No. 00-1473

In the Supreme Court of the United States

ARTHUR GOLDSTEIN AND MEDCO ADMINISTRATORS, LTD., PETITIONERS

v.

ELAINE L. CHAO, SECRETARY OF LABOR, UNITED STATES DEPARTMENT OF LABOR

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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QUESTIONS PRESENTED

1. Whether petitioners exercised control or authority over "plan assets," and were thereby fiduciaries under the Employee Retirement Income Security Act of 1974 (ERISA), when they set "service fees" for themselves and deducted those fees from contributions that employers were required to make to an ERISA benefit plan.

2. Whether petitioners' liability under ERISA was properly determined on cross-motions for summary judgment.

3. Whether ERISA authorizes the permanent injunction granted to the Secretary of Labor against petitioner Goldstein in the circumstances of this case.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-2a) is reported at 224 F.3d 128. The opinion and order of the district court (Pet. App. 3a-29a) is unreported. The final judgment and order of the district court (Pet. App. 30a-34a) is unreported.

JURISDICTION

The court of appeals entered its judgment on September 7, 2000. A petition for rehearing was denied on December 22, 2000 (Pet. App. 35a-36a). The petition for a writ of certiorari was filed on March 22, 2000. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Under the Employee Retirement Income Security Act of 1974 (ERISA), a fiduciary must act solely in the interests of plan participants and beneficiaries, for the exclusive purpose of providing benefits to them and defraying reasonable expenses of administering the plan, and with a high degree of prudence. 29 U.S.C. 1104(a)(1)(A), (B). A fiduciary must also avoid certain prohibited transactions between the plan and parties in interest and may not deal with plan assets in his own interest or for his own account. 29 U.S.C. 1106(a), (b)(1). A fiduciary who violates ERISA not only must repay plan losses and disgorge profits made through the use of plan assets, but also is "subject to such other equitable or remedial relief as the court may deem appropriate." 29 U.S.C. 1109(a).

One of the ways that a person may become a fiduciary with respect to an employee benefit plan is by "exercis[ing] any authority or control respecting management or disposition of [plan] assets." 29 U.S.C. 1002(21)(A)(i). ERISA does not explicitly define the types of property that will be regarded as plan assets. The Department of Labor, which has authority to issue regulations defining ERISA terms, 29 U.S.C. 1135, has decided not to promulgate a comprehensive definition of "plan assets." 50 Fed. Reg. 961, 962 (1985) (withdrawing proposed regulation). The Department reasoned that in most cases, plan assets can be identified "based on ordinary notions of property rights under non-ERISA law and the terms of any contract to which

the plan is a party." *Ibid.*[1]

2. The Solidarity of Labor Organizations Health and Welfare Fund (SOLO) is an employee health benefits plan established by Local 947 of the SOLO Union and certain employers. Pet. App. 4a-5a. Under the plan's trust agreement, participating employers make contributions to a trust fund in the amounts set forth in their agreements with Local 947. See *id.* at 16a (discussing definitions of "Trust Fund" and "contributions to the Trust"). Expenses incurred in administering and operating the plan and Trust Agreement are to be paid out of assets of the Trust Fund. *Id.* at 16a n.9.

In 1989, the trustees of the SOLO Fund instituted an "associate membership program" to obtain more employers to participate in the Fund. Pet. App. 5a. They did so, in part, through contracts with so-called "employer collective bargaining representatives" (ECBRs), who could not bargain over anything except plan-related matters. *Id.* at 5a-6a. Those contracts authorized the ECBRs to negotiate "Associate Membership Agreement[s]" on behalf of employers with Local 947. *Id.* at 6a. Petitioner Medco Administrative Services (Medco) functioned as an ECBR and also enrolled itself in the plan. *Id.* at 7a-8a. Petitioner Goldstein is the former President of Medco. *Id.* at 7a n.5.

In soliciting employers for the Fund, Medco would first require an interested employer to execute a document entitled "Authorization of Collective Bargaining Representative," which named Medco as the employer's collective bargaining representative. Pet. App. 8a.

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[1] The Department has defined "plan assets," however, with respect to plan investments and participant contributions to a plan. 29 C.F.R. 2510.3-101, 2510.3-102. Those regulations do not govern this case, which involves *employer* contributions.

Medco then obtained information concerning the health of the employer's employees, which was forwarded to the Fund. *Ibid.* If the employer met the Fund's criteria, Medco then entered into an Associate Membership Agreement with the employer and Local 947. *Ibid.* Under the membership agreement, the employer agreed to be bound by the terms of the SOLO Fund's Trust Agreement. *Ibid.*

Although the Trust Agreement required employers to contribute to the Fund, Medco's membership agreements directed employers to pay their monthly contributions to Medco. Pet. App. 9a. Medco billed employers for a contribution amount that included not only a contribution to the Fund but also membership fees of employees for Local 947 and a "service fee" for Medco. *Ibid.* Goldstein and Medco determined the amount of this "service fee," but Medco's bills to employers did not specify how much of the employer's monthly contribution would be forwarded to the Fund and how much would be kept by Medco. *Id.* at 9a, 17a-18a & n.12. Medco's "service fees" were sometimes more than 31% of an employer's monthly contribution. *Id.* at 19a. From March 1991 through February 28, 1997, petitioners deducted a total of $6,631,806 in service fees from employer contributions. C.A. App. 1729-1730 (Magistrate's Report and Recommendation).

3. In 1995, the Secretary sued petitioners and other defendants for ERISA violations in connection with the SOLO Fund. Pet. App. 4a. All defendants except petitioners agreed to consent judgments. *Ibid.* The Secretary and petitioners then filed cross-motions for summary judgment. *Id.* at 4a-5a.

The district court granted summary judgment to the Secretary and denied petitioners' motion for summary judgment. Pet. App. 4a, 28a-29a. The court reasoned

that petitioners were fiduciaries as defined in ERISA. *Id.* at 13a-20a; see 29 U.S.C. 1002(21)(A)(i) (fiduciary includes a person who exercises authority or control over the management or disposition of plan assets). The court concluded that contributions petitioners received from employers were plan assets under a "documentary approach," which relies on documents governing the relationship between the Fund and employers. The court noted that those documents gave the plan the right to receive all contribution amounts from a contributing employer. Pet. App. 15a-18a. The court also concluded that the contributions were plan assets under a "functional approach," which considers whether the item in question may be used to benefit a fiduciary at the expense of plan participants or beneficiaries. *Id.* at 15a, 18a-20a. The court held that petitioners were fiduciaries with respect to the plan assets in question (the employer contributions sent to Medco), because petitioners exercised control or authority over the employer contributions by setting the total amount of contributions an employer had to pay. *Id.* at 20a.

Having determined that petitioners were fiduciaries, the district court then held that petitioners engaged in prohibited transactions, in violation of 29 U.S.C. 1106(a)(1)(D) and (b)(1), by transferring plan assets to themselves, despite their status as parties in interest to the SOLO plan, and by dealing with plan assets for their own interest or account. Pet. App. 21a-23a. The court further held that petitioners violated 29 U.S.C. 1104(a)(1)(A) and (B) by failing to act prudently or solely in the interest of the plan in setting the total amount of employer contributions. Pet. App. 24a-26a.

As a remedy, the district court permanently enjoined petitioners from violating ERISA and from ever serving as fiduciaries or service providers to any ERISA

plan. Pet. App. 27a-28a, 32a-34a. The court also required petitioners to repay to the plan the service fees that petitioners had deducted from employer contributions. *Id.* at 28a. With prejudgment interest, that amounted to $9,525,493.16. *Id.* at 31a; see C.A. App. 1734-1735 (calculations in Magistrate's Report and Recommendation).

4. The court of appeals affirmed in a brief, per curiam opinion. Pet. App. 1a-2a. The court concluded that the fees petitioners withheld from employer contributions were plan assets "substantially for the reasons stated in [the district court's opinion], analyzing the terms of the documents governing the Fund." *Id.* at 2a. The court rejected petitioners' arguments that they were not fiduciaries, found "no error in the district court's determination that defendants' conduct violated ERISA," and found petitioners' other arguments to be "without merit." *Ibid.*

ARGUMENT

The court of appeals' decision is correct and does not conflict with any decision of this Court or any other court of appeals. Further review is therefore not warranted.

1. Petitioners argue that the court of appeals applied an ambiguous "governing documents" standard that leads to "arbitrary and inconsistent holdings" in determining that Medco's fees were plan assets. Pet. 10. Petitioners further argue that the court of appeals rejected a standard urged by the Department of Labor, which combines a "governing documents" and a "functional or economic realities" approach. Pet. 8, 11. Neither of petitioners' assertions is accurate.

As discussed above, the Department of Labor has determined that in most cases plan assets can be

identified "based on ordinary notions of property rights under non-ERISA law and the terms of any contract to which the plan is a party." 50 Fed. Reg. at 962. The Department has thus accepted a "governing documents" approach that looks to the plan's rights under contracts to which the plan is a party. The Department advocated that approach in the court of appeals and did not suggest that a "functional" or "economic realities" approach should also be used in determining whether employer contributions are plan assets. See Gov't C.A. Br. 12-17.[2] A "functional" approach is appropriately employed, after plan assets are identified, for purposes of determining whether a defendant exercises the kind of control or authority over such assets that makes the defendant a fiduciary. See 29 U.S.C. 1002(21)(A)(i) (generally defining "fiduciary" in terms of functions performed, such as "exercis[ing] any authority or control respecting management or disposition of [plan] assets"); Gov't C.A. Br. 11, 17-20.

The primary governing document in this case is the plan's trust agreement, to which contributing employers agreed to be bound through Associate Membership Agreements. Pet. App. 8a; see also *id.* at 17a-18a & n.11 (discussing summary plan description). The trust agreement provides that participating employers will make contributions to the plan's trust fund, in amounts to which employers and Local 947 have agreed, and that expenses will be paid out of trust fund assets. *Id.* at 16a & n.9. Therefore, the plan had a right

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[2] The Department informed the district court that courts have applied both a "functional" and a "governing documents" test, see Mem. of Law in Support of Plaintiff's Mot. for Summary Judgment Against Medco Administrators, Ltd. and Arthur Goldstein 14-22, but did not expressly endorse the functional one.

to receive all contributions that employers agreed to make, including the part that petitioners designated as a "service fee" for themselves. See *id.* at 17a. The plan was also responsible for paying expenses incurred by ECBRs in obtaining new business for the plan. Petitioners had no right to compensate themselves for claimed expenses by deducting from employers' contributions a "service fee" in an amount set by petitioners and not disclosed to the employers.

Petitioners attempt to avoid those facts by arguing that they had rights to a service fee under "[t]he Authorization of Collective Bargaining Representative, entered into between Medco and its employer clients." Pet. 11. Because that document is not a "contract to which *the plan is a party*," 50 Fed. Reg. at 962 (emphasis added), it does not alter the plan's rights as set out in the plan's trust agreement. The fact that Medco entered into those contracts with employers shows only that petitioners were attempting to circumvent the trust fund documents by giving themselves authority to do what the trust fund documents prohibited.

Petitioners also argue that the court of appeals misconstrued the Associate Membership Agreements, which, as discussed above, required employers to follow the terms of the plan's trust agreement. See Pet. 13-16 (discussing so-called "collective bargaining agreement[s]" that employers, through petitioners, entered into with Local 947). In petitioners' view, the Associate Membership Agreements establish that employers intended to pay petitioners a service fee that was separate from the contributions that the employers agreed to pay to the trust fund. *Ibid.* Petitioners, however, did not tell employers the *amount* they were being charged as a service fee or separate that amount

from the amount that employers sent to petitioners as a plan contribution. Pet. App. 17a-18a & n.12. Accordingly, petitioners' service fee cannot be separated from the contributions that employers agreed to make to the plan.

2. Petitioners also argue that the court of appeals should have applied a "functional" or "economic realities" test to determine whether its service fees were plan assets, and that the court's failure to do so creates a conflict with *Kayes* v. *Pacific Lumber Co.*, 51 F.3d 1449, 1467 (9th Cir.), cert. denied, 516 U.S. 914 (1995).[3] Pet. 17-21. Neither argument is persuasive.

The court of appeals in this case did not necessarily "ignore[]" consideration of a functional approach, as petitioners assert. Pet. 17. The court affirmed a district court decision that had concluded that petitioners' service fees were plan assets under both a documentary approach and a functional approach. See Pet. App. 14a-20a (district court's decision). Although the court of appeals stated that its affirmance was "substantially" for the district court's reasons "analyzing the terms of the documents governing the Fund," the court cited to pages in the district court's decision that

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[3] Petitioners also incorrectly argue (Pet. 20) that the court of appeals' decision is inconsistent with the court's own decision in *Trustees of the National Automatic Sprinkler Industry Pension Fund* v. *Fairfield County Sprinkler Co.*, 243 F.3d 112 (2d Cir. 2001). *Sprinkler Industry* holds that a collectively bargained pension plan may not accept contributions when there is no written agreement requiring the contributions to be made and the contributions are for employees who are not covered by the plan. *Id.* at 116-118. In this case, there was such a written agreement and the contributions were for employees covered by the SOLO plan. In any event, review by this Court would not be warranted to resolve an intra-circuit conflict.

both analyzed those documents and applied a functional approach. *Id.* at 2a (citing *Metzler* v. *Solidarity of Labor Organizations Health & Welfare Fund*, No. 95 Civ. 7247 (KMW), 1998 WL 477964, at *5-*7 (S.D.N.Y. 1998)); see Pet. App. 13a-20a. Thus, the court's decision may be read to rely "substantially" on a documentary approach but also to consider the functional approach. At the very least, it cannot be said that the court of appeals' brief per curiam opinion firmly commits the Second Circuit to applying only a "governing documents" approach—without consideration of "functional" factors—in the future.

In any event, use of the Ninth Circuit's approach would not change the result in this case. The district court applied that test and concluded that the employers' contributions were "clearly used to benefit [petitioners]" because they set the total amount of such contributions and retained part of that amount for themselves. Pet. App. 19a. Petitioners' actions also harmed plan participants and beneficiaries by leading to higher premiums than were needed to provide benefits. *Ibid.* Petitioners present no reasons to second-guess the district court's determination. Indeed, they themselves urged the court of appeals to reject the Ninth Circuit's test, as applied by the district court, because they would be unable to prevail under it. Pet. C.A. Br. 42-43.[4]

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[4] Petitioners also attempt to expand the Ninth Circuit's functional test into one that looks at the "economic relationship among the employers, Medco, Local 947 and the Fund." Pet. 18. Petitioners then describe that relationship as one in which the employers, Local 947, and the Fund all understood and agreed that Medco's fees were not plan assets. Pet. 18-21. For reasons discussed in text, there was no such agreement or understanding. Nor are petitioners accurate in suggesting that, under the court

3. Petitioners also argue that the court of appeals misapplied statutory and regulatory definitions of a "fiduciary" in concluding that petitioner Goldstein was a fiduciary in all instances in which petitioner Medco set fees. Pet. 21-24. In particular, they argue that because a person is a fiduciary only "to the extent" that he exercises prescribed authority, see 29 U.S.C. 1002(21)(A); 29 C.F.R. 2509.75-8, FR-16, Goldstein is a fiduciary only to the extent that he personally set Medco's fees in each and every instance in which Medco collected a fee. Pet. 22. Petitioners then argue that Goldstein's admission that he set fees for Medco is ambiguous as to when he set them. Pet. 23-24.

There is no ambiguity as to Goldstein's admission or uncertainty as to his liability as a fiduciary. Goldstein was the President of Medco from its inception until March 1996. Pet. App. 7a n.5. His admission that he set fees "at that time," see Pet. 23, is most naturally read as an admission that he set fees during the time he was

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of appeals' decision, "plan assets" could include a fee that an employer pays to its attorney for settling a claim for contributions brought by an ERISA plan. Pet. 21. ERISA permits a contributing employer to pay its attorneys for services rendered to the employer. ERISA also permits a plan to pay service providers, including attorneys, a reasonable fee for their services to the plan. See 29 U.S.C. 1108(b)(2). ERISA does not permit an attorney to do what petitioners did here: solicit employers for the plan, then represent the employers, and then engage in self-dealing by deducting fees from the employers' contributions to the plan without disclosing the amount of those fees to either the plan or the employers. See also *In re Consolidated Welfare Fund ERISA Litig.*, 839 F. Supp. 1068, 1073 (S.D.N.Y. 1993) (defendant's "scheme of funnelling employer contributions to the Fund through his wholly owned companies and deducting 'commissions' before those contributions were paid to the Fund, violates the very essence of trust law").

President. Petitioners present nothing to suggest that anyone else set fees or had the authority to do so during that period. Moreover, Goldstein would be liable even if he did not personally set fees in each and every case, because he knew of Medco's breaches and either enabled Medco to commit them or failed to remedy them. See 29 U.S.C. 1105(a)(2), (3); 29 C.F.R. 2509.75-8, FR 16; Pet. App. 26a-27a. Goldstein also retained indirect control over Medco after March 1996. See Pet. App. 7a n.5 (present President of Medco is Goldstein's brother, and the only shareholders of Medco are Goldstein's spouse and sister-in-law). Further review of petitioners' factbound contentions concerning Goldstein's status as a fiduciary with respect to each of Medco's fees is therefore not warranted.

4. Finally, petitioners argue that the grant of a permanent injunction against petitioner Goldstein, prohibiting him from serving as a fiduciary or service provider to an ERISA plan, deviates so far from the remedies allowed under ERISA as to call for an exercise of this Court's supervisory power. Pet. 26-27.[5] Petitioners do not dispute that a permanent injunction is available under ERISA. Instead, they argue that such an injunction is available only when a defendant's conduct is "egregious," and that Goldstein's conduct did not satisfy that standard. *Ibid.*[6]

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[5] Petitioners also argue (Pet. 25-26) that the court of appeals deviated from summary judgment standards. Petitioners' argument is simply a renewal of their meritless attempt to establish rights to their service fees under the Authorization of Collective Bargaining Representative document and Associate Membership Agreements.

[6] Petitioners complain that the injunction should not have been issued without a hearing because material facts were in dispute. Pet. 26-27. For reasons discussed in text, material facts con-

Neither of petitioners' arguments is accurate. The courts of appeals have recognized that an individual may be permanently enjoined from acting as a fiduciary or service provider because of ERISA violations that are "significant," *Reich* v. *Lancaster*, 55 F.3d 1034, 1054 (5th Cir. 1995), or "serious," *Beck* v. *Levering*, 947 F.2d 639, 641 (2d Cir. 1991), cert. denied, 504 U.S. 909 (1992). See also *Martin* v. *Feilen*, 965 F.2d 660, 673 (8th Cir. 1992) (abuse of discretion not to enjoin defendant who engaged in "actionable self-dealing" and "displayed an appalling insensitivity" to ERISA requirements), cert. denied, 506 U.S. 1054 (1993). Petitioner Goldstein committed serious and significant violations of ERISA, depriving a health care plan of $9,525,493.16 through a pattern of self dealing that continued even after the Secretary sued to stop them. Goldstein's violations would also meet an "egregious" standard because they were intentional and demonstrate a continuing insensitivity to ERISA's requirements. Accordingly, a permanent injunction was appropriate.[7]

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cerning petitioner Goldstein's conduct were not in dispute. Granting an injunction at the summary judgment stage was therefore appropriate. See 10B Charles Alan Wright et al., *Federal Practice and Procedure* § 2731, at 94-95 (3d ed. 1998).

[7] Petitioners inaccurately assert (Pet. 27) that the Department's consent judgments with other defendants do not provide for the kind of permanent injunction that the Department obtained against petitioner Goldstein. The two defendants who, like petitioners, solicited employers for participation in the Fund (Philip Vero and Associated Members Administrative Services, Inc.) consented to such an injunction. C.A. App. 1641, 1645-1646. The other defendants, including the Fund's trustees, were not shown to have engaged in self-dealing comparable to that of petitioners. They were not enjoined from serving as fiduciaries or service providers, but they were enjoined from future ERISA violations and from entering into agreements that would result in the Fund

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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or an employer paying money to entities, including petitioner Medco, unless such payments complied with ERISA. C.A. App. 1631, 1635-1636.