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THE FIDUCIARY RESPONSIBILITIES of MULTIEMPLOYER PLAN TRUSTEES UNDER ERISA

An Overview

by Bobroff, Hesse, Martone & Doetzel, P.C.

Introduction

The recent financial crisis has had a substantial negative effect on the solvency of multiemployer pension plans, including many union pension plans. Most of these plans are governed by a board of trustees made up of representatives of labor and management. As things have gotten worse (and because the end does not appear to be in sight, at least for pension plans), attorneys are increasingly looking to hold trustees accountable for their fund's inadequacies.

This is a short, informational outline on the issue of pension fund trustee liability. **<u>This article is not intended to provide legal advice and should not be taken as legal advice</u>**. In the event that anyone reading this article has any question relating to the potential liability of trustees, and/or if any person needs legal representation, they should consult with an experienced attorney who practices in this area of the law.

Did we mention that this outline is not intended to be a substitute for legal advice?

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I. Who is a Fiduciary?

A. The position or job title is not significant. ERISA employs a functional definition of who is a fiduciary. Under Section 3(21)(A) of the Act, a fiduciary is someone who:

1. Manages or invests plan assets – "exercises any discretionary authority or discretionary control respecting management of such plan or exercises any authority or control respecting to management or disposition of its assets,"

2. Provides investment advise – "renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan, or has any authority or responsibility to do so, or"

3. Administers the plan – "has any discretionary authority or discretionary responsibility in the administration of such plan."

29 U.S.C. §1002(21)(A).

As a general matter, it should be assumed that trustees and administrators of a plan are fiduciaries for matters involving the plan. 29 C.F.R. §2509.75-8, Q&A D-3; see Yeseta v. Baima, 837 F.2d 380, 384 (9th Cir. 1998).

B. Application of the Functional Definition of Fiduciary

1. Plan Sponsors – Settlor functions. The Board of Trustees are the Plan Sponsor and named fiduciary under ERISA. Although courts have made distinctions between actions of the Plan Sponsor acting as "settlor" of the trust and actions of the Plan Sponsor acting as fiduciary, by amendment to Section 1.17 of the Trust Agreement, all "settlor type" decisions of the Board of Trustees, the Board's delegee, or the Administrative Manager are deemed covered by ERISA's fiduciary duty obligations.

2. Investment advisors are generally fiduciaries unless they have no discretion and merely carry out investment decisions made by others. 29 C.F.R.

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§2510.3-21(d). Mutual funds are not considered fiduciaries simply by reason of purchase of shares of the fund by the Pension Fund. 29 U.S.C. §1002(21)(A), (B), §1101(b)(1).

3. Insurance companies which manage plan assets or which hold funds in a "separate account" likely will be deemed fiduciaries. Policies or contracts issued are plan assets, but the underlying assets may or may not be plan assets, depending on whether the policy or contract is "guaranteed benefit policy" supported by the insurer's general account and whether the insurer or the plan bears the investment risk. 29 U.S.C. §1101(b)(2)(B); <u>John Hancock Mutual Life Ins. Co. v. Harris Trust & Savings Bank</u>, 510 U.S. 86, 114 S.Ct. 517 (1993).

4. Insurance companies, TPAs, or claims processors may be fiduciaries if they have discretionary authority to decide claims. <u>See</u> <u>Hill v. Blue Cross & Blue Shield of Mich.</u>, 409 F.2d 710, 716-17 (6th Cir. 2005).

5. Banks, attorneys, and actuaries often are not considered fiduciaries for merely acting in their traditional roles.

C. Identifying Plan Assets – because the definition of "fiduciary" is largely tied to control or management of plan assets, identifying plan assets is a critical inquiry. The Act does not generally define "plan assets" but there are several issues.

1. Regulations govern when the law will "look through" an equity investment by a Plan in another entity to the underlying assets of that entity. 29 C.F.R. §2510.3-101. Exceptions to the "look through" rule include publicly offered securities, insignificant equity investments, and investments in operating companies that produce or sell a product or service other than the investment of capital.

2. Participant contributions (not employer contributions) and amounts withheld from employee wages may constitute plan assets, and the DOL has issued regulations governing this. 29 C.F.R. §2510.3-102.

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D. Starting or Stopping as a Fiduciary

1. Starting – a person becomes a fiduciary when they assume the requisite discretionary authority or control that is defined as fiduciary conduct. Generally a person is not responsible for breaches committed by his or her predecessors, but a fiduciary has a duty not to allow continuation of breaches that began before he or she assumed the duty. In other words, if you inherit a problem, you have an obligation to deal with it.

2. Stopping – when a person ceases serving in the fiduciary role, he or she is no longer liable for breaches that occur thereafter. However, a fiduciary cannot leave the duty unattended, and may be liable for a breach which they set in motion before leaving or for a co-fiduciary's known breach prior to resignation.

II. Plan and Trust Requirements

A. Formal Requirements – written instrument, named fiduciary, mandatory and optional provisions. Section 402 of ERISA, 29 U.S.C. §1102.

B. Trust requirement. The plan assets generally must be held in trust, administered by trustees. There are exceptions – i.e., insurance company separate accounts. The trustees can delegate their authority to manage assets to a properly named fiduciary or investment manager, but the trustees remain obligated for the selection, direction, and retention of those fiduciaries.

III. Fiduciary Standards – Section 404 of ERISA: All duties to the plan must be discharged solely in the interest of the plan's participants and beneficiaries.

A. The Four General Rules:

1. The "exclusive purpose" rule: a fiduciary must act for the exclusive purpose of "(i) providing benefits to participants and their beneficiaries; and (ii) defraying reasonable expenses of administering the plan." Section 404(a)(1)(A), 29 U.S.C. §1104(a)(1)(A).

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2. The "prudence" rule: a fiduciary must act "with the care, skill prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims." Section 404(a)(1)(B), 29 U.S.C. §1104(a)(1)(B).

3. The diversification rule: a fiduciary must diversify the investments of a plan to "minimize the risk of large losses, unless in the circumstances it is clearly prudent not to do so." Section 404(a)(1)(C), 29 U.S.C. §1104(a)(1)(C).

4. Follow the plan documents: a fiduciary must act in accordance with the plan documents, unless those documents are inconsistent with the provisions of ERISA. Section 404(a)(1)(D), 29 U.S.C. §1104(a)(1)(D).

B. The Exclusive Purpose Rule. The fiduciary has a duty of loyalty to the plan. Dealing with plan assets to further the interests of others or of one's self violates this rule.

1. Potential conflicts of interest may not breach the rule where (a) the action is intended to benefit the plan but also incidentally benefits the plan sponsor or the fiduciary or (b) where the fiduciary takes appropriate steps to ensure the decision is not tainted by the conflict.

2. The DOL has issued guidance on when expenses of multiemployer plan trustees may be paid by the plan. DOL Field Assistance Bull. 2002-2 (Nov. 14, 2002).

3. Examples of breaches:

   a) Causing the plan to purchase insurance products to maximize the commissions of the selling agent, who was a fiduciary or to benefit entities controlled by fiduciaries. Reich v. Lancaster, 55 F.2d 1034 (5th Cir. 1995).

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b) Causing the plan to extend coverage to themselves and to plan counsel on favorable terms. Donovan v. Daugherty, 550 F.2d 390 (S.D. Ala. 1982).

c) Loaning funds to a poorly funded sister welfare fund, which did not have the same participants, primarily to bolster that fund. Donovan v. Mazzola, 2 EB Cases 215 (N.D. Cal. 1981).

C. The Prudence Standard

1. Procedural prudence. The decision-making process is reviewed objectively for how the decision was reached: did the trustees employ the appropriate methods to investigate the merits of the matter and how it should be carried out? Good faith is not enough. As one court observed, "a pure heart and an empty head are not enough." Donovan v. Cunningham, 716 F.2d 1455, 1467 (5th Cir. 1983).

   a) Fiduciaries should consult appropriate experts to guide their decisions regarding matters that require technical knowledge or special expertise.

   b) Selection, direction, and retention of experts must also be done prudently. Investigate the expert's qualifications, provide the expert with complete and accurate information, and make certain that reliance on the expert's opinion is reasonably justified under the circumstances.

   c) A decision may be imprudent even if the plan suffers no loss.

   d) Substantive prudence may also be relevant. For example, was a questioned transaction objectively prudent or did the plan comply with applicable non-ERISA law.

2. The DOL's Safe Harbor Rule for fiduciary decisions concerning investments – The "modern portfolio theory." 29 C.F.R. §2550.404(a)-1. In short, the prudence of an investment should be judged with regard to the role that the investment plays within the overall plan portfolio.

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D. Diversification

1. No statutory percentages or requirements: the fiduciary must consider the facts and circumstances of each case. Congress outlined seven factors that may be considered:

    a) The purpose of the plan,

    b) The amount of the plan assets,

    c) Financial and industrial conditions,

    d) The type of investment,

    e) The geographical distribution of the location,

    f) The distribution of the investment among industrial sectors, and

    g) The date of maturity.

1974 U.S.C.C.A.N. at 5084

2. Courts follow a two step analysis: the party claiming the violation must show the plan investments are nondiverse; the plan then bears the burden of showing that its conduct was clearly prudent. Expert testimony is often the key to defending these claims.

E. Act in Accordance with Plan Documents. Claims under this section are often brought in the context of claims under other sections.

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IV. Topics of Note in Applying Fiduciary Standards

A. Fiduciary communications

1. A fiduciary has a duty not to make affirmative misrepresentations. Varity Corp. v. Howe, 5165 U.S. 489, 116 S.Ct. 1065 (1996).

2. Courts have reached different results on the issue of whether a trustee has a duty to disclose truthful information and whether that duty arises only upon a participant's inquiry. In some cases, courts have found a fiduciary had an affirmative duty to make disclosures even without a participant inquiry. Harte v. Bethlehem Steel Corp., 214 F.3d 446 (3rd Cir. 2000) (participant receiving disability benefits; fiduciary should have advised the participant that his service was deemed severed and that he would no longer qualify for certain pension benefits).

3. A number of courts have held that SPDs must be kept up to date, clear, and correct.

4. Communications regarding future benefits, early retirement packages, and retiree health care continue to be a fertile area of litigation.

B. Selection and Monitoring of Service Providers. The DOL has issued guides for selecting and monitoring auditors, service providers, and pension consultants. www.dol.gov/ebsa/fiduciaryeducation.html

C. Collections

1. Trustees have a duty to take effective action to ensure that the fund receives its required contributions. Courts generally give the trustees wide latitude in collection practices. However, a court found a breach of the trustees' fiduciary duty where the trustees regularly waived interest on delinquent contributions, rarely filed suit to collect delinquent contributions and failed to investigate the reasonableness and feasibility of collection procedures. Liss v. Smith, 991 F.Supp. 278 (S.D. N.Y. 1998).

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2. One court has held that this duty continues after expiration of the collective bargaining agreement, but the Supreme Court later held that funds do not have a claim under ERISA for contributions which become due and owing after contract expiration because the obligation to contribute arises only under Federal labor law, not under ERISA.

3. Trustees have a right to conduct audits. However, a trustees' failure to conduct an audit, absent an express duty to do so in the plan documents, is not necessarily a violation of ERISA or its fiduciary duties.

4. Trustees must take reasonable measures to ensure the contributions owed under reciprocity agreements are accurately determined and collected.

D. Benefit Administration

1. Failure to carry out administrative responsibilities may constitute a breach of fiduciary duties.

2. Inconsistency and failing to follow the plan documents gives rise to claims of breach of fiduciary duties in claim denial cases.

3. Under ERISA and the Pension Protection Act of 2006, as pension funds get into financial peril, elimination of non-core benefits, benefit freezes, and benefit reductions may be mandated by law. The trustees should be confident they are getting expert legal advise on the requirements of the law.

4. Voluntary benefit reductions. While some plans expressly provide for benefit reductions to safeguard plan assets, the trust agreement here does not so provide. The trust agreement does not guarantee any particular benefits or benefit levels and appears to permit changes in benefits, but this is not as clear a mandate to cut benefits if necessitated by the plan's financial situation.

5. Investment policy

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a) Courts may take into consideration whether a plan has a written investment policy, but the lack of a policy is not *per se* a violation of the trustees' duties.

b) Non-financial considerations in making investments. The DOL takes the position that non-financial considerations must be secondary in making investment decisions. DOL Interpretive Bulletin 94-1.

V. **Violations by Other Fiduciaries.** Co-fiduciary liability is governed by Section 405(a) of ERISA. A fiduciary is liable for the breach of fiduciary duty of another fiduciary if:

A. He knowingly participates or knowingly conceals an act or omission by another fiduciary, knowing the act or omission is a breach of that fiduciary's duty;

B. If his failure to comply with his fiduciary duties under Section 404(a)(1) enables another fiduciary to commit a breach of duty; and

C. He fails to make reasonable efforts to remedy a breach by another fiduciary if he has knowledge of that breach.

VI. Liability for Breach of Fiduciary Duty

A. Section 409 of ERISA, 29 U.S.C. §1109, provides the remedies for breach of fiduciary duty:

1. Personal liability to the plan for any losses suffered as a result of the breach;

2. Restore to the plan any profits the fiduciary made as a result of misuse of plan assets;

3. Equitable relief, including removal of the trustee. Courts have in some cases appointed independent fiduciaries to replace removed fiduciaries.

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B. Plan losses are often measured by restoring the plan to the position it would have been but for the breach of duty.

C. Enforceable under Section 502(a)(2), (3), and (5), 29 U.S.C. §1132(a)(2), (3), and (5).

   1. Attorneys' fees and court costs may be awarded under Section 502(g)(1), 29 U.S.C. §1132(g)(1).

   2. Section 502(l) mandates that the DOL seek civil penalties against fiduciaries who breach their duties. 29 U.S.C. §1132(l).

D. Statute of Limitations

   1. The statute of limitations for a claim of breach of fiduciary duty is the earlier of:

      a) 6 years after the date of the last action that constituted a part of the breach (or the latest date on which the fiduciary could have cured the breach in the case of an omission) or

      b) 3 years after the earliest date the plaintiff obtains actual knowledge of the breach.

   2. In cases of fraud or concealment, the limitation period is 6 years after the date of discovery of the breach. 29 U.S.C. §1113.

   3. "Actual knowledge" is frequently litigated, and the courts are split on what constitutes actual knowledge. The Seventh and Eighth Circuits hold that actual knowledge requires that a plaintiff know the "essential facts of the transaction or conduct constituting the violation" even if the plaintiff does not understand that the facts give rise to a claim under ERISA. <u>Martin v. Consultants and Adm'rs, Inc.</u>, 966 F.2d 1078, 1086 (7th Cir. 1992); <u>Brown v. American Life Holdings, Inc.</u>, 190 F.3d 856, 859 (8th Cir. 1999).

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E. Non-fiduciaries may be liable under Section 502(a)(3) for "appropriate equitable relief" if the non-fiduciary had actual or constructive knowledge that the transaction was prohibited or violated Title I of ERISA. Harris Trust v. Salomon Smith Barney Inc., 530 U.S. 238, 120 S.Ct. 2180 (2000).

F. Agreements purporting to relieve fiduciary of responsibility or liability for breach of fiduciary duty are void. A plan or fiduciary can purchase insurance to protect themselves. 29 U.S.C. §1110.

VII. Prohibited Transactions

A. Statutory Provisions

1. Sections 406 and 407 of ERISA contain specific provisions involving categories of transactions involving fiduciaries and "parties in interest." 29 U.S.C. §§1106, 1107.

2. The definition of who is a "party in interest" is quite lengthy and quite broad, including employers whose employees are covered by the plan, unions whose members are covered by the plan, and persons who provide services to the plan. 29 U.S.C. §1002(14).

3. Knowledge and proof of harm to the plan are generally not necessary to establish a violation of these provisions.

4. The IRS contains similar, but not identical provisions. IRC §4975.

B. Penalties for violations

1. IRS excise taxes can be imposed on any "disqualified person" who participates in a prohibited transaction under the tax code. The initial tax is 15 percent of the amount involved, but if the transaction is not corrected within the taxable period an additional excise tax of 100 percent is imposed. IRC §4975.

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2. Civil penalties under Section 502(i) of ERISA: 5 percent of the amount involved for each year or part of a year the transaction continues or 100 percent if the transaction is not corrected within 90 days of notice from the DOL. 29 U.S.C. §1132(i). The DOL does not enforce this often because the penalties do not go to the plan.

C. Exemptions

1. Section 408 creates a number of statutory exemptions and permits the DOL to grant individual and class exemptions. 29 U.S.C. §1108. The DOL has issued a significant number of class exemptions.

2. The Pension Protection Act of 2006 added an exemption permitting correction of transactions involving the acquisition, holding or disposition of securities or commodities that would otherwise violate Section 406(a). The exemption allows correction of essentially honest mistakes within a defined correction period and avoidance of excise taxes. 29 U.S.C. §1108(b)(20).

3. It is notable that a court has held that the exemption under Section 408(b)(2) and (c)(2) for reasonable compensation for necessary services does not provide a defense to a claim of fiduciary self-dealing under Section 406(b). <u>Patelco Credit Union v. Sahni</u>, 262 F.3d 897 (9th Cir. 2001).

4. Specific areas of concern for trustees:

   a) Potential problems with transactions and conflicts due to holding a position other than trustee of the plan – i.e., owning a business.

   b) Participating in decisions setting compensation for the fiduciary or for a party in interest.

   c) Acquiring securities of or other financial transactions with an employer.

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VIII. Bonding

A. Section 412 of ERISA requires every fiduciary (and others who handle funds or property of the plan) to be bonded to protect the plan. The bond may cover specific individuals or may be a blanket bond that covers all officers and employees of the plan. 29 U.S.C. §1112.

B. The bond must be at least 10 percent of the money or other property of the plan handled during the preceding plan year by the person or group covered, but the bond cannot be less than $1,000 and need not be more than $500,000 ($1 million if the plan holds employer securities).

C. There are exemptions for domestic insurance companies, banks, and certain broker-dealers.

IX. Comments for Trustees of a Pension Fund in Financial Peril

A. It should be assumed all decisions of the trustees will be scrutinized.

B. Collection procedures and practices should be reviewed carefully. Procedures and practices that might have been prudent when the pension fund was healthy may no longer be prudent when the pension fund is significantly underfunded.

C. Withdrawal liability claims should be pursued and collected vigorously. No cases were found finding a breach of fiduciary duty by trustees for not doing so, but several comments from courts are instructive:

1. Undue delay in pursuing claims for withdrawal liability puts plan solvency at risk and creates a risk of fiduciary liability. Joyce v. Clyde Sandoz Masonry, 871 F.2d 1119, 1126-1127 (D.C. Cir. 1989).

2. Trustees have a duty to investigate the facts surrounding an employer's withdrawal to avoid an improper or premature assessment. T.I.M.E.-DC, Inc. v. New York State Teamsters Conf. Pension & Retirement Fund, 580 F.Supp. 621 (N.D. N.Y. 1984) (fund administrator failed to investigate employer's

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labor dispute exemption before assessing withdrawal liability despite known strike by the union).

3. Although the majority rule is that employers cannot bring suit for a breach of fiduciary duty (see Carl Colteryahn Dairy, Inc. v. Western Pennsylvania Teamsters and Employers Pension Fund, 847 F.2d 113, 116 (3rd Cir. 1988)), employers often make this claim in litigation over withdrawal assessments. Also, participants clearly have standing to assert claims against the Pension Fund.

4. The trustee's role is to set withdrawal liability at an appropriate level, not to set it as high as possible. Keith Fulton & Sons, Inc. v. New England Teamsters & Trucking Industry Pension Fund, Inc., 762 F.2d 1137, 1143 (1st Cir. 1985).

5. Trustees may breach their fiduciary duty to the plan if they do not pursue withdrawal claims against other entities liable for withdrawal liability, for example, under the common control principles. Flying Tiger Line, Inc. v. Central States, Southeast & Southwest Areas Pension Fund, 1986 U.S. Dist. LEXIS 20436, 13-14 (D. Del. Sept. 12, 1986).

D. A pension fund in failing financial health may fall within a number of complex areas of the law, including withdrawal liability, mass withdrawal, the funding requirements of the Pension Protection Act, minimum funding requirements, plan reorganization, plan insolvency, and plan termination. While discussion of these topics is far beyond the scope of this paper, the key point is that the Trustees need to obtain expert advice on the application of these areas of the law and compliance with the requirements in these areas.