ASPECTS FIDUCIARY LIABILITY UNDER ERISA

To what extent is an ERISA fiduciary liable for injury to a plan or its participants resulting from a breach of duty? The obvious answer is that under ERISA § 409 (29 U.S.C. § 1109) a fiduciary is personally liable for any plan losses resulting from his or her breach of duty.[1] But quite frequently, there are many finger prints on the body and sorting out culpability can be difficult. Matters get messier when the "Jekyll & Hyde" theory of fiduciary responsibility (also known as the "two hats" theory) and/or delegation of duties get added to the mix.[2] Given that no one person or entity performs all functions related to an employee benefit plan, the question of who bears ultimate responsibility when something goes wrong should concern every fiduciary.[3]

Scope of ERISA fiduciary status: General Overview

In the first instance, ERISA "reserves fiduciary liability for 'named fiduciaries' defined either as those individuals listed as fiduciaries in the plan documents or those who are otherwise identified as fiduciaries pursuant to a plan specified procedure." (29 USC § 1102(a)(2).[4] ERISA also extends fiduciary liability to "functional fiduciaries”.[5] A person is a functional fiduciary to the extent that (1) he or she exercises discretionary authority or control over the management of the plan, or any authority or control over plan assets; (2) he or she exercises discretionary authority or control over plan administration; or (3) he or she renders investment advice for a fee or other compensation. ERISA §3(21)(A).

Fiduciaries are assigned a number of detailed duties and responsibilities, which "include the proper management, administration and investment of plan assets, the maintenance of proper records, disclosure of specified information and the avoidance of conflicts of interest.”[6] A common explanation for the functional approach to fiduciary status is that Congress intended the term fiduciary to be broadly construed.[7] Some courts

[1] Section 404 identifies the basic duties of an ERISA fiduciary. "In general terms, fiduciary responsibility under ERISA is simply stated. The statute provides that fiduciaries shall discharge their duties with respect to a plan "solely in the interest of the participants and beneficiaries," 29 U.S. C. § 1104(a)(1) that is, "for the fiduciary must act in the sole and exclusive interest of the plan and exclusive purpose of (i) providing benefits to participants and their beneficiaries; and (ii) defraying reasonable expenses of administering the plan," 29 U.S.C. § l104(a)(l)(A)." *Pegram* v. *Herdrich,* 530 U.S. 211, 223-224 (2000).

[2] The "two hat" theory is apparently a creature of ERISA common law. There are no statutory provisions delineating this distinction. However, it is well settled now that when a fiduciary acts in his or her capacity as the settlor of a trust then ERISA's fiduciary obligations are not applicable. *Beck* v. *PACE Intern. Union,* 551 U.S. 96, 101 (2007). *Beck* is an interesting case because it demonstrates the difficulty of drawing the line between fiduciary and non-fiduciary acts. Though a decision may fall squarely in the camp of a settlor's discretion, the implementation of the decision will trigger fiduciary obligations if there are options available.

[3] This is certainly the case when dealing with an employee pension plan. In the welfare benefit plan context, there are instances where one entity assumes

[4] *Beddall* v. *State Street Bank & Trust,* 137 F. 3d 12, 18 (l st Cir. 1998).

[5] *Ince* v, *Aetna Health Management, Inc.,* 173 F. 3d 672, 674 (8th Cir. 1999); e.g. *Beddall,* 137 F. 3d at 18.

[6] *Mertens v. Hewitt Associates,* 508 U.S. 248, 253, 113 S. Ct. 2063 (1993).

[7] *Haddock v. Nationwide Financial Services,* 419 F. Supp. 2d 156, 164 (D. Conn.

have interpreted the functional definition of fiduciary status as the primary test and noted that formal titles are not dispositive of fiduciary status.[8] In *Beddall,* the First Circuit noted that "because fiduciary responsibility under ERISA is directly and solely attributable to his possession or exercise of discretionary authority, fiduciary liability arises in specific increments correlated to the vesting or performance of particular fiduciary functions in service of the plan, not in broad, general terms." 137 F. 3d at 18.[9] In stating this proposition about fiduciary liability, the *Beddall* court did not distinguish between named and functional fiduciaries. In effect, this seems to mean that the named fiduciaries are treated the same as functional fiduciaries for purposes of assessing liability.

Limiting liability to "vesting or performance" of particular fiduciary functions (i.e. to the extent the person functions as fiduciary) can cause some difficulty (or relief) when it is unclear who breached a duty that injured the plan or whether a fiduciary was sufficiently involved in the breach. There are also circumstances when we know who breached the duty but the fiduciary is financially unable to make the plan whole. Under such circumstances, who should (if anyone) make good the plan's losses? Plan participants frequently look to the named fiduciaries as parties financially responsible for the alleged breach and just as frequently they run into the rule that limits liability "to the extent" of a fiduciary's role or function in service to the plan.

If named fiduciaries are treated as functional fiduciaries for purposes of assessing liability, does this create the risk of an unintended gap in fiduciary responsibility? Or do the named fiduciaries remain responsible as a last resort? This would not be the first time that ERISA and case law interpreting the statute resulted in a "gap". ERISA's remedial scheme (as interpreted by the Supreme Court and lower courts) is a frequent target of criticism because Section 502(a)(3) has been interpreted to exclude most if not all forms of monetary relief.[10] Perhaps this feared gap is more fiction than reality. One way to

---

2006)(citing *Blatt v. Marshall & Lassman,* 812 F. 2d 810, 812 (2nd Cir. 1987);

[8] *Haddock"* 419 F. Supp. 2d at 164. *Haddock* cites *Mertens v. Hewitt Associates,* 508 U.S. at 262 for the proposition that the functional definition of fiduciary is the primary concept and that "formal titles" are secondary.

[9] *Livick v. The Gillette Company,* 524 F. 3d 24, 29 (1 st Cir. 2008); *Briscoe v. Fine,* 444 F. 3d 478, 486 (6th Cir. 2006)(observing that several courts have focused on the phrase "to the extent" in holding that "fiduciary status ... is not an all or nothing concept" and that they must therefore "ask whether a person is a fiduciary with respect to the particular activity in question.")(ellipsis in original); *F.H Krear & Co. v. Nineteen Named Trustees,* 810 F. 2d 1250, 1259 (2nd Cir. 1987)("A person maybe an ERISA fiduciary with respect to certain matters but not to others, for he has that status only "to the extent" that he has or exercises the described authority or responsibility.") In *Livick,* the court did not distinguish between named fiduciaries and functional fiduciaries (i.e. persons who are fiduciaries by virtue of performing one of the specified functions. Instead, *Livick* treated all fiduciaries (whether functional or named) as "functional fiduciaries." A person is a fiduciary to the extent they perform one of the defined functions.

[10] See, Langbien, <u>What ERISA Means By Equitable: The Supreme Court's Trail of Error in Russell, Mertens and Great-West</u>, 103 Colum. Law Rev. 1317 (2003). Two salient examples of this remedial gap come to mind. There is split in authority concerning interpretation of Section 502(a)(I)(B). Some court hold that benefit claims based on statutory violations (i.e. a plan provision that violates a substantive ERISA protection) are not 502(a)(I)(B) claims nor are they claims under 502(a)(3). These courts reason that

tackle this question is to examine the areas that might give rise to a gap in fiduciary coverage. The following are just a few examples that show up with relative frequency in ERISA fiduciary litigation.

Thy Brother and Sister's Keeper

The troublesome co-fiduciary is a good place to start our analysis. What responsibility does a named fiduciary (or for that matter any other fiduciary) have for the conduct of a co-fiduciary?[11] ERISA Section 405 provides considerable guidance on allocating liability for a co-fiduciary's breach of duty. Section 405(a) provides that in addition to any liability which he may have under any other provision of this part, a fiduciary with respect to a plan shall be liable for a breach of fiduciary responsibility of another fiduciary with respect to the same plan in the following circumstances:

> (1) if he participates knowingly in, or knowingly undertakes to conceal, an act or omission of such other fiduciary, knowing such act or omission is a breach;
>
> (2) if, by his failure to comply with section 1104(a)(l) of this title in the administration of his specific responsibilities which give rise to his status as a fiduciary, he has enabled such other fiduciary to commit a breach; or
>
> (3) if he has knowledge of a breach by such other fiduciary, unless he makes reasonable efforts under the circumstances to remedy the breach.[12]

Section 502(a)(1)(B) provides relief for participants denied benefits under the terms of the plan and Section 502(a)(3) only provides for equitable relief. Assuming that plan benefits constitute monetary relief, the participant is deprived of relief in the form of plan benefits. *Contra,* West v. AK Steel, 484 F. 3d 395 (6th Cir. *2007), cert. denied,* 129 S. Ct. 895 (2009); Fenwick v. Merrill Lynch & Co., Inc., 2009 WL 426464 (D. Conn., Feb. 20, 2009); Bilello v. lPMorgan Chase Retirement Plan, 592 F. Supp. 2d 654 (S.D.N.Y. 2009)(collecting cases supporting the proposition that participants claim ing that benefits were denied as a result of an unlawful plan provision can assert claims for benefits under 502(a)(1)(B)).

[11] Though the conduct a co-fiduciary may give rise to liability, courts are split on the question of whether a fiduciary can seek contribution from the breaching co-fiduciary. For cases rejectin~ the right of contribution from other co-fiduciaries. *Kim* v. *Fujikawa,* 871 F. 2d 1427, 1432-33 (9t Cir. 1989) and *Travelers Cas. and Sur. Co. of American* v. *IADA Services,* 497 F. 3d 862 (8th Cir. 2007). These cases generally rely on the fact that ERISA's remedial scheme does not provide for contribution. Section 410 prohibits any agreement that would relieve a fiduciary of liability or responsibility for a breach of duty. For cases supporting that right of contribution see *Chemung Canal Trust Co.* v. *Sovran Bank/Maryland,* 939 F. 2d 12, 18 (2nd Cir. 1991); *Haddock* v. *Nationwide Financial Services, Inc.,* 570 F. Supp. 2d 355 (D. Conn. 2008); *Trustee of the Auto Mechanics Local No. 701 Pension & Welfare Funds* v. *Union Bank of California,* 630 F. Supp. 2d 951 (N.D. Ill. 2009).

[12] This section does not impose vicarious liability-it requires actual knowledge by the co-fiduciary. *Banks* v. *Healthways, Inc.,* 2009 WL 211137 (M.D. Tenn. Jan. 28, 2009). Moreover, co-fiduciary liability presupposes a breach of duty by the co-fiduciary. *Id.* * 6; *In Re Dell Inc. ERISA Litigation,* 563 F. Supp. 2d 681, 695 (W.D. Tex. 2008).

A fiduciary under ERISA is strongly encouraged, as a means of avoiding personal liability, to take steps to remedy perceived improprieties in plan operations.[13] That is, an ERISA fiduciary "may not avoid liability for mismanagement by simply doing nothing." 1 Ronald J. Cooke, *ERISA Practice and Procedure,* § 6:11, at 6-126 (2d ed.2004); *Nicolau* v. *Horizon Media, Inc.,* 402 F. 3d 325, 331 (2nd Cir. 2005)(J. Pooler's concurring opinion).

It's fairly obvious that a fiduciary cannot knowingly conceal a co- fiduciary's breach of duty or that knowing a breach has occurred simply ignore it.[14] The harder question is whether a fiduciary has a duty to monitor the conduct of a co-fiduciary and, more importantly, what does such a duty entail. There are two general categories the co-fiduciaries can fall into: (a) a co-fiduciary appointed by another fiduciary and (b) a co-fiduciary who is named fiduciary or otherwise appointed under the terms of the plan.

Courts have routinely found that a fiduciary has an obligation to monitor the conduct of a co-fiduciary they appointed or to whom they delegated duties.[15] As one court recently observed, "an appointing fiduciary has an ongoing duty to monitor its fiduciary appointees." *Banks* v. *Healthways, Inc.,* 2009 WL 211137, * 6 (M.D. Ten. Jan. 28, 2009); *In Ferro Corp. ERISA Litigation,* 422 F. Supp. 2d 850, 863 (N.D. Ohio 2006). The duty to monitor appointed fiduciaries also includes the duty to provide them "with the information necessary to carry out their responsibilities." Though there are not many cases discussing the scope of the duty to provide information" to a co-fiduciary, it normally arises the context of eligible individual account plan cases (i.e. ESOPs or

---

[13] Since co-fiduciary liability is joint and several liability and fiduciaries are personally liable for breaches of duty, this is sound advice. *Leister* v. *Dovetail, Inc.* 546 F. 3d 875 (7th Cir. 2008); *La Scala* v *Scrufari,* 479 F. 3d 213, 220 (2nd Cir. 2007).

[14] A fiduciary under ERISA turns a blind eye to improprieties at her great peril. *Stewart* v. *Thorpe Holding Co. Profit Sharing Plan,* 207 F. 3d 1143, 1157 (9th Cir. 2000)(holding exhusband who was also fiduciary of an ERISA plan had obligation to inform ex-wife that the divorce decree was arguably not a qualified domestic relations order and that co-fiduciaries who were also aware of the QDRO problem had an affirmative duty to prevent the ex-husband from breaching his fiduciary duties).

[15] *See, Willet* v. *Blue Cross & Blue Shield,* 953 F. 2d 1335, 1340-41 (11th Cir. 1992); L.I. Head Start v. Economic Opportunity Commission of Nassau County, 2009 WL 1990423, * 6 (E.D.N.Y. July 8, 2009)(even where a delegation of authority is made, a plan fiduciary may still be liable for known violations by a co-fiduciary and is charged with a certain duty to monitor the activities of its delegates); *Harris* v. *Koenig,* 602 F. Supp. 2d 39, 60 (D.D.C. 2009)(observing that "the power to appoint and remove trustees carries with it the concomitant duty to monitor those trustees' performance."); *In Re Ford Motor Co. ERISA Litigation,* 590 F. Supp. 2d 883, 919 (E.D. Mich. *2008); Baker* v. *Kingsley,* 387 F. 3d 649, 663-64 (7th Cir. 2004)(noting that with the power to appoint comes the duty to take reasonable and prudent steps to ensure that the appointed cofiduciary was fulfilling their fiduciary obligations); *In Re Polaroid ERISA Litigation,* 362 F. Supp. 2d 461, 477 (S.D.N.Y. 2005)("An appointing fiduciary's duty to monitor his appointees is well established."); *Stanford* v. *Foamex L.P.,* 2009 WL 3075390 * (E.D. Pa. Sept. 24, 2009)(noting that on duty of prudence and reasonable care is the duty to monitor other plan fiduciaries); *See,* 29 C.F.R. § 2509.75-8, FR-17 ("At reasonable intervals the performance of trustees and other fiduciaries should be reviewed by appointing fiduciaries ... ").

company stock funds). When raised in such context, the claim is that the appointing fiduciary (usually the board of directors) had an obligation to disclose material adverse information about the company's financial condition to the investment or plan administrative committees.[16]

The seminal case in applying the duty to monitor appointees is *Leigh* v. *Engle,* 727 F. 2d 113 (7th Cir. 1984). In *Leigh,* the Seventh Circuit found that under ERISA an appointing authority is a fiduciary to the extent of the appointment power and had a corresponding "duty to monitor appropriately the administrator's actions." In this respect, the court was following the Department of Labor's guidance. The court further noted that the appointing fiduciaries could not abdicate their responsibilities toward the plan "merely through the device of giving their primary lieutenants primary responsibility for day to day management of the trust." The court in *Leigh* suggested that the amount and degree of oversight may depend on the relationship between the appointing and appointed fiduciaries. In *Leigh,* the court found it significant that the appointed fiduciaries were close business associates of the appointing fiduciaries. Because of such relationship, the appointing fiduciaries should have known or suspected potential conflicts of interests and accordingly monitor the appointed fiduciaries activities. The important point is that a fiduciary cannot ignore information at his or her disposal when discharging their duties, even if their duties to the plan are narrow and limited.

The duty to monitor is a natural extension of the duty to appoint and remove plan fiduciaries. *Lingis* v. *Motorola,* 2009 WL 1708097 (N.D. Ill. June 17, 2009).[17] According to the Department of Labor, an appointing fiduciary should periodically review performance:

> At reasonable intervals the performance of trustees and other fiduciaries should be reviewed by the appointing fiduciary in such manner as may be reasonably expected to ensure that their

---

[16] *Brieger* v. *Tellabs,* 629 F. Supp. 2d 848, 867 (N.D. III. 2009). This aspect of the duty to monitor raises the question of whether inside directors with the power to appoint and removal fiduciaries have an obligation to disclose adverse information about the company to the fiduciaries they appoint. There is an interesting interplay between laws governing securities and ERISA that arises from the duty to provide information to appointed fiduciaries. In *Brieger,* the court rejected the "securities laws" defense on the grounds that adopting such reasoning "would essentially permit a fiduciary to violate his or her ERISA duties under the guise of complying with another statute when other options exist." *ld.* 865. Additionally, the district court in *Lingis* v. *Motorola,* infra, questioned whether such an obligation to provide information existed because the appointed fiduciaries would not have to disclose the information to participants under ERISA. *ld.* at * 18. This reasoning is not particularly persuasive because the appointed fiduciary (though not necessarily required to disclose information other than the information identified in Title I of ERISA) cannot ignore information that adversely impacts the plan.

[17] *In Re WorldCom Inc.,* 263 F. Supp. 2d 745,760-761 (S.D.N.Y 2003) rejecting the proposition that the power to appoint and removal imposes fiduciary status and thus any duty to monitor. The court in WoridCom noted that the Department of Labor's guidance about monitoring was directed to persons who were already ERISA fiduciaries. Most courts have rejected this approach and adopted the view that the power to appoint and removal confers ERISA fiduciary status.

> performance has been in compliance with the terms of the plan and statutory standards, and satisfies the needs of the plan.
> 29 C.F.R. § 2509.75-8.

Very few cases discuss the scope and frequency of required performance reviews. In *Coyne* & *Delaney* v. *Selman,* 98 F. 3d 1457 n. 10 (4th Cir. 1996), the court observed that the duty to monitor does not mean that the responsibility to monitor appointees exposes the appointing fiduciary to open-ended liability. "On the contrary, courts have properly taken a restrictive view of the scope of this duty and its attendant potential for liability." *Id.* Unfortunately, the court in *Coyne* & *Delaney* did not provide any further guidance as to the contours of this restrictive view.

The most recent discussion of the scope of the duty to monitor is found in *Lingis* v. *Motorola,* 2009 WL 1708097 (N.D. Ill. June 17, 2009). The court initially agreed that the duty to appoint and remove confers ERISA fiduciary status. Since such power normally rests with a company's board of directors, it explains why directors frequently find themselves at the center of ERISA fiduciary litigation. In *Lingis,* the court noted that though the board of directors had a duty to monitor, the scope of the duty did not entail monitoring whether the Motorola Stock Fund was a prudent investment. *Id.* at * 17. Rather, the court observed that under the Department of Labor regulation cited above fiduciaries can comply with the duty to monitor by reviewing the appointed fiduciaries' performance "at reasonable intervals" and not the Stock fund. "Beyond this review, as the Seventh Circuit has stated, one with the authority to appoint and remove fiduciaries is 'not obligated to examine every action taken by [the fiduciary]' *Liegh,* 727 F. 2d at 135." *!d.*

With respect to the review undertaken by Motorola's directors, the court found that annual review of performance of the investment committee fiduciaries (i.e. the appointed fiduciaries) and retaining an outside auditing firm to review the fund's overall performance was sufficient to adequately discharge their duty to monitor. The court acknowledged that there maybe circumstances requiring more frequent and extensive performance reviews. But in the absence of specific circumstances warranting such action the court was clearly not inclined to expand the nature and scope of performance reviews, nor did it believe that ERISA required more extensive review under the facts presented. Indeed, the court observed the following:

> Here, however, members of the Board who were tasked with appointing-and, if necessary, removing-members of the Committee were not required to monitor the prudence of the individual investments offered under the Plan. Such a broad duty to monitor would undermine the entire rationale of creating a specialized committee tasked with determining what investments should be offered under the Plan. Plaintiffs effectively suggest that the entire board of one of the world's largest telecommunications company was required not only to monitor the competence and overall performance of its 40 I (k) committee, but also to monitor the committee's individual decisions. Plaintiffs' proposed rule would defeat the efficiency gains corporate boards routinely achieve by delegating primary responsibility for particular functions to specialized committees.

Though the limitation the *Lingis* court imposed on the duty to monitor (i.e. no duty to look at the actual investments) seems to strike the right balance, drawing such a bright line undercuts the court's earlier observation that the scope of the duty should be tailored to the facts. For example, in the context of 401k or ESOP litigation over the prudence of offering company stock as an investment option, can fiduciaries evaluating performance of other fiduciaries ignore what they know about the company's financial condition? Assuming they know that investing in company stock is imprudent, then how can they meaningfully evaluate the performance of the investment committee without taking into account such knowledge? Is it reasonable for the evaluating fiduciary to give a positive review of the investment committee when he or she knows that the committee is unknowingly allowing employees or the ESOP to make and hold imprudent investments? Arguably, the appointing fiduciary with knowledge about the harm being caused to plan participants must take into account such knowledge when evaluating the performance of fiduciaries with direct responsibility over investment or at a minimum communicate such knowledge to the appointed fiduciaries. As noted above, a fiduciary runs a great risk of personal liability if he or she ignores relevant and material information when performing duties in service to the plan.

Johnson v. *Couturier,* 572 F. 3d 1067 (9th Cir. 2009) is an interesting and illustrative example of fiduciaries allowing a co-fiduciary to indirectly injure an ESOP. The case arose when members of the board of directors authorized excessive compensation for executives. At one point, the valuation of one executive's overall compensation package equaled approximately 65 percent of the company's assets. *Id.* 1074. The executives argued that they were not (l) ERISA fiduciaries of the ESOP and (2) that the setting of executive compensation is a business decision not subject to ERISA.[18] On the fiduciary issue, the court noted that the defendants were trustees of the

[18] A third issue in the case of some importance to ERISA fiduciaries concerned indemnification and advancement of litigation expenses. Section 410 prohibits any arrangement which purports to relieve a fiduciary from responsibility or liability for any responsibility, obligation or duty under ERISA's fiduciary provisions. The court noted that Section 410 does not preclude the purchase of liability insurance by a plan, fiduciary or employer. *Id.* at 1080. Though a plan may pay insurance premiums, the exemption does not extend to indemnification of a fiduciary or advancement of legal costs by the ERISA plan itself. *Id.* In *Johnson* v. *Couturier,* the court affirmed the trial court's preliminary injunction precluding advancement of legal costs because the even though the agreement was with the corporation, the corporation was being liquidated and any monies diverted to pay legal expenses would reduce the amount available to ESOP plan participants. *Id.* at 1080; *but cf State Street Bank & Trust* v. *Salovaara,* 326 F. 3d 130 (2nd Cir. 1996)(holding that "the indemnification of a fiduciary by a plan is clearly permitted by ERISA pursuant to the plain language of Section 408(c)"). For further discussion of the scope of Section 410 see *Pfahler* v. *National Latex Products,* 517 F. 3d 816 (6th Cir. 2007); *Srein* v. *Soft Drink Workers Union, Local* 812, 93 F. 3d 1088 (2nd Cir. 1996)(observing the indemnification in a settlement agreement involving an ERISA fiduciary did not likely violate Section 4 I 0); *Packer Engineering* v. *Kratville,* 965 F. 2d 174 (7th Cir. 1992)(ERISA did not void provision in pension plan allowing indemnification of fiduciary who has been absolved from wrongdoing); *u.s. SEC* v. *AA Capital Partners,* 2009 WL 1543809 (N.D. III. June 02, 2009)(denying motion for advancement of legal costs because the likelihood that such advancement violates Section 410 but requiring fund to create a reserve to reimburse costs in the event fiduciaries are exonerated).

ESOP during relevant time periods and also that, if there was a question about any of the defendants service as an ESOP trustee, as members of the board of directors they had the power to appoint and remove ESOP fiduciaries which, in turn, made them ERISA fiduciaries. *Id.* at 1076.

On the second question, the court noted that decisions relating to corporate salaries generally do not fall within ERISA's purview. *Id.* at 1077. However, where plan assets include employer stock, the value of the assets depends on employer's equity. The court noted that "employee compensation levels are, of course, one of the many business expenditures reducing the value of the overall equity of any company. On the other hand, virtually all of an employer's significant business decisions affect the value of its stock, and therefore the benefits that ESOP plan participants will ultimately receive." *Id.* Taken to its logical conclusion, this line of thinking would (in the case of an ESOP) "extend the application of ERISA to a corporation's annual expenditures on office supplies-clearly an absurd result." *Id.* The court then observed that such reasoning led the Eighth Circuit to limit an "ERISA's fiduciary duties to transactions that involve investing the ESOP's assets or administering the plan. Setting executive compensation levels does not obviously fall into either category." *!d.*

Notwithstanding these cautionary notes, the court found that applying ERISA to the facts before it, did not "risk encompassing within its confines any and all day-to-day corporate decisions shielded by the business judgment rule." *Id.* The court noted that the plaintiffs would likely prevail on the claim that the defendant directors breached their ERISA fiduciary duties when they approved the executive compensation package at issue. *Id.* The package substantially diluted the value of the ESOP's assets and lacked a reasonable basis. The court observed that requiring the directors to honor their duties to the ESOP when deciding executive compensation did not risk expanding ERISA fiduciary duties to day-to-day business decisions because "[w]here, as here, an ESOP fiduciary also serves as a corporate director or officer, imposing ERISA duties on business decisions from which that individual could directly profit does not seem [to be] an unworkable rule." *!d.* at 1077; *see Fernandez v. K-M Industries Holding, Inc., 2009* WL 3579643, * 5 (N.D. Cal. Aug. 21, 2009)(extending *Johnson* to situation where company was not liquidating but the annual valuation of a closely held company's shares would be affected by indemnification and thus reduce the value of the ESOP's shares);

The *Johnson* court justifies extending ERISA's fiduciary obligations to compensation decisions where the directors/fiduciaries personally profited on the grounds that such conduct amounts to self dealing by the fiduciaries; conduct that ERISA would never sanction. A couple observations come to mind: first, liability was not limited to the director/fiduciary profiting from the compensation package. Several directors who did not personally profit from the package are also potentially liable under ERISA for the decision. Indeed, the only manageable rule under *Johnson's* rationale is one that holds all directors/fiduciaries who caused the corporation to enter into the transaction subject to liability.[19] The rule can still require that at least one ESOP fiduciary personally profited

[19] One way to limit liability to just the profiting director (and not any director/fiduciary who merely voted for the transaction) is to impose the requirement that ERISA plaintiffs challenging a compensation decision must establish that the profiting director dominated the board. But even such a restriction cannot escape the fact that ERISA fiduciaries have an obligation to exercise independent judgment in the sole interest of the plan and its

from the business decision. Moreover, even if the profiting director owned a sufficient number of shares to control the outcome, as co-fiduciaries on the ESOP, they arguably had a duty to take steps to prevent board from adopting the compensation package.

Second, the *Johnson* opinion does not seem limited to directors who were also named fiduciaries. Nor was there any discussion about the scope of ERISA fiduciary duty and whether actual ERISA fiduciary duties relate to or overlap with duties owed to corporation. Does the mere fact that the defendant was a fiduciary to the ESOP by virtue of the power to appoint and remove ESOP fiduciaries require the defendant *qua* director to protect the plan from excessive compensation awards? Under *Johnson* the answer seems to be a tentative "yes." Otherwise, the opinion's reference to a director's power to appoint and remove fiduciaries as conferring ERISA fiduciary status is a *non sequitur*. It seems that the purpose of this observation was that one defendant argued that he was never appointed or acted as ESOP fiduciary and, though this was contested, it would not matter since he undisputedly served as a corporate director and had the power to appoint and remove ESOP fiduciaries. Thus, the rule articulated in *Johnson* opinion apparently reaches every director on the board to the extent ESOP fiduciaries are appointed and/or subject to removal by the board.

The third and final point is that there seems to be no principled reason for limiting the rule articulated in *Johnson* to executive compensation. The duty of loyalty (i.e. no self dealing) is one of several duties imposed on an ERISA fiduciary and is the most likely duty implicated when setting executive compensation. However, imprudent decisions can frequently harm an ESOP *qua* shareholder to a greater degree than questionable compensation awards. Moreover, as noted above, self dealing alone does not explain why the directors who did not profit from the compensation package are held to account for their decision. In this connection, it seems that the non-profiting directors acted imprudently when they authorized the excessive or "self dealing" compensation of a co-director/fiduciary.

It remains to be seen if the holding in *Johnson* extends to decisions other than executive compensation. Given that the court seems principally concerned with a legal regime that authorizes review of ordinary decisions that the business judgment rule shields from scrutiny, the question will soon arise whether a business decision that the business judgment rule does not insulate from review constitutes a breach of ERISA fiduciary duties when the plan holds employer securities. Should the "business judgment" rule set a <u>floor</u> in the context of ESOP fiduciary litigation over business decisions that injure the plan's assets? In other words, if a decision is not shielded from review by the "business judgment rule", is such business decision the type or kind that automatically triggers liability under ERISA based on employer securities forming part of the plan's assets? Of course, for decisions directly related to the plan, the business judgment rule would have no application.[20]

---

participants. A fiduciary/director that acquiesces to another's breach of duty (even if out of fear) is still liable under Section 405 (i.e. co-fiduciary provisions).

[20] *See, Howardv. Shay,* 100 F. 3d 1484, 1489 (9th Cir. 1996)(noting that the business judgment rule (a corporate law doctrine) than prudent man standard (a trust law doctrine) and that the later is a more demanding standard. Under the prudent man standard, an

The above discussion was premised on the general principle that fiduciary liability arises from the power to appoint and/or remove a plan fiduciary. Once a person is deemed a fiduciary because of such power, they have a duty to monitor the performance of the appointed fiduciaries. This duty to monitor directly arises from the power to appoint but is also related to Section 405's co-fiduciary obligations. If a breach is made possible because the appointing fiduciary did nothing to monitor the appointed fiduciary's performance, then liability can result under Section 405(a)(2).[21]

The situation is a bit less clear when a fiduciary did not appoint nor has the power to remove a co-fiduciary. Section 405(a)(1) and (a)(3) speak to scenarios where a fiduciary either directly participated or concealed a breach and/or learned of a breach but did not take reasonable steps under the circumstances to remedy the breach. In both cases, liability is premised on knowledge of a breach. Neither Section 405(a)(1) or (a)(3) require a fiduciary to use reasonable care to prevent another's breach of duty. Section 405(a)(2) seems directed at circumstances where a fiduciary (by breaching their specific duties) enables another fiduciary to commit a breach (i.e. presents the co-fiduciary with an opportunity). A close reading of all three provisions does not reveal an express textual requirement that ERISA fiduciaries have an obligation to exercise reasonable care to prevent a co-fiduciary from breaching a duty.

Some courts, however, have read Section 405(a) as imposing an "affirmative duty" to prevent a co-fiduciary breach. In *Stewart* v. *Thorpe Holding Co. Profit Sharing Plan,* 207 F. 3d 1143, 1157 (9th Cir. 2000), the court held that co-fiduciaries under Section 405(a) have an affirmative duty to prevent another from breaching his fiduciary duties. In *Stewart,* the defendants were all appointed to the pension plan's administrative committee. The defendants had knowledge that a co-fiduciary (also a participant in the plan) was subject to a qualified domestic relations order yet they took no steps to ensure compliance with the order. Citing *Donovan* v. *Walton,* 609 F. Supp. 1221, 1231 (S.D. Fla. 1985), the

---

ERISA fiduciary must adequately investigate before making a decision to sell the assets of an ESOP to a party in interest and that an "independent appraisal" is not a "magic wand to wave over a transaction to ensure that [fiduciary] responsibilities are fulfilled." *Id.).* Since the business judgment rule is more permissive than ERISA prudent care standard, a decision that is not shielded by the business judgment rule is *a fortiorari* imprudent under ERISA. *See, Sallis* v. *Couturier,* 2009 WL 3055207 * 4 (N.D. Cal. Sept. 17, 2009)(noting that the business judgment rule was not a defense to an alleged ERISA violation); *Hilton Hotels* v. *Dunnet,* 275 F. Supp. 2d 954 n. 1 (W.O. Tenn. 2002)(noting that the business judgment rule does not apply to ERISA fiduciary decisions).

[21] As noted above, Section 405(a)(2) (29 U.S.C. § 1105 (a)(2)) states that a fiduciary shall be liable for the breach of fiduciary responsibility of another fiduciary "if, by his failure, to comply with Section 404(a)(1)[i.e. exclusive benefit, prudent care etc.] in the administration of his specific responsibilities which give rise to his status as a fiduciary, he has enabled such other fiduciary to commit a breach." A fiduciary with the power to appoint and removal has an obligation to monitor performance and if he or she does not discharge that obligation with reasonable and prudent care and that failure enabled a co-fiduciary's breach, then the statute clearly imposes liability.

court found that defendants were liable under Section 405(a) because that section effectively imposes "on every ERISA fiduciary an affirmative duty to prevent other fiduciaries from breaching their duties for which they are jointly and severally liable."[22] *Stewart* is complicated by the fact that the co-fiduciaries had knowledge of the domestic relations order and yet took no steps to ensure compliance with ERISA. Arguably, this makes the co-fiduciaries liable under 405(a)(3) because they had knowledge of a breach and took no steps to remedy the situation.

The *Stewart* court's reliance on *Donovan* for the proposition that every fiduciary has an affirmative duty to prevent co-fiduciaries from breaching their duties is slightly misplaced. The question is not whether a fiduciary upon learning of a breach must take reasonable remedial steps but whether there is an affirmative duty to take reasonable steps to prevent a breach from occurring in the first place. The passage from *Donovan* articulating the "affirmative duty" principle states that under Section 405(a) and 405(b)(1) "trustees" have an affirmative duty to take reasonable care to prevent a co-trustee from committing a breach.

Under ERISA's scheme, trustees are fiduciaries who have exclusive control of the plan's assets.[23] Because trustees have control over a plan's assets, Section 405(b)(1) mandates (in a co-trustee set up) that each trustee use "reasonable care to prevent a co-trustee from committing a breach." This affirmative mandate, however, does not show up in the section establishing co-fiduciary liability with respect to all ERISA fiduciaries.

Directed Trustees or (Fiduciaries)

The above discussion concerning affirmative duties to prevent a co-fiduciary breach is a good segue into the topic of directed trustees. Directed trustee issues are central of much of the 401 k litigation involving ESOPs and/or Company Stock funds. As noted above, ERISA requires that all plan assets be held in trust by one or more trustees. ERISA § 11 02(a). The trustee or trustees must either be named in the trust instrument or in the plan instrument or appointed by a person who is a named fiduciary. *Id.* The trustee must accept the appointment and upon doing so has exclusive authority and discretion to manage and control the assets of the plan unless (a) the plan expressly provides that the trustee(s) are subject to the direction of a named fiduciary who is not a trustee or (b) authority to manage, acquire or dispose of plan assets is delegated to one or more investment managers. *See,* ERISA § 403(a); *Herman v. NationsBank Trust Company,* 126 F. 3d at 1362.

A named or appointed trustee has the highest degree of responsibility under ERISA absent applicability of one of the provisos listed above. This is unremarkable given that the trustee is the person responsible for holding and managing the plan's assets.

---

[22] *See, Solis* v. *Couturier,* 2009 WL 3055207 * 4 (N.D. Cal. Sept. 17, 2009)(citing *Stewart* for the proposition that "The Ninth Circuit has held that ERISA fiduciaries have "an affirmative duty to prevent other fiduciaries from breaching their duties for which they are jointly and severally liable."). The district court in *Solis* applies this obligation across the board to all fiduciaries and not just trustees.

[23] *See, Herman* v, *Nationsllank Trust Company (Georgia),* 126 F. 3d 1354, 1361 (11 th Cir. 1997) observing that ERISA provides that trustees usually shall have exclusive authority and control over plan assets.

However, it is not uncommon for a trustee with physical control of plan assets to work under the direction of non-trustee fiduciary or an investment manager. A trustee who acts under the direction of a named fiduciary or an investment manager is known as a "directed trustee." *Summers v. State Street Bank & Trust,* 453 F. 3d 404 (7th Cir. 2006).

What liability, if any, can a directed trustee incur for following the directions? The answer may depend on the party giving directions. The court in *Summers* noted that the split in authority over a directed trustees liability for following directions results for a "confusing statutory picture." *Id.* at 407. For example, Section 405(b)(3)(B) provides that a trustee shall not be held liable under subsection (b) for obeying the instructions of a named fiduciary pursuant to § 403(a)(l). However, as the court in *Summers* noted, the directed trustee is still subject to the co-fiduciary standards articulated in 405(a)(l). *Id.* Additionally, § 403(a)(l) provides that a trustee is only subject to "proper directions" which are made in accordance with the terms of the plan and not contrary to ERISA. *See, Tullis v. UMB Bank,* 2009 WL 2435084 * 7 (N.D. Ohio Aug. 11,2009).[24] As discussed below, most courts resolved this tension in the context of ESOP and/or Company Stock funds by adopting a "presumption of prudence" approach. Some courts, however, avoid the problem in its entirety by finding that the "directed trustee" is not a fiduciary under

---

[24] In *Summers* v. *State Street Bank & Trust,* the court noted the that statutory tension is reflected in the Department of Labor's own guidance on this issue and also suggest the solution to the internal conflict:

> The tension among these provistons IS reflected in a pamphlet published by the Labor Department's Employee Benefits Security Administration, which affirms both that the directed trustee has a duty of prudence and that he has no "direct obligation to determine the prudence of a transaction" entrusted by the plan to another fiduciary. "Fiduciary Responsibilities of Directed Trustees" (Field Assistance Bulletin 2004-03, Dec. 17, 2004). "[D]irect" is the critical word, inviting us to resolve the tension by ruling that the trustee can disobey the named fiduciary's directions when it is plain that they are imprudent. (The Labor Department's pamphlet, as we'll see, is actually consistent with this approach.) The trustee physically controls the trust assets; knowingly to invest them imprudently or let them remain invested imprudently is irresponsible behavior for a trustee, whose fundamental duty is to take as much care with the trust assets as he would take with his own property. He is "an agent who is required to treat his principal with utmost loyalty and care-treat him, indeed, as if the principal were *himself."Id.* at 406-407 (internal citations omitted).

The Seventh Circuit ends up with striking the same balance as the Third and Sixth Circuit's do with respect to a direct trustee's obligation in the ESOP context. *See, Maniace* v. *Commerce Bank of Kansas City,* 40 F. 3d 264, 268 (8th Cir. 1994)(observing that the obligations of a directed trustee are something less than that owed by typical fiduciaries and that a directed trustee was not required to weigh the merits of an investment in employer stock against all other investment options every time it was directed to purchase said stock by the Committee); *see also, Grindstaff* v. *Green,* 133 F. 3d 416, 431 (6th Cir. 1998) for a collection of early cases discussing the duties of a directed trustee. For the view that directed trustees cannot be held liable for following investment instructions of a named fiduciary see *Wright* v. *Oregon Metallurgical Corp.,* 360 F. 3d 1090, 1102 (9th Cir. 2004).

ERISA because the plan required them to follow instructions. According to these cases, a determination of whether instructions are proper and not contrary to ERISA does not involve a sufficient exercise of discretionary authority to confer fiduciary status.[25] The weakness in these cases is that the statute does not relive a "directed trustee" of the duty of prudence when following instructions of a non-trustee named fiduciary. Indeed, ERISA apparently draws a distinction between instructions received from a non-trustee named fiduciary (§ 403 (a)(1)) and an appointed investment manager (§ 403(a)(2)). First, with respect to instructions from an appointed investment manager, there is no proviso requiring the trustee to assess whether the instructions are proper and consistent with the Act. Second, the co-fiduciary liability provisions are also different. Section 405(b)(2)(B) states that a trustee is not liable under subsection (b) for instructions that comply with 403(a)(1)(i.e. proper directions from a non-trustee named fiduciary that are consistent with the Act). Section 405(d)(1) provides that a trustee is relieved of all liability under § 405(a)(2), (3) or (b) for the acts or omissions of an investment manager appointed under 402(c)(3) to invest and manage plan assets and that the trustee (under such circumstances) has no obligation to invest or manage any of the assets under the authority of the appointed investment manager. Thus, 405(a)(2)-(3) apply to instructions from a non-trustee named fiduciary but do not apply when an investment manager is making decisions. Though § 405(d)(1) does not speak about directions the trustee receives from an investment manager, a fair inference is that no liability can attach if the trustee executes directions from an investment manager.[26]

---

[25] In *Re Citigroup ERISA Litigation,* 2009 WL 2762708 (S.D.N.Y. Aug. 31, 2009), district court dismissed fiduciary duty claim based on the fact that the plan document required that the company stock fund permanently remain an investment option. The district court concluded that the fiduciaries had no authority to eliminate the company stock fund as an investment option. Court further found that the fiduciaries had no discretion to liquidate the plan's holdings of company stock in order to minimize losses. According to the court, the plan only allowed for liquidation of stock holdings for two purposes none of which involved minimizing losses. Finally, the district court rejected the claim that fiduciaries have an obligation to override the plan's terms under any circumstances. The district court rejected the "presumption of prudence" framework and adopted a bright line rule that allowing investments in company stock is never imprudent if the plan documents require such investment. *See, In Re Delphi Corp. Securities, Derivative & ERISA Litigation,* 602 F. Supp. 810, 821-22 (E.D. Mich. 2009)(citing several cases for the proposition that directed trustees lack control over the management of plan assets and thus are not fiduciaries for the purposes of investing monies); *but compare, In Re Ford Motor Co. ERISA Litigation,* 590 F. Supp. 2d 883, 917 (E.D. Mich. 2008)(observing that a plan document cannot relieve a directed trustee of the duty to follow only proper instructions which would only include prudent investments).

[26] Section 405(d)(I) reads as follows:

> If an investment manager or managers have been appointed under Section 402(c)(3), then, notwithstanding subsections (a)(2) and (3) and subsection (b), no trustee shall be liable for the acts or omissions of such investment manager or managers or be under an obligation to invest of otherwise manage any asset of the plan which is subject to the management of such investment manager.

Though on its face, Section 405(d)(1) does not discuss the obligation of a trustee to review instructions from an investment manager, a fair reading of this provision is that a trustee executing the instructions of such manager is relieved of all liability for such action. One could argue that §

In the context of ESOP litigation, many courts continue to apply the "presumption of prudence" as a way of resolving the tension between statutory provisions that relieve directed trustees (or for that matter directed fiduciaries) from liability for following directions and provisions that impose a duty of prudent and reasonable care. By way of background, the genesis of the "presumption of prudence" doctrine is commonly attributed to two cases: *Kuper* v. *lovenko,* 66 F. 3d 144 7 (6th Cir. 1995) and *Moench* v. *Robertson,* 62 F. 3d 553, 571-72 (3rd 1995). Under the "presumption of prudence" approach, a directed trustee or fiduciary will be presumed to act prudently when he or she executes directions to purchase and hold qualified employer securities as part of an ESOP. Plaintiffs can overcome the presumption of prudence by showing that stock had become so risky that the plan sponsors would not have intended continued investment or holding of such stock.[27] Courts adopting the presumption of prudence acknowledge that ERISA requires, under certain limited circumstances, that trustees and other fiduciaries disregard plan language or co-fiduciary directives to invest and/or hold employer securities.[28]

There is some dispute about the obligation of a trustee to override the terms of a plan when the plan "mandates" investment in employer securities. In *Moench,* the court was not confronted with a plan that "absolutely required" the trustee to invest in employer securities nor did it grant the trustee complete discretion. The plan language required the trustee to invest plan assets "primarily" but not exclusively in employer securities. 62 F. 3d at 567. The "presumption of prudence" standard was developed to address this specific

---

405(d)(1) operates under the assumption that investment managers will not turn to the trustee to execute directions but will simply make investment decisions without the aid of the trustee. Thus § 405(d)(I) could be read simply to relieve a trustee of liability from a party with control of assets of the plan. *See, Alfridi* v. *National City Bank,* 509 F. Supp. 2d 655, 664-65 (N.D. Ohio 2007)(noting that a directed trustee can be held liable to the participant if it executes instructions from an investment advisor that pose an apparent or discoverable conflict of interest).

[27] *Harzewski* v. *Guidant Corp.,* 489 F. 3d 799,808 (7th Cir. 2007)(rejecting the view that the holding in Summers exempts the trustee of an ESOP from liability for failing to dispose of stock of the employer. According to Posner, the court in *Summers* held that an ESOP trustee cannot be held liable for failing to second guess the market. However, an ESOP trustee can be held liable if plaintiffs can show that at a certain point in time the trustee knew that holding company stock was excessively risky such that it was imprudent to do so); *Kirschbaum v. Reliant Energy,* 526 F. 3d 243, 256 (5th Cir. 2008)(adopting the *Moench* presumption of prudence and holding that the presumption may only be rebutted if unforeseen circumstances would defeat or substantially impair the accomplishment of the trust's purposes).

[28] *See, Shirk v. Fifth Third Bancorp,* 2009 WL 692124 (S.D. Ohio, Jan. 29, 2009)(initially questioning whether "presumption of prudence" can override express plan instructions but not reaching the issue because facts did not rise to the level of rebutting the presumption);. *In Re Huntington Bancshares Inc. ERISA Litigation,* 620 F. Supp. 2d 842, 852 (S.D. Ohio 2009)(noting that a duty to investigate arises under the presumption of prudence standard only when "red flags" are apparent that continued investment is imprudent); *In Re Bausch & Lomb Inc., ERISA Litigation,* 2008 WL 5234281 (W.D.N.Y. Dec. 12, 2008)(applying the "presumption of prudence" standard and recognizing that it can require a trustee to countermand instructions to continue investing in employer securities); *In Re Syncor ERISA Litigation,* 516 F. 3d 1095, 1102 (9th Cir. 2008)(noting that an ESOP fiduciary cannot continue to hold or invest in company stock knowing that it is an imprudent investment); *but cf In Re Citigroup ERISA Litigation,* 2009 WL 2762708 (S.D.N.Y. Aug. 31, 2009)(holding that the "presumption of prudence" cannot override directives or mandates expressly stated in the trust agreement or plan documents.)

situation.

In *In Re Avon Products Securities & ERISA Litigation,* 2009 WL 848083 n. 22 (S.D.N.Y. March 3, 2009) the court observed that in the wake of *Moench,* a number of courts, including the Third Circuit, have suggested a distinction between (1) plans that require the offering of company stock, (2) plans that leave the matter entirely to the discretion of the fiduciaries, and (3) plans that make plain an expectation that company stock will be offered as an investment vehicle. For plans in the first category, the district Court concluded that even *Moench* recognized that the fiduciary cannot be sued for not diversifying.[29]

The *Kuper/Moench* presumption aims to strike a balance between competing statutory goals, namely, the encouragement of employee ownership of stock and the need to safeguard retirement income from imprudent decisions and excessive risk.[30] The presumption, however, evolved in the context of ESOPs and there was a question whether the presumption should apply to 401k litigation involving Company Stock funds. It was not uncommon for companies sponsoring 401 k plans to offer employees an opportunity to invest in employer securities. Some companies structured the employer match in the form of company stock but allowed employees to direct their own contributions and to dispose of employer securities after a period of time. Should fiduciaries of a 401 k plan that offers a Company Stock fund as one of many investment options have the benefit of a "presumption of prudence" with respect to that option?

Recent court decisions have concluded that the presumption applies to 401k plans that are eligible individual account llans as defined by ERISA. The seminal case is *Edgar* v. *Avaya,* 503 F.3d 340 (3r Cir. 2007). In *Edgar,* the court found that the "presumption of prudence" applied to a fiduciary decision to continue the company stock fund as an investment option. The court's reasoning rest largely on ERISA's definition of an eligible individual account plan. The court noted that "an ESOP is one of several types of pension plans categorized under ERISA as "Eligible Individual Account Plans" or "EIAPs. "" *Id.* at 347.[31] The parties agreed that the 401 k plans at issue in *Edgar* were also EIAPs. Under § 11 04(a)(2), an EIAP does not violate the diversification requirement and the prudence requirement (only to the extent that it requires diversification) because it acquires or holds qualifying employer real property or securities. *!d.* Thus, the 401k plans which include a company stock fund as an investment option are no different (for purposes of fiduciary obligation) than ESOPs. Both are types of EIAPs that the statute

---

[29] *See, Urban* v. *Comeast Corp.,* 2008 WL 4739519 * 12 (£.0. Pa. 2008)(observing that "where a plan fiduciary decides to invest in employer securities, our Court of Appeals has applied differing levels of scrutiny based on whether the plan mandates, encourages, or simply permits such investments."); *In Re Dell ERISA Litigation,* 563 F. Supp. 2d 681, 691 (W.O. Tex. 2008)(noting that there are three different levels of review and that under *Edgar* v. *Avaya,* 503 F.3d 340 (3fd Cir. 2007)when a plan absolutely requires an investment, the decision is immune from judicial review).

[30] In *Summers* v. *State Street Bank & Trust Co.,* 453 F. 3d 404 (7th Cir. 2006), Judge Posner reviews the conflicting goals of ESOPs and suggest that the Congress revisit the policy of encouraging ESOP formation.

[31] An EIAP is defined as "an individual account plan which is (i) a profit-sharing, stock bonus, thrift, or savings plan; (ii) an employee stock ownership plan; or (iii) a money purchase plan which ... [is] invested primarily in qualifying employer securities." 29 U.S.C. § 1107(d)(3)(A).

authorizes and which Congress recognized are subject to greater risks than traditional ERISA pension plans because they can require concentrated holdings of employer securities. *Id.*[32]

Whether the "presumption of prudence" standard should apply to shield directions to fiduciaries to allow employees to invest in a company stock fund is a complicated issue and beyond the scope of this presentation. However, a few observations won't hurt. At first glance, ERISA's definition ofEIAPs supports the extension of the presumption to investments by employees in a company stock fund. It is undoubtedly true that ESOPs are a type of EIAPs but that does compel the conclusion that they should be treated the same. ESOPs are generally non-contributory. Unlike a 401k defined contribution plan where an employee contributes to the plan, ESOPs don't require employees to contribute to the plan. In the 401 k setting, employees are free to invest their contributions in funds other than the company stock fund. Plan fiduciaries undoubtedly have an obligation to periodically review the "other fund" options for suitability purposes so that employees are not investing their contributions in unsuitable investments. Because the assets of the company fund will normally be a mix of employer and employee contributions, such funds are different than ESOP and this difference may influence the analysis. A second related point is the interaction between 404(c) and the "presumption of prudence". Fiduciaries to 40lk plans that include a company stock fund as an investment option will likely claim that the plan qualifies for 404(c) status.[33] If the "presumption of prudence" governs then what role does 404(c) play when the investments at issue involve the company stock fund.

Finally, the definition of "eligible individual account plan" appears in the context

---

[32] Following *Edgar,* several courts have found that the "presumption of prudence" framework also applies to 401 k plans. See, *Shanehchian* v. *Macy's, Inc.,* 2009 WL 2524562 (S.D. Ohio Aug. 14, 2009))(applying the presumption of prudence to a plan that required that offering of a company stock fund as one of the investment options); *Johnson* v. *Radian Group, Inc.,* 2009 WL 2137241 (E.D. Pa. July, 16, 2009)(rejecting argument that "presumption of prudence" framework did not apply to 401k plan and that *Moench* and *Edgar* do not require fiduciaries to depart from ESOP or EIAP plan provisions whenever they are merely aware of circumstances that may impair the value of company stock); *Morrison* v. *MoneyGram Intern. Inc.,* 607 F. Supp. 2d 1033 (D. Minn. 2009)(observing that an ESOP is just one type of EIAP, and all EIAPs are designed to foster investment in employer stock); *Graden* v. *Conextant Systems, Inc.,* 574 F. Supp. 2d 456, 462 (D.N.J. 2009)(observing that the Third Circuit held that the presumption of prudence standard apply to imprudent investment claims in which the underlying benefits plan is categorized by ERISA as an Eligible Individual Account Plan ("EIAP"), such as the subject Conexant Plan).

[33] Generally speaking, section 404(c) states that pension plans which provide individual accounts and permit a participant to exercise control over the assets in his accounts, if a participant or beneficiary exercises control over assets in his account, such participant shall not be deemed a fiduciary and no person who is otherwise a fiduciary shall be liable for any loss or by reason of any breach, which results from a participant's exercise of control. *See,* 29 U.S.C. § 1104 (c)(l)(A).

of statutory limitations on holdings or acquisitions of qualifying employer securities. Generally, Section 407 prohibits a plan from holding or acquiring employer securities or property if more than 10 percent of the fair market value of all the plan's assets consists of such assets. However, § 407 (b)(2) exempts eligible individual account plans from this limitation provided certain conditions are satisfied. The conditions are fairly complex but the important point that they don't apply to ESOPs. In other words, unlike other EIAPs, ESOPs are always exempt from the 10 percent limitation, while other plans (e.g. 401ks) must satisfy additional conditions. Moreover, if a non-ESOP EIAP fails to satisfy the additional requirements, elective deferrals will be treated as a separate plan that is not an EIAP. The upshot is that ESOPs and other EIAPs are treated differently with respect to limitations on acquisition and holding of employer securities.

Delegating Duties to Others

Section 402(a) requires that every employee benefit must be in writing and that the plan must provide for one or more named fiduciaries who jointly or severally have the authority to control and manage the operation and administration of the plan. Section 402(c) provides that, at the settlor's option, the plan can also include provisions that allow the named fiduciaries or appropriate designees to employ persons to render advice with regard to any fiduciary responsibility under the plan.

What liability does a fiduciary have for the conduct of persons so employed? ERISA provides some guidance when the named fiduciary designates another person to carry out fiduciary responsibility (other than trustee responsibilities) under a plan. As discussed above concerning co-fiduciary liability and the duty to monitor, Section 405(c)(2)(A) limits a named fiduciary's liability for acts or omissions of the designated/appointed fiduciary except to the extent that the named fiduciary breached his or her duty of care with respect to the allocation or designation, with respect to the establishment or implementation of the procedure allowing for allocation or designation or by continuing the allocation or designation. Moreover, the named fiduciary remains liable for conduct outlined in Section 405(a).

In *Geddes* v. *United Staffing Alliance Employee Medical Plan,* 469 F. 3d 919 (10th Cir. 2006), the court held that at common law, while a fiduciary may not delegate the entire administration of his trust, absent specific authorizing language in the trust instrument, a fiduciary may delegate the performance of certain tasks which it is unreasonable to require him personally to perform.[34] The court further noted that a

[34] The court in *Geddes* relied on Section 171 of the Restatement (Second) of Trusts which provides, in relevant part, as follows:

> Although a trustee cannot properly delegate the administration of the trust, he can in administering the trust properly delegate the performance of certain kinds of acts.A trustee cannot properly delegate authority to do acts which a person of ordinary prudence would not in like circumstances in the management of his own affairs employ an agent to do. On the other hand, a trustee cannot always properly delegate authority to do acts although a person of ordinary prudence might in like circumstances in the management of his own affairs employ an agent to do them. A trustee can properly delegate the

fiduciary's decision to delegate does not violate his or her responsibililty to the trust beneficiary insofar as the fiduciary remains personally liable for any decisions taken on his or her behalf. The upshot is that, unlike an appointed co-fiduciary, a named fiduciary remains personally liable for the conduct of persons employed to assist or render advice.[35]

When an act or omission by a non-fiduciary results in a dispute, the focus is frequently on whether the disputed conduct constituted an exercise of fiduciary responsibility. An illustrative example is *Livick* v. *The Gillette Company,* 524 F. 3d 24 (l st Cir. 2008). The plaintiff in *Livick* complained that an employee in Gillette's human resource department provided incorrect information concerning his benefits. Specifically, the employee provided an erroneous estimate of benefits under the plan. The plaintiff sued the plan administrator for the error and claimed he was entitled to the benefits as calculate by the HR employee. The court rejected this argument. In particular, the court noted that plaintiffs "negligent training" claim against the plan fiduciary failed because the employee was not engaged in a fiduciary function. It found that under the DOL's interpretation of relevant ERISA provisions, "a named fiduciary can only be liable for the acts and omissions of a person designated to carry out fiduciary responsibilities." *Id.* at 30. The court noted that a fiduciary is required to exercise prudence in the selection of persons charged with only ministerial tasks but only to the extent the fiduciary relies on the information, data, statistics or analyses provided by the non-fiduciary agents. *Id.* Since the plan fiduciary did not rely on the erroneous estimate, there was no recourse against the fiduciary for the error.

> performance of acts which it is unreasonable to require him personally to perform. There is not a clear-cut line dividing the acts which a trustee can properly delegate from those which he cannot properly delegate. In considering what acts a trustee can properly delegate the following circumstances, among others, may be of importance: (1) the amount of discretion involved; (2) the value and character of the fiduciary's decision to delegate does not violate his or her responsibility to the trust beneficiary insofar as the fiduciary remains personally liable for any decisions taken on his or her behalf. The upshot is that, unlike an appointed co-fiduciary, a named fiduciary remains personally liable for the conduct of persons employed to assist or render property involved; (3) whether the property is principal or income; (4) the proximity or remoteness of the subject matter of the trust; (5) the character of the act as one involving professional skill or facilities possessed or not possessed by the trustee himself.

[35] *See, Weeks* v. *UNUM Group,* 2008 WL 4329223 * 5 (D. Utah 2008)(noting that non-fiduciaries employed by a fiduciary are agents of the named fiduciary and that for purposes of liability, the decisions made by third parties are decisions made by the fiduciary). Disputes over delegation of authority to nonfiduciaries are usually connected to whether a court should treat such decisions with deference under *Firestone. See, Holden* v. *Blue Cross* & *Blue Shield of Texas,* 2008 WL 4525403 * 17-18 (S.D. Tex. Sept. 30, 2008)(discussing the split in authority over whether a decision by a non-fiduciary is subject to *de novo* review); *see also, Zurndorfer* v. *Unum Life Insurance Co. of America,* 543 F. Supp. 2d 242, 255-258 (S.D.N.Y. 2008)(for an extensive discussion of delegation by a corporate fiduciary) and *Samaritan Health Center* v. *Simplicity Health,* 516 F. Supp. 2d 939,947-949 (E.D. Wis. 2007)(discussing the doctrine of "implied delegation" and its impact on the standard of review).

Conclusion

We started with the question of whether interpretation of ERISA inadvertently created a gap in fiduciary responsibility. It appears that such a gap potentially exist, if at all, in two circumstances: (l) a non-fiduciary commits an error that the fiduciary did not rely on and (2) in the context of directed trustee where the plan instrument specifically limits a fiduciary's discretion. However, as the opinion in *Defazio* v. *Hollister Inc. 2008* WL 958185 (E.D. Cal. April 8, 2008) demonstrates some courts are reluctant to discharge named fiduciaries from liability when an injury to the plan is alleged. In *Defazio,* the court rejected the argument that individual directors (who were named fiduciaries) were no longer liable for fiduciary breaches because they had delegated their authority to an administrative committee. After careful review of the plan documents the court concluded that "Holister's directors-despite delegating substantial authority to the Hollishare trustees-appear to retain a substantive level of fiduciarl responsibility which could subject them to liability for breach of that duty." *Id.* at * 7.[36]

---

[36] Another important issue raised in *Hollister* is whether individuals who serve on a committee that is the named fiduciary are personally liable for fiduciary breaches. *See, Briscoe* v. *Fine, 444* F. 3d 478, 486-87 (6th Cir. 2006)(discussing the circuit split over the question of whether individual employees and/or directors of a corporation are personally liable when the corporation is the plan's named fiduciary).