[FILED UNDER SEAL]

No. 18-3310

UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

FREDERICK ROZO,

Plaintiff-Appellant,

v.

PRINCIPAL LIFE INSURANCE COMPANY,

Defendant-Appellee,

PRINCIPAL FINANCIAL GROUP, INC.,

Defendant.

Appeal from the United States District Court
for the Southern District of Iowa – Des Moines
(No. 4:14-cv-00463-JAJ)

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SUMMARY OF THE CASE

Plaintiff-Appellant Frederick Rozo sued Defendant-Appellee Principal Life Insurance Company ("Principal") on behalf of himself and a class, asserting claims under the Employee Retirement Income Security Act ("ERISA"). Through his employer, Rozo was a participant in an investment product Principal offered and administrated, the Principal Fixed Income Option ("PFIO"). Rozo alleges that (1) Principal was a fiduciary that breached its duties by using its binding discretion over the interest rate to set artificially low rates that favored itself over participants, and (2) even if Principal is not a fiduciary, Principal violated ERISA's "party in interest" rules by transacting with ERISA plans on unreasonable terms.

The district court granted summary judgment to Principal. On the fiduciary claims, the court held that Principal was not a fiduciary because, by announcing interest-rate changes in advance, Principal lacked authority to set the rate, even though the PFIO contract imposes substantial impediments to plans (and participants) withdrawing their money in response to an unfavorable change. On the party-in-interest claim, the court held that Principal needed to know not just that its compensation was excessive, but that its compensation violated ERISA.

Oral argument of 20 minutes per side is warranted because this case presents important and novel questions of law under ERISA, based on a complex financial arrangement.

TABLE OF CONTENTS

Introduction 1

Jurisdictional Statement 4

Statement Of The Issues Presented For Review 4

Statement Of The Case 5

I. Facts 5

A. Principal Has Discretion To Set The Rate At Which Participants Earn Interest. 5

B. The Contract Prevents Plans And Participants From Freely Withdrawing Or Transferring Their Money. 8

II. Procedural History 10

Summary Of Argument 12

Standard Of Review 16

Argument 16

I. The District Court Erred In Granting Summary Judgment To Principal On The Two Fiduciary Claims. 16

A. Because Principal Has Binding Unilateral Discretion To Set The Interest Rate, Principal Holds Fiduciary Duties As To That Rate. 17

B. That Principal Exercised Discretion Provided By The Contract Does Not Preclude Fiduciary Status. 19

C. That Principal Announced The Interest Rate In Advance Does Not Preclude Fiduciary Status Because

Plans And Participants Lack Meaningful Ability To Withdraw From The PFIO. 25

II. The District Court Erred In Granting Summary Judgment To Principal On The "Party-In-Interest" Claim. 35

A. ERISA Polices Plans' Transactions With Parties In Interest For Reasonableness. 35

B. Principal Bears The Burden Of Showing It Meets The Section 1108 Exemption. 41

C. Genuine Issues Of Material Fact Remain Regarding Whether Principal Earned Reasonable Compensation Under A Reasonable Contract. 42

Conclusion 45

Certificate Of Compliance 47

Certificate Of Service...48

TABLE OF AUTHORITIES

Page(s)

Cases

Abraha v. Colonial Parking, Inc.,
243 F. Supp. 3d 179 (D.D.C. Mar. 20, 2017) 23

Allen v. GreatBanc Tr. Co.,
835 F.3d 670 (7th Cir. 2016) 41

In re Baycol Prods. Litig.,
596 F.3d 884 (8th Cir. 2010) 44

Braden v. Wal-Mart Stores, Inc.,
588 F.3d 585 (8th Cir. 2009) 5, 41

Charters v. John Hancock Life Ins. Co.,
583 F. Supp. 2d 189 (D. Mass. 2008)..27

Chi. Bd. Options Exch., Inc. v. Conn. Gen. Life Ins. Co.,
713 F.2d 254 (7th Cir. 1983) 20

DiFelice v. U.S. Airways, Inc.,
497 F.3d 410 (4th Cir. 2007) 29

Ed Miniat, Inc. v. Globe Life Ins. Grp., Inc.,
805 F.2d 732 (7th Cir. 1986) 4, 20, 24

F.H. Krear & Co. v. Nineteen Named Trs.,
810 F.2d 1250 (2d Cir. 1987) 22

Fish v. GreatBanc Tr. Co.,
740 F.3d 671 (7th Cir. 2014) 37, 38, 41

Glass Dimensions, Inc. ex rel. Glass Dimensions, Inc. Profit Sharing Plan & Tr. v. State St. Bank & Tr. Co.,
931 F. Supp. 2d 296 (D. Mass. 2013)..22

Golden Star, Inc. v. Mass Mut. Life Ins. Co.,
22 F. Supp. 3d 72 (D. Mass. 2014)...22

Harris Tr. & Sav. Bank v. John Hancock Mut. Life Ins. Co.,
302 F.3d 18 (2d Cir. 2002) 28

Harris Tr. & Sav. Bank v. Salomon Smith Barney, Inc.,
530 U.S. 238 (2000)...*passim*

Henderson v. City of Woodbury,
909 F.3d 933 (8th Cir. 2018) 16

Hi-Lex Controls, Inc. v. Blue Cross Blue Shield of Mich.,
751 F.3d 740 (6th Cir. 2014) 21

Howell v. Motorola, Inc.,
633 F.3d 552 (7th Cir. 2011) 29

Insinga v. United of Omaha Life Ins. Co.,
No. 8:17 Civ179, 2017 WL 6884626 (D. Neb. Oct. 26, 2017) 32, 33

John Hancock Mut. Life Ins. Co. v. Harris Tr. & Sav. Bank,
510 U.S. 86 (1993)...34

John Morrell & Co. v. John Hancock Mut. Life Ins. Co.,
No. 85-09166, 1988 WL 58619 (N.D. Ill. May 31, 1988) 22

McCaffree Fin. Corp. v. Principal Life Ins. Co.,
811 F.3d 998 (8th Cir. 2016) 24, 25

Midwest Cmty. Health Serv., Inc. v. Am. United Life Ins. Co.,
255 F.3d 374 (7th Cir. 2001) 20

Neil v. Zell,
753 F. Supp. 2d 724 (N.D. Ill. 2010)..39

Pegram v. Herdrich,
530 U.S. 211 (2000)...18

Perez v. Chimes D.C., Inc.,
No. 15-03315, 2016 WL 4993293 (D. Md. Sept. 19, 2016) 22

Pipefitters Local 636 Ins. Fund v. Blue Cross
& Blue Shield of Mich., 722 F.3d 861 (6th Cir. 2013) 21, 22

Reich v. Lancaster,
55 F.3d 1034 (5th Cir. 1995) 22

Rozo v. Principal Life Ins. Co.,
No. 4:14-CV-000463-JAJ-CFB, 2017 WL 2292834
(S.D. Iowa May 12, 2017) 11

Santomenno v. Transamerica Life Ins. Co.,
883 F.3d 844 (9th Cir. 2018) 23

Schulist v. Blue Cross of Iowa,
717 F.2d 1127 (7th Cir. 1983) 24

Smith v. BMW N. Am., Inc.,
308 F.3d 913 (8th Cir. 2002) 44

Teets v. Great-West Life & Annuity Ins. Co.,
286 F. Supp. 3d 1192 (D. Colo. 2017)..33, 34

United States v. Ameren Mo.,
No. 4:11 Civ. 77 (RWS), 2016 WL 728234
(E.D. Mo. Feb. 24, 2016)...44

United States v. Glick,
142 F.3d 520 (2d Cir. 1998) 21

Zang v. Paychex, Inc.,
728 F. Supp. 2d 261 (W.D.N.Y. 2010)..27

Statutes

28 U.S.C. § 1291 4

28 U.S.C. § 1331 4

29 U.S.C. § 1001 31

29 U.S.C. § 1002 ....4, 17, 18, 37

29 U.S.C. § 1101 34

29 U.S.C. § 1104 ....4, 10, 29

29 U.S.C. § 1106 ....*passim*

29 U.S.C. § 1108 .... *passim*

29 U.S.C. § 1132 .... 4, 10

Other Authorities

29 C.F.R. § 2550.404 29

29 C.F.R. § 2550.408b-2 .... *passim*

Black's Law Dictionary (8th ed. 2004) 39

Restatement (Second) of Trusts 40

INTRODUCTION

Principal offers an investment product, the Principal Fixed Income Option ("PFIO"), to retirement plans governed by ERISA. Through these plans, individuals like Plaintiff Frederick Rozo invest their retirement savings in the PFIO. Principal has complete discretion to change the PFIO's interest rate—called the "Composite Crediting Rate"—and that rate is binding on plans for at least 12 months unless they pay a 5% withdrawal penalty. Principal has used this binding control to artificially inflate its own profit at the expense of participants. The lower the Composite Crediting Rate, the less participants earn but the more Principal takes.

ERISA forbids Principal's actions. *First*, ERISA categorically bars self-dealing by those with discretion over a retirement plan's assets. Congress deemed such arrangements so inherently ripe for abuse that they are prohibited under any circumstances—no matter how fantastic the participants' returns or how reasonable the company's profits. That means any fiduciary who uses discretion over a plan asset to generate profits for itself must return those profits to the plan.

Principal did not contest before the district court that the PFIO is a self-dealing arrangement. But it argued, and the district court agreed, that by announcing changes to the Composite Crediting Rate in advance, Principal effectively lacked discretion to impose that rate, as plans and participants can simply withdraw their money if

they dislike Principal's choice. That conclusion—particularly at the summary judgment stage—was incorrect.

The PFIO contract prevents plans from terminating without giving Principal 12 months' notice, meaning they are locked into the new rate for a year (which rate Principal can continue to change during the waiting period). For the privilege of terminating immediately, a plan must pay Principal *5%* of its assets. Twelve months' wait or a 5% penalty is plainly not free termination.

As for participants, their ability to exit the PFIO is legally irrelevant. Participants in self-directed 401(k) plans can virtually always transfer freely between investment options. Using that flexibility to preclude fiduciary status for any entity that controls fewer than all of the plan's options would deeply offend ERISA's core principles. What matters is whether *the plan* or *the service provider* has ultimate control over the terms of a given option.

Even so, participants here face a delay in transferring their money, unless they transfer into an investment option that is not a "competing" investment—a euphemistic term for an investment that carries materially more market risk than the PFIO. But taking on more risk is a starkly unpalatable alternative for a retirement saver who has picked the low-risk PFIO. Participants' only other option—withdrawing the funds from their 401(k) *altogether*—is perhaps even worse. Not only do most participants face substantial tax penalties for early withdrawal, but

forcing people who dislike the rate to pull their nest-eggs from the system entirely is fundamentally inconsistent with ERISA's goal of promoting retirement security.

Contrary to the district court's understanding, Principal holds the kind of control over the Composite Crediting Rate that makes it an ERISA fiduciary. At bare minimum, Principal could not obtain summary judgment on that question.

Second, even if Principal could escape fiduciary status, it would still be in violation of a narrower ERISA restriction. When ERISA permits an entity to deal self-interestedly with a plan (*i.e.*, when the entity is not a fiduciary), the statute still polices those transactions for reasonableness. As relevant here, Principal needed to show, as a matter of law, both that its hundreds of millions of dollars in undisclosed profits were reasonable and that the contract itself was reasonable. But, by regulation, a contract is unreasonable if it doesn't permit termination by the plan without penalty on reasonably short notice. The 12-month waiting period and 5% surrender fee readily flunk that test. And as to whether the amount of Principal's compensation was reasonable, Rozo's multiple expert reports defeat any possibility of summary judgment. The dispute here—with experts dueling over what qualifies as "reasonable" under the circumstances—is indeed a paradigmatic factual dispute.

Principal accordingly failed to carry its summary-judgment burden, and the district court erred in holding otherwise. The court's judgment should be vacated and the case remanded for further proceedings.

JURISDICTIONAL STATEMENT

This action arises under 28 U.S.C. § 1331 and ERISA, 29 U.S.C. § 1132(e)(1). Rozo alleges that Principal breached 29 U.S.C. §§ 1104 and 1106 and may thus be held liable under § 1132(a)(2) and (a)(3).

On September 25, 2018, the district court entered summary judgment in favor of Principal on all claims. Rozo timely filed a notice of appeal on October 24, 2018. This Court has jurisdiction pursuant to 28 U.S.C. § 1291.

STATEMENT OF THE ISSUES PRESENTED FOR REVIEW

1. Whether the district court erred in concluding that no genuine issues of material fact remained regarding whether Principal was a fiduciary under ERISA, despite Principal's discretion to set the Composite Crediting Rate and undisputed obstacles to plans and participants withdrawing from the PFIO.

- 29 U.S.C. § 1002(21)(A)
- *Ed Miniat, Inc. v. Globe Life Ins. Grp., Inc.*, 805 F.2d 732 (7th Cir. 1986)

2. Whether the district court erred in concluding that no genuine issues of material fact remained regarding whether Principal had "actual or constructive knowledge of the circumstances" rendering its transactions with the plans unlawful, such that Principal could be held liable as a non-fiduciary under ERISA's rules governing "parties in interest."

- 29 U.S.C. § 1106(a)(1)

- 29 U.S.C. § 1108(b)(2)
- 29 C.F.R. § 2550.408b-2
- *Harris Tr. & Sav. Bank v. Salomon Smith Barney, Inc.*, 530 U.S. 238 (2000)
- *Braden v. Wal-Mart Stores, Inc.*, 588 F.3d 585 (8th Cir. 2009)

STATEMENT OF THE CASE

I. Facts

A. Principal Has Discretion To Set The Rate At Which Participants Earn Interest.

Principal sells an investment product called the Principal Fixed Income Option ("PFIO") to 401(k) retirement plans. Individuals like class representative Frederick Rozo invest in the PFIO through their ERISA-governed retirement plans, the sponsors of which enter into a contract with Principal (the "Contract").

The PFIO is structured as a series of "funds" called Guaranteed Interest Funds. App. 107. These notional funds are simply accounting mechanisms; assets attributed to different funds are not separated or segregated. App. 153. Each fund carries its own notional Guaranteed Interest Rate. App. 109-110. Principal sets the Guaranteed Interest Rate at its sole discretion. App. 149.

Participants earn interest at what is called the Composite Crediting Rate, which represents a weighted average of the Guaranteed Interest Rates for the Guaranteed Interest Funds in existence. App. 111-114, 148-149. (Participants do not

earn the Guaranteed Interest Rates; they receive only the Composite Crediting Rate calculated from them. *Id.*) The Contract does not limit how often Principal can create a new fund or how long the new fund must stay open. App. 107-108, 153. During the class period at issue here, however, Principal created a new Guaranteed Interest Fund every six months and held each one open for new deposits for a six-month period. App. 107-108. Consequently, Principal changed the Composite Crediting Rate every six months. App. 148.

Principal notifies plans of the new Composite Crediting Rate 30 days before it takes effect. App. 164-165. Principal does not directly notify participants of the rate change; instead, it is "totally up to the plan sponsor" whether to communicate the rate change to participants. App. 165.

The Contract does not establish the Guaranteed Interest Rate or the Composite Crediting Rate. Although the Contract does describe factors that go into the Composite Crediting Rate, Principal admits that it unilaterally sets the Guaranteed Interest Rates, which are "inputs" to the Composite Crediting Rate. App. 112.

Principal picks the new Guaranteed Interest Rate for a new fund by subtracting various "deducts" from Principal's expected rate of return on the assets underlying the PFIO. App. 163-164. The deducts purport to account for risk, expenses, and expected profit. *See, e.g.*, *id.*; App. 244 (explaining "many factors" that affect the determination of the Guaranteed Interest Rate, including "risk charges" and "profit

charges" based on Principal's actuarial assumptions); App. 378-379, 458-468. Neither the deducts nor any method for calculating them is established by the Contract. And aside from a "recordkeeping" deduct, the deducts are not disclosed to Principal's clients. App. 247; *see* App. 218.

Critically, Principal does not disclose to plans or participants how it determines the Guaranteed Interest Rates, the deducts used to compute those rates or, ultimately, the Composite Crediting Rate. App. 220. The upshot is that Principal has unfettered discretion to choose the rate at which participants will earn interest in the PFIO.

Principal makes money by investing the assets attributable to the PFIO and retaining the difference—the "spread"—between what it earns and the Composite Crediting Rate that it picked for the PFIO (less Principal's expenses). App. 215. So the lower Principal sets the Composite Crediting Rate, the greater its own profit. Since late 2008, Principal has set its deducts to target a 20% after-tax return on equity. *E.g.*, App. 190. (By contrast, participants never made more than 3.5%. App. 116.)

Principal does not disclose the amount or existence of the spread. App. 215-216. And, again, it does not disclose most of the inputs that produce the Guaranteed Interest Rates, the building blocks of the Composite Crediting Rate.

During the class period, the Composite Crediting Rate declined from 3.50% to 1.25%. App. 116. While participants' earning rate has thus steadily declined, Principal's spread has averaged 2.69%, with a low of 2.16% in 2009 and a high of 2.94% in 2011, settling to 2.67% in 2015. App. 208; App. 497; App. 221-222.

Rozo contends that Principal has inflated the deducts to impermissibly and artificially increase its profit from the PFIO. According to one of Rozo's experts, for instance, "Principal's deductions were excessive compared to the underlying costs and risks Principal bore," and "they double-counted the potential cost of Principal's risks." App. 374. That expert opined that, had Principal selected appropriate figures for its deducts, the Composite Crediting Rate would have been substantially higher. The artificially low rate cost the class "approximately $180 million using simple interest and $214 million using compound interest, from November 2008 through December 2017." *Id.*

B. The Contract Prevents Plans And Participants From Freely Withdrawing Or Transferring Their Money.

The Contract imposes multiple structural obstacles that box plans and participants into staying with the PFIO. These obstacles exist at both the plan level and the participant level. Plans may terminate their interest in the PFIO by either (a) giving Principal 12-months' advance notice or (b) paying a surrender charge of 5% of all the plan's funds. App. 158-159. Accordingly, if a plan wishes to terminate after receiving Principal's notice regarding the new Composite Crediting Rate, the

plan either must endure that new rate for up to a year or it must pay Principal a meaningful share of its assets. For many plans, the surrender charge would be $3.5 million or more of their participants' retirement savings, amounting to several thousand dollars per participant. *E.g.*, App. 379; App. 209-210; App. 225 (5% fee would amount to more than $2000 per participant). Nor are these obstacles hypothetical. When Rozo's plan gave notice of its intent to withdraw, Principal imposed the waiting period required by the PFIO contract. *See* App. 131, 159; App. 225 (showing $32 million in plan assets remaining with Principal nine months after the notice).

At the participant level, limits on withdrawal also exist. Should a participant wish to divest from the PFIO, the Contract imposes an "equity wash": the participant may transfer her funds but only to a "non-competing" investment option, *i.e.*, an investment that carries more market volatility and thus more risk to the participant's retirement account. App. 123-124; App. 83; App. 102. The Contract gives Principal discretion to set the duration of the equity wash, and throughout the class period at issue here, Principal chose a 90-day period during which a transferring participant could not use a competing plan option. App. 123-124.

Moreover, the Contract's "stampede" provision effectively imports a plan-level restriction onto participants. Whereas any given participant is technically free to withdraw (subject to the equity wash), if a sufficient number of participants

withdraw their money apparently "in contemplation of termination of a Plan's Interest," then Principal may impose the 5% surrender charge on the plan. App. 102; *see, e.g.*, App. 250 ("A stampede is a colloquial term, an informal term that we use internally, to describe a situation where a fiduciary attempts to circumvent the employer level surrender provisions by directing employees/participants, to use employee transfer flexibility . . . to get money out of PFIO and circumvent the employer role surrender requirements."). Principal always conducts a stampede inquiry if, during a three-month period, withdrawals representing 20% or more of the plan's total interest in the PFIO have occurred. App. 102.

II. Procedural History

In November 2014, Rozo sued Principal in the U.S. District Court for the Southern District of Iowa, on behalf of himself and other investors in the PFIO. He brought three claims, all under ERISA. *See* App. 57-69 (live complaint). His first and second claims assert that Principal's control over the Composite Crediting Rate rendered it a fiduciary, and that Principal breached its fiduciary duties and engaged in prohibited transactions by using its discretion to profit at the expense of the plans and their participants. *See* 29 U.S.C. §§ 1104, 1106, 1132. Specifically, the first claim alleges that Principal breached its duties by, among other things, setting the Composite Crediting Rate for its own benefit; setting that rate artificially low; charging excessive fees; and failing to disclose its retention of the spread. The

second claim alleges that Principal dealt with the Contract in its own interest and for its own account. Rozo's third claim, brought in the alternative to the fiduciary claims, alleged that even if Principal was not a fiduciary, ERISA barred it from receiving more than reasonable compensation from the plans. 29 U.S.C. § 1106(a).

In May 2017, the district court certified a class of roughly 50,000 participants in the PFIO. *Rozo v. Principal Life Ins. Co.*, No. 4:14-CV-000463-JAJ-CFB, 2017 WL 2292834 (S.D. Iowa May 12, 2017).

In 2018, Principal moved for summary judgment and to decertify the class. The court granted summary judgment on all claims and denied the motion to decertify as moot. On the two fiduciary claims, the court's conclusion rested on two bases. First, the court wrote that Principal was simply "acting pursuant to the PFIO Contract, which is the result of an arms-length bargaining process with the plan sponsors." App. 44. Second, the court thought "that announcing the rate in advance forestalls fiduciary responsibility under ERISA." *Id.* Although the court did not elaborate why, it found that as a matter of law the various restrictions the Contract imposes on plans' and participants' ability to withdraw their funds did not constitute "meaningful" obstacles to rejecting "an objectionable" Composite Crediting Rate. App. 44-45.

On Rozo's non-fiduciary claim, the district court concluded that, although ERISA prohibited Principal from receiving more than reasonable compensation,

Principal could not be held liable for this violation unless it knew, or should have known, that its conduct in fact violated ERISA. App. 49, 51. The court acknowledged that the Supreme Court enunciated the standard as "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) (*see* App. 47), but interpreted that language as requiring knowledge of the conduct's illegality rather than just knowledge of the relevant facts and circumstances. The court accordingly granted summary judgment to Principal on all of Rozo's claims.

SUMMARY OF ARGUMENT

The district court erred in granting summary judgment to Principal.

I. ERISA categorically prohibits fiduciaries from self-dealing. Principal does not deny that the PFIO is a self-dealing arrangement. So the dispositive question on Rozo's first two claims is whether genuine issues of material fact remain regarding whether Principal is indeed a fiduciary.

ERISA defines a fiduciary as an entity that exercises discretion over the management and control of a plan or its assets. Here, there is no dispute that Principal sets the Composite Crediting Rate under the Contract (a plan asset) and that this rate is binding on plans for at least 12 months, unless the plan pays a 5% surrender

penalty. That is a paradigmatic circumstance in which courts impose fiduciary status on a third-party service provider.

The thrust of the district court's contrary reasoning was that, by announcing the Composite Crediting Rate to plans in advance, plans and participants had the final say in accepting or rejecting that rate by either maintaining their investment in the PFIO or withdrawing (or transferring) their funds. But there is nothing special about simply *announcing* a rate in advance. What matters is whether Principal can force its chosen rate on plans. If plans are effectively stuck with Principal's choice either way, it is irrelevant whether Principal tells them in advance what the rate will be.

And here, Principal cannot possibly get summary judgment on the question whether its rate-setting is binding. Principal indeed *does not dispute* (1) that it chooses the interest rate, and (2) that plans must either accept that rate for 12 months or pay a 5% surrender surcharge—an obvious penalty (and windfall to Principal). The district court's conclusion that, *as a matter of law*, this does not place Principal in control cannot be squared with bedrock ERISA principles or the record.

The district court also believed that Principal could avoid fiduciary status based on *participants'* ability to exit if they disliked its rate-setting decision. But beyond a single out-of-circuit district court, not one case has ever held that participants' ability to move their money elsewhere can insulate a service provider

from fiduciary status. That's because such a rule makes no sense: if Principal had discretion to choose one investment to put on the plan's menu and it chose a Ponzi scheme, it would not dream of arguing that because participants could have chosen one of the *other* investments offered by the plan, it would be absolved of fiduciary status. The exact same thing is true here. What matters is not that participants could move their money, but that Principal controls the terms of an investment option in an ERISA plan, and its control cannot be overridden by *anyone*.

Even so, there is also a triable fact dispute over whether participants can in fact exit freely. *First*, participants face the equity wash provision. They can exit only by first putting their retirement nest-egg into a riskier investment vehicle. Forcing participants to take on greater risk flies in the face of ERISA's goals and protections. *Second*, if too many participants nonetheless take on that risk, the stampede provision will trigger the 5% surrender charge on top. *Third*, practical obstacles, like investor inertia and tax penalties, further detract from what the district court thought was meaningful freedom to respond to an unfavorable rate change. The district court therefore erred in holding *as a matter of law* that participants retain meaningful freedom in the face of all these impediments.

II. Even were the district court correct that Principal is not a fiduciary, summary judgment was still improper because Principal can be held liable as a non-fiduciary "party in interest." ERISA creates a special participant-protection regime

that requires scrutiny of *every single transaction* between a plan and a third-party service provider for reasonableness, and it requires the *defendant* to establish that the transaction at issue happened on reasonable terms. 29 U.S.C. § 1108(b)(2).

When that defendant is a third-party service provider, the Supreme Court has held the defendant will be liable if it 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 district court incorrectly held that *Salomon*'s standard requires knowledge of the conduct's illegality; rather, the plain meaning of *Salomon* is that Principal needed only actual or constructive knowledge of the facts surrounding the compensation arrangement.

Under that standard, summary judgment was improper. To satisfy Section 1108(b)(2), Principal's compensation must be reasonable *and* the contract governing the services itself must be reasonable. *See* 29 C.F.R. § 2550.408b-2(a)(2), (3). But the pertinent regulation provides that a contract is *not* reasonable if it does not "permit termination by the plan without penalty to the plan on reasonably short notice under the circumstances to prevent the plan from being locked into an arrangement that has become disadvantageous." 29 C.F.R. § 2550.408b-2(c)(3). The Contract's 12-month delay and 5% surrender charge easily create a fact issue (at minimum) that defeats summary judgment.

Moreover, as to the amount of Principal's compensation, Rozo presented expert reports explaining that Principal's compensation was excessive. Although Principal has its own experts who disagree, that is a classic battle of the experts that cannot be resolved on summary judgment.

The district court's judgment should be vacated and the case remanded.

STANDARD OF REVIEW

This Court "review[s] the district court's grant of summary judgment de novo, viewing the record in the light most favorable to the nonmoving party and drawing all reasonable inferences in that party's favor." *Henderson v. City of Woodbury*, 909 F.3d 933, 938 (8th Cir. 2018) (citation omitted).

ARGUMENT

I. The District Court Erred In Granting Summary Judgment To Principal On The Two Fiduciary Claims.

Reduced to their essentials, Rozo's first two claims contend that Principal exercised binding control over the Contract (a plan asset) by setting the interest rate, and then unlawfully used its control to profit from that asset. Congress concluded that such self-interested arrangements present an unacceptably high risk of abuse, so ERISA bars them under any circumstances.

A. Because Principal Has Binding Unilateral Discretion To Set The Interest Rate, Principal Holds Fiduciary Duties As To That Rate.

ERISA's categorical bar on self-dealing restricts only those who carry fiduciary duties under ERISA. Principal does not dispute that the PFIO creates a self-dealing arrangement. Principal's fiduciary status is thus the dispositive question on which the district court rested its judgment for Principal on Rozo's first two claims. App. 38, 40. Contrary to the court's conclusion, however, Principal is a fiduciary because it holds undisputed, unilateral discretion to set the Composite Crediting Rate, and it can force plans to either accept its decision or face serious negative consequences.

The basic framework for answering the fiduciary status question is not in dispute. Under ERISA, "a person is a fiduciary with respect to a plan to the extent . . . he exercises any discretionary authority or discretionary control respecting management of such plan or exercises any authority or control respecting management or disposition of its assets." 29 U.S.C. § 1002(21)(A). This inquiry is functional, not formal. Regardless of whether a plan actually labels Principal a fiduciary, "to the extent" it wields "any discretionary authority or discretionary

control" over the plan or its assets, it owes fiduciary duties with respect to that action. *See Pegram v. Herdrich*, 530 U.S. 211, 225-26 (2000).[1]

The "authority or control" inquiry is straightforward here. There is no dispute that Principal unilaterally establishes the Composite Crediting Rate. The Contract says so ("the rate which we [*i.e.*, Principal] declare," App. 81); Principal agrees as much ("Principal announces what interest rate it will promise," Principal's Reply in Support of Summary Judgment at 2); and the district court recognized the same ("during the class period, Principal established a new CCR every six months," App. 35). Nobody besides Principal has any say over what the Composite Crediting Rate will be. It is Principal's and only Principal's decision, and Principal is entitled to make that decision using whatever criteria it pleases. That control makes Principal a fiduciary.

Principal, moreover, could have avoided becoming a fiduciary by setting the Composite Crediting Rate in a non-discretionary manner. Even if it is not feasible for Principal to offer a stable-value product that guarantees a fixed interest rate forever, Principal's contract with the plans could have specified how, and under what

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[1] With regard to plan assets (including the plans' contract with Principal), as opposed to the plan itself, ERISA requires only "control," not "discretionary control." *See* 29 U.S.C. § 1002(21)(A). But for purposes of this case, the two inquiries are functionally identical: the question is whether Principal exercised control over the contract by setting the Composite Crediting Rate. This brief therefore uses the terms interchangeably.

circumstances, the rate would mechanically change. The rate could, for example, be set using a contractually predetermined formula tied to certain interest rate benchmarks. Instead, Principal retained and exercised unchecked and unilateral discretion to set the rate, thereby assuming the role of a fiduciary under ERISA's most basic principles.

The district court avoided that result by holding that (a) Principal was merely acting pursuant to the Contract, which was negotiated at arm's length, and (b) Principal actually lacked discretion because plans and participants can "vote with their feet" by moving their money out of the PFIO should they dislike the new Composite Crediting Rate. App. 44. As explained below, both contentions are incorrect; at the very least, genuine issues of material fact preclude summary judgment.

B. That Principal Exercised Discretion Provided By The Contract Does Not Preclude Fiduciary Status.

The district court wrote that Principal is not a fiduciary in setting the Composite Crediting Rate because "Principal is acting pursuant to the PFIO Contract, which is the result of an arms-length bargaining process with the plan sponsors." App. 44. That conclusion rested on the idea that "when a service provider and a plan trustee negotiate at arm's length over the terms of their agreement, discretionary control over plan management lies not with the service provider but with the trustee, who decides whether to agree to the service provider's terms." App.

43 (quoting *Santomenno ex rel. John Hancock Tr. v. John Hancock Life Ins. Co. (USA)*, 768 F.3d 284, 293 (3d Cir. 2014)).

The district court fundamentally misunderstood the scope of that principle. Although a service provider is not a fiduciary with respect to negotiating and executing terms of the contract, the provider unequivocally can become a fiduciary if the contract gives the provider ongoing discretion and the provider exercises that discretion in a way that affects the plan or plan assets.

1. It is well settled that where, as here, the service provider has discretion over the contract's terms going forward, the service provider holds fiduciary duties as to those terms. For example, as the Seventh Circuit put it, if the contract "grants an insurer discretionary authority, *even though the contract itself is the product of an arm's length bargain*, the insurer may be a fiduciary." *Ed Miniat, Inc. v. Globe Life Ins. Grp., Inc.*, 805 F.2d 732, 737 (7th Cir. 1986) (emphasis added); *see also, e.g.*, *Midwest Cmty. Health Serv., Inc. v. Am. United Life Ins. Co.*, 255 F.3d 374, 376-377 (7th Cir. 2001) ("because [defendant] had discretionary authority over the contract in its ability to amend the value of the contract, [it] is an ERISA fiduciary"); *Chi. Bd. Options Exch., Inc. v. Conn. Gen. Life Ins. Co.*, 713 F.2d 254, 257, 260 (7th Cir. 1983) (holding an insurer's unilateral right to alter the terms of its annuity contract with an employee pension plan, including the ability to "change the rates" of return, allowed the insurer to "alter [the contract's] value" and made it a fiduciary).

The Sixth Circuit has recognized this principle as well. In *Hi-Lex Controls, Inc. v. Blue Cross Blue Shield of Michigan*, 751 F.3d 740 (6th Cir. 2014), Blue Cross Blue Shield of Michigan (BCBSM) had contracted to administer Hi-Lex's health benefit plans by processing employees' healthcare claims and granting them access to provider networks. Pursuant to its authority under the contract, BCBSM unilaterally added certain charges to its bills that were not part of the initially-negotiated rates. When sued for breach of fiduciary duty, BCBSM argued its decision to add these charges was permitted by the contract and thus could not trigger a fiduciary duty to the plan.

The Sixth Circuit rejected this argument. It concluded that BCBSM was not merely collecting a pre-determined, agreed-upon price. It had discretion regarding whether to impose the fees, and so was an ERISA fiduciary when making that decision. *Id.* at 743 (following *Pipefitters Local 636 Ins. Fund v. Blue Cross & Blue Shield of Mich.*, 722 F.3d 861, 866-67 (6th Cir. 2013) (insurer held to be ERISA fiduciary with respect to hidden administrative fees that it unilaterally added to hospital claims)). So too here. Principal's contractual authority to change the interest rate at will makes it a fiduciary.

The Second Circuit has recognized this principle in the specific context of an insurer's control over the amount of its compensation, holding that such control gives rise to a fiduciary duty. *United States v. Glick*, 142 F.3d 520, 528 (2d Cir.

1998) (insurance agent was fiduciary where he had discretion to set his own commission rate for marketing health insurance plan). As the Second Circuit has further explained: "after a person has entered into an agreement with an ERISA-covered plan, the agreement may give it such control over factors that determine the actual amount of its compensation that the person thereby becomes an ERISA fiduciary with respect to that compensation." *F.H. Krear & Co. v. Nineteen Named Trs.*, 810 F.2d 1250, 1259 (2d Cir. 1987).

The Fifth Circuit has drawn the same conclusion, as have district courts across the country. *See Reich v. Lancaster*, 55 F.3d 1034, 1049 (5th Cir. 1995) (insurance agent was a fiduciary because he was the "decision maker when it came to insurance purchases and the payment of compensation to those who procured it on behalf of the Fund," including himself); *Pipefitters*, 722 F.3d at 867; *see also Golden Star, Inc. v. Mass Mut. Life Ins. Co.*, 22 F. Supp. 3d 72, 81 (D. Mass. 2014) ("The caselaw is clear that a service provider's retention of discretion to set compensation can create fiduciary duties under ERISA with respect to its compensation."); *Glass Dimensions, Inc. ex rel. Glass Dimensions, Inc. Profit Sharing Plan & Tr. v. State St. Bank & Tr. Co.*, 931 F. Supp. 2d 296, 304 (D. Mass. 2013); *Perez v. Chimes D.C., Inc.*, No. 15-03315, 2016 WL 4993293, at *7-8 (D. Md. Sept. 19, 2016); *John Morrell & Co. v. John Hancock Mut. Life Ins. Co.*, No. 85-09166, 1988 WL 58619,

at *1 (N.D. Ill. May 31, 1988); *Abraha v. Colonial Parking, Inc.*, 243 F. Supp. 3d 179, 187 (D.D.C. Mar. 20, 2017).

In short, where, as here, a service provider retains and exercises ongoing discretion over a contractual term, it is a fiduciary.

2. Cases finding no fiduciary status only underscore that what matters is whether terms are definitively set in the initial arm's-length negotiation as opposed to the service provider retaining ongoing discretion. For example, in *Santomenno v. Transamerica Life Insurance Co.*, the Ninth Circuit held that the third-party administrator of a defined-contribution 401(k) plan was not a fiduciary with respect to the decision to withdraw its fees from the plan's pooled accounts, because the fees were fixed by a contractual formula and thus withdrawing them was a "purely ministerial" act. 883 F.3d 833, 840-41 (9th Cir. 2018). The court characterized its holding as "narrow[ly]" addressed to the situation where "a service provider's definitively calculable and nondiscretionary compensation is clearly set forth in a contract with the fiduciary-employer" and the service provider collects its fees "out of plan funds in strict adherence to that contractual term." *Id.* at 841 (emphasis added). The court recognized that if the service provider's compensation were not "definitively calculable and nondiscretionary," "this might well be a different case." *Id.* That "different case" is this one.

Similarly, in *Schulist v. Blue Cross of Iowa*, the Seventh Circuit found the insurer "d[id] not exercise discretionary authority with respect to the setting of [its] rates" because the rates were definitively set in the initial contract negotiation, and the insurer had no discretion to later change them. 717 F.2d 1127, 1131-32 (7th Cir. 1983). As that court later explained, *Schulist* "stands for the proposition that if a specific term (not a grant of power to change terms) is bargained for at arm's length, adherence to that term is not a breach of fiduciary duty. No discretion is exercised when an insurer merely adheres to a specific contract term." *Ed Miniat*, 805 F.2d at 737.

This Court's decision in *McCaffree Financial Corp. v. Principal Life Insurance Co.*, 811 F.3d 998 (8th Cir. 2016), upon which the district court relied, is no different. *McCaffree* supports the principle that retaining ongoing discretion confers fiduciary status, while setting terms definitively in the initial arm's-length negotiation does not. The district court quoted *McCaffree* as explaining that "a service provider's adherence to its agreement with a plan administrator does not implicate any fiduciary duty where the parties negotiated and agreed to the terms of that agreement in an arm's-length bargaining process." 811 F.3d at 1003. But the contract there "clearly identified each separate account's management fee and authorized [the defendant] to pass through additional operating expenses to participants in these accounts." *Id.* The contract there, moreover, calculated

management fees "as a percentage of the assets invested in a separate account" and capped those fees; it also limited operating expenses to clearly defined expenses. *Id*. at 1001. The defendant thus merely executed the kind of non-discretionary ministerial act that does not confer fiduciary status.

Here, by contrast, Principal retained and exercised discretion to change the Composite Crediting Rate at will, based on factors of its own choosing that are neither defined nor disclosed in the Contract. That unfettered control triggers fiduciary responsibilities.

3. The upshot of these cases is plain. An entity in Principal's shoes will *not* be a fiduciary if the contractual term at issue—here the Composite Crediting Rate—was definitively set by the contract. But if, on the other hand, the entity retains discretion over a contractual term going forward, it *will* hold fiduciary responsibility with respect to that term. That is precisely what happened here; the Composite Crediting Rate lies exclusively within Principal's discretion. The fact that the Contract gave Principal that discretion—that Principal was "acting pursuant to the PFIO Contract" (App. 44)—wholly fails to shield it from fiduciary obligations.

C. That Principal Announced The Interest Rate In Advance Does Not Preclude Fiduciary Status Because Plans And Participants Lack Meaningful Ability To Withdraw From The PFIO.

Because unilaterally deciding the PFIO's interest rate would plainly be an exercise of discretionary authority, Principal also argued that it didn't really have

that authority at all. Rather, according to Principal, it is the plans and participants who have the final say “because [Principal] announces each new [Composite Crediting Rate] in advance,” which the plan and its participants can then accept or reject by staying in or leaving the PFIO. App. 40.

The district court agreed with that contention. It held that the participant-level restrictions “do[] not obviate the meaningfulness of a participant’s ability to leave the PFIO” and the plan-level restrictions “do not pose such a bar to leaving the PFIO that plan sponsors do not have a meaningful way to reject Principal’s rate-setting decisions.” App. 44-45. That was error, especially at the summary-judgment stage. There is at least a fact issue whether plans and participants (even if participants’ ability to exit mattered) have a meaningful opportunity for a costless exist from the PFIO based on a 30-day notice from Principal to the plan.

1. At the plan level, the Contract forbids a plan from terminating unless it gives Principal 12-months’ advance notice. That means Principal can force the plan to accept the new Composite Crediting Rate for an entire year. The plan’s only other option would be to pay Principal the 5% surrender charge, a windfall for Principal’s decision to lower the Composite Crediting Rate.

These obstacles are not hypothetical. When Rozo’s plan gave notice of its intent to withdraw, Principal imposed the waiting period. App. 131-132; App. 225. Had Rozo’s plan wished to avoid that costly delay, it would have had to pay

approximately $1.5 million—or about $2000 per participant invested in the PFIO. App. 225. And for many plans invested in the PFIO, the amount would be two or more times that size. *E.g.*, App. 379; App. 209.

The district court did not explain how these obstacles leave plan sponsors "a meaningful way to reject Principal's rate-setting decisions." App. 45. The court simply asserted that conclusion. It thought these restrictions were "not as severe as those in" *Charters v. John Hancock Life Insurance Co.*, 583 F. Supp. 2d 189 (D. Mass. 2008), but *Charters found* fiduciary status and in no way indicated that the restrictions there represented the floor. Regardless, the termination fee there was 2%, less than half the surrender charge here. *Id.* at 199.[2]

This plan-level obstacle means that Principal cannot be insulated from fiduciary responsibility based on plans' purported "approval" of its rate-setting decision. At bare minimum, that question must be put to a factfinder.

2. The district court also rested on *participants'* purported ability to exit. But participants' ability to exit is legally irrelevant. The relevant focus is on *plans'* freedom to reject a service provider's exercise of discretion. The reason for this is simple: keying fiduciary status to participants' ability to exit makes no sense and is

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[2] The court also cited *Zang v. Paychex, Inc.*, 728 F. Supp. 2d 261 (W.D.N.Y. 2010) (*see* App. 42), but that case helps Rozo by negative implication. The plan in *Zang* possessed a *completely unfettered* right of termination—no waiting period *or* financial penalty. 728 F. Supp. 2d at 271. By contrast, the substantial obstacles here readily defeat summary judgment.

inconsistent with the law. It is typical for 401(k) plans to permit free selection among and transfer between investment options. It would be fundamentally contrary to ERISA for that flexibility to preclude fiduciary status for any entity who controls fewer than all of the plan's options.

To illustrate: everyone agrees that if a third-party service provider has discretion to select one or more of the investments available to plan participants, it holds fiduciary duties with respect to that selection. *See, e.g.*, *Harris Tr. & Sav. Bank v. John Hancock Mut. Life Ins. Co.*, 302 F.3d 18, 28 (2d Cir. 2002) (citing *Johnson v. Georgia-Pacific Corp.*, 19 F.3d 1184, 1189 (7th Cir. 1994)). That means its choice must be prudent and not self-interested. *See id.* That could not be the law if participants' ability to choose a different investment were relevant to the fiduciary status of the third-party service provider. In other words, no one believes that a service provider can avoid fiduciary status merely because participants are free to reject the investment option over which the service provider has control.

A simple example underscores this point. Suppose that a service provider is given discretion to select one of ten options available to plan participants, and it selects a Ponzi scheme. In that case, participants would be free to choose another investment (selected by somebody else). They would also be free to move their money out of the Ponzi scheme at any time. Yet the service provider would swiftly lose if it argued that participants' ability to exit absolved it of fiduciary status. Courts

and regulations have indeed consistently rejected attempts to escape liability based on individual participants' ability to select alternative investments. *E.g.*, *Howell v. Motorola, Inc.*, 633 F.3d 552, 567 (7th Cir. 2011); 29 C.F.R. §§ 2550.404c-1, c-5.

The same reasoning applies here. Although Principal does not choose whether a plan offers the PFIO in the first place, it does bindingly choose the PFIO's interest rate on an ongoing basis—*i.e.*, it controls the *terms* of the investment option. It would be nonsensical to say that participant exit affects fiduciary status for entities that choose an investment's *terms*, but not for entities that choose whether to include an investment *in the first instance*. In either case, participant exit is entirely irrelevant.

Moreover, even under the narrow affirmative defense pertaining to participant-directed investments, 29 U.S.C. § 1104(c), which is not at issue in this case, an entity may not excuse its *own* wrongdoing simply because the participant could have chosen an alternative investment. *See, e.g.*, *DiFelice v. U.S. Airways, Inc.*, 497 F.3d 410, 423 (4th Cir. 2007) ("[A] fiduciary cannot free himself from his duty . . . simply by arguing that other funds, which individuals may or may not elect . . . could theoretically . . . create a prudent portfolio.") (emphasis omitted). Section 1104(c) in fact makes clear that—even though the fiduciary may be shielded from *liability* where a participant's investment choice (*e.g.*, to allocate all funds to risky stocks) causes her loss—the entity "otherwise" remains a fiduciary. 29 U.S.C. § 1104(c)(1)(A)(ii). The district court was therefore wrong to use participants'

ability to choose between the PFIO and other investments to deny Principal's fiduciary status.

3. In any event, even were participants' ability to withdraw money from the PFIO relevant to the issue presented, the PFIO Contract erects obstacles in front of participants as well. First and foremost, under the "equity wash" provision, participants must wait 90 days before moving money into a "competing" investment. App. 123-124; App. 83, 102. Principal "strictly adhered" to the equity wash restriction. App. 156. Participants thus must keep their money in the PFIO, earning at the new Composite Crediting Rate with which they're unhappy, or move their money into a non-competing, *i.e.*, riskier, investment. But particularly for a retirement account, an investment's risk profile constitutes the critical factor in an investment decision. *Cf.* App. 450-452 (Plaintiff's rebuttal expert report) ("Principal's equity wash restrictions would force participants to transfer their money from the [PFIO] to investment options that have market risk at precisely the time that the market risk in those options is relatively great.").[3] ERISA should not tolerate service providers effectively forcing participants to undertake more risk than

[3] Principal itself emphasizes risk profile in giving investment advice. *See, e.g.*, https://www.principal.com/individuals/explore-life-money/new-investing-or-just-need-quick-review-basics ("Risk and years to retirement are probably not on your list of favorite topics. But when these two are aligned, they may help you make informed investment choices"); https://www.principal.com/individuals/explore-life-money/asset-allocation-creating-your-individual-mix.

they want. For people relying on having a stable, low-risk investment option to make their money last through retirement, that is no choice at all.

And if too many participants decide to tolerate the equity wash in order to get out of the PFIO, the stampede provision kicks in, which triggers a 5% surrender fee on the plan. Although that charge is nominally incurred by the plan, Principal acknowledges that the plan can pass it on to participants. App. 159. So this marks another way that Principal tries to keep unwilling participants in the PFIO after announcing an unfriendly rate change.

On top of these contractual obstacles, Principal and the district court ignored the practical impediments to withdrawing retirement funds from the PFIO.

First, as Principal's expert admitted, while some participants take a more active management role in their portfolios, "a large number of participants" simply decide on an allocation then leave their funds as is "for long periods of time." App. 252. Principal takes advantage of that inertia.

Second, participants withdrawing funds from 401(k) plans may be subject to income taxes and penalties, which further discourage withdrawals, despite that the participant dislikes the new Composite Crediting Rate. *See* App. 163. Forcing people to withdraw their retirement savings *altogether* to avoid Principal's rate-setting decision is fundamentally contrary to ERISA's purpose. *See, e.g.*, 29 U.S.C. § 1001(a) (declaring ERISA's purposes to include "the continued well-being and

security of millions of employees and their dependents" and ensuring "employees with long years of service [receive] anticipated retirement benefits").

And third, there is no evidence that a mere 30 days allows busy participants a meaningful opportunity to evaluate their options (or allows plans willing to pay the 5% surrender charge enough time to shift tens of millions of dollars into a new contract with a different company that will meet participants' needs).

Again, the district court's analysis dismissing these obstacles was largely conclusory. The court stated that the equity wash "does not obviate the meaningfulness of a participant's ability to leave the PFIO," App. 44, but failed to explain how putting participants to that choice comported with ERISA, let alone how there could not even be a fact issue regarding participants' withdrawal ability.

The court noted that another case, *Insinga v. United of Omaha Life Insurance Co.*, No. 8:17 Civ179, 2017 WL 6884626 (D. Neb. Oct. 26, 2017), found that a service provider was not a fiduciary with respect to a plan containing a similar equity wash provision. App. 44. But *Insinga* is wholly unpersuasive—although its statement of facts mentioned the equity wash, its analysis of fiduciary status turned entirely on "[t]he Plan['s] . . . full discretion to invest in a different fund" at any time. 2017 WL 6884626, at *3. The court did not even mention participant exit or the equity wash, much less square those with the fiduciary inquiry. *See id*.

4. Nor do plans and participants provide so-called "approval" of Principal's decision about how much spread to retain and thus how much compensation it receives. The district court's reasoning here follows from its conclusion regarding setting the Composite Crediting Rate—"Principal cannot control its own compensation through retaining the spread because ultimately its compensation is based on how many people invest in the PFIO," and plans and participants have a meaningful opportunity to withdraw from the PFIO. App. 46. That analysis fails for the reasons already explained. No such meaningful opportunity exists.

In all events, plans and participants cannot possibly approve or reject Principal's compensation *because Principal does not disclose where it has set the spread.* App. 215-216; *see, e.g.*, App. 258 ("Q. So you were able to avoid going to clients and talking to them about a fee increase by . . . creating the FSA pricing support deduct? A. That's right."). Nor can plans or participants deduce the size of the spread based on the information that Principal does disclose. They therefore have no ability to determine how much compensation Principal has elected to keep for itself. Principal cannot hide behind the "approval" of its compensation when it has given nothing to approve.[4]

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[4] Throughout the district court's opinion, the court relied on *Teets v. Great-West Life & Annuity Ins. Co.*, 286 F. Supp. 3d 1192 (D. Colo. 2017), *appeal pending* No. 18-1019 (10th Cir.), a decision granting summary judgment to the defendant on

5. In short, Principal imposes major obstacles to both plans and (although it is irrelevant) participants withdrawing from the PFIO. At a minimum, it is a fact question whether those obstacles allow meaningful freedom to escape. The court's ruling is irreconcilable with a proper application of the summary judgment standard. The court cannot simply declare, as a matter of law, that they retain a "meaningful" ability to move their money. App. 44-45.[5]

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substantially similar ERISA claims for substantially similar reasons. The reasoning in *Teets* fails for all the same reasons the district court's analysis here fails.

[5] Before the district court, Principal also argued it was not a fiduciary based on a rule called the guaranteed benefit policy exemption ("GBP exemption"). The GBP exemption shields insurers from fiduciary responsibility for plan money placed in their general accounts, if the insurer guarantees to provide a certain level of benefits to participants in return. *See* 29 U.S.C. § 1101(b)(2). The exemption applies only "to the extent" that the contract "allocates investment risk to the insurer," rather than to plan participants. *John Hancock Mut. Life Ins. Co. v. Harris Tr. & Sav. Bank*, 510 U.S. 86, 97, 106 (1993). It also requires the insurer to guarantee a reasonable rate of return on any money that is not yet guaranteed. *Id.* And even when the exemption applies, the contract itself remains a plan asset, even though the plan money held in the insurer's general account does not. *See id.*; 29 U.S.C. § 1101(b)(2)(B) (explaining that when the GBP exemption applies, "the assets of [the] plan shall be deemed to include [the] policy").

Here, the GBP exemption does not apply to the PFIO Contract at all, because the Contract guarantees neither what the Composite Crediting Rate will be nor that participants will receive a reasonable rate of return. Every six months, the rate may change entirely in Principal's discretion. Thus, on a prospective basis, the contract in fact allocates investment risk to plan participants, not Principal. And because Principal can set the rate at zero, the contract does not guarantee a reasonable rate of return.

Nonetheless, as the district court correctly concluded, the GBP exemption is ultimately irrelevant here. App. 40. When it applies, the insurer is not a fiduciary with respect to plan money held in its general account. But here, even setting aside

II. The District Court Erred In Granting Summary Judgment To Principal On The "Party-In-Interest" Claim.

Even if Principal is not a fiduciary, it is liable as a party in interest—*i.e.*, an entity that provides services to an ERISA plan—that received more than reasonable compensation from the plans. To fall within the reasonable-compensation exemption, the compensation for Principal's services must be reasonable and furnished under a reasonable contract. Principal, moreover, bears the burden of proving its compensation was reasonable and pursuant to a reasonable contract, according to the law of every circuit to address the issue. Because genuine issues of material fact remain regarding whether Principal carried that burden, the district court erred in granting summary judgment to Principal.

A. ERISA Polices Plans' Transactions With Parties In Interest For Reasonableness.

Although the issue ultimately comes down to the simple question whether Principal received reasonable compensation under a reasonable contract, it takes several steps to explain why. The first is setting out the statutory underpinnings of ERISA claims against parties in interest, including service providers like Principal.

1. Although ERISA places the strictest limitations on fiduciaries' dealings with ERISA plans, it also polices service providers' interactions with plans. By and

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the plan money that Principal holds, the contract itself is indisputably a plan asset. And each of Rozo's claims is based entirely on Principal's control over the contract, not its handling of the plans' money. The GBP exemption is thus irrelevant.

large, it does so by imposing a reasonableness check on those interactions. In this way, ERISA imposes varying levels of scrutiny depending on the risk that a given type of relationship or transaction poses. A fiduciary with unfettered discretion over plan assets has the greatest opportunity to take advantage of participants. Thus, ERISA (following the common law of trusts) completely bars fiduciaries from self-dealing.

A service provider, on the other hand, poses less risk to plan participants for the simple reason that it lacks the direct control of a fiduciary. Plans, moreover, would be unable to function if ERISA entirely precluded them from engaging with service providers. But just because the risk is lower does not mean Congress gave service providers carte blanche to deal sharply with ERISA plans. Congress instead recognized that service providers, too, could be positioned to take advantage of participants. It thus opted to permit service providers to deal with plans for their own benefit but with certain checks to ensure participants remain protected.

ERISA accomplishes this goal through two interlocking and somewhat counterintuitive statutory provisions. First, Section 1106(a) codifies certain restrictions on how plans can interact with parties in interest. *See* 29 U.S.C. §§ 1002(14)(B), 1106(a). It does so by broadly prohibiting plans from engaging in transactions with service providers that carry the potential for self-dealing. Section 1108(b), in turn, provides exemptions from these prohibitions, designed to allow

plans to do business with parties in interest if certain conditions are met to protect the plan's interests.

Given this statutory structure, "ERISA plans engage in transactions nominally prohibited by § 1106 all the time, while also taking steps to comply with ERISA by relying on one or more of the many exceptions under § 1108." *Fish v. GreatBanc Tr. Co.*, 740 F.3d 671, 685-86 (7th Cir. 2014). But when Section 1106 prohibits a transaction and no Section 1108 exception applies, the transaction violates ERISA.

2. Thus, Section 1106(a) generally prohibits parties in interest from "furnishing . . . services" to a plan or dealing with plan assets for their own benefit. 29 U.S.C. § 1106(a). But Section 1108(b) allows them to do so in connection with "provid[ing] services necessary for the establishment or operation of the plan," so long as they do so under a "reasonable arrangement[]" and "no more than reasonable compensation is paid therefor." 29 U.S.C. §§ 1106(a)(1)(C)-(D), 1108(b)(2).

To meet the Section 1108(b)(2) exemption, the compensation must be reasonable *and* it must be "furnished under a contract or arrangement which is reasonable." 29 C.F.R. § 2550.408b-2(a)(2), (3). And for a contract to be reasonable, it must "permit termination by the plan without penalty to the plan on reasonably short notice under the circumstances to prevent the plan from being locked into an arrangement that has become disadvantageous." 29 C.F.R. § 2550.408b-2(c)(3).

That, as explained below, presents an enormous problem for Principal in light of the PFIO's 5% surrender charge and 12-month lock-in provisions.

3. When a party-in-interest transaction violates ERISA, it is not just the plan's fiduciaries that can be held responsible. The Supreme Court has squarely held that a party in interest may also be held liable for such a violation if it "had actual or constructive knowledge of the circumstances that rendered the transaction unlawful." *Salomon*, 530 U.S. at 251.

Here, Principal cannot dispute that the threshold for a prohibited transaction under Section 1106(a)(1) has been met—the named fiduciary knew or should have known that Principal would "use . . . an[] asset of the plan" (the Contract) for its own benefit (to make money for itself). 29 U.S.C. § 1106(a)(1)(D). This is precisely the sort of "transaction[] nominally prohibited by § 1106" that "[p]lans engage in . . . all the time." *Fish*, 740 F.3d at 685-86. Thus, the transaction here was unlawful unless an exemption under Section 1108(b) applies. *See id.*

Under *Salomon,* that means Principal can be held liable—and summary judgment should have been denied—if fact questions remain over whether Principal knew or should have known of the circumstances rendering its compensation or its compensation arrangement unreasonable. *See* 29 U.S.C. § 1108(b)(2) (exemption asserted by Principal).

In evaluating this question, the district court mangled *Salomon*'s standard. It thought that Rozo had to "'show that the defendant knew or should have known that the transaction violated ERISA.'" App. 49 (quoting *Teets*, 286 F. Supp. 3d at 1209). That is, the district court held that Principal needed knowledge of its conduct's *illegality*, not just of the *circumstances* that rendered its conduct illegal. Not so.

The district court elided a critical part of *Salomon*'s standard for party-in-interest liability. *Salomon* does not say that the party in interest must know its conduct was unlawful. It does not require knowledge of the law. *See Neil v. Zell*, 753 F. Supp. 2d 724, 731 (N.D. Ill. 2010) (interpreting *Salomon* as requiring only "actual or constructive knowledge of the deal's details"). Rather, *Salomon* says that the party in interest must have "actual or constructive knowledge of the *circumstances* that rendered the transaction unlawful." 530 U.S. at 251 (emphasis added). That is a crucial difference. A circumstance is a "fact, event, or condition, such as a piece of evidence that indicates the probability of an event." *Circumstance*, *Black's Law Dictionary* (8th ed. 2004) (emphasis added). Thus, knowledge of the circumstances that rendered the transaction unlawful means knowledge of the facts, events, conditions, or evidence that rendered the transaction unlawful.

The district court found support in the Second Restatement of the Law of Trusts, which *Salomon* cited, but that Restatement says the exact opposite of what the district court held. Like the Supreme Court, the Restatement states that the

transferee of trust property may be held liable if the transferee "knows the circumstances which make the transaction illegal." Restatement (Second) of Trusts § 290. Addressing the precise question disputed here, the Restatement explicitly rejects the district court's view that knowledge of illegality is required: "The rule stated in this Section is applicable if the transferee knows the circumstances which make the transaction illegal, *even though he does not know that as a matter of law it is illegal.*" *Id.* cmt. b. (emphasis added).

It should not be surprising that knowledge of the law is not required. It is blackletter law that even for *criminal* liability, a defendant cannot avoid jail time by claiming he was unaware of his conduct's illegality. ERISA's comprehensive remedial scheme, designed to protect beneficiaries and participants, should not be interpreted more favorably to defendants. The district court's contrary conclusion is untenable.[6]

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[6] Even if the district court were correct that Principal can be liable only if it "knew or should have known" its conduct violated the law, summary judgment would not be warranted. As explained below, the applicable regulations say that for a contract to be reasonable, it must "permit termination by the plan without penalty to the plan on reasonably short notice under the circumstances to prevent the plan from being locked into an arrangement that has become disadvantageous." 29 C.F.R. § 2550.408b-2(c)(3). A factfinder could certainly conclude that Principal should have known the choice between a 5% withdrawal penalty and a 12-month lock-in period violates this rule.

B. Principal Bears The Burden Of Showing It Meets The Section 1108 Exemption.

The law is clear that Principal bears the burden to show that any Section 1108 exception applies. "[B]ecause the [defendant] will ordinarily have the information needed to know whether an exception applies under § 1108," the defendant bears "[t]he burden of proof" on that issue. *Fish*, 740 F.3d at 685-686; *see Allen v. GreatBanc Tr. Co.*, 835 F.3d 670, 676 (7th Cir. 2016) (agreeing with "[f]ive of our sister circuits . . . that section [11]08 exemptions are affirmative defenses, or that the defendant bears the burden of proof, or both" (collecting cases from the Second, Fourth, Fifth, Eighth, and Ninth Circuits)); *Braden v. Wal-Mart Stores, Inc.*, 588 F.3d 585, 601 n.10 (8th Cir. 2009).

With scant explanation, the district court ruled that Rozo bears the burden because Principal is not a fiduciary. But Principal's fiduciary status does not affect the rationale that the defendant ordinarily has "the information needed to know whether an exception applies." *Fish*, 740 F.3d at 685-686. And indeed, Principal alone possesses all the information regarding its compensation and its arrangement with the plans. Nor does the district court's rationale explain why a defendant's non-fiduciary status would alter the traditional allocation of the burden of proof on affirmative defenses. To put it bluntly: fiduciary status has nothing to do with courts' allocation of that burden to defendants in any context.

The district court cited two district court decisions that placed the burden on the plaintiff vis-à-vis a non-fiduciary, but neither case explained why it did so. App. 50 (citing *Hans v. Tharaldson*, No. 3:05 Civ. 115, 2011 WL 7179644, at *16 (D. N. Dak. Oct. 31, 2011); *Keach v. U.S. Trust Co., N.A.*, 256 F. Supp. 2d 818, 821-822 (C.D. Ill. 2003)). Their persuasive value is nil. While there are times under ERISA to distinguish between fiduciaries and non-fiduciaries, this is not one of them, and the district court erred in holding otherwise.

In any event, regardless of who bears the burden, summary judgment was inappropriate as explained below.

C. Genuine Issues Of Material Fact Remain Regarding Whether Principal Earned Reasonable Compensation Under A Reasonable Contract.

Because the district court applied the wrong standard, this Court should remand for that court to re-analyze the Section 1108(b)(2) exemption. Alternatively, given how straightforward the proper analysis is, the Court could order that summary judgment be denied on Rozo's party-in-interest claim.[7]

The simplest reason for denying summary judgment to Principal is that the Contract facially violates the regulations governing what constitutes a "reasonable

[7] The district court did not address whether the arrangement here met the "reasonable contract for necessary services" standard, and Rozo did not present comprehensive briefing on the issue, because Principal did not move for summary judgment on this issue. Principal Mot. for Summary Judgment at 18-20.

contract" under Section 1108(b)(2). To meet the Section 1108(b)(2) exemption, a party-in-interest's compensation must not only be reasonable, but also "furnished under a contract or arrangement which is reasonable." 29 C.F.R. § 2550.408b-2(a)(2), (3). And "[n]o contract or arrangement is reasonable" under Section 1108(b)(2) "if it does not permit termination by the plan *without penalty* to the plan *on reasonably short notice* under the circumstances to prevent the plan from being locked into an arrangement that has become disadvantageous." 29 C.F.R. § 2550.408b-2(c)(3) (emphases added). Here, the Contract permits termination only if a plan pays a 5% surcharge or waits an entire 12 months. That is the type of "lock[] in[]" the law prohibits. *Id.* At minimum, a factfinder could conclude that the surcharge is a "penalty" and that 12 months is not "reasonably short." This alone requires denial of summary judgment.

The second reason summary judgment is inappropriate here is also simple: the reasonable-compensation question presents a quintessential fact dispute incapable of resolution on summary judgment. The dispute boils down to whether Principal charges too much money for the amount of risk it shoulders in guaranteeing to (1) preserve participants' principal and (2) credit the Composite Crediting Rate to participants' accounts. That inquiry may sound nebulous, but just as the reasonable value of a chair or an office building is determinable, so too is the reasonable value of risk (and financial services to manage such risk). How much does it cost Principal

to purchase hedging investments? How much would it cost Principal if more plans than expected terminate their PFIO investments? How large are Principal's reserves? Answering questions like these allows experts to determine the economic value of the risk of guaranteeing PFIO investors' principal and interest amounts. *See, e.g.*, App. 374, 396.

From there, the only question is whether Principal charges more than that amount. *See, e.g.*, App. 412-415. Rozo says yes; Principal says no. Indeed, the parties have produced no fewer than five dueling expert reports on the issue. App. 259-281, 282-295, 296-370, 371-443, 444-476. And "[w]hen parties rely on battling experts to establish material facts, the facts are not 'undisputed' as required to grant summary judgment." *United States v. Ameren Mo.*, No. 4:11 Civ. 77 (RWS), 2016 WL 728234, at *12 (E.D. Mo. Feb. 24, 2016); *see Smith v. BMW N. Am., Inc.*, 308 F.3d 913, 922 (8th Cir. 2002) ("admissible [expert] testimony . . . makes summary judgment for [the opposing party] inappropriate"); *cf. In re Baycol Prods. Litig.*, 596 F.3d 884, 892 (8th Cir. 2010) (affirming summary judgment where plaintiff "failed to put forth competent [expert] evidence with which to create a conflict. Without competent evidence on both sides, there can be no 'battle of the experts' in which a fact-finder could weigh competing claims."). The factfinder might agree with Rozo or with Principal; but either way that decision cannot be made as a matter of law on summary judgment.

Therefore, the Court should at minimum remand for the district court to analyze the Section 1108(b)(2) question under the proper standard. But because that analysis is straightforward here, the Court could alternatively remand with instructions that Principal's summary judgment motion be denied.[8]

CONCLUSION

This Court should vacate the district court's grant of summary judgment to Principal and remand for further proceedings.

Dated: January 18, 2019

Respectfully submitted,

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[8] In a single paragraph at the end of its summary judgment motion, Principal argued that even if its conduct violates the law, ERISA offers Rozo no remedy. Principal Mot. for Summary Judgment at 20. The district court did not address this issue and this Court need not do so either. In any event, Principal is wrong. In *Salomon* (a case, like this one, against a third-party service provider), the Supreme Court identified the remedies available in this context: "the trustee or beneficiaries may . . . maintain an action for restitution of the property (if not already disposed of) or disgorgement of proceeds (if already disposed of), and disgorgement of the third person's profits derived therefrom." *Salomon*, 530 U.S. at 250. Those are the remedies that Rozo seeks here. App. 69 (prayer for relief).

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CERTIFICATE OF COMPLIANCE

I, Peter K. Stris, hereby certify that this document complies with the type-volume limitation of Federal Rule of Appellate Procedure 32(a)(7)(B)(i) as it contains 10,949 words, excluding the parts of the document exempted by Rule 32(f). I further certify that this document complies with the format, typeface, and type-style requirements of Rules 32(a)(4)-(6).

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CERTIFICATE OF SERVICE

I, Peter K. Stris, hereby certify that on January 18, 2019, I filed the foregoing document under seal with the Clerk of the Court for the United States Court of Appeals for the Eighth Circuit via U.S. first-class mail, as provided in Eighth Circuit Rule 25A(h). I further certify that I have served counsel of record for Appellee via U.S. first-class mail at the following addresses:

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