 F.2d 113, 123 (7th Cir. 1984) ("The *per se* rules of section 406 make much simpler the enforcement of ERISA's more general fiduciary obligations." (citing S. Rep. No. 93-383, *reprinted in* 1974 U.S.C.C.A.N. 4890, 4979)); *Donovan v. Cunningham*, 716 F.2d 1455, 1464-65 (5th Cir. 1983) ("The object of Section 406 was to make illegal per se the types of transactions that experience had shown to entail a high potential for abuse."); *M & R Inv. Co., Inc. v. Fitzsimmons*, 685 F.2d 283, 287 (9th Cir. 1982) ("The party-in-interest prohibitions act to insure arm's-length transactions by fiduciaries of funds subject to ERISA. A transaction with a party in interest is prohibited under the presumption that it is not arm's-length. The result is a broad per se prohibition of transactions ERISA implicitly defines as not arm's-length."); *Eaves v. Penn*, 587 F.2d 453, 459 (10th Cir. 1978) (noting that under certain circumstances, a fiduciary may be released from the per se violations enumerated in § 406); *Huffer v. Herman*, 168 F. Supp. 2d 815, 2001 WL 345455, at *6 (S.D. Ohio Apr 09, 2001) ("There is no 'good faith' exception to ERISA's fiduciary provisions. [Section 406] sets forth certain transactions that are prohibited *per se*."); *Gray v. Briggs*, 45 F. Supp. 2d 316, 326 (S.D.N.Y. 1999) ("The transactions covered by Section 406(a)(1) 'are per se violations of ERISA regardless of the motivation which initiated the transaction, the prudence of the transaction, or the absence of any harm arising from the transaction.'" (quoting *Reich v. Polera Bldg Corp.*, 1996 U.S. Dist. LEXIS 1365, No. 95 Civ. 3205, 1996 WL 67172, *2 (S.D.N.Y. Feb. 15, 1996))); *Metzler v. Solidarity of Labor Org. Health & Welfare Fund*, 1998 U.S. Dist. LEXIS 12565, No. 95 CIV. 7247, 1998 WL 477964 (S.D.N.Y. Aug 14, 1998), *aff'd Herman v. Goldstein*, 224 F.3d 128 (2d Cir. 2000), *cert. denied Goldstein v. Chao*, 533 U.S. 928, 121 S. Ct. 2549, 150 L. Ed. 2d 716, 2001 WL 290239 (U.S. June 25, 2001) (referring to the per se prohibitions in § 406); *Polera Bldg Corp.*, 1996 U.S. Dist. LEXIS 1365, 1996 WL 67172, *2 ("Congress made it a per se violation of ERISA to conduct transactions [set forth in § 406(a)(1)] because they inherently compromise the duty of trust that is imposed on a

*Co.*, 285 F.3d 415, 440 n.12 (6th Cir. 2002). This was also the rule in the Second Circuit until *Cunningham*. In *Marshall v. Snyder*, 572 F.2d 894 (2d Cir. 1978), that court examined a transaction involving payments to parties in interest for providing services to the plan, prohibited by 406(a)(1)(C). Defendants argued that the [plaintiff] Secretary [of Labor] could avoid the exceptions of 408(b)(2) and (c)(3) only by showing that the amounts were unreasonable. *Id.* at 900. That argument was rejected by the court.

> The responsibility for paying reasonable compensation was the unequivocal fiduciary responsibility of the defendants. Also, it would be new law to find that in a self-dealing transaction - and prohibited transactions involve self-dealing - the party representing the beneficiaries of the fiduciary whose self-dealing transaction is challenged must prove the unfairness of the transaction. The settled law is that in such situations the burden of proof is always on the party to the self-dealing transaction to justify its fairness.

*Marshall,* 572 F.2d at 900. That ruling was affirmed in 1994 in *N.Y. State Teamsters Council Health & Hosp. Fund,* 18 F.3d at 183, noting that proof of fiduciary's

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fiduciary."); *Reich v. Valley Nat. Bank of Arizona*, 837 F. Supp. 1259, 1281 (S.D.N.Y. 1993) (explaining that actions taken in good faith which violate § 406 are still a violation because this is a per se rule); *McDougall v. Donovan*, 552 F. Supp. 1206, 1215 (N.D. Ill. 1982) ("it is apparent that Congress intended § [406] to be virtually a *per se* prohibition against the enumerated transactions.")

employment of parties in interest "alone ... was sufficient to shift to the defendants the burden to show that the employment of [the parties in interest] was fair and reasonable under all of the circumstances." The rule has been the same in the Eighth Circuit:

> "[A] plaintiff need not plead facts responsive to an affirmative defense before it is raised. *See, e.g., Goodman v. Praxair, Inc.,* 494 F.3d 458, 465–66 (4th Cir.2007). Even if Braden's allegation of unreasonableness were seen as raising the exemption for pleading purposes, that does not mean he thereby assumes the burden of proof on the issue. *See* 5 Charles Alan Wright & Arthur R. Miller, *Federal Practice and Procedure* § 1276, at 624–25 (3d ed.2004)."

*Braden v. Wal-Mart*, 588 F.3d 585, 601 fn 10 (8th Cir. 2009). Indeed, the same fears raised by Respondents here were raised and rejected in *Braden*.

> Appellees object that this construction of § § 1106 and 1108 renders virtually any business between a covered plan and a service provider a prima facie "prohibited transaction." They argue that unless a plaintiff is required to plead facts plausibly suggesting a transaction is not exempted under § 1108, ERISA fiduciaries will be forced to defend the reasonableness of every service provider transaction.

*Id.* at 601. In addition to the very cogent reasons for the Eighth Circuit's rejection of that argument—no support in the statute, consistency with the common law of trusts, all

relevant information is in the control of the fiduciary, *Id.* at 601-602—those fears apparently have never come to fruition, as witnessed by Respondents once again crying wolf.

**c. The structure of the statute requires affirmative action by a plan fiduciary which should not be presumed to have been performed.**

The court in *Braden* specifically noted the practical reality that only the plan fiduciary is in control of the facts demonstrating satisfaction of all the conditions of the applicable exemption. The statute itself, however, is even more compelling than that. The Second Circuit has correctly focused on the introductory phrase of 406—"[e]xcept as provided in Section 1108 of this Title", but for the wrong reason. Whereas the Second Circuit uses the phrase as a limitation on the scope of 406(a), its real function is to put fiduciaries on notice, and cautions a plan fiduciary that if he proposes to engage in any of the transactions specified in 406(a)(1), he will breach his duties unless he determines that the transaction meets the conditions of an exemption provided by § 408. In the case of a contract for plan services, 408(b)(2) imposes an affirmative obligation to obtain specific and detailed disclosures from the service provider, and the failure to do so results in a non-exempt prohibited transaction.

Respondents' argument, that interpreting 406(a)(1)(C) to prohibit routine contracts for necessary services would lead to absurd results, presumes that such contracts with a party in interest are fundamentally different from sales or exchanges

of property, or loans or extensions of credit, or the transfer of plan assets, between a plan and a party in interest prohibited by 406(a)(1)(A), (B) or (D). They are all, however, clauses of section 406(a)(1) that forbids a fiduciary from engaging in any of those transactions and, are therefore, of a kind.

It is, admittedly, easier to see a potential conflict when a fiduciary is selling plan assets (prohibited by 406(a)(1)(A) and (D)) or loaning money to a party in interest (prohibited by 406(A)(1)B)). But where's the harm in hiring a party in interest to provide recordkeeping services that are clearly necessary for plan operation? The answer is that, because of the variety of ways plan recordkeepers are compensated, there is a significant risk that the plan fiduciary may not even know how much compensation a recordkeeper is receiving. In fact, prior to July 2012 which is when the 408(b)(2) Rule became effective[5], recordkeepers had no explicit legal obligation to disclose compensation being received from third parties—indirect compensation—such as revenue sharing payments.

Since 2005, the EBSA has had a singular focus: ensuring that plan fiduciaries obtain disclosure of ***all*** of the compensation that plan service providers receive in connection with their services, either directly from the plan or indirectly from other parties. The purpose of these enhanced disclosure obligations is to ensure that, in light of the

[5] "Effective Date: The final rule is effective on July 1, 2012." 77 FR 5632 (Feb. 3, 2012).

complexities in the way plan services were provided and how they were paid for, "responsible plan fiduciaries understand what the plan actually pays for the specific services rendered and the extent to which compensation arrangements among service providers present potential conflicts of interest that may affect not only administrative costs, but the quality of services provided." *Reasonable Contract or Arrangement Under Section 408(b)(2)—Fee Disclosure*, 72 FR 70988.

In December 2007, the EBSA proposed the implementing regulation for the 408(b)(2) exemption, 29 C.F.R. § 408b-2(c), *Reasonable Contract or Arrangement Under Section 408(b)(2) – Fee Disclosure,* requiring specific, detailed disclosures by plan service providers, describing the service to be provided, whether the service was being provided by an affiliate or subcontractor, and all compensation expected to be received by any of them in connection with the service. The DOL explained:

> In recent years, there have been a number of changes in the way services are provided to employee benefit plans and in the way service providers are compensated. Many of these changes may have improved efficiency and reduced the costs of administrative services and benefits for plans and their participants. However, the complexity resulting from these changes also has made it more difficult for plan sponsors and fiduciaries to understand what service providers actually are paid for the specific services rendered.

* * *

> The Department's proposal required that reasonable contracts and arrangements between employee benefit plans and certain providers of services to such plans include specified information ***to assist plan fiduciaries in assessing the reasonableness of the compensation paid for services and the conflicts of interest that may affect a service provider's performance of services.***

Reasonable Contract or Arrangement Under Section 408(b)(2)—Fee Disclosure, 75 FR 41618 (emphasis added). The regulation followed Governmental Accounting Office reports about hidden fees in 401(k) plans. *See Fulfilling Fiduciary Obligations Can Present Challenges for 401(k) Plan Sponsors* (GAO July 2008) http://www.gao.gov/assets/280/278247.pdf.

After four years of public comment and multiple revisions, the final 408(b)(2) Rule[6] was explicit: "***No*** contract or arrangement for services between a covered plan and a covered service provider, nor any extension or renewal, is reasonable within the meaning of section 408(b)(2) of the Act … unless the requirements of this paragraph (c)(1) are satisfied." (Emphasis added.) Failure to satisfy the requirements of the 408(b)(2) Rule means the contract constitutes a non-exempt prohibited transaction under ERISA § 406(a)(1)(C). Rule 408(b)(2) applies to every contract in existence prior

[6] 77 FR 5631 (Feb. 3, 2012)

to July 1, 2012 and every contract entered into on or after July 1, 2012.[7]

Rule 408(b)(2) requires each covered service provider to disclose to the responsible plan fiduciary all direct and indirect compensation it receives including:

> A description of all indirect compensation … that the covered service provider, an affiliate, or a subcontractor reasonably expects to receive in connection with the services described pursuant to paragraph (c)(1)(iv)(A) of this section; including identification of the services for which the indirect compensation will be received, identification of the payer of the indirect compensation, and a description of the arrangement between the payer and the covered service provider, an affiliate, or a subcontractor, as applicable, pursuant to which such indirect compensation is paid.

29 F.R. § 2550.408b-2(c)(1)(iv)(C)(2).

The long and short of this discussion is that Congress included transactions involving plan services, including routine contracts for necessary services, in the same category of other transactions--loans, sales and exchanges of property, and transfers

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[7] 77 FR at 5649.

of plan assets--that Congress determined present special risks to plans and are categorically prohibited, unless the fiduciary affirmatively determines that the transaction is a good deal for the plan.[8] Despite Respondents' benign characterization of recordkeeping and other administrative service agreements as "routine arm's-length agreements to provide necessary plan services," they are anything but routine and require the exercise of prudence and diligence to ensure they are at arm's-length.

Furthermore, the development and issuance of the 408(b)(2) Rule was necessary because the EBSA, stimulated by a variety of sources, including the government study of hidden fees in the administration of 401(k) plans noted above, determined that fiduciaries were failing in their obligation to thoroughly evaluate a service provider's compensation.[9] The 408(b)(2) Rule provides plan

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[8] Further evidence That Congress intended to categorically prohibit "routine" service contracts is found in ERISA's Effective Date provision 29 U.S.C. § 1114(c). Congress recognized that the prohibited transaction rules could snare service contracts in place on ERISA's effective date. So it provided a transition rule exempting from the coverage of 406(a)(1)(C) until June 30, 1977 service arrangements either (A) subject to a binding contract in effect on July 1, 1974 or (B) with a party in interest who customarily provides such services and on terms at least as favorable as an arm's-length transaction with an unrelated party.

[9] "Although the Department of Labor (Department) has issued technical guidance and compliance assistance materials relating to the obligations of plan fiduciaries in selecting and monitoring service providers, the Department continues to believe that, given plan fiduciaries' need for complete and accurate information about compensation and revenue sharing,

fiduciaries with a powerful tool to aid them in ensuring that they obtain complete disclosure of the terms of complicated multi-party contracts and ensure that the compensation is reasonable in relation to the services provided. It makes perfect sense, therefore, to require a plan fiduciary to demonstrate that he has performed that affirmative obligation. [10]

### 2. The conflict among the circuits is based on a fundamental misreading of *Lockheed v. Spink*

The apparent conflict among the Second (*Cunningham)*, Third (*Sweda*), Seventh (*Albert*), Eight (*Braden*), and Ninth Circuits (*Bugielski*) is directly traceable back to an error in the Third Circuit's opinion in *Sweda.* In that case, the court apparently endorsed defendant's characterization of recordkeeping agreements as harmless routine transactions of a different character than the other transactions listed in 406(a)(1), prompting the court

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both plan fiduciaries and service providers would benefit from regulatory guidance in this area." *Reasonable Contract or Arrangement Under Section 408(b)(2)—Fee Disclosure*, 75 FR 41600.

[10] We note that a fiduciary must meet all the conditions for the exemption, or conversely, the transaction is not eligible for the exemption if the fiduciary fails to meet any one of the conditions; an issue relevant to any discussion about pleading standards should the Court affirm.

to rule that "Section 1106(a)(1) is not meant to impede necessary service transactions, but rather transactions that present legitimate risks to participants and beneficiaries . . . ." The court relied on *Lockheed* which it interpreted to say that 406(a)(1) prohibits only those transactions likely to injure the plan, and that it would be "absurd" and contrary to "the balance that Congress struck in ERISA" to believe that Congress intended to "prohibit ubiquitous service transactions and require a fiduciary to plead reasonableness as an affirmative defense under [Section] 1108 to avoid suit." Id. at 336-337. Therefore, allegations that a routine service contract constituted a prohibited transaction required something more than just the existence of the contract. The court perceived a "common thread" among Section 1106(a)(1)'s provisions: the "element of intent to benefit a party in interest." 923 F.3d at 338. Therefore, that "something more" must include factual allegations that support an element of intent to benefit a party in interest. *Id.*

*Lockheed*, however, states specifically that the transactions identified in 406(a)(1), including transactions for legal, accounting, and other services, are those very transactions that "generally involve uses of plan assets that are potentially harmful to the plan", *Id.* at 893, citing *Commissioner v. Keystone Consol. Industries, Inc.,* 508 U.S. 152, 160 (1993)..

The other obvious proof that routine contracts for necessary services are subject to the prohibitions of 406(a)(1)(C) is the very existence of the 408(b)(2) exemption expressly applicable to contracts for services necessary for the

establishment or operation of the plan. The 408(b)(2) exemption exists only because contracts for necessary services are prohibited by 406(a)(1)(C).

Nor is there a common thread among the 406(a)(1) transactions of an intent to benefit a party in interest. The only transaction that could plausibly be interpreted to include such an intent is 406(a)(1)(D) prohibiting the use of plan assets by or for the benefit a party in interest. None of the other listed transactions include that element.

As it turns out, *Lockheed* did address a transaction that involved the use of plan assets by or for the benefit of Lockheed prohibited by 406(a)(1)(D). In that case, plaintiff had challenged the amendment to Lockheed's defined benefit pension plan to provide enhanced retirement benefits to employees who elected early retirement, conditioned on the employees' release of employment-related claims. The payment of enhanced benefits from the plan in exchange for the release, Spink claimed, was a use of plan assets for the benefit of the employer, a party in interest, in violation of 406(a)(1)(D). The Court disagreed. First, the Court noted that "Section 406(a)(1)(D) does not in direct terms include the payment of benefits by a plan administrator", *Id.* at 882. To determine whether the statute should be interpreted to include the payment of benefits, the Court examined the other three categories of transactions prohibited by 406(a)(1) to determine whether payment of plan benefits presented the same type of risk to the plan. The Court concluded that the types of transactions specified in the other clauses

of 406(a), including transactions for necessary services prohibited by 406(A)(1)(C), "generally involve uses of plan assets that are potentially harmful to the plan. . . . The payment of benefits conditioned on performance by plan participants cannot reasonably be said to share that characteristic." *Id.* at 893.

The Court noted further that the statute should not be interpreted in a manner that produces absurd results. Since the entire purpose of ERISA is to protect the provision of benefits to plan participants, it would be absurd to interpret 406(a)(1)(D) to prohibit the payment of benefits. This discussion became the source for another error by the Third Circuit in *Sweda*.

The absurdity the Court was protecting against in *Lockheed* is a logical absurdity resulting in a paradox: interpreting a statute designed to protect benefits in a manner to prevent the payment of benefits. There is no such absurdity at work if 406(a)(1)(C) is interpreted consistently with the plain language of the statute to prohibit routine services contracts between a plan and a party in interest. It would be absurd if 406 were interpreted to absolutely prohibit contracts for necessary services—without exception. This is where the introductory clause of 406(a) is most relevant—"except as provided in Section 1108 . . . ." Under ERISA § 408, a fiduciary is absolutely permitted to engage a party in interest to provide services to the plan, provided he does the things prescribed by 408(b)(2). In other words, it would be absurd to interpret 406(a)(1)(C) as prohibiting ubiquitous contracts for necessary services while ignoring the

exemptions of 408. "Congress (in ERISA § 406) intended to create an easily applied per se prohibition . . . of certain transactions, no matter how fair, unless the statutory exemption procedures (of ERISA § 408(a)) are followed." *Cutaiar v. Marshall*, 590 F.2d 523, 529-30 (3d Cir. 1979).

To the extent that *Albert v. Oshkosh Corp.*, 47 F.4th 570 (2022), relies on *Sweda* and the same incorrect interpretation of *Lockheed,* its reasoning should also be rejected.

**3. The incorporation-by-reference theory is a poor fit for the structure and substance of the prohibited transaction rules.**

Incorporating something by reference generally means importing the entire referenced material verbatim—here, effectively repeating and realleging in 406 the provisions of 408. Otherwise, some amount of legislating is required. The exemptions provided in 408 are varied and can be quite complex. There are currently twenty exemptions provided in § 408(b) and dozens of class exemptions published by the EBSA. It is unclear whether a plaintiff would need to plead facts tending to disprove the application of all possible exemptions or just the one that seems most applicable. The concept of incorporation by reference does not seem to admit a parsing of 408's provisions; that is, it's either all or nothing. For example, if the alleged prohibited transaction involves services provided by a party in interest, does the incorporation by reference argument incorporate into 406(a)(1)(C) only the exemption provided in 408(b)(2), or all of 408, thereby

requiring a plaintiff to negate all possible exemptions? This issue was thoughtfully addressed explicitly in *Allen v GreatBanc*:

> If there is an administrative problem to be worried about, it is the chance that courts would start requiring plaintiffs to negate all section 408 exemptions in their complaints. Pleading the absence of the exemption in subsection (b)(19), for example, would be particularly burdensome: it exempts "cross trading" between a plan and an account managed by the same investment manager where nine specific conditions are met, some of which have further exceptions contained within them. 29 U.S.C. § 1108(b)(19). Requiring a plaintiff to demonstrate that subsection (b)(19) is *not* met in order to bring a prohibited-transaction claim would prematurely defeat many claims where the plaintiffs lack access to detailed information about the plan manager's dealings with other entities.

835 F.3d at 677 .

The provisions of 408 are referred to as exemptions, which implies that some activity otherwise illegal may be saved, or exempted, by special circumstances; a concept that fits more neatly into an affirmative defense rather than an element of the offense. "An affirmative defense raises matters extraneous to the plaintiff's prima facie case; as such, they are derived from the common law plea of 'confession and avoidance.' 5 C. Wright & A. Miller, Federal Practice &

Procedure § 1270, at 289 (1969)." *Ford Motor Co. v. Transp. Indem. Co.*, 795 F.2d 538, 546 (6th Cir. 1986).

This Court has said on more than one occasion, that "Section 1106(a) 'supplements the fiduciary's general duty of loyalty' by 'categorially barring' transactions that are 'likely to injure' the plan." Harris Tr. & Sav. Bank v. Salomon Smith Barney, Inc., 530 U.S. 238, 241-242 (2000). That characterization necessarily means that ***all*** transactions with parties in interest to provide services to a plan are prohibited, "including transactions for routine and essential services that are in no way harmful to the plan." Opp. At 10. Those transactions may be redeemed, however, by complying with the terms of an applicable exemption prescribed by 408.

Respondents, as well as the Second, Third and Seventh Circuits all make the same obvious logical error in their formulation that 406(a) is not intended to prohibit "transactions for routine and essential services that are in no way harmful to the plan." The nature of that flaw is that it presumes the point to be proven which, in the context of 406 and 408, is whether the transaction is in fact routine and in no way harmful to the plan. The reason for that flawed position is that it ignores the essential problem that is the target of 406 in the first instance. It is not, as presumed by the Third Circuit in *Sweda* and the Seventh Circuit in *Albert*, the ***type*** of transaction at issue (e.g., routine contracts for necessary services), it is the identity of the counter-party—a party in interest. Tthat relationship is what creates the risk of unfair or non-arm's-length transactions, as it is with every other transaction prohibited by 406(a). Nor is

anything in 408 that helps identify or clarify the problem with 406(a) transactions, which is the potential conflict with related parties. *See, Cunningham* at 977:

> "Put simply, when read on its own, § 1106(a)—and in particular, § 1106(a)(1)(C), which addresses the "furnishing of goods, services, or facilities between the plan and a party in interest"—is missing an "ingredient[] of the offense." Cook, 84 U.S. (17 Wall.) at 173. That ingredient is the exemption for "reasonable compensation" paid for "necessary" services, reflected in § 1108(b)(2)(A)."

None of the exemptions of 408(b) identifies some otherwise hidden inherent harm in a prohibited transaction. Rather, they all, especially 408(b)(2), provide a procedure for ensuring that the transaction is at arm's-length and not harmful to the plan.

This discussion further highlights another material flaw in the Second Circuit's incorporation theory. The 408(b)(2) exemption is phrased as an affirmative obligation on the part of the plan fiduciary—to obtain disclosures and determine reasonableness. But the incorporation theory requires the obligation be applied in the negative to make the failure of the requirements of 408(b)(2) an "element" of the 406(a) prohibition. In other words, by incorporating 408(b)(2) into 406(a)(1)(C), the statute would have to be read to prohibit "transactions between a plan and a party in interest involving services to the plan *and for which the fiduciary has failed to obtain required disclosures and/or failed to determine that the compensation for the services was reasonable*." In real life, however,

406 and 408 clearly operate in the opposite direction: "transactions between a plan and a party in interest involving services to the plan are prohibited, ***unless*** *the fiduciary has obtained all required disclosures and determined that the compensation for the services was reasonable*."

Even Respondents awkward description of the interplay between 406 and 408 to shoehorn the incorporation theory demonstrates the weakness in the argument. "Section 1106(a) lists common types of transactions that are not inherently wrongful. See 29 U.S.C. 1106(a). Section 1108's exemptions then furnish the missing elements needed to understand which potentially harmful transactions between a plan and a party in interest are prohibited." Opp. at 10. That description turns the statute on its head. At the risk of repetition, the transactions listed in 406(a)(1) are "commercial bargains that present a special risk of plan underfunding because they are struck with plan insiders, presumably not at arm's length." *Lockheed* at 893. So, 1106(a) lists transactions that ***are*** inherently wrongful and are categorically prohibited. Section 1108's exemptions then describe the conditions required to redeem those transactions, not elements that make the 406(a) transactions harmful.

Finally, the whole incorporation approach flies in the face of the practical application of the statute. Section 406 acts as a big red stop sign—"do not engage in any of the listed transactions unless you determine that the transaction satisfies the conditions of an available exemption." The fiduciary must then identify the specific exemption applicable to the proposed transaction and engage in a prudent

process to ensure the transaction meets the conditions of the exemption. This approach eliminates the administrative problem identified in *Allen*. There will be no question which exemption is at issue because the fiduciary should have identified in advance which exemption he intends to rely on. Any prudent fiduciary should be able to then easily demonstrate his performance of the process prescribed by the exemption.

## CONCLUSION

From every conceivable perspective—the explicit legislative history, the decades of federal precedent and consistency with the law of trusts, the logical structure of the statute, including the expression of the 408(b)(2) exemption as an affirmative duty rather than a negative element of the prohibited transaction, the obvious and significant problems with how incorporation would actually work, the erroneous focus on the nature of the transaction rather than the relationship between the parties--it is clear that 406(a)(1) was intended to categorically bar the listed transactions, subject to a fiduciary's affirmative action to thoroughly evaluate a proposed transaction and confirm its reasonableness. For the foregoing reasons, this Court should reverse the judgment of the United States Court of Appeals for the Second Circuit.

Respectfully submitted,

/s/*John J. Nestico*
John J. Nestico
*Counsel of Record*
Schneider Wallace Cotrell Konecky
2138 Harris Road
Charlotte, NC 28211
(704) 840-5263
jnestico@schneiderwallace.com

Norman Stein
*Of Counsel*
Pension Rights Center
1730 M Street , N.W.
Suite 1000
Washington, D.C. 20036
(202) 296-3776
NStein@pensionrights.org