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.	§	

DEFENDANT VALIC FINANCIAL ADVISORS, INC.'S REPLY IN SUPPORT OF MOTION TO DISMISS

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Introduction

For well over a year, Plaintiffs firmly stood on the allegations in their Complaint and maintained that this putative class action seeks to recover surrender charges and other fees allegedly imposed by co-Defendant VALIC under an annuity and service provider agreement to which Defendant VFA was not a party. As summed up in paragraph 1 of the Complaint:

> This is an action brought by the plan and plan administrator of an employee pension benefit plan to recover and otherwise seek redress, on a class-wide basis, for fees improperly withheld from plan assets ***by a life insurance company*** . . .

Compl. [Dkt. 1] at ¶ 1 (emphasis added). VFA is not a life insurance company. It also is never alleged to have entered a contract with the Plaintiffs or received fees from Plan assets.[1]

As set forth in VFA's moving papers, the Complaint states no legally cognizable claim against VFA based on ERISA §§ 406(a)(1)(C) and 502(a)(3) because it: (1) fails to identify specific conduct by VFA entitling Plaintiffs to relief and instead lumps all the named defendants together, (2) contains no facts establishing VFA ever provided services to the Plan or was a party to the subject contracts, and (3) lacks facts showing equitable restitution is available where VFA is not alleged to have received or remain in possession of Plan assets. Plaintiffs' Opposition fails to refute these points and instead acknowledges the Complaint's numerous defects by relying on "facts" and theories found nowhere in the Complaint. These new contentions illustrate the validity of VFA's Motion to Dismiss.

Argument

A. Plaintiffs Failed To Satisfy the Notice Pleading Requirements of Rule 8(a)(2)

1. The Complaint Lacks Factual Allegations Supporting VFA's Involvement in a Prohibited Transaction

[1] In this Reply, "the Plan" refers to Plaintiff D.L. Markham, DDS, MSD, Inc. 401(k) Plan.

While never specifically mentioning VFA, Count I alleges that "VALIC" knowingly participated in an ERISA prohibited transaction and identifies that transaction as the imposition of the Annuity's surrender fee. *See* Compl. [Dkt. 1] at ¶ 17. Plaintiffs do not contend that VFA was a party to the Annuity or was involved in the decision to impose the surrender charge.

While arguing that the Complaint satisfies Rule 8(a), Plaintiffs' Opposition sets forth numerous new "facts" to justify VFA's inclusion in the suit. However, it is "wholly inappropriate" to rely on new allegations or a new claim that are not included in the Complaint. *See Diamond Beach Owners Assn. v. Stuart Dean Co., Inc.*, No. 3:18-CV-00173, 2018 WL 7291722, *4 (S.D. Tex. Dec. 21, 2018). "[T]he sufficiency of a complaint rises or falls with the allegations contained in the lawsuit." *Id.* at *2, n. 2. When deciding a Rule 12(b)(6) motion, a district court generally must limit itself to the contents of the pleadings. *See Estes v. JP Morgan Chase Bank, Nat. Ass'n.*, 613 Fed.Appx. 277, 280 (5th Cir. 2015) (unpublished); *see also Spivey v. Robertson,* 197 F.3d 772, 774 (5th Cir. 1999).

Clearly, Plaintiffs fail to meet the notice pleading requirements of Rule 8(a)(2) where VFA never is mentioned in the Complaint after paragraph 6, no allegation specifies VFA's role in the alleged prohibited transaction, and Plaintiffs are forced to rely on a host of new facts to justify VFA's presence in the action.

Steinley v. Health Net, Inc., No. CV 18-5458 PSG (SKx), 2019 WL 3059383 (C.D. Cal. Mar. 28, 2019) is of no help to Plaintiffs. In *Steinley*, the amended complaint added allegations that described each defendant's role in the alleged wrongdoing and provided a description for why each defendant was liable for the alleged wrongdoing. *See id.* at **3 and 4. Here, the Complaint contains no such factual allegations. *Steinley* is consistent with the

case law cited in VFA's moving papers, holding that lumping multiple defendants together without identifying who is responsible for which acts does not satisfy the requirements of Rules 8(a)(2). *See Del Castillo v. PMI Holdings North America Inc.,* No. 4:14-CV-03435, 2016 WL 3745953, *13 (S.D. Tex. July 13, 2016).

The new theories based on VFA's marketing and sale activities and the receipt of commissions by its representative are nowhere stated in the Complaint. The purpose of Rule 8(a)(2) is to give the defendant fair notice of what the claim is and the grounds upon which it rests. *See Bell Atlantic Corp. v. Twombly,* 550 U.S. 544, 555, 127 S.Ct. 1955, 1964 (2007). As alleged, Count I is based entirely on the "compensation" VALIC received via the Annuity's surrender provision and seeks "fees paid by the Class members' plans to VALIC (including its affiliates)." Compl. [Dkt. 1] at ¶¶ 28 and 29. These factual allegations do not involve VFA.

2. The Putative Class Definitions Do Not Include VFA or Its Purported Conduct

Plaintiffs' putative class action defines the proposed classes as:

a. All ERISA covered plan administrators/plans that entered an agreement with VALIC in which VALIC had discretion to impose a surrender charge on outgoing transfers and which paid VALIC a fee of any kind since January 4, 2018.

b. All ERISA covered plan administrators/plans that entered an agreement with VALIC in which VALIC imposed the surrender charge on outgoing transfers since January 4, 2018.

Compl. [Dkt. 1] at ¶ 18. The common factor for each putative class member is an agreement entered with VALIC pursuant to which fees were paid or a surrender charge imposed. Again, no facts alleged establish that VFA was a party to a contract with Plaintiffs, was involved in the decision to impose the surrender charge, or received Plan assets in the form of fees or surrender charges. The defined classes do not include VFA or its conduct.

As to VFA, the Complaint fails to meet federal pleading standards, under both Rule 8(a) and 12(b)(6), and is subject to dismissal.

B. Count I of the Complaint Substantively Fails To State A Claim Against VFA

1. The Complaint Does Not State a Prohibited Transaction Claim Against VFA

Count I is brought under ERISA §§ 406(a)(1)(C) and 502(a)(3) based on the specific allegation that the Plaintiffs' contractual arrangement with VALIC (i.e., the Annuity) contained a penalty provision and therefore constituted a prohibited transaction. *See* Compl. [Dkt. 1] at ¶ 29. Based on the Complaint and the express terms of § 406(a)(1)(C), this "transaction" must be between VFA and the Plan, which it obviously is not. As such, no claim under § 406(a)(1)(C) is cognizable against VFA. *See In re Nighthawk Oilfield Services Ltd.,* No. H-11-0079, 2012 WL 13156742, **6-7 (S.D. Tex. Mar. 23, 2012) (as a matter of law, a bank could not have engaged in a prohibited transaction where there was no direct transaction between the bank and the plan).

§ 406(a)(1)(C) prohibits a plan fiduciary from causing the plan to engage in a transaction that constitutes a furnishing of goods, services, or facilities "between the plan and a party in interest." A cause of action under §502(a)(3) is permissible to provide an equitable remedy for the requisite ERISA violation, which in the instant case is the alleged prohibited transaction under § 406(a)(1)(C). *See Harris Trust and Sav. Bank v. Salomon Smith Barney, Inc.,* 120 S.Ct. 2180, 2184 (2000); *see also Depot, Inc. v. Caring for Montanans, Inc.,* 915 F.3d 643, 659 (9th Cir. 2019).

The "first element" of a § 406(a)(1) claim is that "there must be a 'transaction.'" *See Tibble v. Edison Intern.,* 639 F.Supp.2d 1122, 1125 (C.D. Cal. 2009). Contrary to Plaintiffs' briefing, the Supreme Court in *Harris* did not remove the preliminary requirement that a defendant engage in a prohibited transaction with the plan to be subject to § 406(a)(1)(C) and §

502(a)(3) liability. Under *Harris*, "plaintiffs may seek restitution and other 'appropriate equitable relief' from nonfiduciary parties in interest to transactions barred by § 1106." *Chavez v. Plan Benefit Services, Inc.,* AU-17-CA-00659-SS, 2018 WL 6220119, *3 (W.D. Tex. Sept. 12, 2018).

"§ 406 of ERISA prohibits fiduciaries from involving the plan and its assets in certain kinds of business deals" with a party in interest because "[t]hese are commercial bargains that present a special risk of plan underfunding because they are struck with plan insiders, presumably not at arm's length." *Lockheed Corp. v. Spink*, 517 U.S. 882, 888 and 893, 116 S.Ct. 1783 (1986). Neither the Annuity nor the SPA (the only contracts alleged in the Complaint) were contracts "between" VFA and the Plan nor did their terms require the furnishing of goods, services, or facilities by VFA. *See* Exhibits A and B to Declaration of Eric S. Levy [Dkt. 55-1]. In ruling on a 12(b)(6) motion, "[w]hile the Court must accept Plaintiffs factual allegations as true and view those facts in the light most favorable to them, it is not required to ignore facts that do not favor them." *Middaugh v. InterBank*, 528 F.Supp.3d 509, 540 (N.D. Tex. 2021).[2]

As explained in *Chavez,* "the crux of a transaction under both § 1106 and § 1108 is the act of contracting that establishes the legal rights and obligations between the parties." *Chavez,* 2018 WL 6220119, *3. As defined by the *Tibble* Court, a transaction under § 406(a)(1) is "the exchange of money for services." *Tibble,* 639 F.Supp.2d 1122, 1125. None of the cases cited by Plaintiffs hold that a plaintiff can state a prohibited transaction under § 406(a)(1) without alleging facts showing the existence of a transaction between the purported party in interest and the subject plan. The Court in *In re Nighthawk Oilfield Services, Ltd., supra,* held otherwise. *See* 2012 WL 13156742, **6-7.

[2] Plaintiffs' new assertion that Ozeroff or VFA continued to provide services to the Plan after the Annuity sale remains insufficient to show the requisite "transaction" because no allegation exists that Ozeroff or VFA entered a contract for services with the Plan.

In addition to the absence of an alleged transaction between VFA and the Plan, the Complaint lacks facts showing that VFA provided any services to the Plan. The Complaint only alleges that "VALIC" was "a service provider to the Plan" and therefore an ERISA defined party in interest under 29 U.S.C. § 1002(14)(B). Compl. [Dkt. 1] at ¶ 16. In early 2018 (when Mr. Ozeroff allegedly marketed the retirement services of VALIC), VFA was not alleged to have been providing any services to the Plan such that VFA was an ERISA party in interest. *See id.* at ¶¶ 8 and 9. This is an additional barrier to the prohibited transaction claim against VFA.

"§ 1106(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, *4; *see also Ramos v. Banner Health*, 1 F.4th 769, 787 (10th Cir. 2021) ("some prior relationship must exist between the fiduciary and the service provider to make the provider a party in interest under § 1106.") "ERISA is meant to prevent fiduciaries from engaging in transactions with parties with whom they have pre-existing relationships, raising concerns of impropriety." *Ramos*, 1 F.4th 769, 787.

Given the above, the Complaint fails to state a viable prohibited transaction claim against VFA under §§ 406(a)(1)(C) and 502(a)(3).

2 Plaintiffs Fail to Establish a Prohibited Transaction Claim Against VFA

In opposing this motion, Plaintiffs now argue that VALIC's products were marketed by VFA, that VFA knew of the Annuity's surrender penalty, and that VFA's liability is based on its role in marketing and receiving compensation for an arrangement prohibited by ERISA. None of these facts are alleged in the Complaint. Additionally and of substantive importance, the purported facts relating to the marketing of the Annuity and SPA, prior to its purchase by Plaintiffs, do not render VFA a party in interest. Again, it was not providing any services to the

Plan nor did it allegedly have any relationship to the Plan at the time. *See* VALIC's Motion to Dismiss, etc. [Dkt. 55] at Argument, Section C(a), which is incorporated here by reference.

None of the case law cited by Plaintiffs supports that a defendant, such as VFA, who was not providing services to the ERISA plan, did not receive plan assets, or who was not a party to the contract which constitutes the prohibited transaction can be found liable or potentially liable under § 406(a)(1)(C). *See* Plaintiffs' Opposition [Dkt. 59] at Argument, Section II.

3. Count I Does Not Entitle Plaintiffs to Equitable Relief Against VFA

The only relief sought in Count I is equitable restitution of fees paid under the contracts with VALIC pursuant to § 502(a)(3). Compl. [Dkt. 1] at ¶ 29. However, equitable restitution requires Plaintiffs to allege facts showing that plan assets were received by VFA and that those assets remain in VFA's possession. No such facts are alleged here.

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 . . .." *Cooperative Ben. Adm'rs, Inc. v. Ogden*, 367 F.3d 323, 332 (5th Cir. 2004). Thus, a plaintiff can recover equitable restitution, in the form of a constructive trust or an equitable lien, where money or property identified as belonging in good conscience to the plaintiff can clearly be traced to particular funds or property in the defendant's possession. *See Teets v. Great-West Life & Annuity Ins. Co.,* 921 F.3d 1200, 1224 (10th Cir. 2019). Accounting and disgorgement of profits require the defendant be in possession of money belonging to the plaintiff. *See id.* at pp. 1224-1225.

Plaintiffs never allege that VFA received Plan assets or remains in possession of Plan assets. Moreover, the Complaint expressly seeks to recover fees paid by Plaintiffs under the Annuity and/or SPA entered with VALIC and VFA was not a party to those contracts.[3]

Unwilling to concede, Plaintiffs argue their request for equitable relief includes a request for rescission and an injunction, which is not alleged in the Complaint. As a stranger to the contract identified in the Complaint, VFA is not a proper defendant to an equitable rescission claim. By definition, "rescission" is the unmaking or termination of a contract. *See* Black's Law Dictionary (11th ed. 2019). Further, the Annuity and SPA contracts were terminated in 2020. Compl. [Dkt. 1] at ¶¶ 12 and 15. Rescission therefore is moot and not an available remedy.

Injunction is equally unavailable here. "To obtain standing for injunctive relief, a plaintiff must show that there is reason to believe that he would directly benefit from the equitable relief sought" and, "[i]n other words, a plaintiff must face a threat of present or future harm." *Plumley v. Landmark Chevrolet, Inc.,* 122 F.3d 308, 312 (5th Cir. 1997) (citations omitted); *see also Deutsch v. Annis Enterprises, Incorporated,* 882 F.3d 169, 173 (5th Cir. 2018) (a plaintiff seeking an equitable injunction must show a real and immediate threat of repeated injury and a past injury is insufficient"). A plaintiff is not entitled to an injunction solely based on a past wrong. *See Plumley,* 122 F.3d 308, 312. Here, the subject contracts have been terminated and there are no facts showing Plaintiffs continue to do business with VFA or intend to do business with VFA again. Plaintiffs therefore have no grounds to seek an injunction against VFA.

[3] Plaintiffs state they can and would allege Ozeroff continued to provide services after the relationship was established with VALIC. Dkt. 59 at ECF p. 6. This bare allegation fails to entitle Plaintiffs to equitable restitution without a factual showing that *plan assets* were paid to VFA due to Ozeroff's services, these assets remain in VFA's possession and these assets are traceable to a specific fund held by VFA. *See Cent. States, Se. & Sw. Areas Health & Welfare Fund v. Health Special Risk, Inc.,* 756 F.3d 356, 362 and 366 (5th Cir. 2014).

To survive a motion to dismiss, a plan fiduciary seeking relief under § 502(a)(3) against a non-fiduciary must allege an entitlement to appropriate equitable relief. *See Cooperative Ben. Adm'rs., Inc.,* 367 F.3d at 335. VFA never possessed or received Plan assets nor have Plaintiffs alleged facts showing Plan assets remain in VFA's possession in a specific fund. VFA cannot be plausibly subject to a claim for equitable restitution, including in the form of equitable disgorgement or an accounting. Rather, Plaintiffs seek money damages from VFA which is not authorized under § 502(a)(3).

C. No Claim Against VFA Exists for Knowing Participation in a Fiduciary Breach

In opposing this motion, Plaintiffs contend VFA can be liable for a knowing participation in a fiduciary breach. This is not a claim alleged in the Complaint. Plaintiffs also neglect to offer facts showing that such a claim has merit. They fail to identify the specific ERISA provision on which this new fiduciary breach claim would be premised. Moreover, since VFA is not a fiduciary, Plaintiffs remain limited to seeking appropriate equitable relief under § 502(a)(3) which is not available against VFA. *See* Argument, Section B(3), *supra.* ERISA does not permit a civil action for legal damages against a non-fiduciary charged with knowing participation in a fiduciary breach. *See Cent. States, Se. & Sw. Areas Health & Welfare Fund,* 756 F.3d 356, 367 and *Mertens v. Hewitt Associates,* 508 U.S. 248, 113 S.Ct. 2063 (1993).

No viable claim for knowing participation in a breach of fiduciary duty can be stated.

D. Leave to Amend Should be Denied

Plaintiffs have not formally sought leave to amend the Complaint and, in their Opposition, only request leave to amend if VFA's motion is granted. Plaintiffs provide no particular grounds on which the amendment is sought, asserting only that they are able to allege new facts to state a claim against VFA. This bare request for leave to amend is insufficient. *See*

U.S. ex rel. Willard v. Humana Health Plan of Texas Inc., 336 F.3d 375, 387 (5th Cir. 2003) ("A formal motion is not always required, so long as the requesting party has set forth with particularity the grounds for the amendment and the relief sought"); *see also* F.R.C.P. 7(b)(1)(B).

Further, a motion for leave to amend may be denied where there is undue delay, bad faith, or dilatory motive on the part of the movant, repeated failure to cure deficiencies by amendments previously allowed, or undue prejudice to the opposing party by virtue of allowance of the amendment. *See U.S. ex rel. Willard,* 336 F.3d 375, 386. Here, Plaintiffs have unduly delayed in seeking leave to amend the Complaint. The Complaint was filed on January 4, 2021, and VFA moved to dismiss on March 1, 2021 notifying Plaintiffs of the failure to state any cognizable claim. *See* Dkts. 1 and 19. Thus, Plaintiffs have had over one year to cure the defects in the allegations against VFA. Yet, they never sought leave to amend the Complaint and instead forced VFA to file a second motion to dismiss in this Court. If this motion to dismiss is granted and Plaintiffs are allowed leave to amend, VFA likely will be required to file a third motion to dismiss, which is unduly prejudicial.

Additionally, leave to amend properly may be denied when amendment would be futile. *See U.S. ex rel. Willard,* 336 F.3d 375, 387. As discussed above, no legally cognizable claim can be stated against VFA even under the new "facts" set forth in the Opposition. Leave to amend should be denied.

Conclusion

The Complaint is subject to dismissal without leave to amend as to VFA for multiple reasons. Plaintiffs have failed to satisfy the notice pleading requirements under Rule 8(a)(2); Count I, based on participation in a prohibited transaction under § 406(a)(1)(C), states no legally cognizable claim where VFA was never a party in interest providing services to the Plan nor a

party to the subject contracts; no equitable relief is available against VFA under § 502(a)(3); Plaintiffs have known of the defects in their claims against VFA for more than one year but never sought leave to amend; and amendment would be futile under Plaintiffs' new "facts" and theories.

Dated: June 6, 2022

By: */s/ David T. McDowell*

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CERTIFICATE OF SERVICE

I hereby certify that on June 6, 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
David T. McDowell