IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

D.L. MARKHAM DDS, MSD, INC. 401(K) PLAN and D.L. MARKHAM DDS, MSD, INC., as plan administrator, on behalf of themselves and others similarly situated,	§ § § §	**C.A. NO. 4:22-cv-00974**
	§	
Plaintiffs,	§	
v.	§	
	§	
THE VARIABLE ANNUITY LIFE INSURANCE COMPANY, VALIC FINANCIAL ADVISORS, INC., and VALIC RETIREMENT SERVICES COMPANY,	§ § § §	
	§	
Defendants.	§	

MOTION TO DISMISS AND/OR MOTION TO STRIKE OF DEFENDANT THE VARIABLE ANNUITY LIFE INSURANCE COMPANY

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Introduction and Summary of the Argument

This is a case in which Plaintiffs seek to avoid responsibility for the consequences of their own decisions. Attempting to hold Defendants liable for fee provisions to which Plaintiffs themselves expressly agreed in a contract, Plaintiffs seek to dramatically expand liability under the ERISA laws governing employee benefit plans. Plaintiffs can only succeed on this theory by disregarding Supreme Court precedent, the prevailing view taken by courts around the country, and ERISA public policy. Because Plaintiffs are responsible for entering into and accepting the contracts about which they now complain, they cannot maintain this action against Defendants as a matter of law.

Plaintiff D.L. Markham, DDS, MSD, Inc. ("Markham DDS"), purchased a group annuity from VALIC to fund the obligations of the D.L. Markham, DDS, MSD, Inc. 401(k) Plan (the "Markham Plan" or the "Plan"), an employee pension benefit plan governed by ERISA. Markham DDS was the Plan's named fiduciary. *See* Complaint [ECF No. 1] at ¶ 5. In purchasing the annuity, Markham DDS agreed that VALIC could charge the Plan a surrender fee if the annuity contract was terminated. *The surrender fee is plainly disclosed on the first page of the annuity contract.* It allows providers like VALIC to offset start-up costs, such as account set-up, fund transfers, mandatory notices, and commissions, in the event of early termination of the annuity contract. But now that VALIC has imposed the agreed upon surrender charge, Plaintiffs challenge the charge as impermissible from the outset and they claim it transformed their entire relationship with VALIC into a prohibited transaction under ERISA (Count I).[1] Plaintiffs also

[1] Plaintiffs also sue VALIC Financial Advisors, Inc. ("VFA"). However, VFA is an improper defendant to this action, as shown further in its Motion to Dismiss filed concurrently with VALIC's Motion to Dismiss. In the unlikely event the Court finds VFA is a proper defendant to this action, the arguments and authorities set forth herein apply with equal force to any of the Defendants.

claim that VALIC engaged in prohibited self-dealing by refusing to waive the surrender fee when Markham DDS unilaterally terminated the annuity contract just two years after it was issued (Count II). Both claims are nonsensical and should be dismissed in their entirety.

Plaintiffs ask this Court to ignore well-established ERISA law and impose obligations on service providers while they are negotiating at arm's length the fees and services to be provided to an ERISA-governed plan. But the prevailing view among the circuits rejects the notion of service provider liability in this situation as it would allow an employer who knowingly agreed to a fee structure to nonetheless later sue to lower it.[2] Accepting Plaintiffs' argument would render meaningless the negotiation of contract terms and make it impossible for service providers to function in the marketplace, thereby thwarting ERISA's goals. *See Varity Corp. v. Howe*, 516 U.S. 489, 497, 116 S.Ct. 1065 (1996). It is no surprise, therefore, that Plaintiffs' claims fail as a matter of law.

First, VALIC never acted as a fiduciary to the Markham Plan in negotiating or imposing the agreed upon surrender charge. Acting as a fiduciary is a prerequisite for Plaintiffs' Count II claim. Plaintiffs cannot escape the simple truth that Markham DDS—the plan's fiduciary bearing the responsibility for ensuring the welfare of the Markham Plan—approved the contractual agreement negotiated at arm's length over several months *before* Plaintiffs had any relationship with VALIC (i.e., before VALIC owed any duties to either Plaintiff). Further, Plaintiffs' allegation that VALIC's imposition of the agreed-to surrender charge gives rise to a fiduciary

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[2] *See infra* Section B.

status contradicts binding precedent and makes no sense. Thus, Plaintiffs' self-dealing claims under ERISA §§ 404(a)(1)(A), 406(b) and 409(a) in Count II fail.[3]

Second, VALIC never engaged in a "prohibited transaction" under ERISA—i.e., VALIC never engaged in a transaction as a conflicted "party in interest" that is unlawful or contrary to the Plan's best interests. The remaining claim under Count I, brought under § 502(a)(3) of ERISA for purported violations of § 406(a)(1)(C), requires Plaintiffs to allege facts showing that VALIC (and Markham DDS) took advantage of the Plan through the issuance of the annuity contract to the Plan. But VALIC had no existing relationship with the Plan when it negotiated and issued an annuity contract that included the surrender fee, barring any possibility that such a contractual commitment constituted a prohibited transaction under ERISA. Further, Plaintiffs fail to allege that both VALIC and Markham DDS had the knowledge needed to state a prohibited transaction claim. Finally, Plaintiffs' § 502(a)(3) claim impermissibly seeks money damages from VALIC's general assets, instead of the required equitable relief.

Third, separate and apart from the above, Plaintiffs' nationwide class action claim should be dismissed or otherwise stricken: Plaintiffs seek to represent a nationwide class of plans and plan sponsors who paid VALIC service fees under a service provider agreement, yet Plaintiffs only paid fees to VALIC as part of its group annuity contract. Plaintiffs did not elect to receive any services through the *separate* service provider agreement; therefore, Plaintiffs cannot assert claims on behalf of a class who paid any such service fees.

For these reasons, Plaintiffs' Complaint should be dismissed in its entirety.

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[3] VALIC previously argued that this is also fatal to Plaintiffs' prohibited transaction claim under § 406(a)(1)(C) in Count I, to the extent the Complaint asserted such a claim. In their Opposition to VALIC's Motion to Dismiss in the Eastern District of California, Plaintiffs clarified they are not asserting a standalone claim under § 406(a)(1)(C) in Count I. [ECF No. 23 at p. 5:5-7.]

Nature and Stage of the Proceedings

On January 4, 2021, Plaintiffs filed the Complaint in the United States District Court for the Eastern District of California, seeking relief on a class wide basis, and named as Defendants VALIC, VFA, and VALIC Retirement Services Company ("VRSCO"). ECF No. 1. Thereafter, the Defendants' motion to transfer to this Court was granted. ECF No. 36. On April 15, 2022, this Court granted the parties' Agreed Motion to Dismiss, dismissing VRSCO from the case and dismissing Count II against VFA, Inc. ECF No. 51. VALIC filed its motion to dismiss and/or motion to strike in the Eastern District of California, but the motion was denied as moot as part of the order transferring the case to this Court. ECF No. 36*.* VALIC renews its motion to dismiss and/or motion to strike Plaintiffs' Complaint.

Factual and Procedural Background

A. The Markham Plaintiffs Approach VALIC for Services

As noted, Plaintiffs are an ERISA-governed employee pension benefit plan (the Markham Plan) and the Plan Sponsor and Administrator (Markham DDS). *See* Complaint [ECF No. 1] at ¶¶ 1, 5. Plaintiffs admit that Markham DDS is the Markham Plan's named fiduciary. *Id.* at ¶ 5. Prior to May 2018, VALIC had no relationship with Markham DDS nor the Markham Plan. *Id.* at ¶ 9. Per the Complaint, Markham DDS approached VALIC about becoming a service provider for the Markham Plan. *Id.* Negotiations and discussions to that end lasted several months. *Id.* at 8.

B. VALIC and Markham DDS Ultimately Enter Two Contracts

As a result of the negotiations, Markham DDS entered into two contracts with VALIC. First, on May 18, 2018, VALIC issued a Group Fixed and Variable Deferred Annuity Contract No. 72278 to the Markham Plan ("the Annuity") to fund Plan obligations. *See* Compl. at ¶ 11; *see also* Exhibit 1, Declaration of Eric S. Levy in Support of VALIC's Motion to Dismiss and/or

Motion to Strike ("Levy Dec").[4] Through the Annuity, VALIC provided an insurance product through which various investment options were provided to participants in the Markham Plan. *Id.* As plainly referenced on the Annuity's first page, Markham DDS agreed that VALIC could impose a surrender charge upon termination of the Annuity. *See id.* at pp. 1, 6-7.

"Because annuities are structured as long-term investments, a customer who withdraws money early incurs [surrender] charges meant to compensate . . . up-front costs, such as commissions paid to brokers and enhancements added to the annuities." *Cruson v. Jackson Nat. Life Ins. Co.*, 954 F.3d 240, 246 (5th Cir. 2020). While some providers offset these costs via a front-end implementation fee, VALIC utilizes a surrender fee, which is only imposed if Markham DDS or an individual employee terminates their participation in the Annuity. *See* Exhibit A to Levy Dec.

Here, the Annuity states that VALIC will assess a surrender charge of "5% of (1) the amount withdrawn, or (2) the amount of any Purchase Payments received during the most recent 60 months prior to the surrender or withdrawal, whichever is less." *Id.* at p. 6. A "Purchase Payment" is any amount paid to VALIC for allocation to a participant's account. *Id.* at 3. The Annuity also states:

> The surrender charge may be waived or reduced uniformly on all Participant Accounts for contracts issued under certain plans or arrangements which are expected to result in administrative cost savings. No reduction or waiver will be made that is unfairly discriminatory to any person.
>
> We may waive any withdrawal or surrender charge attributable to

[4] In considering this Rule 12(b)(6) motion, the Court may properly consider the Levy Dec and its accompanying exhibits because the documents attached to the Levy Dec are referenced in the Complaint and are central to Plaintiffs' claims. *See Collins v. Morgan Stanley Dean Witter,* 224 F.3d 496, 498 (5th Cir. 2000) (explaining that a court may consider documents attached to a motion to dismiss that are referenced in the complaint and central to the claims); *see also Rittgers v. United States*, 131 F. Supp. 3d 644, 649 (S.D. Tex. 2015).

> Purchase Payments received during specific periods of time, and under conditions and limitations set by Us. Any such waiver will be made by Resolution of the Board of Directors. Notice of the right to surrender without charge will be mailed to the Contract Owner when such waiver is declared by the Board of Directors.

Id. at p. 7. In other words, the surrender charge may be waived under certain circumstances and upon occurrence of specific actions, none of which are alleged to have occurred.

The second contract between VALIC and Markham DDS, also dated May 18, 2018, was a "Service Provider Agreement – Portfolio Director" ("SPA"). *Id.* at ¶ 10; Exhibit B to Levy Dec. Under the SPA, Markham DDS agreed to perform certain functions regarding the Plan's administration. *Id.* at pp. 2-3. Additionally, VALIC agreed to offer certain *ad hoc* services in exchange for a fee. *Id.* at p. 3-5. Markham DDS, however, never utilized any fee-based service; instead, it retained a third-party administrator, America's Best – Account Services Team, to perform such services. *See id.* at pp. 1, 5. Thus, no service fees were ever due to VALIC under the SPA. *Id.* at p. 5. Through the SPA, Markham DDS also expressly "acknowledges and agrees that the services provided by VALIC hereunder are solely non-discretionary services" and that Markham DDS "or its designee shall be responsible for the duties of Plan Sponsor, Plan Administrator, Plan fiduciary and other related functions of a discretionary nature in support of the establishment and maintenance of the Plan." *Id.* at p. 6. Put differently, no discretion was delegated to VALIC.

C. <u>Markham DDS Terminates the Contracts and Plaintiffs File This Lawsuit.</u>

Less than two years later, in January 2020, Markham DDS decided to terminate the SPA and the Annuity. Compl. at ¶ 12. As agreed to by Markham DDS, VALIC assessed the Annuity's surrender fee. Compl. at ¶¶ 12, 14 & 15. Despite the Annuity's clear language about the existence and nature of the fee, Markham DDS now alleges it lacked knowledge of the surrender provision until 2020. *Id.* at ¶ 13. Plaintiffs assert that, because the Annuity allowed VALIC to

waive the surrender charge under certain circumstances, the application of the surrender provision was a fiduciary act. *Id.* at ¶¶ 25(i), 25(m). Plaintiffs' Complaint seeks relief on a class-wide basis and alleges two counts against "Defendants." *Id.* at ¶¶ 9, 10.

Count I, entitled "Knowing Participant in a Prohibited Transaction – ERISA §§ 406(a)(1)(C); 502(a)(3)," arises out of the existence of a surrender fee provision in the Annuity. Compl. at ¶¶ 28, 29. The requested relief is "[r]equiring VALIC to provide an accounting for, and to disgorge, all losses caused to Class Members' plans—including all fees retained—as a result of their knowing participation in a prohibited transaction *as a nonfiduciary*." *Id.* at ¶¶ 27-29, Prayer for Relief at ¶ 1 (emphasis added). Plaintiffs make no allegation regarding a specifically identifiable fund or account possessed by VALIC to hold such fees.

Count II, entitled "Self-Dealing Prohibited Transaction – ERISA §§ 404(a)(1)(A); 406(b); 409(a)," is based on the purported fiduciary act of deliberating "on whether to waive the surrender fee." *Id.* at ¶ 30. The relief sought is disgorgement and "[r]equiring VALIC to restore all losses caused to the Subclass Members' plans as a result of their self-dealing prohibited transaction as a fiduciary in imposing the surrender fee." *Id.* at ¶ 30, Prayer for Relief at ¶ 2.

For the reasons set forth below, Counts I and II fail as a matter of law both individually as to Plaintiffs and on a class-wide basis.

<u>Standard for Rule 12(b)(6) Failure to State a Claim</u>

Rule 8 of the Federal Rules requires a complaint to contain "a short and plain statement of the claim showing that the pleader is entitled to relief." FED. R. CIV. P. 8(a)(2). The rule, however, "demands more than an unadorned, the-defendant-unlawfully-harmed-me accusation." *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009). Failure to comply with Rule 8 constitutes grounds for dismissal under Rule 12(b)(6), which is "appropriate when a defendant attacks the complaint

because it fails to state a legally cognizable claim." *Ramming v. U.S.*, 281 F.3d 158, 161 (5th Cir. 2001).

To survive a Rule 12(b)(6) motion, a complaint "must provide the plaintiff's grounds for entitlement to relief—including factual allegations that when assumed to be true raise a right to relief above the speculative level." *Cuvillier v. Taylor*, 503 F.3d 397, 401 (5th Cir. 2007) (citing *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 555 (2007)). "[A] plaintiff's obligation to provide the 'grounds' of his 'entitle[ment] to relief' requires more than labels and conclusions, and a formulaic recitation of a cause of action's elements will not do." *Twombly*, 550 U.S. at 545 (citations omitted). Indeed, "a claim has facial plausibility when the plaintiff pleads ***factual content*** that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged." *Iqbal*, 556 U.S. at 678 (emphasis added). In the ERISA context, the Supreme Court has endorsed "careful judicial consideration of whether the complaint states a claim that the defendant has acted imprudently" so as to protect defendants from meritless claims. *Fifth Third Bancorp v. Dudenhoeffer*, 573 U.S. 409, 425 (2014).

In considering a Rule 12(b)(6) motion, a court may consider documents attached to the complaint or identified as central to the claims made, documents attached to the motion to dismiss that are referenced in the complaint, and documents subject to judicial notice as public record. *See Collins v. Morgan Stanley Dean Witter,* 224 F.3d 496, 498 (5th Cir. 2000); *see also Rittgers v. United States*, 131 F. Supp. 3d 644, 649 (S.D. Tex. 2015).

Statement of the Issues

VALIC's Motion raises the following issues:

A. Whether Count II is subject to dismissal under Federal Rule of Civil Procedure 12(b)(6) because VALIC did not act as a plan fiduciary under ERISA when negotiating for and assessing contractually agreed for fees.

B. Whether Count I is subject to dismissal under Federal Rule of Civil Procedure 12(b)(6) because: (1) VALIC was not a party-in-interest under ERISA when negotiating and entering into the subject contract/transaction; (2) Plaintiffs fail to plead facts that both Markham and VALIC had knowledge of the prohibited transaction; and (3) Plaintiffs do not seek appropriate equitable relief.

C. Whether the Court should strike class allegations pertaining to the service provider agreement under Federal Rules of Civil Procedure 12(b)(6) and 12(f) because Markham DDS did not contract for VALIC to perform fee-based administrative duties under the service provider agreement.

Argument[5]

A. Plaintiffs' Claims Undermine the Public Policies Behind ERISA

This case is about the sale of an annuity, which is *not* conduct regulated by ERISA. Indeed, ERISA imposes duties and potential liability on plan fiduciaries and those with existing relationships to a plan—not insurers negotiating and selling their products up-front and at arm's length with plan fiduciaries. *See, e.g.*, 29 U.S.C. §§ 1104, 1106, and 1109; *see also Chavez v. Plan Benefit Services, Inc.*, No. AU-17-CA-00659-SS, 2018 WL 6220119, *4 (W.D. Tex. Sept. 12, 2018) (holding that paying a service providers' fees in accordance with the terms of the initial contract is not the risk that Congress sought to legislate against).[6] The statutes relied on by Plaintiffs aim to prohibit transactions with characteristics such as "commercial bargains that present a special risk of plan underfunding because they are struck with plan insiders, presumably not at arm's length." *Lockheed Corp. v. Spink*, 517 U.S. 882, 893 (1996).

[5] Concurrent with this motion, VFA has filed a separate motion to dismiss under Rule 8(a)(2) of the Federal Rules of Civil Procedure, on the ground the Plaintiffs have failed to allege any specific allegations against it and instead have engaged in group pleading by lumping all named Defendants together as "VALIC." VALIC incorporates the VFA Motion to Dismiss by reference as if fully set forth herein, and Plaintiffs' group pleading provides an independent reason why the Complaint should be dismissed in its entirety as to VALIC.

[6] In accordance with the Court's Procedures 5.I., copies of all cases not found in the United States Code, Supreme Court Reporter, Federal Reporter, Federal Rules Decisions, Federal Supplement, Southwestern Reporter, or Vernon's Revised Statutes and Codes Annotated are attached hereto as Exhibit 2.

"Contracting at arm's length with unrelated service providers plainly does not share that characteristic: it is not a deal struck with 'plan insiders.'" *Sellers v. Anthem Life Ins. Co.*, 316 F. Supp. 3d 25, 36 (D.D.C. 2018).

In enacting ERISA, Congress recognized the national public interest in private employee benefit plans and the need to protect the interests of participants and their beneficiaries. *See* 29 U.S.C. § 1001. ERISA therefore established standards of conduct, responsibility, and obligation for fiduciaries of such plans. *See id.* At the same time, the Supreme Court recognizes the danger of imposing liability on non-fiduciaries which could cause unnecessarily high insurance costs or might deter companies from providing services to a plan. *See Mertens v. Hewitt Associates*, 508 U.S. 248, 262-263, 113 S.Ct. 2063 (1993) (acknowledging a "tension between the primary [ERISA] goal of benefiting employees and the subsidiary goal of containing pension costs") (citation omitted); *see also Reich v. Rowe*, 20 F.3d 25, 32 (5th Cir. 1994) ("We are concerned that extending the threat of liability over the heads of those who only lend professional services to a plan without exercising any control over, or transacting with, plan assets will deter such individuals from helping fiduciaries navigate the intricate financial and legal thicket of ERISA"). Thus, "the limited remedies available under ERISA are an inherent part of the 'careful balancing' between ensuring fair and prompt enforcement of rights under a plan and the encouragement of the creation of such plans." *Aetna Health Inc. v. Davila,* 542 U.S. 200, 215, 124 S.Ct. 2488 (2004).

As a result, ERISA seeks to allocate "liability for plan-related misdeeds in reasonable proportion to respective actors' power to control and prevent the misdeeds." *See Mertens*, 508 U.S. at 262. Here, Markham DDS alone had the power to control whether the Markham Plan entered into the contracts with VALIC and whether to agree to the clearly disclosed fee

provisions. *See Santomenno v. Transamerica Life Ins. Co.*, 883 F.3d 833, 841 (9th Cir. 2018) (noting that "any plan sponsor who agreed to a 99% fee arrangement would *itself* be liable for breaching its fiduciary duty. The employer has the express duty under § 1104(a)(1)(A)(ii) of defraying reasonable expenses of administering the plan, and, absent some sort of conduct not alleged in plaintiffs' complaint, claims that fully disclosed fee arrangements are unreasonable lie against the employer, not the service provider") (cleaned up). On the flip side, an insurer selling its products to the employer or negotiating its prospective fees at arm's length is not subject to liability. *See Am. Fed'n of Unions v. Equitable Life Assur. Soc'y*, 841 F.2d 658, 664 (5th Cir. 1988) ("Simply urging the purchase of its products does not make an insurance company an ERISA fiduciary with respect to those products."). Indeed, any other finding undermines ERISA's very purpose by "discourage[ing] service providers from contracting with [plans] in the first place." *Sellers*, 316 F. Supp. 3d at 36.

Plaintiffs' claims arise solely from the fee arrangements Markham DDS agreed to, at arm's length, with VALIC before VALIC had any relationship with the Plaintiffs. Consistent with its purposes, ERISA does not impose liability on VALIC in these circumstances.

B. VALIC Did Not Act as a Fiduciary in Negotiating or Applying the Surrender Fees

Plaintiffs' claims under Count II require a finding that VALIC functioned as a fiduciary in negotiating and assessing the surrender fee. As a matter of law, VALIC's actions were not fiduciary in nature.

"In every case charging breach of ERISA fiduciary duty . . . the threshold question is not whether the actions of some person employed to provide services under a plan adversely affected a plan beneficiary's interest, but whether that person was acting as a fiduciary (that is, was performing a fiduciary function) when taking the action subject to the complaint." *Pegram v.*

Herdrich, 530 U.S. 211, 226, 120 S.Ct. 2143 (2000). Applying this principle, courts have repeatedly held that negotiating for and imposing an agreed upon charge are not the acts of a fiduciary. Thus, Plaintiffs' self-dealing claims under ERISA §§ 404(a)(1)(A), 406(b) and 409(a) in Count II fail.

a. VALIC was not a Fiduciary when it Negotiated a Surrender Fee in the Annuity

It is black letter law across the circuits that a service provider to an ERISA plan does not act as a fiduciary when negotiating its compensation with a prospective customer (or in collecting the fee allowed under the signed contract). *See Equitable Life*, 841 F.2d at 664 ("Simply urging the purchase of its products does not make an insurance company an ERISA fiduciary with respect to those products."); *Santomenno*, 883 F.3d at 841 (holding that a service provider is "not an ERISA fiduciary when negotiating its compensation with a prospective customer," nor when it withdraws the predetermined fees); *F.H. Krear & Co. v. Nineteen Named Trs.*, 810 F.2d 1250, 1259 (2d Cir. 1987) ("When a person who has no relationship to an ERISA plan is negotiating a contract with that plan, he has no authority over or responsibility to the plan…. Such a person is not an ERISA fiduciary with respect to the terms of the agreement for his compensation."); *McCaffrey Financial Corp. v. Principal Life Insurance Co.*, 811 F.3d 998, 1003 (8th Cir. 2016) ("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"); *Hecker v. Deere & Co.*, 556 F.3d 575, 583 (7th Cir. 2009) ("[A] service provider does not act as a fiduciary with respect to the terms in the service agreement if it does not control the named fiduciary's negotiation and approval of those terms."); *Santomenno ex rel. John Hancock Tr. v. John Hancock Life Ins. Co. (U.S.A.)*, 768 F.3d 284, 293 (3d Cir. 2014) ("[A] service provider owes no fiduciary duty to a plan with respect to

the terms of its service agreement if the plan trustee [or fiduciary] exercised final authority in deciding whether to accept or reject those terms.”).

Agreements negotiated at arm’s length, like the Annuity and the SPA, are governed by competition in the marketplace, and the prospective purchaser (i.e., Markham DDS) is free to reject the insurer’s product. This reasoning forecloses any argument that the insurer is acting as a fiduciary in that situation.[7] And this reasoning makes sense, because the insurer is not a service provider until those negotiations are completed and the service contract or annuity is executed. *Se Danza v. Fidelity Mgmt. Tr. Co.,* 533 F. App’x. 120, 125-126 (3rd. Cir. 2013) (“At the point that [the service provider] was negotiating its fees, it was not a fiduciary of the plan and owed no duty to the plan participants to defray reasonable expenses of administering the plan.”) (cleaned up). To hold otherwise would place a potential service provider at peril when negotiating the very terms and conditions on which the provider would be willing to enter into a relationship with a plan or plan fiduciary.

b. VALIC was not a Fiduciary When It Assessed the Surrender Charge Expressly Permitted by the Annuity

Because VALIC was not a fiduciary when it negotiated the Annuity in 2018, the only question remaining is whether VALIC was a fiduciary when it assessed the surrender charge two years later. Markham DDS admits it was the Plan’s *named* fiduciary. Accordingly, the question for the Court is whether Plaintiff has alleged facts showing that VALIC *functioned* as a fiduciary when imposing the surrender fee. *See Tiblier v. Dlabal*, 743 F.3d 1004, 1008 (5th Cir. 2014) (“It is not enough for Plaintiffs to show that [the defendant] acted in a general fiduciary capacity. Rather, Plaintiffs must establish that [the defendant] acted as a fiduciary with regard to the

[7] Indeed, Plaintiffs conceded as much in their Opposition to VALIC’s Motion to Dismiss in the Eastern District of California. [ECF No. 23 at pp. 17-19.]

specific transaction about which they complain.") A party is a "functional fiduciary" under ERISA if:

> (i) 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, (ii) he renders investment advice for a fee or other compensation direct or indirect, with respect to any moneys or other property of such plan, or has any authority or discretionary responsibility in the administration of such plan.

29 U.S.C. § 1002(21)(A) (emphasis added). Whether waiver of the fee could be considered an exercise of discretion is irrelevant because, as the Complaint and Annuity make clear, VALIC did not waive the surrender fee; instead, it assessed the fee per the Annuity's unambiguous terms. *See Dlabal*, 743 F.3d at 1008-9 ("[W]hether Plaintiffs gave [the defendant] discretionary authority or control over the Plans is irrelevant here because it is undisputed that [the defendant] did not *exercise* that authority with respect to the only transaction at issue in this case.") (emphasis in original).

Consistent with ERISA's purposes, an insurer is not a fiduciary when it charges a fee that the parties contracted for at arm's length. *See Reich v. Lancaster*, 55 F.3d 1034, 1047 (5th Cir. 1995) ("We recognize, of course, that '[a]n entity which assumes discretionary authority or control over plan assets will not be considered a fiduciary if that discretion is sufficiently limited by a pre-existing framework of policies, practices and procedures.'"). To hold that a party is not a fiduciary when it negotiates its fees but then somehow becomes a fiduciary when it charges said fees is nonsensical. *See Depot, Inc. v. Caring for Montanans, Inc.*, 915 F.3d 643, 655 (9th Cir. 2019) ("[A]fter the contract is executed, the 'service provider cannot be held liable for merely accepting previously bargained-for fixed compensation' because 'the plan administrator act[s] as 'a fiduciary only for purposes of administering the plan, not for purposes of negotiating or collecting its compensation.'") (internal citations omitted). Here, Plaintiffs concede that

VALIC imposed the surrender charge in accordance with the contract terms. Compl. at ¶¶ 12, 14 and 17. The concession ends the inquiry – VALIC was not acting as a fiduciary when it applied the surrender fee per the Annuity.

That VALIC had discretion to waive the fees under certain circumstances is of no moment. *See Humana Health Plan, Inc. v. Nguyen*, 785 F.3d 1023, 1027 (5th Cir. 2015) ("[N]ot every act that could be described as 'discretionary' in the general sense makes the actor a fiduciary under ERISA."); *see also Leimkuehler v. Am. United Life Ins. Co.*, 713 F.3d 905, 914 (7th Cir. 2013) (holding that the defendant's decision *not* to exercise its contractual right to substitute less expensive funds for the plan does not make it a fiduciary because "an act of omission fails to satisfy the requirement that the individual *exercise* discretionary authority over plan assets") (emphasis in original). A provider can almost always decide to waive a fee. But a service provider's *ability* to waive its fees does not equate to the "exercise" of discretion (and, thus, fiduciary status) where the service provider imposed the fee as agreed. *See Chavez*, 2018 WL 6220119 at *4 (explaining that a service provider's collection of a fee contracted for at arms-length does "not present the risks against which Congress sought to legislate"); *see also Santomenno*, 883 F.3d at 841, n.8 (explaining that a service provider's *ability* to change or waive its fees does not create fiduciary status when the service provider does not *change* its fee, such as withdrawing more than it was entitled to under the contract or if the service provider's fee was based on self-reported hours worked). Plaintiffs further allege no "condition or limitation" that required VALIC to waive the fee per the Annuity. *See* Exhibit A to Levy Dec., at p. 7.

Given that VALIC simply imposed the surrender fee as stated in and permitted by the Annuity, VALIC was not acting as a fiduciary.

c. Because VALIC was not a Fiduciary, Count II Fails

Because VALIC was not acting as a fiduciary, the Court can quickly dispense with all of Count II, in which Plaintiffs assert a cause of action for a "self-dealing prohibited transaction" based on §§ 404(a)(1)(A), 406(b), and 409(a). Compl. at p. 10. Each of these statutory provisions addresses only fiduciary obligations: § 404(a)(1)(A) ("a *fiduciary* shall discharge his duties with respect to a plan…"); § 406(b) ("A *fiduciary* with respect to a plan shall not…"); and § 409 ("Any person who is a *fiduciary* with respect to a plan who breaches…") (all emphases added). Moreover, as explained by § 409, "[n]o fiduciary shall be liable with respect to a breach of fiduciary duty under this subchapter if such breach was committed *before he became a fiduciary* or after he ceased to be a fiduciary." 29 U.S.C. § 1109 (emphasis added). Because VALIC was not acting as a fiduciary, Plaintiffs have not and cannot state a claim for relief under Count II.

C. Count I Fails Because VALIC was not a "Party in Interest" to a Prohibited Transaction

Through Count I, Plaintiffs also seek recovery under § 502(a)(3) for VALIC's alleged knowing participation – whether as a fiduciary or not – in a "prohibited transaction" under ERISA. Compl. at ¶¶ 16, 28 and 29. In particular, ERISA prohibits fiduciaries like Markham DDS from entering into transactions with "parties in interest" who "a fiduciary might be inclined to favor at the expense of the plan's beneficiaries." *Harris Trust and Sav. Bank v. Salomon Smith Barney, Inc.*, 530 U.S. 238, 238, 120 S.Ct. 2180 (2000); *see Lockheed Corp. v. Spink,* 517 U.S. 882, 893, 116 S.Ct. 1783 (1996) (holding that § 406 seeks to prevent "commercial bargains that present a special risk of plan underfunding because they are struck with plan insiders, presumably not at arm's length"). Here, Markham DDS makes no allegation of a relationship that would have caused it to favor VALIC at the expense of the Plan's beneficiaries. To the

contrary, the Complaint makes clear that prior to entering the SPA and the Annuity, VALIC had no relationship with Plaintiffs. As such, Count I fails as a matter of law.

a. VALIC was not a Party in Interest When Negotiating the Annuity

To plead a claim under § 502(a)(3) for purported violations of § 406(a)(1)(C), Plaintiffs must allege facts showing that VALIC was a "party in interest" when it entered the SPA and Annuity with Markham DDS. *See Harris Trust*, 530 U.S. at 245. A transaction is prohibited under ERISA if Markham DDS caused "the plan to engage in a transaction, if he knows or should know that such transaction constitutes a direct or indirect . . . (C) furnishing of goods, services, or facilities between the plan and a party in interest . . .." § 406(a)(1)(C). "Party in interest" includes "a person providing services to such plan." 29 U.S.C. § 1002(14). Thus, the first pertinent question is *when* did VALIC become a party in interest to the Plan. *See Chavez,* 2018 WL 6220119, at *3.

To answer this question, Plaintiffs allege VALIC was a party in interest when it negotiated and entered the Annuity and SPA with Markham DDS. *See* Compl. at ¶ 25(c) ("[d]oes Class Members' contracting with VALIC to furnish services to their plans constitute prohibited transactions . . .") and ¶ 28 ("VALIC understood that it would receive additional compensation from the Plan and Class Members' plan by inserting a substantial penalty in it contract documents. . ."). But for reasons similar to the fiduciary analysis above and the points discussed in Section B, *supra*, VALIC cannot be a party in interest at a time it had no relationship with the Plaintiffs. Quite simply, § 406(a) "does not cover arms-length transactions with third parties who have no preexisting relationship with a plan or its fiduciaries." *Chavez,* 2018 WL 6220119 at *4 (citing *Lockheed Corp.,* 517 U.S. at 893 and *Harris Trust*, 530 U.S. at 242).

Applying Supreme Court precedent and consistent with the majority view nationwide, the Western District of Texas has explained that when defendants are "not parties in interest when they negotiated the initial contract to provide services, *the initial contract does not qualify as a prohibited transaction . . .*." *Chavez,* 2018 WL 6220119, at *3 (explaining "Defendants were not parties in interest when they initially contracted to provide services because, at that time, they were not yet 'providing services to the plan'") (emphasis added). Indeed, to accept Plaintiffs' "reading would be circular reasoning: the transactions were prohibited because the service provider was a party in interest, and the service provider was a party in interest because it engaged in a prohibited transaction." *Sellers*, 316 F. Supp. 3d at 34 (cleaned up).[8] To avoid this nonsensical outcome, the majority view confirms that "some prior relationship must exist between the fiduciary and the service provider to make the provider a party in interest under § 1106." *See, e.g.*, *Ramos v. Banner Health*, 1 F.4th 769, 787 (10th Cir. 2021). On this basis alone, Count I fails.[9]

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[8] In *Sellers*, the court explains that the clear weight of authority supports that a service provider is not a party in interest when contracting with a plan. *Patrico v. Voya Fin., Inc.*, No. 16-cv-7070 (LGS), 2018 WL 1319028, at *7 (S.D.N.Y. Mar. 13, 2018); *Cunningham v. Cornell Univ.*, No. 16-cv-6525 (PKC), 2017 WL 4358769, at *10 (S.D.N.Y. Sept. 29, 2017); *Sweda v. Univ. of Pa.*, No. 16-cv-4329, 2017 WL 4179752, at *11 (E.D. Pa. Sept. 21, 2017); *Sacerdote*, 2017 WL 3701482, at *13–14; *Fite v. Merrill Lynch & Co*, No. 8:10-cv-008 DOC, 2010 WL 11556808, at *7 (C.D. Cal. Nov. 2, 2010); *UFCW Local 56 Health & Welfare Fund v. Brandywine Operating P'ship, L.P.*, No. 05-cv-2435, 2005 WL 3555390, at *2–4 (D.N.J. Oct. 28, 2005).

[9] Similarly, paying fees to satisfy a contractual obligation does not constitute a "transaction." *See Chavez,* 2018 WL 6220119, at *3 ("[T]he crux of a transaction under both [§ 406 and § 408] is *the act of contracting* that establishes the legal rights and obligations between the parties.") (emphasis added). Thus, even if the alleged prohibited transaction under Count I was VALIC's enforcement of the Annuity's surrender charge (which is not the allegation), enforcing a surrender charge is not a "transaction" with the Plan. Instead, it was the implementation of an existing contractual right under the Annuity, which is not governed by § 406(a).

b. Plaintiffs Fail to Allege that Markham DDS or VALIC Had the Requisite Knowledge Needed to State a Prohibited Transaction Claim

Assuming *arguendo* that VALIC was a party in interest (which would be a clear change in existing law), Plaintiffs additionally must allege facts reflecting that both Markham DDS and VALIC had actual or constructive knowledge that what they were doing was unlawful. Plaintiffs fail to plead the knowledge required of either Markham DDS or VALIC.

First, to properly plead Count I, Plaintiffs must allege facts that Markham DDS (as the named plan fiduciary) entered into the Annuity with actual or constructive knowledge of the surrender charge. *See Harris Trust*, 530 U.S. at 240 (holding that an action for restitution against a party in interest "involve[s] a showing that the *plan fiduciary*, with actual or constructive knowledge of the facts satisfying the elements of a § 406(a) transaction, caused the plan to engage in the transaction.") (emphasis in original); *see also* 29 U.S.C. § 1106(a)(C). But Plaintiffs plead themselves out of their claim by alleging that Markham DDS did *not* have actual or constructive knowledge of the surrender charge until two years after the alleged prohibited transaction took place. Compl. at ¶ 13. Because no plan fiduciary with the requisite knowledge caused the Plan to engage in the prohibited transaction, the claim fails. *See Hannan v. Hartford Financial Servs., Inc.*, 688 F. App'x. 85, 91 (2d Cir. 2017) (dismissing prohibited transaction claim against non-fiduciary when complaint failed to identify an ERISA violation arising out of plan fiduciary's conduct that would subject the non-fiduciary to liability).

Second, Plaintiffs must allege facts showing that VALIC, as the alleged party in interest, had knowledge of the circumstances that rendered the subject transaction unlawful. *See Harris Trust*, 530 U.S. at 251 ("[T]he transferee must be demonstrated to have had actual or constructive knowledge of the circumstances that rendered the transaction unlawful.") As already established, VALIC was not a party in interest. But even if it was, Plaintiffs plead no facts that

VALIC had knowledge that negotiating the surrender fee was unlawful, nor could they, given existing law making clear that negotiating a surrender fee is in fact lawful. *See supra*, Section B.

Instead, Plaintiffs simply posit a legal conclusion that the surrender fee is a prohibited penalty per ERISA Regulation § 2550.408b-2(c)(3). But Plaintiffs plead no facts to ground the legal conclusion. *See Iqbal*, 129 S. Ct. at 1949 (providing that conclusory allegations in a complaint must be disregarded as they are not entitled to the presumption of truth). The lack of factual allegation prevents the Court from determining whether the surrender fee is a prohibited penalty or a permitted "necessary services exemption":

> (3) Termination of contract or arrangement. No contract or arrangement is 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 becoming locked into an arrangement that has become disadvantageous. [] *A provision in a contract or other arrangement which reasonably compensates the service provider or lessor for loss upon early termination of the contract, arrangement, or lease is not a penalty*. For example, a minimal fee in a service contract which is charged to allow recoupment of reasonable start-up costs is not a penalty.

29 C.F.R. § 2550.408b-2(c)(3) (emphasis added). As noted above, annuities typically include a surrender fee provision to offset "start-up costs." *See Cruson*, 954 F.3d at 246. Ignoring the very regulation they invoke, Plaintiffs' entire claim is premised on an incorrect assumption that *any* surrender fee is a penalty. But 29 C.F.R. § 2550.408b-2(c)(3) says otherwise.

Plaintiffs' mistake in this regard causes them to plead no facts to show that the surrender charge was unreasonable compensation or was in excess of VALIC's reasonable start-up costs with respect to the Plan. Plaintiffs simply leap to the legal conclusion that the surrender fees amount to a prohibited penalty, which is insufficient to make a plausible claim for relief. *See Del Castillo v. Community Child Care Council of Santa Clara County, Inc.,* No. 17-cv-07243-BLF, 2019 WL 6841222, *3-4 (N.D. Cal. Dec. 16, 2019) (finding conclusory allegations that

unreasonable compensation was paid insufficient to meet plaintiff's burden to plead a prohibited transaction claim against a non-fiduciary).

Because Plaintiffs fail to satisfy the requirements of showing that the Plan fiduciary and the party in interest knew of the circumstances that rendered the allegedly prohibited transaction unlawful, Count I fails as a matter of law.

c. Plaintiffs Seek Relief Not Permitted by ERISA

Even if Plaintiffs sufficiently alleged a prohibited transaction, their claims asserted under § 502(a)(3) for purported violations of § 406(a) still fail because such claims are limited to equitable relief. *Mertens,* 508 U.S. at 253; *see also Montanile v. Bd. Of Trs. of Nat'l Elevator Indus. Health Benefit Plan*, 577 U.S. 136, 142, 136 S.Ct. 651 (2016). "Equitable relief is contrasted with 'legal relief,' which constitutes claims seeking 'nothing other than compensatory damages.'" *Cent. States Se. & Sw. Areas Health & Welfare Fund v. Health Special Risk, Inc.*, 756 F.3d 356, 360 (5th Cir. 2014) (citing *Mertens*, 508 U.S. at 255). A judgment imposing "merely personal liability on the defendant to pay a sum of money" is a legal remedy. *Great-W. Life & Annuity Ins. Co. v. Knudson*, 534 U.S. 204, 213 (2002). "An equitable remedy, by contrast, seeks the return 'of money or property [that is] identified as belonging in good conscience to the plaintiff [and can] clearly be traced to particular funds or property in the defendant's possession.'" *Id.*

"[A] plaintiff bringing suit against a non-fiduciary party in interest must show that equitable relief can be granted" and "[s]atisfying § 502(a)(3) functions as an element of the ERISA claim." *Teets v. Great-West Life & Annuity Insurance Co.,* 921 F.3d 1200, 1223 (10th Cir. 2019). "If a plaintiff cannot demonstrate that equitable relief is available, the suit cannot proceed." *Id.* The Fifth Circuit has "stressed that, for a plan fiduciary's action to fall within §

502(a)(3)'s jurisdictional grant, it must seek recovery of (1) specifically identifiable funds, (2) that belong in good conscience to the Plan, and (3) that are within the possession and control of the defendant . . ..” *Coop. Ben. Adm'rs, Inc. v. Ogden*, 367 F.3d 323, 332 (5th Cir. 2004).

Plaintiffs contend they are seeking “equitable disgorgement” and an “accounting.” Compl. at ¶¶ 29, 30. “Accounting for profits (also referred to as an ‘accounting’) and disgorgement of profits are forms of restitution.” *Teets,* 921 F.3d 1200, 1225. Only equitable restitution is available under § 502(a)(3) and equitable liens by restitution require that the “res” be clearly traceable to a particular fund in the defendant's possession. *See Cent. States,* 756 F.3d at 362 and 366; *see also JPMorgan Chase Severance Plan v. Romo,* No. H-21-1685, 2021 WL 4442519, *8 (S.D. Tex. Sept. 28, 2021). Put differently, to properly assert a claim for equitable relief, Plaintiffs must plead facts showing a “specifically identified particular fund distinct from [VALIC's] general assets.” *See Cent. States,* 756 F.3d at 366. The Complaint alleges nothing as to a specific fund. Instead, Plaintiffs contend they are “entitled to *some* funds” from VALIC, which is simply “the imposition of personal liability.” *Id.* Thus, Plaintiffs fail to sufficiently identify specific property currently in VALIC's possession and instead improperly seek monetary damages from VALIC's general assets, which is not an equitable remedy. Plaintiffs' failure to seek appropriate equitable is fatal to Count I. *Id.* (“The funds in question are simply the general assets of Defendants, which were not received from, and have not been promised to, [Plaintiff]. Any relief sought as restitution is not equitable.”).

D. <u>The Court Should Dismiss Portions of the Class Allegations</u>

If the Court does not dismiss the entire Complaint, it should dismiss Plaintiffs' allegations pertaining to fees paid under the SPA as the contract itself contradicts Plaintiffs' contention.

Along with Rule 12(b)(6), the standard for which is set forth above and incorporated herein, VALIC also moves pursuant to Rule 12(f) to strike Plaintiffs' class action claim to pursue relief on behalf of plans and plan administrators who paid fees under the SPA. A motion to strike allows a court to strike from a pleading any "redundant, immaterial, impertinent, or scandalous matter." F.R.C.P. 12(f). Federal Courts have utilized Rule 12(f) with Rule 23(d)(1)(D) to strike class allegations prior to discovery when "the complaint itself demonstrates that the requirements for maintaining a class action cannot be met." *Free v. Allstate Indem. Co.*, 541 F. Supp. 3d 767, 770 (E.D. Tex. 2021) (collecting cases).

Plaintiffs seek recovery of, among other things, fees paid to VALIC under the SPA. Yet as shown by the face of the SPA, Markham DDS did not contract for VALIC to perform fee-based administrative duties regarding the Plan. Instead, Markham DDS selected a third-party administrator, America's Best – Account Services Team, to perform such services. *See* Exhibit B to Levy Dec. at pp. 1, 5. Thus, no fees were due to VALIC under the SPA for administrative services. More importantly, the only fee relevant to Plaintiffs' claims is the surrender charge assessed pursuant to the Annuity. Both Counts I and II are specifically based on the Annuity which allowed the imposition of the surrender charge, not fees paid under the SPA. Compl. at ¶¶ 28, 29 and 30. Accordingly, allegations pertaining to fees purportedly paid under the SPA should be stricken because Plaintiffs cannot possibly represent a class with respect to these claims. *See Free*, 541 F. Supp. 3d at 770.

Conclusion

Plaintiffs fail to state any cognizable claim against VALIC. Based on the facts alleged, the terms of the subject contracts, and legal authority, Plaintiffs are entitled to no relief under Count I, Count II or the referenced ERISA statutes. Moreover, amendment would be futile.

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CERTIFICATE OF SERVICE

I hereby certify that on April 22, 2022, I electronically filed the foregoing with the Clerk of the Court using the CM/ECF system and forwarded the foregoing via email to all counsel of record.

/s/ David T. McDowell
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