No. 99-579

IN THE SUPREME COURT OF THE UNITED STATES

HARRIS TRUST AND SAVINGS BANK, ETC., ET AL.,
Petitioners,

v.

SALOMON BROTHERS, INC., ET AL.
Respondents.

BRIEF FOR THE BOND MARKET ASSOCIATION AND THE SECRUITIES INDUSTRY ASSOCIATION AS *AMICI CURIAE* SUPPORTING RESPONDENTS

Filed March 22, 2000

QUESTION PRESENTED

Whether Section 406 of the Employee Retirement Income Security Act of 1974 ("ERISA"), 29 U.S.C. § 1106, renders nonfiduciary parties in interest subject to private civil actions under ERISA § 502(a)(3), 29 U.S.C. § 1132(a)(3), for entering into prohibited transactions.

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MISCELLANEOUS

IN THE

Supreme Court of the United States

No. 99-579

HARRIS TRUST AND SAVINGS BANK, not individually but solely as Trustee for the Ameritech Pension Trust, and AMERITECH CORPORATION,

Petitioners,

v.

SALOMON SMITH BARNEY INC. and SALOMON BROTHERS REALTY CORP.,

Respondents.

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

BRIEF FOR THE BOND MARKET ASSOCIATION AND THE SECURITIES INDUSTRY ASSOCIATION AS *AMICI CURIAE* SUPPORTING RESPONDENTS

INTEREST OF *AMICI CURIAE*

The Bond Market Association and the Securities Industry Association (together, the "Associations") respectfully submit this brief in support of respondents.[1]

[1] This brief is accompanied by the written consents of all parties, which are being filed concurrently with the Clerk of the Court, as specified in Supreme Court Rule 37.3. No counsel for any party authored any portion of this brief. No persons other than *amici curiae* and their members, through the Associations' general dues and assessments, made a monetary contribution to the preparation and submission of this brief.

The Bond Market Association represents approximately 200 securities firms and banks that underwrite, trade, and sell fixed-income securities in the U.S. and international markets. The Bond Market Association's members deal in a wide variety of public and private fixed-income securities. All of the primary dealers of Treasury bonds, notes, and bills, as recognized by the Federal Reserve Bank of New York, are members of The Bond Market Association, as are other securities dealers.

From its inception in 1976 (and under its prior name of the Public Securities Association), The Bond Market Association has addressed significant issues confronting the U.S. government and securities markets and has sought to foster sound credit, business, and trading practices for participants in the fixed-income securities market. Among other activities, the Association provides a market perspective on securities legislation and regulation and undertakes numerous industry initiatives to improve industry practices and market efficiency.[2]

The Securities Industry Association (the "SIA") brings together the shared interests of more than 740 securities firms throughout North America. The SIA's members—including investment banks, broker-dealers, specialists, and mutual fund companies—are active in all markets and in all phases of corporate and public finance. In the United States, the SIA member firms collectively account for approximately 90% of securities firms' annual revenues and employ more than 600,000 individuals. The

[2] The Bond Market Association has filed other *amicus* briefs concerning regulation of the this country's bond market, including *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Kravitz*, 135 F.3d 266 (3d Cir.), *cert. denied*, 525 U.S. 811 (1998), *NACCO Indus. v. Tracy*, 681 N.E. 2d 900 (Ohio 1997), *cert. denied*, 522 U.S. 1091 (1998), and *Dunn v. CFTC*, 519 U.S. 465 (1997). More information about the Bond Market Association may be found on its web site: http://www.bondmarkets.com.

U.S. securities industry maintains the accounts of approximately 50 million investors directly, and tens of millions of investors indirectly, through corporate, thrift, and pension plans.[3]

The Associations' members directly, or indirectly through affiliates, engage in transactions with employee benefit plans [4] and some may also provide services to them in a variety of capacities. They are also active issuers of equity and debt securities, which plans may choose as investments. The roles that the Associations' members play in the markets are ever increasing because of consolidation in the financial services industry and the evolution of financial products. For example, a broker-dealer could participate in the markets as an issuer, a trader, an investment manager, a custodian, and a trustee. In today's market place, some financial services firms that participate in these various capacities may often assume for business planning purposes that they could be alleged to be "providing services" to plans and thus could be alleged to be "parties in interest" [5] under the Employee Retirement Income Security Act of 1974 ("ERISA"). Accordingly, their dealings with employee benefit plans may be alleged to be subject to the prohibited transaction rules of ERISA.

[3] In the last two years, the SIA filed 16 *amicus* briefs in federal courts, including nine in this Court. More information about the SIA is available on its home page: http://www.sia.com.

[4] The terms "employee benefit plan," "benefit plan," and "plan" are used interchangeably throughout this brief.

[5] A party in interest is defined as, among other things, any person providing services to the plan, an employer any of whose employees are covered by the plan, an employee organization whose members are covered by the plan, and certain relatives of parties in interest. *See* 29 U.S.C. § 1002(14) (1994). For purposes of this brief, we use the terms nonfiduciary party in interest and party in interest interchangeably, although a party in interest may also be a fiduciary. In this case, the courts below assumed that respondents were nonfiduciary parties in interest. *See* J.A. 299, 347.

Consequently, to the extent it is feasible and within their control, some financial service firms may generally limit transactions with plans to those types for which an exemption from the prohibited transaction rules is thought to be available. Indeed, because of the risks of penalties and taxes by the Department of Labor and the Department of the Treasury associated with engaging in prohibited transactions, many financial institutions will not transact with plans at all unless an exemption is considered available.

As nonfiduciary parties in interest factor the risk of litigation into the costs of engaging in financial transactions with plans, they may determine that some of those transactions are no longer viable. Thus, the proposed cause of action here could constrain competition by decreasing the number of available or attractive investment opportunities for plans. Employee benefit plans, however, play a critical role in U.S. capital markets and any decrease in the number of transactions with plans could significantly affect the securities markets as a whole. This likely chilling effect on plans' investment and market activities could reduce liquidity in the capital markets and raise the cost of capital for all borrowers and those seeking equity capital—from the average home buyer to the Fortune 500 corporation.

Bearing in mind the importance of plans to the securities markets, the Associations believe there are important legal principles at issue here involving the exposure of nonfiduciary parties in interest to private lawsuits for alleged participation in prohibited transactions. The Associations' participation as *amici curiae* in this proceeding is prompted by their strong interest in ensuring (i) that the judicial treatment of these transactions accurately reflects the text of ERISA and the policies and purposes underlying the statute and (ii) that securities firms and banks transacting with employee benefit plans have ap-

propriate and consistent guidance, ensuring an environment of greater legal certainty that will foster stability and efficiency in the marketplace.

SUMMARY OF ARGUMENT

ERISA is a comprehensive statute. As such, ERISA is complete with its own express enforcement mechanisms. The statute reflects the balance Congress struck between operating employee benefit plans efficiently and protecting those plans effectively. That balance does not provide for a private cause of action against nonfiduciary parties in interest allegedly involved in prohibited transactons.

The creation of a private cause of action against nonfiduciary parties in interest would likely harm the long-term interests of plans, their participants, and beneficiaries. Subjecting nonfiduciaries to litigation for transactions that are later considered—with hindsight—to be non-exempt will drive up the costs and risks associated with conducting business with plans. A private plaintiff potentiallv could sue a nonfiduciary any time a transaction turned out to be unfavorable to the plan. When faced with the possibility of incurring such costs, nonfiduciary parties in interest would at a minimum try to pass those costs on to plans and may even limit their transactions with plans.

Moreover, this chilling effect could spill over to the securities markets as a whole. The number of market participants that could be affected by a private cause of action is quite substantial, considering that consolidation in the financial services sector means that more and more entities transacting business with plans could be deemed "related". Many counterparties to transactions often may have to assume that they could be alleged to be parties in interest. As more nonfiduciaries limit transactions with

plans due to their fear of private litigation, plans inevitably would become less active participants in the capital markets—reducing overall liquidity and ultimately increasing the cost of capital.

These underlying policy considerations, among others, led Congress to create an integrated system of enforcement under ERISA to protect plans. Such a comprehensive system, as this Court has repeatedly recognized, creates a presumption against implying a private cause of action. *See, e.g., Mertens v. Hewitt Assocs.*, 508 U.S. 248, 254 (1993); *Massachusetts Mut. Life Ins. Co. v. Russell*, 473 U.S. 134, 146-47 (1985). Insofar as the rules against prohibited transactions are concerned, the system has several facets designed to protect the interests of plans. First, Congress created an administrative exemption scheme under ERISA and authorized the Department of Labor to grant exemptions. The Department of Labor has adopted final exemption procedures requiring that exemptions, among other things, be in the interest and protective of plans and their participants and beneficiaries. These exemptions are quite complex and often are issued after much consultation between the Department of Labor and market participants. Congress did not intend for private suits against nonfiduciary parties in interest to be the mechanism for interpreting these complex exemptions. Instead, Congress placed with the Department of Labor and the Department of the Treasury the primary responsibility for enforcement of the rules and exemptions related to prohibited transactions between plans and nonfiduciary parties in interest.

Next, ERISA provides express remedies to recover funds from parties in interest involved in prohibited transactions. Rather than creating a private cause of action against nonfiduciary parties in interest, Congress allows

the Department of Labor or the Internal Revenue Service (the "IRS") to penalize or tax certain parties in interest for their participation in prohibited transactions. In addition to the initial assessment, a party in interest can be fined or taxed up to 100% of the amount involved in the transaction, if it does not undo the transaction.

Finally, Congress placed on fiduciaries the primary responsibility for protecting the interests of plans. If private suits against nonfiduciary parties in interest were allowed, fiduciaries could seek to shift their liability to nonfiduciaries—an action not authorized by the statute. When trying to determine whether a transaction is prohibited or exempt, it is often necessary for a nonfiduciary to rely to a great extent upon the fiduciary's knowledge. If the liability for such a decision can be shifted to the nonfiduciary (as petitioners are trying to do here), the fiduciary's incentive to act with the care, skill, prudence, and diligence required of it to avoid a prohibited transaction could diminish.

The text of ERISA confirms that Congress did not provide for private litigation against nonfiduciary parties in interest. Neither ERISA Section 502(a)(3), Section 406(a), nor a combination of the two provisions creates a private cause of action against nonfiduciary parties in interest. Section 502(a)(3) allows private suits only to remedy violations of ERISA; it does not expand the universe of persons who may be sued. *See Mertens*, 508 U.S. at 253. The claim that a nonfiduciary (including a party in interest) can violate Section 406, and thus be subjected to a private suit under Section 502(a)(3), is without merit. The plain language of Section 406 requires only that a *fiduciary* shall not cause a plan to engage in a prohibited transaction.

ARGUMENT

I. A PRIVATE CAUSE OF ACTION WOULD UNNECESSARILY DISRUPT THE OPERATION OF EMPLOYEE BENEFIT PLANS AND SECURITIES MARKETS.

ERISA seeks to protect employee benefit plans against self-dealing, conflicts of interest, and other abuses while at the same time facilitating the efficient operation of those plans. *See Alessi v. Raybestos-Manhattan, Inc.*, 451 U.S. 504, 515 (1981) (there is a "tension between the primary goal of benefiting employees and the subsidiary goal of containing pension costs"). One of the statutory safeguards is the prohibition of transactions between plans and parties in interest. *See* ERISA § 406. Congress, however, allowed for statutory and administrative exemptions to those prohibited transaction rules, *see* ERISA § 408, "in order not to disrupt the established business practices of financial institutions"—as long as there are satisfactory protections for plans. H.R. CONF. REP. No. 93-1280, at 309 (1974), *reprinted in* 1974 U.S.C.C.A.N. 5,038, 5,089. Judicially creating a private cause of action against nonfiduciary parties in interest would frustrate, not further, Congress's goals.

A. The Proposed Cause Of Action Would Escalate The Cost Of Maintaining And Administering Plans And Decrease The Number Of Investment Opportunities Available To Plans.

Petitioners' proposed cause of action (and seemingly open-ended theory of liability) would raise unnecessarily the costs for plans to engage in financial transactions with service providers as well as lead to needless inefficiencies. Nonfiduciary parties in interest would face increased exposure to liability and naturally would become more conservative when dealing with plans. In an effort to protect

themselves, nonfiduciary parties in interest may seek more extensive representations or even indemnification from plans and their fiduciaries regarding compliance with the prohibited transaction rules or exemptions from those rules.[6] In the context of negotiation, however, some plans may not agree to such representations or indemnification. In the end, plans could find themselves unable to participate as broadly in the capital markets as they do today.

Alternatively, if nonfiduciary parties in interest are required to bear fiduciary-like responsibilities, they may seek, with greater certainty, assurance that the transactions meet the conditions of the exemptions.[7] They would incur the increased costs of directly ascertaining certain information about plans and their fiduciaries. One must assume that parties in interest, to the extent possible, would pass these increased compliance costs onto plans. Also, parties in interest may exact a risk premium, as self-insurance in the event that they get some of the information wrong. Thus, the plans unnecessarily would pay more in the future for the same investments. As this Court previously explained:

> All that ERISA has eliminated . . . is the common law's joint and several liability, for all direct and consequential damages suffered by the plan, on the part of persons who had no real power to control what the plan did. Exposure to that sort of liability would impose high insurance costs upon persons who

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[6] However, if those representations turn out to be false, under petitioners' theory of liability, the nonfiduciary party in interest would still be subject to a private cause of action as a result of the fiduciary's breach of its responsibilities.

[7] Parties in interest for the most part may have to obtain the necessary information from the plans themselves and would potentially encounter the plans' or the fiduciaries' reluctance to provide such information.

> regularly deal with and offer advice to ERISA plans, and hence upon ERISA plans themselves.

Mertens, 508 U.S. at 262-63.

Costs to plans could also increase because the number of available trading partners may decrease. There has been significant consolidation in the financial services markets, as affiliations among banks, investment advisors, and broker-dealers have increased substantially.[8] This changing landscape makes it more likely that these counterparties will be deemed "related" and thus exposed to the proposed cause of action as nonfiduciary parties in interest. A nonfiduciary party in interest may discover that it cannot competitively price a financial product at a level that compensates it for the increased compliance burden and risk. As a result, firms may eliminate some investment choices for plans. These increased costs and reduced investment opportunities could even limit plans' abilities to diversify their portfolios and manage risks. Under petitioners' proposal, therefore, "desirable investment opportunities may be foreclosed for employee benefit plans . . . [and] as a result capital markets may be disrupted." [9]

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[8] *See, e.g.*, Steven Lipin & Matt Murray, *Bigger Than Big: The Superregional, As a Banking Model, Has Passed Its Prime: Now, the Quest for Revenue is Prompting Mergers With a National Scope*, WALL ST. J., Apr. 13, 1998, at A1; Peter Pae, *Fortunes Rising In Financial Services: Consolidation That Spawned Citicorp-Travelers Deal a Bonanza For Investors*, WASH. POST, Apr. 12, 1998, at H01.

[9] Proposed Class Exemption for Certain Transactions Involving Purchases of Securities Where Issuer May Use Proceeds to Reduce or Retire Indebtedness to Parties in Interest, 44 Fed. Reg. 44,286, 44,287 (1979).

B. A Private Cause of Action Would Be Detrimental To Securities Markets.

Employees benefit plans are major market participants, ensuring capital adequacy in our markets. As of September 1999, private pension plans held nearly $5.0 trillion of financial assets.[10] Nearly $1.0 trillion of that amount consisted of bonds and other debt instruments. According to the most recent data available, there are more than 6 million private health and welfare plans covering more than 150 million participants and beneficiaries and almost 700,000 private pension plans covering more than 90 million participants.[11] Private pension plans are major holders of corporate stocks and bonds, holding an estimated 20% of all outstanding stocks and 17% of all outstanding bonds.[12] Plans are critical to and benefit from the securities markets' depth and liquidity. Their participation in the markets helps to lower financing costs for corporations, governments, homebuyers, consumer borrowers, and many others who regularly go to the markets to finance investments.

If this Court were to recognize a private cause of action against nonfiduciary parties in interest, many financial services firms would consider curtailing their business with the plans because of the increased risk of litigation associated with these types of transactions. Limiting plans' ability to transact with these firms (which include certain investment banks and broker-dealers, among others) could

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[10] *See* BOARD OF GOVERNORS OF THE FED. RESERVE SYS., FLOW OF FUNDS ACCOUNTS OF THE U.S.: FLOWS & OUTSTANDINGS, 4TH QUARTER 1999, at 76 (2000).

[11] *See* PWBA Milestones: 1974-1999 at http://www.dol.gov/dol/pwba/public/pubs/annivdoc.htm; U.S. DEPT. LABOR & WELFARE BENEFITS ADMIN., ABSTRACT OF 1995 FORM 5500 ANNUAL REPORTS, PRIVATE PENSION PLAN BULLETIN NO. 8 (Spring 1999).

[12] The information is available on the Department of Labor's web site at http://www.dol.gov/dol/pwba/pubs/factshtl.htm.

seriously impede the ability of employee benefit plans to participate fully in the capital markets. Accordingly, the high liquidity and price efficiency of U.S. capital markets could be adversely affected, to the detriment of plans, participants, and beneficiaries.

II. BECAUSE ERISA EXPRESSLY PROVIDES FOR AN INTEGRATED SYSTEM OF ENFORCEMENT, PETITIONERS CANNOT OVERCOME THE STRONG PRESUMPTION AGAINST IMPLYING A PRIVATE CAUSE OF ACTION.

There is no need for this Court to read an implied private cause of action under Section 502 of ERISA when Congress elsewhere has provided for remedies with respect to nonfiduciary parties in interest. Indeed, the Court has recognized the strong presumption against inferring a cause of action when Congress has already provided an integrated system for enforcement. *See Texas Indus., Inc. v. Radcliff Materials, Inc.*, 451 U.S. 630, 645 (1981) (quoting *Northwest Airlines, Inc. v. Transport Workers,* 451 U.S. 77, 97 (1981) ("The presumption that a remedy was deliberately omitted from a statute is strongest when Congress has enacted a comprehensive legislative scheme including an integrated system of procedures for enforcement.")). ERISA is just such a comprehensive statute. Indeed, this Court has already recognized that new causes of action should not be inferred in the ERISA context:

> In Russell we emphasized our unwillingness to infer causes of action in the ERISA context, since that statute's carefully crafted and detailed enforcement scheme provides strong evidence that Congress did not intend to authorize other remedies that it simply forgot to incorporate expressly.

Mertens, 508 U.S. at 354 (quoting *Massachusetts Mut. Life Ins. Co. v. Russell,* 474 U.S. 134, 146-47 (1985)).

ERISA protects plans in a number of ways, making a private cause of action against nonfiduciary parties in interest unwarranted. First, the Department of Labor grants administrative exemptions to allow plans to take advantage of investment opportunities while at the same time (1) safeguarding the interests of plans and (2) providing a safe harbor for nonfiduciary parties in interest that engage in transactions that otherwise might be prohibited. Second, in the event that nonfiduciary parties in interest participate in non-exempt prohibited transactions, the Department of Labor and the Department of the Treasury are statutorily authorized to impose penalties and excise taxes upon certain parties in interest. Finally, and of greatest import, is the role that fiduciaries play in protecting plans. Congress established fiduciaries as the centerpiece of ERISA's protective scheme. A private cause of action against a nonfiduciary party in interest could allow a fiduciary simply to sidestep its responsibilities with respect to a prohibited transaction. Congress chose each of these measures to protect the interests of plans and their participants and beneficiaries. The supplementary remedy petitioners seek here is unnecessary and unfounded.

A. Petitioners' Argument For A Private Cause Of Action Disregards ERISA's Complex Administrative Scheme Of Exemptions.

Congress empowered the Department of Labor, in consultation with the Department of the Treasury, to administer a system of exemptions to allow plans to engage in transactions with parties in interest that may otherwise technically violate the statute. The Department of Labor grants exemptions when it determines that the conditions of the exemptions and other regulatory regimes provide sufficient protection for plans and that beneficiaries and participants would benefit from a wider universe of op-

tions.[13] Before granting an exemption, the Department of Labor must determine that the exemption is (1) administratively feasible, (2) in the interest of the plan and its participants and beneficiaries, and (3) protective of the rights of participants and beneficiaries. *See* ERISA § 408(a). Moreover, some exemptions require that transactions be effected "on terms at least as favorable to the plan as an arm's-length transaction with an unrelated party would be." [14]

The exemptions protect the interests of plans, fiduciaries, and nonfiduciary parties in interest transacting business with plans.[15] In the event that questions arise as to whether a transaction between a plan and a party in interest met the conditions of particular exemption, Congress intended for these matters to be addressed in the first instance through the administrative process. Congress did not provide for these complicated, fact-driven exemptions to be interpreted in hostile civil litigation against nonfiduciaries. Rather it authorized the Department of Labor, which has expertise in these matters and is equipped to understand the exemptions, to do so.

One exemption that the district court considered in this case, PTE 75-1, is relatively less complex as compared to others. The four basic conditions of the exemption span less than one-half of a page in the Federal Register. *See*

13 *See, e.g.*, Amendment to Prohibited Transaction Exemption (PTE) 81-6 Involving Lending of Securities by Employee Benefit Plans, 52 Fed. Reg. 18,754, 18,755 (1987).

14 *See, e.g.*, Exemptions From Prohibitions Respecting Certain Classes of Transactions Involving Employee Benefit Plans and Certain Broker-Dealers, Reporting Dealers and Banks, 40 Fed. Reg. 50,845, 50,846 (1975) [hereinafter PTE 75-1].

15 As explained above, increasing the level of risk experienced by parties transacting with plans could be harmful to plans, participants, and beneficiaries. Thus, Congress authorized the Department of Labor to create these safe habors.

PTE 75-1, 40 Fed. Reg. at 50,850.[16] Contrasting that exemption with the amendment to the Underwriters Exemptions, however, underscores Congress's reasons for placing this process within the administrative realm.[17] These exemptions are complex and have grown out of the coordinated efforts of the Department of Labor and market participants. To have their nuances interpreted in the first instance in private litigation against nonfiduciaries rather than through administrative deliberation would be inappropriate and harmful to the interests of plans. Although petitioners argue that judicial intervention is now necessary to protect plans, Congress simply did not agree. Petitioners' approach would increase the systemic risks of transacting with plans without providing countervailing benefits to plans or their participants and beneficiaries.

B. Other Enforcement Mechanisms Govern A Nonfiduciary Party In Interest's Involvement In Prohibited Transactions And Adequately Protect Plans.

Although a nonfiduciary party in interest cannot itself violate Section 406, that does not mean that it has no independent incentive to avoid entering into a prohibited transaction. Congress did not exclude nonfiduciary parties in interest from all of the enforcement provisions of ERISA. To the contrary Congress's inclusive enforcement

16 Yet as this very case shows, even this exemption, when subject to private litigation against alleged nonfiduciary parties in interest creates vexing questions. *See* J.A. 313-20 (district court's discussion of whether participation interests in question were "securities").

17 *See* Amendment to Prohibited Transaction Exemptions (PTEs) 90-30 Involving Bear, Stearns & Co. Inc., 90-32 Involving Prudential Securities Incorporated, et al., 62 Fed. Reg. 39,021 (1997). This exemption is five Federal Register pages long. The Underwriter Exemptions are individual exemptions that provide relief for the certain transactions involving asset pool investment trusts and asset backed pass-through certificates. *See id.*

scheme shows why it would be inappropriate to upset that scheme by implying a private cause of action. The Department of Labor can pressure certain nonfiduciary parties in interest to undo a prohibited transaction. Section 502(i) of ERISA provides in relevant part:

> In the case of a transaction prohibited by section 1106 of this title by a party in interest with respect to a plan to which this part applies, the Secretary may assess a civil penalty against such party in interest. The amount of such penalty may not exceed 5% of the amount involved in each such transaction . . . for each year or part thereof during which the prohibited transaction continues, except that, if the transaction is not corrected . . . such penalty may be in an amount not more than 100% of the amount involved.

29 U.S.C. § 1132(i) (1994). Further, the IRS has the power to levy taxes against certain nonfiduciary parties in interest involved in prohibited transactions. *See* 26 U.S.C. § 4975 (Supp. III 1997). Under Section 4975 of the Internal Revenue Code (the "Code" or "I.R.C."), a disqualified person (which is similar to a party in interest) involved in a prohibited transaction may be subject to a tax of up to 15% per year of the amount involved in the transaction.[18] If the disqualified person does not correct the

[18] Section 502(i) of ERISA applies to all plans except for certain tax-exempt plans, which are governed by Section 4975(a) & (b) of the Code. *See* ERISA § 502(i); I.R.C. § 4975(a) & (b). Petitioners argue that because Section 502(i) does not apply to the plan at issue in this case, the civil enforcement provisions "provide inadequate protection for plan participants and beneficiaries." Pet. Br. at 35. Simply because Congress chose to subject different plans to civil enforcement under different provisions does not make the enforcement scheme inadequate. Furthermore, the fact that Section 4975 uses the term "disqualified person" instead of "party in interest" does not somehow suggest that Congress intended to create a private cause of action. While it is true that the definition of "disqualified person" is marginally more narrow than the term "party in interest," *compare* 26 U.S.C. § 4975(e)(2) *with* 29 U.S.C. § 1002(14), this difference does not show that a private cause of action is needed to protect plans. Rather, it reveals that Congress merely chose to treat differently those dealing with different types of plans.

transaction, it may be subject to a tax of up to 100% of the amount involved. Petitioners claim that these two provisions do not afford sufficient relief because they compensate the government and do not directly benefit the plan. *See* Pet. Br. at 33-34. To the contrary, the correction of a prohibited transaction must inure to the benefit of the plan. *See* I.R.C. § 4975(f)(5); ERISA § 502(i); 29 C.F.R. § 2560.502i-1 (1999); 26 C.F.R. § 53.4941(e)-(1)(c) (1999).[19] These two provisions reveal that when Congress intended to sanction nonfiduciary parties in interest, Congress did so explicitly.

Assuming, for the sake of argument, that ERISA creates a private cause of action, a nonfiduciary party in interest may not be able to settle a private dispute without negotiating a four-party agreement among itself, the plan, the Department of Labor, and the IRS.[20] Any settlement with the plan may not be binding on either the Department of Labor or the IRS. Conversely, any settlement reached with the Department of Labor or the IRS may not be binding upon the plan. We doubt Congress could have intended by the simple phrase, "to obtain other appropriate equitable relief," that nonfiduciary parties in

[19] The Department of Labor applies the principles of Section 4975 of the Code and its regulations in interpreting the term "correction" under Section 502(i) of ERISA. *See* 29 C.F.R. § 2560.502i-1(e) (1999).

[20] A four-party agreement may be required when the alleged prohibited transaction is with a tax-exempt plan. In the case of a prohibited transaction with a non-tax-exempt plan (to which Section 502(i) would apply), the parties may still have to negotiate a three-party agreement among the party in interest, the plan, and Secretary of Labor.

interest be placed in such an untenable position. This type of whipsaw effect will, in fact, make settlement with each of the parties so much more difficult that it will discourage any settlement with the IRS or the Department of Labor that would have benefitted the plan.

Petitioners' argument also ignores that in the vast majority of cases, a party in interest will likely correct the transaction when faced with possible civil penalties or taxes. At the outset, there is a legitimate business reason to do so. If a party in interest is facing a penalty or tax for the full amount involved in the transaction, it is in its interest to return the money to the plan rather than pay the penalty or tax to the government. The party in interest will receive in return the underlying securities or assets that it sold to the plan. As long as these assets retain value, the party in interest is better off unwinding the transaction rather than paying a penalty or tax in the same amount while receiving absolutely nothing in return. Also, because the party in interest generally has a continuing business relationship with the plan, it is to the party in interest's advantage to do as little harm to that relationship as possible. Thus, these penalties and taxes provide an economic deterrent against parties in interest engaging in transactions they suspect might be prohibited and an incentive to correct transactions when they later learn that the transactions were not exempt.

Even if these provisions did not always provide full relief, they represent the balance struck by Congress between protecting plans and having them operate efficiently. ERISA is not an insurance policy protecting plans against investment loss.[21] Rather, a fundamental objective of

21 Petitioners are in essence asking the Court to grant plans free put options, with no expiration date, that they can exercise any time the value of the undulying assets decreases. By exercising the put through a private lawsuit against the party in interest, a plan could have its principal returned. On the other hand, if the value of the assets increases, the plan would participate in the upward movement, having the perfect "hedge" against losses.

ERISA is to ensure that plans have broad access to the capital markets while at the same time minimizing transaction costs for plans. It is therefore sensible that Congress intentionally would limit through the express language of the statute the kinds of relief available against nonfiduciary parties in interest who transact with plans.

In addition to the protection ERISA affords employee benefit plans, other regulators and self-regulatory organizations are available to assist in protecting benefit plans. Nonfiduciary parties in interest may include various entities such as banks, securities firms, broker-dealers, insurance companies, and accountants, and they are highly regulated entities. In addition to being subject to sanctions by the Department of Labor and the Department of the Treasury, they are regulated directly or indirectly by the Securities Exchange Commission, the National Association of Securities Dealers, the Board of Governors of the Federal Reserve System, the Board of Directors of the Federal Deposit Insurance Corporation, the New York Stock Exchange, other exchanges, and other federal and state governmental authorities. In sum, plans are protected by a variety of regulatory authorities armed with potent remedies. In these circumstances, creating a private cause of action is unnecessary.

C. A Private Cause Of Action Would Undermine Congress's Aim To Hold Fiduciaries Accountable.

ERISA places on fiduciaries affirmative duties regarding the management of plans and their assets. In addition to those duties, ERISA prohibits fiduciaries from causing plans to enter into prohibited transactions, absent an exemption. Contrary to ERISA's goals, creating a private

cause of action against nonfiduciary parties in interest shifts the burden of complying with the prohibited transaction exemptions from fiduciaries to their counterparties.[22] These counterparties are often the least able to ascertain whether the transactions meet the conditions of any given exemption. A nonfiduciary party in interest relies, to a great extent, upon the judgment of the plan's fiduciary that the transaction meets the relevant exemption's conditions. Indeed, the fiduciary, as a condition precedent to entering into a transaction, often makes certain representations to the nonfiduciary party in interest that the transaction is exempt. That is the case because it is the plan and its fiduciaries that often have better access to the information necessary to determine whether a particular transaction is exempt.[23]

For example, one of the conditions of an exemption for qualified professional asset managers ("QPAM") is that the party in interest cannot be "related" to the QPAM.[24]

22 As the Joint Explanatory Statement of the Committee of Conference explained:

> Under the labor provisions (title I), the fiduciary is the main focus of the prohibited transaction rules. This corresponds to the traditional focus of trust law and of civil enforcement of fiduciary responsibilities through the courts. On the other hand, the tax provisions (title II) focus on the disqualified person [party in interest].

H.R. CONF. REP. 93-1280, at 306 (1974), *reprinted in* 1974 U.S.C.C.A.N. at 5,038, 5,087.

23 Even if a party in interest were able to make some inquiries at the initiation of the transaction, continuing transactions, such as loans, may become prohibited during the terms of the loan if conditions for the plan change. A nonfiduciary party in interest is unlikely to be aware of the changed circumstances but could be the one held responsible under petitioners' theory of liability.

24 *See* Class Exemption for Plan Asset Transaction Determined by Independent Qualified Professional Asset Managers, 49 Fed. Reg. 9,494, 9,504, Section I(d) (1984) [hereinafter PTE 84-14].

Under the exemption, a QPAM is "related" to a party in interest if, among other things, the QPAM (or a person controlling, or controlled by, the QPAM) owns a 5% or more interest in the party in interest. *See* PTE 84-14, Section V(h), 49 Fed. Reg. at 9,506. It would be relatively less difficult for the QPAM than for the party in interest to determine whether the transaction meets the condition.[25] The same concerns arise in transactions with in-house asset managers.[26]

Another example of how the plan is better positioned to determine whether a transaction is exempt can be found in the conditions of the class exemption involving bank collective investment funds.[27] PTE 91-38 allows a bank collective investment fund to engage in certain transactions with a party in interest. For some transactions, the exemption is conditioned upon the interests of all plans maintained by the same employer or employee organization not exceeding 10% of the total assets in the bank collective investment fund. *See* PTE 91-38, Section I(a)(1)(A)(iii), 56 Fed. Reg. at 31,968. Surely the fiduciary stands in a better position than the nonfiduciary party in interest to determine whether those interests exceed 10%.

25 Interestingly enough in this case, if National Investments Services of America, Inc. was a registered investment adviser, *see* J.A. 37, and the fiduciary that made the investment decision, and if less than 20% of it clients' assets under its management were derived from Ameritech, these transactions would have been exempt under the QPAM exemption. Only Ameritech and NISA, the two fiduciaries involved here, would know whether the transactions met those conditions; Salomon, the alleged nonfiduciary party in interest, would not. *See* PTE 84-14, Part I(e), V(c)(1), 49 Fed. Reg. at 9,504-05.

26 *See* Class Exemption for Plan Asset Transactions Determined by In-House Asset Manager, 61 Fed. Reg. 15,975 (1996).

27 *See* Amendment to Prohibited Transaction Exemption (PTE) 80-51 Involving Bank Collective Investment Funds, 56 Fed. Reg. 31,966 (1991) [hereinafter PTE 91-38].

Indeed, this case provides but one example of fiduciaries trying to shift their statutory obligations and liabilities. During the relevant time period, petitioner Ameritech sponsored and administered benefit plans funded through Ameritech Pension Trust ("APT"), and as such Ameritech was a fiduciary. *See* J.A. 285. ERISA allows a fiduciary to designate others to carry out fiduciary responsibilities. *See* ERISA § 405(c)(1). In so doing, a fiduciary may limit its liability. Ameritech appointed National Investments Services of America, Inc. ("NISA") to serve as the investment manager for some of APT's assets, *see* J.A. 343, and by all accounts Ameritech has designated NISA as a fiduciary, *see* J.A. 285-86, 311. NISA agreed that it would "not knowingly engage in any transaction prohibited by ERISA and other applicable law." J.A. 151.

Salomon's role stood in sharp contrast to that of NISA, because as the district court ruled, Salomon was not a fiduciary to the plan. *See* J.A. 294. Unlike NISA, a nonfiduciary party in interest, such as Salomon was alleged to be, accepts no fiduciary-like responsibility. As discussed above, ERISA's comprehensive enforcement scheme addresses nonfiduciary parties in interest's involvement in prohibited transactions through other mechanisms. Yet here, the two fiduciaries, Ameritech and NISA, are trying to shift retroactively to a nonfiduciary their responsibilities and liabilities as fiduciaries. Surely, the statute does not allow fiduciaries to foist such an obligation on a nonfiduciary whenever the plan suffers a loss. Despite these fiduciaries' role in the transactions at issue in this case, the plan is not pursuing relief from either one of them. As this case demonstrates, the proposed cause of action erodes the force of the fiduciary responsibility provisions that form the core of ERISA, ultimately to the detriment of employee benefit plans.

This shifting of responsibility from fiduciaries to nonfiduciaries will simply increase the costs associated with operating plans. The best way to minimize the administrative costs of protecting the plan is to place the burden of compliance on the party that is most able to avoid substantial additional costs. The complexity and fact-specific nature of complying with the conditions of exemptions point to fiduciaries as the "cheapest cost avoiders" and the ones best able to ensure compliance. But, under petitioners' proposal, nonfiduciary parties in interest—already working with limited information—would face increased exposure to liability.

The cause of action that petitioners advocate also shifts liability to nonfiduciary parties in interest that is disproportionate to their authority. On the one hand, the proposed cause of action would make the obligations and liabilities of fiduciaries and nonfiduciary parties of interest almost identical with respect to prohibited transactions. The nonfiduciary party in interest would effectively be a guarantor of the fiduciary's obligations to the plan. On the other hand, nonfiduciary parties in interest lack the fiduciary's discretion to administer the plans, they do not manage or dispose of assets, and they often lack the necessary information to determine if a given transaction is exempt or would violate Section 406. Recognizing this asymmetry or lack of mutuality, ERISA "allocates liability for plan-related misdeeds in reasonable proportion to respective actors' power to control and prevent the misdeeds." *Mertens*, 508 U.S. at 262.

III. THE TEXT OF ERISA DOES NOT CREATE A PRIVATE CAUSE OF ACTION AGAINST NONFIDUCIARY PARTIES IN INTEREST.

Congress deliberately did not create a private cause of action against nonfiduciary parties in interest. The language of the relevant provisions in ERISA reveals that

no private cause of action against parties in interest exists. In resolving an issue of statutory construction, the Court must first "examine . . . the language of the governing statute." *John Hancock Mut. Life Ins. Co. v. Harris Trust & Sav Bank,* 510 U.S. 86, 94 (1993). The Court must not only look to the particular statutory language, "but to the design of the statute as a whole and to its object and policy." *Crandon v. United Sates,* 494 U.S. 152, 158 (1989); *see also Pilot Life Ins. Co. v. Dedeaux,* 481 U.S. 41, 51 (1987). Upon reviewing the text of ERISA Sections 406 and 502 and considering ERISA's objectives, it is apparent that ERISA affords no private cause of action against nonfiduciaries such as parties in interest.

A. Section 502(a)(3) Does Not Afford A Private Cause Of Action Against Parties Who Have Not Violated A Substantive Provision of ERISA.

Petitioners claim that Section 502(a)(3) of ERISA empowers them to sue a nonfiduciary for a fiduciary's violation of one of ERISA's substantive provisions. That interpretation of Section 502(a)(3) cannot be squared with the statute's language, nor would it further the legislative scheme Congress created. Section 502(a)(3) provides that a civil action may be brought

> by a participant, beneficiary, or fiduciary (A) to enjoin any act or practice which violates any provision of this subchapter or the terms of the plan, or (B) to obtain other appropriate equitable relief (i) to redress such violations or (ii) to enforce any provisions of this subchapter or the terms of the plan.

29 U.S.C. § 1132(a)(3) (1994). Petitioners and their *amici* interpret the language "any act or practice" and "to obtain other appropriate equitable relief" as expanding the universe of individuals who may be sued by private plaintiffs to include nonfiduciaries. *See* Pet. Br. at 16; U.S. Br. at 15-18. This language, however, does not reach quite that far. As the Seventh Circuit explained, "Section [502(a)(3)] as a remedial statute only serves to provide a private cause of action for violations of ERISA; it does not expand the scope of liability under the Act." J.A. 349. Thus, a private cause of action is permitted against only those who have violated an obligation expressly placed upon them by the statute. *See Mertens,* 508 U.S. at 253 (holding that Section 502(a)(3) does not authorize appropriate equitable relief at large, but only to redress violations of the statute).

Indeed, a party should not be subject to private lawsuits "to obtain other appropriate equitable relief . . . to redress such violations" if the party itself did not violate a substantive provision of ERISA. Such an expansive reading would place no limits on who could be sued. For example, a fiduciary has a duty under Section 404(a)(1)(C) of ERISA to diversify the plan's holdings. If the fiduciary fails to diversify without good reason, petitioners' proposal would allow the plan (and the fiduciary) to sue a nonfiduciary to recover any benefits the nonfiduciary received from transacting with the plan.[28] This regime cannot be the balance Congress intended. If it were, transacting business with plans would be a risky proposition—a kind of Russian roulette that could severely limit plans' access to the markets.

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[28] There is literally no end to the scope of this proposed liability. Another example would be that under Section 404(a)(1)(D), the fiduciary has a duty to follow the documents and instruments governing the plan. What if, for example, the fiduciary purchases assets from a nonfiduciary that do not satisfy the plan's investment objectives? The nonfiduciary will have, and could have, no idea that ERISA is being violated. However, under the interpretation put forth by petitioners, if the transaction does not benefit the plan, the plan and the fiduciary could sue the unwitting nonfiduciary.

B. A Party In Interest Cannot Violate Section 406 Because Section 406 Places Duties Only On Fiduciaries.

Petitioners claim that Section 406 places an obligation on nonfiduciary parties in interest that can be enforced through a private lawsuit under Section 502(a)(3). *See* Pet. Br. at 19-21. Section 406, however, places no duty on nonfiduciary parties in interest. Rather, fiduciaries must avoid certain transactions, and only fiduciaries are capable of violating Section 406. Section 406 provides in relevant part:

> (1) *A fiduciary with respect to a plan shall not cause* the plan to engage in a transaction, if he knows or should know that such transaction constitutes a direct or indirect—
>
> > (A) sale or exchange, or leasing, of any property between the plan and a party in interest; . . . [or]
> >
> > (D) transfer to, or use by or for the benefit of, a party in interest, of any assets of the plan.

29 U.S.C. § 1106(a)(1) (1994) (emphasis added). This provision states that a *fiduciary* shall not cause the plan to enter into certain transactions. It *does not* state that a party in interest shall not enter into certain transactions.[29]

[29] The legislative history reveals that Congress purposefully did not create the kind of private cause of action petitioners now seek. The Senate version of ERISA explicitly created liability against a party in interest for entering into a prohibited transaction. *See* S. 1179, 93d Cong., 1st Sess., at 176-77 (1973). The House Bill, on the other hand, limited liability simply to fiduciaries. *See generally* H.R. 2, 93d Cong., 2d Sess. (1974). The Conference Committee staff recommended that the conferees adopt the approach taken by the House bill and "not provide civil liability for parties-in-interest." STAFF OF CONF. COMM., 93d Cong., 2d Sess., SUMM. DIFFERENCES BETWEEN SEN. VERSION & HOUSE VERSION OF H.R. 2 —TO PROVIDE FOR PENSION REFORM (Comm. Print. 1974), *reprinted in* LEGISLATIVE HISTORY OF THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974, Vol. 3, at 5249, 5259 (1976). Accordingly, the "labor provisions . . . provide general standards of conduct for fiduciaries, and make certain specific transactions 'prohibited transactions' which plan fiduciaries are not to engage in." H.R. CONF. REP. NO. 93-1280, at 294 (1974), *reprinted in* 1974 U.S.C.C.A.N. 5,038, 5,076.

Only a fiduciary can be held liable for violating Section 406. *See Lockheed Corp. v. Spink*, 517 U.S. 882, 888-89 (1996) (holding that plaintiff must prove that fiduciary caused transaction in violation of Section 406 to successfully bring private action under Section 502).

Petitioners argue that Section 406 places duties, not only on fiduciaries, but also on nonfiduciariy parties in interest, because the provision is entitled "Prohibited Transactions." *See* Pet. Br. at 21. This reading ignores the text and the statute's overall structure. The provision is found in the subchapter of ERISA entitled "Fiduciary Responsibilities." It is the *fiduciary's responsibility* not to enter into certain prohibited transactions. Simply because a transaction involves multiple parties does not mean that ERISA provides a private cause of action against all the parties to that transaction.

Petitioners also argue that because the provision mentions "parties in interest" by name, it shows that parties in interest can independently violate the section. *See* Pet. Br. at 21-23. However, as the Seventh Circuit points out, "[t]he mere fact that [Section 406] mentions 'parties in interest' when it describes the transactions that fiduciaries must avoid does not mean that parties in interest are liable when a fiduciary does engage in a prohibited transaction." J.A. 349. Indeed, the term party in interest is added to the statutory text to describe the kinds of transactions that a fiduciary "shall not cause the plan to enter into." Its inclusion is merely a means to explain the fiduciary's obligations with respect to entering into certain transactions.

If Congress had intended to place a duty on parties in interest under Section 406, it presumably could have said a fiduciary shall not cause a plan to engage in certain transactions *and neither shall a party in interest* participate in such transactions.

Furthermore, Section 408, which provides for exemptions from the operation of Section 406, reveals that Congress used the term party in interest for descriptive purposes in Section 406—not to place obligations on nonfiduciary parties in interest. *See* 29 U.S.C. § 1108 (1994). Nowhere does this provision exempt parties in interest from the reach of Section 406. Rather, it allows the Secretary of Labor to exempt "any *fiduciary* or transaction . . . from all or part of the restrictions imposed by sections [406 and 407]." 29 U.S.C. § 1108(a) (1994) (emphasis added). Had Congress intended that parties in interest be held liable under Section 406, it would have included parties in interest in the universe of entities protected by the exemptions. If the Court interprets Section 406 as petitioners argue, a nonfiduciary party in interest could be sued for the same transaction that the secretary of Labor has exempted for a fiduciary. Such an interpretation would be nonsensical.

C. This Court Has Already Expressed Its Reservations About Finding A Private Cause Of Action Under ERISA Against Nonfiduciary Parties In Interest.

This Court has twice been reluctant to find that a private cause of action exists against nonfiduciaries (including parties in interest). In *Lockheed Corp v. Spink*, the Court was faced with a private cause of action under Section 502(a)(2) & (3) for alleged violations of Section 406(a). 517 U.S. 882 (1996). The question before the Court was whether the transaction was a "prohibited transaction." The Court ruled that a plaintiff must first

"show that a *fiduciary* caused the plan to engage in the allegedly unlawful transaction" to sustain an action under Section 406(a). *Id.* at 888 (emphasis added). Although the Court did not go on to decide whether a private party could sue the nonfiduciary party in interest for entering into a prohibited transaction, it identified the *fiduciary's* breach of *its* duty as the key element for a violation of Section 406.

The Court in *Mertens v. Hewitt Assocs.* considered whether a private cause of action exists under ERISA for violations by nonfiduciaries. 508 U.S. 248 (1993). In *Mertens*, plaintiffs sued the nonfiduciary actuary of a retirement plan under Section 502(a)(3), claiming that the actuary knowingly participated in the fiduciary's breach of his fiduciary duties. *See id.* at 251. Although the narrow issue before the Court was whether monetary damages were available under Section 502(a)(3), the Court considered whether a private cause of action exists at all under Section 502(a) against nonfiduciaries. Expressing its doubt, the Court acknowledged that the provision "does not, after all, authorize 'appropriate equitable relief' at large but only 'appropriate equitable relief' for the purpose of 'redress[ing any] violations or . . . enforc[ing] any provisions' of ERISA or an ERISA plan." *Id.* at 253. The Court both limited the relief available under Section 502 to relief for violations of ERISA's substantive provisions and expressed its doubt as to whether a private plaintiff could sue a nonfiduciary. *See id.* at 253-55.

* * * * *

Congress crafted ERISA with mechanisms that protect employee benefit plans while being cognizant of the costs of that protection. Petitioners have argued that this protection is insufficient and that a private cause of action is needed to protect plans adequately. As shown above, there are no compelling reasons for this Court to take

that step to "attempt to adjust the balance between those competing goals [—benefiting employees and containing cost—] that the text adopted by Congress has struck." Mertens, 508 U.S. at 263.

CONCLUSION

The judgment of the court of appeals should be affirmed.

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