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UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF CALIFORNIA

SAN FRANCISCO DIVISION

Charles Baird and Lauren Slayton, as individuals, and on behalf of all others similarly situated, and on behalf of the BlackRock Retirement Savings Plan,

Plaintiffs,

vs.

BlackRock Institutional Trust Company, N.A.; BlackRock, Inc.; The BlackRock, Inc. Retirement Committee; The Investment Committee of the Retirement Committee; Catherine Bolz, Chip Castille, Paige Dickow, Daniel A. Dunay, Jeffrey A. Smith; Anne Ackerley, Amy Engel, Nancy Everett, Joseph Feliciani Jr., Ann Marie Petach, Michael Fredericks, Corin Frost, Daniel Gamba, Kevin Holt, Chris Jones, Philippe Matsumoto, John Perlowski, Andy Phillips, Kurt Schansinger, and Tom Skrobe,

Defendants.

Case No: 4:17-cv-01892-HSG

MEMORANDUM IN SUPPORT OF OPPOSITION TO MOTION TO DISMISS AMENDED COMPLAINT

Complaint Filed: April 5, 2017
Amended Complaint Filed: October 18, 2017

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INTRODUCTION

Plaintiffs' Complaint[1] states plausible claims on behalf of two classes of retirement plan participants, reflecting Defendants' pattern and practice of self-dealing and other ERISA[2] violations with respect to the BlackRock Retirement Savings Plan ("BlackRock Plan" or "Plan") and other employee benefit plans. The Complaint details how, at every turn, BlackRock and BlackRock Institutional Trust Company ("BTC") select themselves and their affiliates to provide products and services to the Plan and to the BlackRock CTIs.[3] BlackRock and its affiliates illegally profit from such arrangements, while members of the BlackRock Plan Class[4] and the CTI Class[5] are harmed.

On behalf of the BlackRock Plan Class, Plaintiffs allege that Defendants acted in their own and BlackRock's self-interests by giving preferential treatment to BlackRock funds; failed to disclose the true cost of the BlackRock funds to participants; failed to properly diversify the Plan with non-BlackRock funds; and improperly profited from the BlackRock Plan. All of these ERISA violations harm participants in the BlackRock Plan by eroding participants' investment earnings, thereby diminishing their retirement savings. Instead of squarely addressing these allegations of preferential treatment and self-dealing, Defendants mischaracterize the Complaint as merely about imprudent fees and then argue that selecting virtually all BlackRock funds for the Plan is prudent because BTC has waived its investment management fees. *E.g.*, MTD[6] at 8. Defendants' attempt to replace the well-pled allegations of the Complaint through the factual submission of 6,771 pages of documents is improper at the pleadings stage, where a court must take the facts pled in the complaint as true. Even if the improperly introduced documents are considered[7], Defendants' characterization of their funds as "fee-free" (*id.*) is contradicted by such documents, which reveal that participants pay an array of fees and costs to BlackRock and its affiliates through their investment in BlackRock

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[1] The Amended Complaint (ECF No. 75) is referred to herein as the "Complaint" or the "AC."
[2] The Employee Retirement Income Security Act of 1974, 29 U.S.C. § 1001, *et seq.*
[3] "BlackRock CTIs" refer to the collective trust investments ("CTIs") into which the individual accounts of Plaintiffs and members of the CTI Class were invested, listed at AC ¶ 231.
[4] The "BlackRock Plan Class" consists of all participants and beneficiaries in the BlackRock Retirement Savings Plan from April 5, 2011 through the date of judgment. AC ¶ 282
[5] The "CTI Class" consists of all participants whose individual accounts were invested directly or indirectly in the BlackRock CTIs from April 5, 2011 through the date of judgement. AC ¶ 292.
[6] "MTD" refers to Defendants' brief in support of the Motion to Dismiss the AC, ECF No. 79.
[7] Plaintiffs oppose, in part, Defendants' Request for Judicial Notice in a concurrently-filed brief.

proprietary funds. This alone exposes Defendants' "waiver" argument as a straw man.

Plaintiffs also allege claims on behalf of the CTI Class for engaging in fiduciary breaches, self-dealing, and other prohibited transactions with the assets of the BlackRock CTIs. Because BTC has exclusive authority over the BlackRock CTIs, it is a fiduciary to the CTI Class and must act prudently and with undivided loyalty to them. However, in contravention of these duties, BTC gives itself and other BlackRock affiliates preferential treatment for compensation from the BlackRock CTIs, such as trading fees, brokerage commissions, soft dollars, and securities lending fees. For example, BTC hires itself to act as the securities lending agent for all the BlackRock CTIs, and then pays itself an excessive fee of 50% of all securities lending revenue. BTC also self-servingly invests the BlackRock CTIs' securities lending collateral almost entirely in funds it manages, which again results in fees paid to BTC.

FACTUAL BACKGROUND

Starting in late 2009, BlackRock began using Plan assets to support its acquisition of asset management firm Barclays Global Investors, which was subsequently renamed BlackRock Institutional Trust Company, or "BTC." AC ¶¶ 25, 58, 59, 65-71. BlackRock Plan fiduciaries did this by giving preferential treatment to funds owned, operated or managed by BlackRock, BTC, or other affiliates ("BlackRock funds" or "proprietary funds"). As a result, in the span of six years, the share of Plan assets invested in BlackRock funds went from 63% to 92%. AC ¶¶ 65-68. Moreover, since 2009, Plan fiduciaries have not added a single non-BlackRock fund to the Plan. AC ¶ 93.

Though Defendants assert that many of these funds are "fee-free" (MTD at 1), this contradicts the Complaint's allegations and the documents upon which Defendants rely, which show that there are many types of fees and costs deducted from the Plan's assets, which reduce the investment returns of participants' retirement accounts. For example, BTC takes a 50% cut from all securities lending revenue generated with the Plan's assets and, in addition, BTC pays itself fees for investing the securities lending cash collateral in almost entirely in its own funds. AC ¶¶ 201, 256-266; Ex. FF to Edwards Decl. at BAIRD_0001837 ("BTC is paid 50% of the net income earned from securities lending transactions . . . the net income divided between the client and BTC is also net of Cash Collateral Fund management fees paid to BTC"). BlackRock Plan fiduciaries also cause

the Plan to pay ***other*** compensation to BlackRock affiliates, like trading fees and brokerage commissions. AC ¶ 105; Ex. T at 3 (BAIRD_0000349)("the Manager [BTC] and its affiliates may obtain and keep any profits, commissions, and fees accruing to them in connection with their activities as agent or principal in transactions for the Account [the BlackRock Plan assets]").

Additionally, Defendants have chosen as Plan investment options numerous BTC-managed collective trust funds,[8] which are structured in a manner that obscures the true fees and costs that participants pay to BlackRock and its affiliates. AC ¶¶ 154-211. Each collective trust fund consists of a number of "layers;" that is, a series of BTC-managed funds that invest in still more BTC-managed funds. AC ¶ 159 (graphical depiction of the many different BTC funds that are below a single fund). In some extreme instances, a participant investing in one fund, like the LifePath 2050 Fund, will have her money funneled through 27 - 51 other BTC-managed funds until it is ultimately invested in securities, such as stocks and bonds. AC ¶ 156. Any return generated by the participants' investments in this maze of funds is reduced by the "expenses" which are subtracted – without disclosure – out of the income of each of the underlying funds. AC ¶¶ 100-104; *see also, e.g.*, Edwards Decl. (ECF No. 79-1) Ex. U, at BAIRD_0000836 (disclosing, in a footnote, that "the expenses incurred by underlying funds in which the [BlackRock collective trust] fund invests are not included in this [expense] ratio. The collective fund income allocated to the [BlackRock collective trust] fund from underlying funds is ***net of those expenses***.") (emphasis added). As a result, participants pay investment costs, due to this fund layering, that are not disclosed in the participant disclosures Defendants rely on. *Id;* Edwards Decl. Ex. W (BAIRD_000676-676).

The upshot of this structure is that BlackRock and its affiliates are able to take substantial fees and compensation to enrich themselves before sending investment income back to the Plan's participants. These costs to participants – which are revenue streams for BlackRock – mean that participants incur greater investment costs than they would have, had Defendants considered different investment structures or non-BlackRock funds. AC ¶¶ 156-57, 167-68. Indeed, participants pay at least 500% more in investment costs than what is disclosed to them. AC ¶¶ 201-203.

[8] Plaintiffs use the term "collective trust funds" to refer to the same the type of investments which Defendants, in the MTD, refer to as "CTFs."

Defendants selected BlackRock funds for the Plan without proper consideration of non-BlackRock funds. AC ¶¶ 90-107. On numerous occasions, Defendants selected new proprietary funds for the Plan contemporaneously with their creation, making it impossible for the fiduciaries to consider the performance of these investments because they had no track records. AC ¶ 96. And when investments began to underperform—in some instances for up to decades—they remained options in the Plan. AC ¶¶ 107, 123, 125, 135, 150, 168, 172-173, 184-185. In addition, Defendants failed to properly evaluate all of the investment costs associated with the BlackRock proprietary funds, which reduced the value of participants' retirement accounts. AC ¶¶ 105-107. This harmed participants, as the hidden fees and underperformance put a lasting drag on their retirement earnings, and created unnecessary risk from the failure to diversify the Plan, as nearly all the Plan's assets are exposed to one firm's – BlackRock's – systemic risks. *See, e.g.*, AC ¶¶ 5, 106, 213-14.

The CTI Class consists of all participants whose individual accounts were invested directly or indirectly in the BlackRock CTIs. AC ¶ 292. In other words, the CTI Class members invested in BTC-managed collective trust funds that, through several layers of BTC-managed funds, ultimately invested in the BlackRock CTIs. AC ¶¶ 226-32. The BlackRock CTIs are the funds that actually invest in securities like stocks and bonds, and engage in securities lending. AC ¶¶ 248-54. Because they hold almost entirely ERISA-governed retirement "plan assets,"[9] ERISA fiduciary duties apply to the management of the BlackRock CTIs. AC ¶¶ 212-23. BTC, which has exclusive management authority over the BlackRock CTIs, violated its fiduciary duties to the CTI Class by giving itself and its affiliates preferential treatment with respect to receiving compensation from the BlackRock CTIs, such as trading fees, securities lending fees, and brokerage fees. *Id*. ¶¶ 334-35. For example, BTC self-servingly selected itself as securities lending agent to the BlackRock CTIs and failed to consider using outside lending agents who charge significantly less for the same services. *Id*. ¶¶ 246-80, 336-39. These breaches harmed the members of the CTI Class by increasing the costs of their retirement investments and diminishing the returns on their retirement savings. *Id*.¶¶ 199, 302-7.

LEGAL STANDARD

[9] *See* 29 C.F.R. § 2510.3-101.

To state a valid claim under ERISA, a complaint must contain a "short and plain statement of the claim showing that the pleader is entitled to relief." Fed. R. Civ. P. 8(a)(2). It need not contain "detailed factual allegations" to survive a Rule 12(b)(6) motion, *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 555 (2007), but rather must contain sufficient factual matter to state a claim that is plausible on its face. *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009). A reviewing court must accept all factual allegations in the complaint as true, and must construe the pleadings in the light most favorable to plaintiff. *Knievel v. ESPN*, 393 F.3d 1068, 1072 (9th Cir. 2005).

A motion to dismiss under Rule 12(b)(1) for lack of standing constitutes a challenge to the court's subject-matter jurisdiction. *Chandler v. State Farm Mut. Auto. Ins. Co*., 598 F.3d 1115, 1122 (9th Cir. 2010). "In a facial attack, the challenger asserts that the allegations contained in a complaint are insufficient on their face to invoke federal jurisdiction." *Safe Air for Everyone v. Meyer*, 373 F.3d 1035, 1039 (9th Cir. 2004). When evaluating a 12(b)(1) facial attack, like this one, "a district court must accept all allegations in the complaint as true and draw all reasonable inferences in favor of the plaintiff." *Jadeja v. Redflex Traffic Sys., Inc.*, 764 F. Supp. 2d 1192, 1195 (N.D. Cal. 2011). Finally, summary judgment is only appropriate where the "movant shows that there is no genuine dispute as to any material fact and the movant is entitled to judgment as a matter of law." Fed. R. Civ. P. 56(a).[10]

ARGUMENT

I. PLAINTIFFS HAVE STANDING TO SEEK PLAN-WIDE RELIEF.

Defendants' 12(b)(1) challenge is predicated on their view that, because Plaintiffs did not invest in every fund offered by the Plan, they lack standing to sue on behalf of the entire Plan. MTD at 12, n.10. This argument rests on the improper conflation of Article III standing and class certification, two separate inquiries. In this Circuit, "once the named plaintiff demonstrates her individual standing to bring a claim, the standing inquiry is concluded, and the court proceeds to consider whether the Rule 23(a) prerequisites for class certification have been met." *Melendres v. Arpaio*, 784 F.3d 1254, 1261 (9th Cir. 2015) (quoting William B. Rubenstein, *Newberg on Class*

[10] Because Plaintiffs have not had sufficient opportunity to discover facts central to their claims, Plaintiffs, concurrently with the filing of this brief, seek relief pursuant to Fed. R. Civ. P. 56(d).

Actions, § 2:6 (5th ed. 2017). For this reason, this Court recently denied a similar motion to dismiss, reasoning "defendants do not dispute that plaintiffs have standing to bring their own claims under ERISA, or that other individuals in the putative class did invest in the other options. Thus, whether the named plaintiffs are appropriate class representatives will be resolved at the class certification stage." *Johnson v. Fujitsu Tech. & Bus. of Am., Inc.*, 250 F.Supp. 3d 460,465 (N.D. Cal. 2017).

Here, Plaintiffs have pled all three necessary elements of Article III standing: they allege that they suffered financial harm (injury-in-fact), caused by Defendants' preferential treatment of BlackRock's underperforming and more expensive proprietary funds (causation). And Plaintiffs seek restoration of the losses they suffered as a result of Defendants' fiduciary breaches (redressability). AC ¶¶ 16-20, 70-71, Prayer VII(B). As such, they have established Article III standing. *Lorenz v. Safeway Inc.*, No. 16-cv-04903-JST, 2017 WL 952883 at *5 (N.D. Cal. Mar. 13 2017) (plaintiff has Article III standing in 401(k) class action where he "alleges that the prohibited transaction . . . caused him to suffer real financial injury"). Because Defendants' standing challenge is a class certification argument, rather than a legitimate standing challenge, it must be rejected.

II. THE FIDUCIARY BREACH CLAIMS ARE ADEQUATELY PLED.

A. Defendants Violated Their Duty of Loyalty.

ERISA's duty of loyalty requires plan fiduciaries to avoid conflicts of interest and act with an eye single to the interest of the plan and its participants. *See Donovan v. Mazzola*, 716 F.2d 1226, 1238 (9th Cir. 1983) ("At the heart of the fiduciary relationship is the duty of complete and undivided loyalty to the beneficiaries of the trust") (internal quote omitted). ERISA also prohibits certain transactions between plans and parties in interest that Congress categorically barred as harmful to plans and their participants. *Harris Tr. & Sav. Bank v. Salomon Smith Barney, Inc*., 530 U.S. 238, 241-42 (2000). Defendants misstate the law to imply that financial services companies may give preferential treatment to their own proprietary investments if they are relying on a prohibited transaction exemption ("PTE") for investing in their own proprietary funds. MTD at 8 (asserting that "ERISA explicitly permits financial services companies to make their own products available for investment in their employees' retirement accounts—even when they actually charge

fees for doing so.") To the contrary, neither 29 U.S.C. § 1108(b)(8) nor PTE 77-3[11] expressly permit prohibited transactions. At most, these exemptions provide affirmative defenses, available only if Defendants prove all the necessary elements of each exemption. *See infra* III.B. Defendants have not met their burden to show all elements of either § 1108(b)(8) or PTE 77-3, nor could they at the pleadings stage.[12]

Moreover, even if Defendants are able to later prove that they are entitled to a prohibited transaction exemption, any such exemption would not relieve them of their duty of loyalty pursuant to 29 U.S.C. § 1104(a)(1)(A). As the Department of Labor ("DOL") stated when granting PTE 77-3: "The fact that a transaction is the subject of an exemption granted under section 408(a) of [ERISA] … does not relieve a fiduciary … from certain other provisions of [ERISA, including] ... general fiduciary responsibility provisions of section 404 [29 U.S.C. § 1104.]" 42 Fed. Reg. at 18734.

The duty of loyalty wholly forbids fiduciaries from considering their self-interest when making fiduciary decisions. *See Pilkington PLC v. Perelman*, 72 F.3d 1396, 1401 (9th Cir. 1995) (decisions influenced by self-interest violate a fiduciary's duty of loyalty); s*ee also Bogert's Trusts and Trustees* § 255 (2d ed. 2009) (same). Here, the Complaint details a pattern and practice of the BlackRock Plan fiduciaries giving preferential treatment to BlackRock proprietary funds. The Complaint alleges in detail how, prior to BlackRock's acquisition of Barclays Global Investors (n/k/a BTC), not a single Barclays/BTC investment was selected for the Plan. AC ¶¶ 65-71. But by 2015, more than 93% of the Plan's assets were invested in BTC funds. *Id*. ¶ 86. And, not a single non-BlackRock fund has been added to the Plan since 2009. *Id*. ¶ 93.

Defendants ignore the manifold allegations regarding preferential treatment and instead attempt to recast Plaintiffs' fiduciary breach claims as entirely based on excessive fees. MTD at 8-9. While the Complaint alleges that the hidden fees and costs that participants paid for BlackRock proprietary funds were excessive, it does not rest on those allegations alone. The Complaint also

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[11] PTE 77-3 refers to the Class Exemption Involving Mutual Fund In-House Plans Requested by the Investment Company Institute, 42 Fed. Reg. 18,734, 18,735 (Apr. 8, 1977).

[12] Defendants' reliance on 56 Fed. Reg. 10724 is misplaced, as it involves proposed regulations describing the circumstances in which 29 U.S.C, § 1104(c) applies to a transaction involving a participant's or beneficiary's exercise of control over his individual account. Such regulations have nothing to do with the prohibited transaction exemptions.

alleges that Defendants favored BlackRock funds to enhance the marketability of their products (especially new funds which required institutional assets to seed them), *see e.g.*, AC ¶ 120, and that numerous BlackRock funds were added to the Plan without the requisite three-year performance histories and/or remain in the Plan despite having extended periods of underperformance. AC ¶¶ 95, 120, 150. These facts plausibly allege that Defendants gave BlackRock funds preferential treatment and thus violated their duty of loyalty. Courts have found that plaintiffs stated a claim for breach of the duty of loyalty based on similar allegations. *E.g., Urakhchin v. Allianz Asset Mgmt. of Am., L.P.*, No. SACV15-1614-JLS-JCGX, 2016 WL 4507117, at *6 (C.D. Cal. Aug. 5, 2016) (denying motion to dismiss claims alleging defendants "limit[ed] designated investment options to Allianz-affiliated funds and retain[ed] those funds despite their excessive fees and poor performance."); *Terraza v. Safeway Inc.*, No. 16-CV-03994-JST, 2017 WL 952896, at *2-8 (N.D. Cal. Mar. 13, 2017) (same).

Defendants' primary argument is that the BTC-managed collective trust funds are loyal and prudent because they "bore no investment management fees." MTD at 11. Even if it were true that the BTC collective trust funds had no investment management fees, the waiver of a single *type* of fee cannot erase the other disloyal and imprudent actions taken by Defendants. *Tussey v. ABB, Inc.*, 850 F.3d 951, 957 (8th Cir. 2017) ("The fact the ABB fiduciaries apparently did not always favor Fidelity as much as they could, or seize every opportunity to send Fidelity more of the participants' money, does little to undermine the district court's finding [of the breach of loyalty]".).

Tellingly, Defendants do not address Plaintiffs' allegations regarding the failure to disclose all the costs of BlackRock's proprietary funds to participants. *E.g.*, AC ¶ 203. These allegations also support the fiduciary breach of loyalty claim. *Terraza v. Safeway Inc.*, 241 F. Supp. 3d 1057, 1071 (N.D. Cal. 2017) ("Consistent with its duty of loyalty, a plan fiduciary must disclose material investment information to Plan participants."). Indeed, DOL regulations mandate that Defendants disclose, in the expense ratios for the BTC collective trust funds, any fee or expense that reduces the funds' rates of return, because such information is material to participants. *See* 29 C.F.R. § 2550.404a–5. Moreover, Defendants now admit[13] that BTC takes securities lending fees, but they

[13] *Compare* MTD at 10-11 *with* Motion to Dismiss, ECF No. 35 at 11 (asserting that ***no*** fees were paid to BlackRock affiliates).

sidestep the allegations that Defendants breached their duty of loyalty by not disclosing significant securities lending fees to participants as required by 29 C.F.R. § 2550.404a–5. AC ¶ 203.

B. Defendants Violated Their Duty of Prudence.

A court reviewing an ERISA fiduciary's process must determine whether the individual fiduciaries, "at the time they engaged in the challenged transactions, employed the appropriate methods to investigate the merits of the investment and to structure the investment." *Donovan*, 716 F.2d at 1232. This duty extends beyond the initial selection of an investment and requires fiduciaries to continually monitor investments and remove imprudent ones. *Tibble v. Edison Int'l*, 135 S. Ct. 1823, 1828-29 (2015). When determining whether a fiduciary has acted prudently, the court must "focus on the process by which it makes its decisions rather than the results of those decisions." *Braden v. Wal-Mart Stores, Inc.*, 588 F.3d 585, 595 (8th Cir. 2009). *Contra, e.g.*, MTD at 8.

Appropriate methods of investigation require reasoned deliberation rather than acting on self-interest. *See Leigh v. Engle*, 727 F.2d 113, 136-37 (7th Cir. 1984) (instructing lower court to examine defendants' "clear conflict of interests" when considering fiduciaries' actions); *Wildman v. Am. Century Servs., LLC*, 237 F. Supp. 3d 902, 914 (W.D. Mo. 2017) (denying motion to dismiss allegations that defendants "acted in their own self-interest by following a process that failed to consider lower-cost funds in favor of higher-cost [proprietary] funds."). Not only did Defendants fail to adequately consider non-BlackRock funds, *e.g.*, AC ¶ 93, the "process" they used to select funds for the Plan exhibited most other common indicia of imprudence, such as limiting a Plan's investments to proprietary funds (AC ¶¶ 86, 93, 96); using untested proprietary investments (AC ¶¶ 95, 120-21, 136-37); and retaining costly and underperforming investments (AC ¶¶ 116-123, 134, 150, 189). *See, e.g.*, *Allianz*, 2016 WL 4507117, at *6-7 (sustaining claims of imprudence where defendants limited investments to proprietary funds despite high fees and in some cases with little track-record, and continued to offer these investments despite underperformance); *Wildman*, 237 F.Supp.3d at 913-14 (same); *Moreno v. Deutsche Bank Americas Holding Corp.*, No. 15 CIV. 9936 (LGS), 2016 WL 5957307, at *6 (S.D.N.Y. Oct. 13, 2016) (same).

Plaintiffs are not required to allege specific facts detailing Defendants' decision-making process, as such facts are outside of Plaintiffs' reach. *Braden*, 588 F.3d at 596. Instead, Plaintiffs

need only allege facts that, when "taken as true, and considered as a whole," allow the Court to "infer from what is alleged that the process was flawed." *Id.* Plaintiffs have done that here. *Id*.

(1) Defendants Selected and Retained BlackRock Funds with Hidden, Excessive Costs.

Rather than squarely address Plaintiffs' many allegations regarding preferential treatment, Defendants improperly attempt to recast the Complaint as merely about imprudent fees, and then argue that loading the Plan with BlackRock proprietary funds is prudent because BTC has waived its investment management fees. *E.g.*, MTD at 8. However, Defendants' purported "waiver" of investment management fees is misleading, because it ignores the Complaint's allegations that BlackRock has shifted its compensation for the BlackRock funds into other areas, such as securities lending, which are not properly disclosed. *E.g.*, AC ¶¶ 100, 107, 112, 187, 257. Indeed, Defendants' own documents show that the Blackrock funds have costs stemming from fund layering which are ***not disclosed*** to participants.[14] This is, in part, because the investment costs of the underlying funds are simply subtracted from the fund's income, and therefore are not reflected in the expense ratio disclosed to participants.[15] AC ¶¶ 101-04, *see, e.g.*, Edwards Decl., Ex. U, at BAIRD_0000836 and BAIRD_0000900 ("the expenses incurred by underlying funds in which the [BlackRock collective trust] fund invests are not included in this [expense] ratio. The collective fund income allocated to the [BlackRock collective trust] fund from underlying funds is net of those expenses."). Notably, such costs are not quantified in the audited financial statements.

In fact, Defendants now admit that BTC, in its role as the securities lending agent, takes a 50% cut of all securities lending revenue generated with the Plan's assets. AC ¶ 256, MTD at 5. And BTC invests the securities lending collateral of the BlackRock CTIs into BTC-managed funds, which ***do*** charge investment management fees. AC ¶¶ 112-13, 267-72. *Contra* MTD at 9. These

[14] While Defendants assert that their document submission "irrefutably and unambiguously show that no such hidden fees exist," they only discuss and cite to documents for their single factual assertion that they have waived the investment management fee (MTD at 8-9), which does not address the allegations that expenses are subtracted from underlying fund income.

[15] The Complaint further alleges that BlackRock offers similar funds without excessive layering, such as fund options for the government's Thrift Savings Plan, and that outside managers like Vanguard offer similar funds without the use of extensive layering. AC ¶¶ 174-89, 194-97. Choosing funds without such excessive layering would have reduced the costs to participants and thus would have increased their retirement savings. *Id.*

securities lending related fees are excessive (*see infra* at V), undisclosed, and significantly reduce the retirement income earned by participants. AC ¶¶ 201, 203, 256-57. By comparison, managers such as Vanguard do not charge a fee for securities lending other than the 1% to cover the actual lending costs. AC ¶ 263. Regardless of whether the investment management fee was in fact waived[16], Defendants do not address, much less refute, the Complaint's allegations regarding the many other types of undisclosed expenses and costs arising from the underlying funds.

Similarly, Defendants do not meaningfully address Plaintiffs' allegations that BlackRock affiliates receive many other types of compensation for services to the Plan, such as trading fees, brokerage commissions, dealer markups, soft dollars, agency and principal fees, and receive indirect monetary benefits like improved product marketability. AC ¶¶ 103-105. Rather, Defendants state that "the audited financial statements" attached to the MTD "foreclose this allegation," but neglect to point to any language in the financial statements that actually contradicts Plaintiffs' well-pled facts. *See* MTD at 10, n.7. Indeed, if considered, Defendants' documents corroborate the Complaint's allegations that BlackRock affiliates ***did receive*** fees and other types of compensation from the Plan's assets. *E.g.*, Ex. T at 3 (BAIRD_0000349)("the Manager [BTC] and its affiliates may obtain and keep any profits, commissions, and fees accruing to them in connection with their activities as agent or principal in transactions for the Account [the Plan assets]"); *id.* at 20 (BAIRD_0000366) (disclosing that BTC will use BlackRock Execution Services for brokerage services and the Plan will pay commissions for such services).

Finally, Defendants fault Plaintiffs for "alleging nothing about the overall economic bargain" citing *Hecker v. Deere & Co.*, 556 F.3d 575, 586 (7th Cir. 2009), which discusses a "total fee." Defendants take this language wildly out of context: the discussion of total fees in *Hecker* concerned participants' ability to make an investment decision if they are given a comprehensive expense ratio. *Id.* Here, Defendants have selected investments that do not fully disclose all the investment costs associated with Plan investments and thus Plaintiffs could not allege facts about the overall

[16] Plaintiffs require additional discovery regarding whether all investment management fees were waived, given that the documents produced to date show that investment management fees ***were*** charged to Plan participants for the investment of securities lending collateral. AC ¶¶ 112-13.

economic bargain. Moreover, *Hecker* and the other decisions Defendants cite are inapposite because they are cases where there were no allegations of self-dealing, as the investments at issue were not proprietary investments of the sponsoring employer. Here, fiduciary self-dealing and conflicts of interests are at the heart of the Complaint. *Laboy v. Bd. of Trs. of Bldg. Serv. 32 BJ SRSP*, No. 11 CIV. 5127(HB), 2012 WL 701397, at *2 (S.D.N.Y. Mar. 6, 2012) (explaining *Young v. Gen. Motors Corp.* 325 F. App'x 31, 33 (2d Cir.2009) is inapposite in situations where there are also allegations of self-dealing); *Tussey v. ABB, Inc.*, 746 F.3d 327, 336 (8th Cir. 2014) (explaining that excessive fee cases are not instructive in cases with allegations of self-dealing and other wrongdoing).

Defendants ask this Court to prematurely dismiss the Complaint based on vague references to their cherry-picked documents. But as discussed more fully in Plaintiffs' opposition to the Request for Judicial Notice, Defendants' attempt to use external documents to resolve complex issues of fact on a motion to dismiss is improper. *United States v. Corinthian Colls.*, 655 F.3d 984, 999 (9th Cir. 2011) ("[W]e may not, on the basis of evidence outside of the Complaint, take judicial notice of facts favorable to Defendants that could reasonably be disputed."). Yet, even if the Court were to consider Defendants' documents, much of the evidence in those documents supports Plaintiffs' claims and demonstrates that there are numerous genuine disputes of fact that must be resolved through further discovery before judgment can be entered.

a. *The Plan Purchased A More Expensive Share Class of Certain Funds.*

In another attempt to dispute the factual allegations of the Complaint, Defendants assert that the Plan only participates in the F class of the LifePath Fund and U.S. Debt Index, and a fee-free Short-Term Investment fund, and ask the Court to ignore their own DOL filings to the contrary. AC ¶¶ 139-46, 205-07 (explaining that the fund BTC identifies with EIN-PN 161673805-001 bears an investment management fee contrary to Defendants' representation about waiver of such fee); *see also, e.g.*, Edwards Decl. Ex. F(b) (Form 5500 listing the BlackRock Plan as participating in the M class, which is more expensive than the F Class of the LifePath 2040 Fund); Edwards Decl. Ex. E (BlackRock Plan's 5500 stating Plan invests in Short-Term Investment Fund with EIN-PN

161673805-001).[17] Defendants cannot fairly rely on the information in the Forms 5500 and then disavow other information in the same documents as "errors." MTD at 10. At best, Defendants' attempt to displace the Complaint's allegations with their own facts merely "raise[s] factual issues that cannot be resolved at the motion to dismiss stage." *Deutsche Bank*, 2016 WL 5957307, at *6.

b. *The Plan Retained Expensive, Proprietary Mutual Funds.*

Defendants selected and retained their own Global Allocation and Low Duration Bond mutual funds without adequately considering cheaper, non-proprietary alternative funds. AC ¶¶ 116, 126. The Global Allocation Fund is a "moderate-risk global allocation" mutual fund that charged between 99 and 87 bps during the class period. *Id.* ¶ 115. The American Funds Capital Income Builder Fund and DFA Global Allocation 60/40 Portfolio offer alternative "moderate-risk global allocation" mutual funds that charge 36 and 30 bps, respectively. *Id.* ¶ 116. Similarly, Vanguard offers a cheaper alternative to the Low Duration Bond Fund: the Vanguard Short-Term Investment Grade Fund.[18] The 300 – 900% premium BlackRock charged for their mutual funds supports an inference of imprudence. *Id.* ¶¶ 115-16, 126.

Plaintiffs do not contend, as Defendants argue, that Defendants breached their fiduciary duties simply because they failed to select the cheapest funds available in the market. *Contra* MTD at 15. Instead, the Complaint alleges that Defendants acted out of self-interest when they failed to adequately consider comparable, cheaper, non-proprietary funds. *See Wildman*, 237 F. Supp. 3d at 914 (rejecting a similar argument because "Plaintiffs are not complaining that Defendants failed to find the lowest cost funds, rather, they allege Defendants acted in their own self-interest by following a process that failed to consider lower-cost funds in favor of [in-house funds.]").

Defendants also argue Plaintiffs' comparisons are improper. But Plaintiffs have adequately alleged the basis of their comparison, and resolution of those factual issues is improper at this stage.

[17] Regardless, Defendants' contention that they invested in only the F class does not address all of Plaintiffs' allegations about hidden, excessive fees. Plaintiffs have not had an opportunity to discover this issue fully and thus simultaneously move for relief under Rule 56(d).

[18] The Vanguard and BlackRock funds are comparable because they invest in a similar sub-section of bonds and Vanguard's fund maintains an effective duration within the guidelines set by BlackRock. *Id.* ¶¶ 126-30.

See Cryer v. Franklin Templeton Res., Inc., No. C 16-4265 CW, 2017 WL 818788 at *4 (N. D. Cal. Jan. 17, 2017) (whether funds with lower fees or better performance are comparable are questions of fact and "the Court may not resolve such factual questions at the motion to dismiss stage"); *Wildman*, 237 F. Supp. 3d at 914 (same).

(2) Defendants Selected and Retained Underperforming Funds.

Selecting and retaining underperforming proprietary investments supports an inference of imprudence. *Terraza*, 2017 WL 952896, at *12 (inferring imprudence from retention of excessively expensive and underperforming investments); *Braden*, 588 F.3d at 598 (inferring imprudence where fiduciary retained underperforming funds when alternatives existed); *cf. White v. Chevron Corp.*, No. 16-cv-0793-PJH, 2017 WL 2352137, at *20 (N.D. Cal. May 31, 2017) (no inference of imprudence where fiduciary removed underperforming investment). Additionally, retaining underperforming investments is part of the totality of circumstances surrounding Defendants' process, which must be considered in light of other factual allegations. *Wildman*, 237 F. Supp. 3d at 915. *Contra* MTD at 12 (Plaintiffs are "*separately"* inferring imprudence from underperformance).

The Complaint alleges with specificity that many of the Plan's investments underperformed relevant benchmarks and readily available alternative funds. For example, the Complaint alleges that the LifePath funds underperformed the Dow Jones Target Date indices by almost 20% from December, 31 2010 to December 31, 2015, AC ¶ 173; underperformed the Thrift Savings Plan target date funds by 5.6% on average during this same period, *id.* ¶ 185, and underperformed the Vanguard Target Date Funds by 8.5% on average during this same period, *id.* ¶ 172. Similarly, the Active Stock Fund has underperformed its benchmark by 17 bps annually over the past decade, and the Global Allocation Fund has underperformed its benchmark by 82 bps since being added to the Plan. *Id.* ¶¶ 123, 150. Despite extended periods of underperformance, due (at least in part) to the hidden costs associated with these investments, these funds are still offered to participants in the Plan.

This is not a mere "hindsight critique." MTD at 13. Rather, the Complaint alleges that, had Defendants prudently monitored the Plan's investments and not given preferential treatment to the BlackRock funds, participants would not have been stuck with underperforming funds. In other words, the inclusion and retention of underperforming funds are indicia of Defendants' preferential

treatment for BlackRock's funds, which is imprudent because it is based on the Plan's fiduciaries acting based on their own self-interest. *Leigh*, 727 F.2d at 136-37; *Terraza* 2017 WL 952896, at *12 (citing *Braden*, 588 F.3d at 596–98). Moreover, the Complaint alleges that the underperformance of the BlackRock proprietary funds was ***caused***, in part, by the unnecessary fund and fee layering which reduced the performance gains of the funds. AC ¶¶ 156-168. In contrast, the Vanguard and the Thrift Savings Plan target date funds do not have the excessive fund and fee layering which cannibalizes investment returns. *Id*. ¶¶ 170-187. These allegations, that BlackRock funds underperformed because the fees from fund layering reduced returns, are certainly not hindsight allegations. Finally, Defendants' attempt to attack the Complaint's allegations of underperformance ***in isolation*** is improper; rather all the Complaint's allegations must be evaluated together to determine whether they support an inference of imprudence. *Braden*, 588 F.3d at 594.

Defendants challenge the benchmarks used for the LifePath funds in the Complaint, because the LifePath funds use target date strategies. Strangely, Defendants now assert that performance comparisons for target date funds are improper because "they vary considerably in their asset allocations and 'glide paths.'" MTD at 13. First, the appropriateness of Plaintiffs' comparators is a question of fact not properly resolved on a motion to dismiss. *Cryer*, 2017 WL 818788 at *4 (the appropriateness of fund comparators is a question of fact and "the Court may not resolve such factual questions at the motion to dismiss stage"). Second, Defendants' argument that performance comparisons for target date funds, such as the BlackRock LifePath funds, are improper is contradicted by statements in their own documents. Edwards Decl. Ex. W at 4 (BAIRD_0000675-677) (providing a benchmark for each LifePath fund and stating that a fund's benchmark "measures how an index of similar funds has performed over the same period."). If Defendants believe that benchmarks are not meaningful for the LifePath funds, it is unclear why they stated the opposite in participant disclosures. Moreover, this argument, taken to its logical conclusion, would mean that plan fiduciaries can never evaluate the performance of target date funds based on benchmarks.

(3) Defendants Imprudently Selected and Retained BlackRock Funds Without Three Years of Performance History.

Plaintiffs' allegations that Defendants failed to adequately consider non-BlackRock funds for

the Plan is further supported by Defendants' history of adding proprietary funds to the Plan that did not have adequate performance histories. Using an untested fund is generally imprudent. *Krueger v. Ameriprise Fin., Inc.*, No. 11-CV-02781 SRN/JSM, 2012 WL 5873825, at *10 (D. Minn. Nov. 20, 2012); *Allianz*, 2016 WL 4507117, at *2 ("new funds are generally imprudent selections for a retirement plan because they are untested and carry expensive start-up costs"). A fiduciary cannot evaluate a fund without observing the performance history of the fund over a sufficiently long period. *Id.* On numerous occasions, Defendants added proprietary collective trust funds to the Plan shortly after their creation, without consideration of the investments' performance history (indeed, there were none), in order to support the new product's success. *See.* AC ¶¶ 95, 121, 136. The Plan's investment in these funds was often substantial; sometimes 25% or more of the ***entire fund***. *Id*. ¶ 121. These allegations further support Plaintiffs' claim of imprudence.

Defendants only dispute the impropriety of adding the Total Return and Global Allocation collective trust funds without an adequate track-record. They contend that the mutual fund analogues for these two funds provided the requisite track-records needed for decision-making.[19] MTD at 17. However, this reasoning fails because the Global Allocation fund and Total Return fund are managed by BTC, while the mutual funds were managed by a different firm, defeating a meaningful analysis. *See* AC ¶¶ 58, 89, 120, 136. Moreover, comparing mutual funds to collective trusts is an "apples to oranges comparison," because the two have unique "regulatory and transparency features." *White v. Chevron Corp.*, 2016 WL 4502808, at *12 (N.D. Cal. Aug. 29, 2016). This alleged conduct thus supports Plaintiffs' allegation of Defendants' imprudent process.

C. Defendants Failed to Diversify the Plan's Investments.

29 U.S.C. § 1104(a)(1)(C), mandates that a fiduciary "diversify[] the investments of the plan so as to minimize the risk of large losses[.]" Diversification is evaluated by reference to "open-ended facts and circumstances" about the risk and how it is concentrated. *See Metzler v. Graham*, 112 F.3d 207, 209 (5th Cir. 1997) (internal citations omitted). This inquiry concerns the nature of risk, rather

[19] Tellingly, Defendants previously argued that the Global Allocation Fund did not have a long enough track-record to support a switch. *See* Motion to Dismiss, ECF No. 35 at 16 (arguing that Plan fiduciaries did not select the Global Allocation Fund earlier because, in part, there was no collective trust strategy "with a track record that would have supported a switch.").

than the actualization thereof. *See id*.; *contra* MTD at 18.

By concentrating nearly all the Plan's assets in BlackRock managed funds and into BlackRock's securities lending program, Defendants exposed the Plan to extreme manager concentration risk—a risk that could easily be mitigated by diversifying the Plan to include a significant number of non-BlackRock managed funds. AC ¶ 222. Pertinent systemic risks include BlackRock's cyber-security risks, collateral reinvestment risks, and common operational mechanisms used to manage such risk. *Id.* ¶¶ 215-18. These systemic risks are common to *all* BlackRock funds, as they are part of the technological and operational architecture through which BlackRock manages all funds. *Id*. ¶¶ 219-21; *contra* MTD 18. BlackRock discloses these risks to investors, stating that they can cause financial loss and other costs. AC ¶¶ 216-23. Because nearly all of the Plan's assets are subject to these BlackRock-specific risks, nearly all of the Plan's assets are subject to financial loss should these risks actualize. If the Plan were properly diversified among other asset managers, an exploit of BlackRock's operations would not harm virtually all the Plan's assets. *Contra* MTD at 18. The Complaint alleges that Defendants did not give appropriate consideration to these risks when making their investment decisions. AC ¶¶ 214-23.

III. PLAINTIFFS' PROHIBITED TRANSACTIONS CLAIMS ARE TIMELY AND ADEQUATELY PLED

A. The Prohibited Transaction Claims Are Timely.

Defendants argue that the Complaint's prohibited transaction claims are time barred under ERISA's three year and six year statutes of limitation based on their view that the "relevant transaction" that starts the clock running is "the initial inclusion of a fund in the Plan lineup." MTD at 19-20. But this focus on the initial inclusion of funds is not supported by the statute or case law. First, 29 U.S.C. §1106(a) prohibits ***transactions*** between plans and parties in interest; it does not prohibit ***decisions***. In fact Defendants' own authority, *Wright v. Or. Metallurgical Corp.*, distinguished a sale, exchange or leasing of property (which is a transaction) from a decision to engage in a particular course of conduct (which the court found not to be a transaction). 360 F.3d 1090, 1101 (9th Cir. 2004). Nor does *David v. Alphin*, 704 F.3d 327, 340-41 (4th Cir. 2013) help Defendants. There the plaintiffs alleged that the defendants engaged in prohibited transactions by

failing to remove proprietary funds from the line-up. As the Fourth Circuit noted, the failure to act cannot be a transaction because the common meaning of transaction implies that ***affirmative action*** is required, such as an exchange or transfer of funds.[20] Similarly, in *Phillips v. Alaska Hotel & Rest. Emps. Pension Fund*, 944 F.2d 509, 520 (9th Cir. 1991) the prohibited transaction claim was that the trustees failed to relax vesting rules, which is not a transaction.[21]

Here, the Complaint does not allege that the initial decision to include BlackRock funds in the Plan is a prohibited transaction; it alleges "[e]ach purchase by the Plan of an interest in the BlackRock proprietary fund during the Class Period constituted a separate violation of [] 29 U.S.C. 1106(a)(1)(A)" AC ¶ 310, and the "repeated transfer" of the Plan's assets "in the form of direct or indirect fees to BlackRock, BTC and/or their affiliates constituted "multiple" violations of 29 U.S.C. § 1106(a)(1)(D) and § 1106(b)(1). AC ¶¶ 312, 314.

Defendants attempt to bar ***all*** the prohibited transaction claims for funds included in the Plan more than three years before the date of filing, by arguing that the claims all accrued (even purchases of those funds that had yet to occur), when Plaintiffs received disclosures that the funds in the Plan were affiliated with BlackRock.[22] MTD at 19. This argument turns 29 U.S.C. § 1106 on its head because it allows a fiduciary to engage ad infinitum in prohibited transactions so long as they tell participants of the first violation of § 1106. Notably, Defendants' argument that the disclosures provided knowledge that virtually all the funds in the Plan were/are affiliated BlackRock, only applies to the § 1106(a)(1)(A) prohibited transaction claims. The § 1106(a)(1)(D) and (b)(1) claims challenge ***undisclosed*** transfers of fees to BlackRock affiliates such as securities lending fees. Defendants advance no argument that Plaintiffs knew of the various types of compensation (other than investment management fees) that BlackRock received. In fact, the securities lending and other

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[20] Similarly, in *Chevron*, 2017 WL 2352137, at *21-22, plaintiffs alleged that the choice of a plan record keeper was a prohibited transaction, not that the continued payment of plan money to the record keeper was prohibited.

[21] *Lorenz*, 2017 WL 952883, at *7, mistakenly relied on *Phillips* for the proposition that in a series of breaches of the same character, knowledge of the first breach starts the limitations period. But *Phillips* was not about a series of transactions; it was about the continued failure to cure a breach that occurred more than three years previously.

[22] There are BlackRock funds which were added to the Plan within three years of the filing of the Complaint; the prohibited transaction claims related to those funds are timely even under Defendants' misapprehension of the law.

fees were not disclosed to participants at any point during the class period, and were certainly not disclosed in the participant disclosures Defendants rely on. Ex. W to Edwards Decl. at BAIRD_0000676-77. Thus, even if the Court considers Defendants' documents, they fail to show that Plaintiffs had actual knowledge of all the undisclosed transfers of assets to BlackRock and its affiliates in violation of § 1106(a)(1)(D) and (b)(1).

With respect to the six year statute, Defendants' "initial inclusion" argument also fails because it is contrary to the Supreme Court's decision in *Tibble,* which reversed the Ninth Circuit holding that claims regarding the prudence of certain mutual funds in a 401k plan were time-barred because "those mutual funds were included in the Plan more than six years before the complaint was filed[.]" *Tibble*, 135 S. Ct. at 1825. The Supreme Court rejected the Ninth Circuit's holding because plan fiduciaries have a "continuing duty" to act prudently that "exists separate and apart from the duty to exercise prudence in selecting investments at the outset." *Id.* at 1828. Because many of these purchases of interests in BlackRock funds, and many payments of fees or compensation to BlackRock, occurred after April 5, 2011, it is impossible for those prohibited transaction claims to be time barred by the six year statute of limitation.

B. Plaintiffs Are Not Required to Anticipate Defendants' Affirmative Defenses.

Defendants insist that investing the Plan in BlackRock funds is permissible because those investments were exempt under 29 U.S.C. § 1108(b)(8) and PTE 77-3. MTD at 20-22. However, prohibited transaction exemptions are affirmative defenses that defendants, not plaintiffs, must prove. *See Braden*, 588 F.3d at 602 (holding that PTEs fall under the "general rule of statutory construction that the burden of proving justification or exemption under a special exception to the prohibitions of a statute generally rests on one who claims its benefits"). Thus, at this stage of the pleadings, Plaintiffs have no duty to plead facts showing that the PTEs do not apply. *Scott v. Kuhlmann*, 746 F.2d 1377, 1378 (9th Cir. 1984)("Ordinarily affirmative defenses may not be raised by motion to dismiss."); *ASARCO, LLC v. Union Pac. R.R. Co*., 765 F.3d 999, 1004 (9th Cir. 2014); *Albino v. Baca*, 747 F.3d 1162, 1169 (9th Cir. 2014) (motions to dismiss based on affirmative defenses are "rare because a plaintiff is not required to say anything about [facts concerning

defenses] in his complaint"); *Jones v. Bock*, 549 U.S. 199, 216, (2007) (same).

Defendants assert in a footnote that the Complaint, on its face, establishes the applicability of the affirmative defenses. MTD at 20, n.15. But this argument fails, as well. Even if the Court were to assess Defendants' affirmative defenses at this juncture, the Complaint alleges sufficient facts to defeat the cited exemptions – BTC's compensation from management of the BlackRock proprietary funds was unreasonable because it was based on unnecessary fund and fee layering, and was not properly disclosed as required by DOL regulations. *See* AC ¶¶ 176-90. These allegations are sufficient to overcome Defendants' prohibited transaction exemptions defenses. *See Krueger*, 2012 WL 5873825 at *17 ("Both § 408(b)(8) [29 U.S.C. § 1108(b)(8)] and PTE 77–3 require that the transaction provide the fiduciaries or parties in interest no more than reasonable compensation."). Moreover, Defendants rely on their disputed assertion that BTC ***only*** receives securities lending compensation and no other compensation (MTD at 21), when the Complaint alleges otherwise and Defendants' assertion is contradicted by the very documents upon which they rely. *See supra* II.B.1.

Finally, Defendants' position is based on their misquotation of PTE 77-3: that it merely requires "dealings between the plan and ***the affiliated fund*** [are] 'on a basis no less favorable to the plan than such dealings are with other shareholders,'" (MTD at 21, emphasis added) when, in fact, PTE 77-3 requires that "[a]ll other dealings between ***the plan and the investment company, the investment adviser or principal underwriter for the investment company, or any affiliated person of such investment adviser or principal underwriter,*** are on a basis no less favorable to the plan[.]"[23] The bolded text shows that the universe of entities for which dealings with the Plan must be no less favorable is much larger than Defendants' brief indicates. And the Complaint alleges facts that show that the relevant transactions do not meet the requirements of PTE 77-3. AC ¶¶ 102, 105 (Plan pays excessive fees to ***BlackRock affiliates*** for services, such as trading fees, brokerage commissions, dealer markups, and agency and principal fees). These allegations are supported by the prospectus upon which Defendants rely. Edwards Decl. Ex. G at 398 ("the Affiliates (and their personnel and other distributors) will be entitled to retain fees and other amounts that they receive in

[23] Class Exemption Involving Mutual Fund In-House Plans Requested by the Investment Company Institute, 42 Fed. Reg. 18,734, 18,735 (Apr. 8, 1977) (emphasis added.)

connection with their service to the Funds as broker, dealer, agent, lender, adviser or in other commercial capacities and no accounting to the Funds or their shareholders will be required").

Furthermore, the Ninth Circuit has held that 29 U.S.C. § 1108 exemptions apply only to § 1106(a) violations and that there is never a defense to a § 1106(b) violation. *Barboza v. Cal. Ass'n of Prof'l Firefighters*, 799 F.3d 1257, 1269 (9th Cir. 2015) ("while a plan may pay a fiduciary 'reasonable compensation for services rendered' under 29 U.S.C. § 1108, the fiduciary may not engage in self-dealing under 29 U.S.C. § 1106(b) by paying itself from plan funds.") (quoting *Patelco Credit Union v. Sahni*, 262 F.3d 897, 910–11 (9th Cir. 2001). As such, the § 1106(b) claims stand under all circumstances.

IV. THE MONITORING AND CO-FIDUCIARY CLAIMS ARE WELL-PLED

As demonstrated above, Plaintiffs have stated claims for breaches of fiduciary duty against Defendants. *Supra* at II. The derivative claims for failure to monitor an appointed fiduciary, and for co-fiduciary breach, therefore, are also properly pled. *See, e.g., Solis v. Webb*, 931 F. Supp. 2d 936, 951-54 (N.D. Cal. 2012) (monitoring and co-fiduciary liability claims are sufficient where underlying claims sufficiently pled); *Monper v. Boeing Co.*, 104 F. Supp. 3d 1170, 1186 (W.D. Wash. 2015) (same). In Count III, Plaintiffs sufficiently allege that BlackRock and the Retirement Committee Defendants, as appointing fiduciaries, breached their duty to monitor the performance of their appointees. AC ¶¶ 317-20; *Solis*, 931 F. Supp. 2d at 953 (duty to monitor is "[i]mplicit within the duty to select and retain fiduciaries[.]"); *Johnson*, 250 F.Supp.3d at, at 466 (allegations that defendant "fail[ed] to monitor and evaluate the performance of their appointees" adequate).

In Count IV, Plaintiffs allege that BlackRock, BTC, and the Committee Defendants knew their co-fiduciaries breached their duties by giving preferential treatment to BlackRock proprietary funds for the BlackRock Plan, and thus were aware of, participated in, enabled, concealed and failed to remedy their co-fiduciaries' breaches. AC ¶¶ 241-42. Courts consistently uphold similar co-fiduciary claims on motions to dismiss. *See, e.g., In re JDS Uniphase Corp. Erisa Litig.*, No. C 03-04743 CW (WWS), 2005 WL 1662131, at *14 (N.D. Cal. July 14, 2005) (sustaining co-fiduciary liability claims where plaintiffs stated fiduciary breach claim); *Page v. Impac Mortg. Holdings, Inc.*, No. 07-cv-1447-AG, 2009 WL 890722, at *6 (C.D. Cal. Mar. 31, 2009) (same).

V. THE CTI CLASS CLAIMS ARE ADEQUATELY PLED

ERISA's fiduciary duties apply to the management of the BlackRock CTIs because these pooled vehicles held almost exclusively ERISA-governed retirement "plan assets." AC ¶¶ 228, 230; 29 C.F.R. § 2510.3-101.[24] BTC has exclusive authority over management of the ERISA "plan assets" held in the BlackRock CTIs. AC ¶¶ 234, 236.[25] BTC is therefore a fiduciary to each employee benefit plan invested in the BlackRock CTIs, including the BlackRock Plan. 29 U.S.C. § 1002(21)(A) ("[A] person is a fiduciary with respect to a plan to the extent [i] he … exercises any authority or control respecting management or disposition of its assets"). BTC violated the fiduciary duties it owed to those plans by giving itself and its affiliates preferential treatment for compensation from the BlackRock CTIs, such as securities lending compensation. AC ¶¶ 246-80, 334-39. Defendants' only argument in response to these claims is that BTC was not acting in its fiduciary capacity when it became the securities lending agent for the BlackRock CTIs. MTD at 11, n.9, 23-24 (asserting the Investment Committee was the responsible fiduciary for determining BTC's securities lending compensation). This argument misses the mark for two reasons.

First, it is undisputed that BTC used the BlackRock CTIs' assets (which are ERISA-governed pooled assets from various employee benefit plans) for the securities lending transactions and not assets held directly in the BlackRock Plan or in any other employee benefit plans. And because only BTC (not the BlackRock Plan fiduciaries) has authority to manage the pooled assets in the BlackRock CTIs,[26] BTC ***alone*** is liable for the securities lending transactions that occurred with the assets of the BlackRock CTIs. It is impossible for the fiduciaries of the individual plans (like the BlackRock Investment Committee) to be legally responsible for decisions regarding the selection, maintenance and compensation of the securities lending agent to the BlackRock CTIs when they had no authority over the BlackRock CTIs, nor the power to choose or replace the securities lending agent to the BlackRock CTIs.

While the BlackRock Investment Committee members have their own liability for selecting

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[24] Defendants do not dispute that each of the BlackRock CTIs hold ERISA-governed "plan assets."
[25] Defendants' documents, if considered, corroborate this allegation. *See, e.g* Ex. Z to Edwards Decl. at 3 ("BTC, as trustee, has exclusive authority over management of the Funds").
[26] *See id., supra* n.25; AC ¶¶ 236-37.

and maintaining imprudent funds in the BlackRock Plan because such funds, among other things, paid excessive securities lending fees to BTC, that does not diminish BTC's liability for actions it took with the assets of the BlackRock CTIs. *See, e.g.*, *Kanawi v. Bechtel Corp*., 590 F. Supp. 2d 1213, 1225 (N.D. Cal. 2008) (ERISA service provider "cannot hide behind the [named fiduciary's] oversight to shield itself from possible liability over its own actions[.] Accordingly, [the service provider] was a fiduciary[.]"); *Charters v. John Hancock Life Ins. Co.*, 583 F. Supp. 2d 189, 197 (D. Mass. 2008). BTC is a *de facto* fiduciary based on its control over the ERISA-governed "plan assets" held in the BlackRock CTIs (AC ¶¶ 234, 236-37) and it cannot attempt to absolve itself from any imprudent or disloyal actions it took with assets of the BlackRock CTIs, just because the BlackRock Investment Committee fiduciaries may have also breached their fiduciary duties by selecting and maintaining the BTC-managed funds for the BlackRock Plan. *See infra* at II.

Second, if the Court considers Defendants' documents over Plaintiffs' opposition, even those documents do not support Defendants' position. Defendants make the conclusory assertion that BTC's appointment and its securities lending compensation are set forth in BTC's agreements with the BlackRock Plan, without citing any contractual language. MTD at 24 (citing Edwards Decl. Ex. T (Investment Management Agreement or "IMA") and Ex. S (Guideline & Fee Agreements or "GLFA")). To the contrary, the IMA gives BTC wide latitude over its role and compensation by granting BTC "full discretionary authority to invest the Account subject to ERISA's fiduciary standards, in investments of any kind,"[27] and ***expressly authorizes BTC*** to make decisions regarding securities lending for the Plan.[28] While the IMA provides that BTC "*may* lend, including through a collective investment fund, securities,"[29] it does not say that BTC *must* engage in securities lending, that it *must* act as the agent for such securities lending, or that BTC will receive a 50% fee for acting as the securities lending agent. Neither the IMA nor the GLFA entered into simultaneous with the IMA (in November of 2010), appoints BTC as the securities lending agent or sets BTC's compensation for any securities lending activities. Edwards Decl. Exs. T, M. The first mention of

[27] Edwards Decl., Ex. T at 1 (BAIRD_0000347).
[28] *Id*., *supra* n.27, at 2 (BAIRD_0000348) (BTC is authorized "To lend, including through a collective investment fund, any securities [] and to invest any collateral provided by any borrower").
[29] *Id*., *supra* n.27, at 5-6 (BAIRD_0000351-52) (emphasis added).

BTC's securities lending fee is four years later in a GLFA dated June 30, 2014. Thus, it is simply incorrect that BlackRock Plan fiduciaries, or any other plan fiduciaries, decided to pay BTC 50% of lending revenue, when the 50% split is not provided for in the original contracts. Similarly, while the GLFA authorizes BTC to invest the Plan's assets in Short Term Investment Funds ("STIFs"), neither the IMA nor GLFA require it or provide that the STIFs must be managed by BTC. *Id.*

Defendants cite several cases for the proposition that fiduciary status does not attach to actions taken in accordance with the terms of a contract entered into with a named fiduciary to a plan. MTD 24, n.18. Again, this rule gives way when the contract itself gives discretionary authority to the contractor [here BTC] and when the plaintiff challenges conduct undertaken ***after*** entry into the contract. *See, e.g.*, *Perez v. Chimes D.C., Inc.*, 2016 WL 4993293, at *7 (D. Md. Sept. 19, 2016) (distinguishing *McCaffree Fin.l Corp. v. Principal Life Ins. Co.*, 811 F.3d 998 (8th Cir. 2016) because the plaintiff not "only challenge[d] the management fees as provided for by the contract initially negotiated" with the service provider, but rather challenged the service provider's exercise of its contractual authority to enter into transactions that benefitted itself); *Tussey v. ABB, Inc.*, 2008 WL 379666, at *7 (W.D. Mo. Feb. 11, 2008) (noting that *Schulist v. Blue Cross of Iowa*, 717 F.2d 1127, 1131-32 (7th Cir. 1983) "does not apply to the fiduciary's future conduct which may violate ERISA."). Here, Plaintiffs challenge BTC's selection and maintenance of itself as the securities lending agent and its excessive compensation in that role, as well as its disloyal preference for BTC-managed STIFs. None of this conduct was authorized by the parties' initial agreements.

Further, the cases on which Defendants rely all address adherence to a contractual term bargained for at arm's length. But the GLFAs from 2014 forward cannot reasonably be treated as arm's length agreements. Given that BTC had been managing the BlackRock CTIs as a fiduciary for years at that point, the agreements were certainly not "adversarial negotiations between parties that are each pursing independent interests." *Santomenno v. Transamerica Life Ins. Co.*, 2013 WL 603901, at *6 (C.D. Cal. Feb. 19, 2017). Rather, the GLFAs (and any subsequent IMAs) are agreements between related parties.

Defendants' arguments are too clever by half. Defendants would have the Court decide that, although BTC is a fiduciary for purposes of managing the assets in the BlackRock CTIs, it was not a

fiduciary when selecting and maintaining itself as the securities lending agent for the BlackRock CTIs or choosing and maintaining BTC funds for investment of the cash collateral of the BlackRock CTI. This is not the law. "[A]n investment manager for an ERISA plan must unequivocally cease to serve in that position and terminate in writing all contracts or arrangements with the plan concerning that position *before* playing any role in transactions denied to fiduciaries by Section 406. It cannot be a fiduciary every other hour and the recipient of plan assets in the intervals." *Lowen v. Tower Asset Mgmt., Inc.*, 829 F.2d 1209, 1219 (2d Cir. 1987) (emphasis added). In short, BTC's compensation arrangement is subject to ERISA's fiduciary duties. An alternative finding would effectively allow parties to contract entirely around ERISA's fiduciary rules, and it is well established that they cannot. *See, e.g.*, *IT Corp. v. Gen. Am. Life Ins. Co*., 107 F.3d 1415, 1421-22 (9th Cir. 1997).

Finally, Defendants make a half-attempt to argue that Plaintiffs' allegation that BTC engaged affiliates to provide services to the BlackRock CTIs for a fee is controverted by the audited financial statements for those funds. MTD at 25. But those documents, at best, demonstrate that there is a material dispute about the facts. For example, the audited financials expressly state that the expenses which are capped at 2 bps are "reflected in the statement of operations as operating expenses borne by BTC,"[30] but the statements of operations for each fund state that ***other*** "expenses incurred by underlying funds in which the fund invests ***are not included in this [expense] ratio***. The collective fund income allocated to the fund from underlying funds is net of those expenses."[31] As such, Defendants' documents expressly disclose ***additional*** non-capped expenses which were subtracted from the income of underlying funds and not disclosed to participants. Regardless, the allegations of the Complaint cannot be displaced by Defendants' alternative and untested version of the facts.

CONCLUSION

For the foregoing reasons, Plaintiffs respectfully request that Defendants' Motion be denied.

[30] Edwards Decl. Exhibit U at 322 (BAIRD 0001128).

[31] Edwards Decl. Exhibit U at 30 (BAIRD_0000836), 40 (BAIRD_0000846), 94 (BAIRD_0000900), 134 (BAIRD_ 0000940), 139 (BAIRD_0000945), 144 (BAIRD_0000950), 149 BAIRD_0000955), 154 (BAIRD_0000960), 159 (BAIRD_0000965), 164 (BAIRD_0000970), 169 (BAIRD_0000975), 174 (BAIRD_0000980), 229 (BAIRD_0001035), 249 (BAIRD_0001055), 259 (BAIRD_0001065), 299 (BAIRD_0001105), 309 (BAIRD_0001115).

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Respectfully submitted,

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