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July 21, 2015

VIA FEDERAL ERULEMAKING PORTAL

Office of Regulations and Interpretations
Office of Exemption Determinations
Employee Benefits Security Administration
U.S. Department of Labor
200 Constitution Avenue, NW
Washington DC 21210

Attention: Conflict of Interest Rule

Re: Definition of the Term "Fiduciary"; Conflict of Interest Rule – Retirement Investment Advice
RIN 1210-AB32

Proposed Best Interest Contract Exemption
ZRIN 1210-ZA25

Proposed Amendments to Class Exemptions 75-1, 77-4, 80-83 and 83-1
ZRIN 1210-ZA25

Ladies and Gentlemen:

This letter is submitted in response to the request for comments by the Employee Benefits Security Administration ("EBSA") in Release Nos. RIN 1210-AB32 regarding the Definition of the Term 'Fiduciary'; Conflict of Interest Rule — Retirement Investment Advice, and ZRIN 1210-ZA25, published at 80 Fed. Reg. 21927 (Apr. 20, 2015), and the attendant proposed prohibited transaction exemptions and amendments to existing exemptions, including the Proposed Best Interest Contract Exemption ("BICE"), published at 80 Fed. Reg. 21960 (Apr. 20, 2015) (collectively for purposes of this comment, the "Proposed Rule").

The focus of this comment is to address a few of the litigation implications should the Proposed Rule be finalized. Specifically, we wanted to call to EBSA's attention two significant impacts of the Proposed Rule in the context of private litigation, implications that do not appear intended by EBSA but are ones that we believe will result if the Proposed Rule is promulgated as presently structured: (1) a substantial number of individuals and entities will become subject to costly

litigation and exposure under ERISA provisions, such as the "exclusive purpose" rule, even if those individuals and entities comply with the proposed prohibited transaction exemptions, and (2) the litigation burdens on the regulated community necessary to demonstrate compliance even with respect to the new prohibited transaction exemptions will be extensive. Based on our experience, we believe that the approach taken by EBSA would cause those who become or are alleged to have become fiduciaries under the Proposed Rule to face the prospect of costly and burdensome litigation, the outcome of which would be uncertain even as to practices that EBSA states in its preamble it is intending to preserve and as to which it provides limited protection in the form of proposed prohibited transaction exemptions.[1]

Those Who Have Newly Created Fiduciary Status Will Be Subject to Burdensome Litigation Even if They Have Fully Complied with the Proposed Prohibited Transaction Exemptions Simply Because they Sell Products and Support For-Profit Companies.

EBSA's approach in the Proposed Rule will cause newly created fiduciaries to be subject to costly and burdensome litigation for many routine and casual activities, which appears to expand the scope of fiduciary liability beyond EBSA's stated intention. The approach taken by the Proposed Rule—expanding the fiduciary definition, and then providing exemptions to allow newly created fiduciaries to avoid most ERISA § 406 prohibited transactions if they abide by certain conditions—exposes these regulated individuals and entities to liability under ERISA § 404(a) without any corresponding "exemption."

The fiduciary responsibilities set forth in ERISA § 404(a)(1) include, among other things, the duty to act "solely in the interest of the participants and beneficiaries." This has been interpreted as requiring that a fiduciary act with an "eye single" to participants.[2] To be sure, limited exceptions to the "eye single" principal have been identified under ERISA, such as where an action to be taken with respect to a plan "incidentally benefits" the fiduciaries.[3] But the Department of Labor (the "Department") has previously explained its view of the narrowness of that exception. For example, the Department has, in "limited circumstances," found that a fiduciary may satisfy is obligation under ERISA § 404(a)(1) to act solely in the interests of a plan and its participants by choosing an investment that has "economically targeted benefits," (*i.e.*, providing benefits apart from the return to the plan) *only* after the fiduciary has satisfied

[1] This comment does not address whether the Proposed Rule is a permissible exercise of the Department's rulemaking authority or a permissible interpretation of the statutory language. These comments are directed to the effects of the Proposed Rule if it is promulgated as written.

[2] *Donovan v. Bierwirth*, 680 F.2d 263, 271 (2d Cir. 1982).

[3] *Id.* at 271. The Proposed Rule does not contain similar guidance addressing ERISA § 404(a)(1).

itself "that the alternative options are truly equal." Interpretive Bulletin 08-1, 29 CFR § 2509.08-1. Thus, even when it comes to investing in securities of environmentally progressive companies or in bonds issued by authorities that provide affordable housing in a local community, the Department believes that fiduciaries "will rarely be able to demonstrate compliance with ERISA [§ 404(a)(1)]" when they "rely on factors outside the economic interests of the plan." *Id.*

Here, the Proposed Rule will place individuals in an even more difficult position, particularly those who work for for-profit companies that offer investments for retirement plans or IRAs and who do not currently have fiduciary status under existing regulations. Under Massachusetts corporate law, for example, it is well-settled that a corporation's officers have an undivided duty of loyalty to their corporation: "They are bound to act with absolute fidelity and must place their duties to the corporation above every other financial or business obligation . . . They cannot be permitted to serve two masters whose interests are antagonistic." *Spiegel v. Beacon Participations, Inc.*, 297 Mass. at 410-411 (1937). ERISA jurisprudence has long addressed the potential for conflict between a corporation's state law profit motive and the fiduciary obligations attendant to management of plans or their assets by allowing the officers of a corporation sponsoring a plan to simultaneously serve as plan fiduciaries, and thus wear "two hats," so long as they wear one at a time. *See, e.g.*, *Pegram v. Herdrich*, 530 U.S. 211, 225 (2000) (explaining rule). EBSA has built in no protection under the "two hat" doctrine (or otherwise) for the ERISA § 404(a)(1) liability of newly created fiduciaries.

The absence of protection from the "solely in the interest" requirement will substantially impact those who now will become fiduciaries under the Proposed Rule. The Proposed Rule captures, among other things, any recommendation as to the advisability of acquiring a security or management of a security, without regard to whether the conduct is performed on a regular basis or is the primary basis for decision-making, as was required by the former rule. *Compare* proposed 29 C.F.R. § 2510.3-21(a)(1)(i) *with* 29 C.F.R. § 2510.3-21(c)(ii)(B) (2015). As such, the Proposed Rule would require that the representative of a financial services company, who otherwise has no relationship with a plan and is selling a product to a plan's fiduciary, would have to act "solely in the interest of the participants and beneficiaries" in doing so.

This seems especially onerous in the case of those who only sell products from one family of funds and are negotiating the sale of such funds. For that matter, under the Proposed Rule someone who would like to provide advice to a plan or an IRA investor cannot even negotiate a contract with the appropriate fiduciary or IRA investor without fear of the negotiation itself becoming a fiduciary act. It is the case under current law that a service provider is not a fiduciary where an independent fiduciary retains the "final authority" over plans' service contracts. *Chi. Dist. Council of Carpenters Welfare Fund v. Caremark, Inc.*, 474 F.3d 463, 473, 477 (7th Cir. 2007). *Accord Renfro v. Unisys Corp.*, 671 F. 3d 314, 324 (3d Cir. 2011); *Hecker*

v. Deere, 556 F.3d 575, 583 (7th Cir. 2009). However, under the Proposed Rule, a service provider can now become an investment advice fiduciary for its discussions concerning its retention, even if that person or entity has no authority to control the decision of a plan or IRA investor to hire the provider or select its products and services. In that case, the person negotiating the arrangement will face litigation risk for simply entering into a discussion about the terms of the retention and investments that would be provided if engaged. The Proposed Rule would seem to put that person in the untenable position of having to act solely in the interests of the plan, participants, beneficiaries, or IRA investor when negotiating the terms of its own engagement, including its compensation.

Although the Proposed Rule relies on newly proposed prohibited transaction exemptions to allow certain marketplace conduct to proceed, those exemptions only address prohibited transaction liability. The duty under ERISA § 404(a)(1) applies separate and apart from a fiduciary's obligation to avoid a non-exempt prohibited transaction under ERISA § 406. For example, one court held that, while the fiduciaries of a plan sponsored by a financial services company need not be subject to prohibited transaction claims given satisfaction of the relevant exemptions, claims under ERISA § 404(a) could proceed concerning the same exempted conduct. *See Leber v. Citigroup, Inc.*, No. 07 Civ. 9329(SHS), 2010 WL 935442 (S.D.N.Y. Mar. 16, 2010), at *13.

Given the expansion of the definition of fiduciary in the Proposed Rule, the regulated community can expect that additional costly and burdensome litigation will ensue separate and apart from whether a person or entity has complied with the new prohibited transaction exemptions. And given the strictness of the "eye single" approach often taken by courts to the duties under ERISA § 404(a)(1), the Proposed Rule could expose newly created fiduciaries who sell products or services to retirement plans or IRAs, and those who engage in one-off conversations concerning aspects of plan management (such as loans), to potentially significant liability regardless of whether an exemption is provided for transactions otherwise prohibited under ERISA § 406. Further, this expanded liability would also occur as to those who currently are fiduciaries but who would have increased potential exposure for additional functions as set forth in the Proposed Rule, such as those who otherwise have limited fiduciary responsibilities as to the management or administration of specific aspects of a plan or its assets.

The Creation of New Prohibited Transaction Exemptions Will Not Eliminate Costly Litigation Over Whether Advice Providers Have Complied with the New Rules.

The Proposed Rule relies on prohibited transaction exemptions, most notably the BICE, to allow many firms and individuals who sell financial products and services to plans and IRAs to "continue common fee and compensation practices." 80 Fed. Reg. at 21929. As described above, this approach does not address provisions of ERISA other than the prohibited transaction

provisions, and will create potential liability where none currently exists as to newly created fiduciaries and as to newly created fiduciary functions.

Even within the context of the proposed prohibited transaction exemptions themselves, EBSA's approach could substantially increase the litigation costs and burdens necessary to prove compliance with the exemptions, given (1) the way some courts have interpreted the burden of proof, and (2) the fact-intensive inquiry that could be demanded by some courts to establish compliance.

First, some courts have held that the burden of proving the availability of exemptive relief for conduct that would otherwise constitute a prohibited transaction is on the party seeking to avail itself of the exemption. *See, e.g.*, *Braden v. Wal-Mart, Inc.*, 588 F.3d 585, 601 (8th Cir. 2009). Under this line of reasoning, a prohibited transaction provides an affirmative defense that cannot be established on a motion directed to the pleading, requiring costly discovery for a person who seeks to avail itself of the exemption to adduce evidence and then prove that the conditions for the exemption are satisfied. *See, e.g.*, *Krueger v. Ameriprise Financial, Inc.*, No. 11-cv-02781(SRN/JSM), 2012 WL 5873825, at *17 (D. Minn. Nov. 20, 2012); *Goldenberg v. Indel, Inc.*, 741 F. Supp. 2d 618, 632 (D.N.J. 2010).[4]

Second, putting aside the question as to which party bears the burden of proof, as a practical matter, most if not all of the facts tending to establish or disprove satisfaction with an exemption are likely to be in the possession of the party charged with committing a prohibited transaction. Accordingly, by establishing a framework that intentionally casts a wide net on activities that now will be deemed fiduciary in nature, and forcing the newly enmeshed fiduciary to avail itself of a prohibited transaction exemption, the Proposed Rule will likely subject numerous fiduciaries to extensive, costly and burdensome discovery. Given that litigation under ERISA against financial service providers imposes "asymmetric costs" of discovery on the service provider—costs that often are imposed for no other reason than "to force a settlement," *Pension Benefit Guar. Corp. v. Morgan Stanley Inv. Mgmt.*, 712 F.3d 705, 719 (2d Cir. 2013)—the Proposed Rule will substantially increase litigation costs and burdens with respect to prohibited transaction claims, regardless of which party bears the ultimate burden of persuasion. Inevitably, these costs will be passed on to the service provider customers in the form of higher fees.

[4] The burden-shifting view espoused by these courts is not uniform. Other courts have taken a contrary approach and dismissed prohibited transaction claims at the pleading stage, where the claims do not suggest a failure to comply with an exemption, without requiring defendants to prove their innocence. *See, e.g.*, *Leber v. Citigroup, Inc.*, No. 07 Civ. 9329(SHS), 2010 WL 935442 (S.D.N.Y. Mar. 16, 2010), at *10; *Mehling v. N.Y. Life Ins. Co.*, 163 F. Supp. 2d 502, 510-11 (E.D. Pa. 2001). Given that there is a split amongst the courts, EBSA's approach can be expected to lead to increased litigation over which side bears the burden in any particular case.

Further, the specific proof necessary to demonstrate compliance with the proposed BICE will create additional, substantial litigation burdens for those who seek its protection. For example, to avail itself of the BICE, a newly created fiduciary will need to establish, among other things: that the total compensation to the advice providers does not "exceed reasonable compensation in relation to the total services they provide"; the advice is made "without regard to the financial or other interests of the Advisor, Financial Institution or any Affiliate, Related Entity, or other party"; and that "[n]either the Financial Institution nor (to the best of its knowledge) any Affiliate or Related Entity uses quotas, appraisals, performance or personnel actions, bonuses, contests, special awards, differential compensation or other actions or incentives to the extent they would tend to encourage individual Advisers to make recommendations that are not in the Best Interest of the Retirement Investor." BICE §§ II(c)(1), (c)(2), and (d)(4). 80 Fed. Reg. at 21984.[5]

Each of these items could be construed as requiring the presentation of a detailed factual exposition to a court, established and tested only through a prolonged discovery process. For example, recent litigation experience with respect to suits over "reasonable compensation" show how expensive and time-consuming it might be simply to prove that one condition of the BICE. Although ERISA does not require that fiduciaries provide their plans or participants with the lowest cost products and investments available in the market,[6] some courts have permitted costly litigation to proceed where plaintiffs allege merely that cheaper investments were available in the market—which will necessarily be the case with every investment except the one with the absolute lowest cost. *E.g.*, *Figas v. Wells Fargo*, No. 08-4546, 2009 WL 702004, at *1-2 (D. Minn. Mar. 13, 2009); *Krueger*, 2012 WL 5873825, at *10-11.[7] Expanding the universe of individuals or entities that are subject to fiduciary obligations in the first instance can be expected to result in an expansion of those who will be subjected to expensive and burdensome discovery to demonstrate compliance with the relevant prohibited transaction exemptions, regardless of which side bears the ultimate burden of persuasion. Further, the Proposed Rule

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[5] These three examples are not meant to be exhaustive, but only illustrative of the openings that are created by the Proposed Rule to those who might seek to impose asymmetric costs on the regulated industry through expensive and burdensome discovery in order to drive a settlement regardless of the merits of the potential suit.

[6] Appellate courts have recognized that "nothing in ERISA requires every fiduciary to scour the market to find and offer the cheapest possible fund (which might, of course, be plagued by other problems)." *Hecker v. Deere & Co.*, 556 F.3d 575, 586 (7th Cir. 2009). EBSA, too, has sensibly recognized in other contexts that a fiduciary is not required to provide the cheapest possible service arrangement: "Fees are just one of several factors fiduciaries need to consider in deciding on service providers and plan investments." *Meeting Your Fiduciary Responsibilities*, February 2012, at 5, http://www.dol.gov/ebsa/pdf/meetingyourfiduciaryresponsibilities.pdf.

[7] Without any judicial finding of harm, these cases settled for substantial sums after extensive and costly discovery; *Figas* for $17 million, and *Krueger* for $27.5 million.

expands the universe of individuals who have a fiduciary obligation with respect to the reasonableness of compensation to include the seller of investment services (the fiduciary purchasing such services already has a fiduciary obligation in the case of ERISA-covered plans)—creating significant potential exposure, and litigation costs and burdens, for at least hundreds of thousands of individuals and entities.[8]

* * *

We believe that these litigation implications of the Proposed Rule will result in unnecessary costs and burdens to the financial services community, and ultimately, IRA holders and plan participants and beneficiaries as costs are passed onto them. Hundreds of thousands of individuals and entities will be potentially subject to extensive discovery costs and burdens in litigation that can be addressed to nearly every sale of an investment product or service to a plan or IRA. These litigation costs will increase providers' costs of doing business, which can be expected to be passed on to plans and investors in the form of overall higher fees for products and services, creating additional barriers to retirement savings. Not only does such an outcome appear to be bad public policy, but it also appears contrary to the careful balancing of interests that led to the near unanimous, bi-partisan passage of ERISA in 1974, and the congressional goal, recognized by the Supreme Court, that the statute not "create a system that is so complex that administrative costs, or litigation expenses, unduly discourage employers from offering" benefit plans. *Varity Corp. v. Howe*, 516 U.S. 489, 497 (1996).

Very truly yours,

/s/ Jamie Fleckner

James O. Fleckner

[8] EBSA recognizes that at least 418,000 individuals and entities will be subject to the new regulation. *See* Fiduciary Investment Advice Regulatory Impact Analysis at 172, at http://www.dol.gov/ebsa/pdf/conflictsofinterestria.pdf.