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FIDUCIARY OR NOT FIDUCIARY? THAT IS A DIFFICULT QUESTION

by: Nicole M. Wotlinski

If you are an employer, plan administrator, or financial advisor, how can you tell whether you are a fiduciary as defined by ERISA? There is a myriad of case law addressing this exact issue, but still, bright line rules are difficult to identify.

Express or Implied Status

Fiduciary status can be created in two ways. First, fiduciary status is created if a person or persons are expressly named as fiduciaries in the plan documents. 29 U.S.C. § 1102 (a). If not named specifically in the plan, fiduciary status can be created through action to the extent a party: (1) exercises any discretionary authority or control regarding management of a plan or exercises any authority or control respecting management or disposition of its assets; or (2) 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) has any discretionary authority or discretionary responsibility in the administration of such plan. 29 U.S.C. § 1002(21)(A). Thus, the concept of fiduciary under ERISA is broader than common law concept of trustee and it includes not only those named as fiduciaries in the plan or those who, pursuant to procedure specified in the plan, are identified as fiduciaries, but any individual who de facto performs specified discretionary functions with respect to management, assets, or administration of plan. *Custer v. Sweeney*, 89 F.3d 1156, 1161 (4th Cir. 1996).

Not every action taken by an employer rises to the level of fiduciary status. *Bendaoud v. Hodgson*, 578 F. Supp. 2d 257, 276 (D. Mass. 2008). Thus, the threshold inquiry is "whether that person was acting as a fiduciary (that is, performing a fiduciary function) when taking the action subject to complaint." *Pegram v. Herdrich*, 530 U.S. 211, 226, 120 S. Ct. 2143, 147 L. Ed. 2d 164 (2000).

For instance, courts have found that day-to-day business decisions by an employer that may affect a retirement or pension plan do not necessarily give rise to fiduciary status. *See, e.g., Berger v. Edgewater Steel Company*, 911 F.2d 911, 915 (3rd Cir. 1990) (holding that an employer's decision to refuse to grant retirement benefits during a difficult financial time was a business decision that did not implicate fiduciary duties); *Flanigan v. General Electric Co.*, 242 F.3d 78, 88 (2nd Cir. 2001) (a selling company's decision to transfer pension funds in a spinoff did not implicate fiduciary duties under ERISA); *Dzinglski v. Weirton Steel Corp.*, 875 F.2d 1075, 1079 (4th Cir. 1989) ("[b]usiness decisions can still be made for business reasons, notwithstanding their collateral effect on prospective, contingent employee benefits."); *Ames v. American Nat'l Can Co.*, 170 F.3d 751, 757 (7th Cir. 1999) (when company representatives are negotiating the sale of a division, they are not acting in their capacity as a plan fiduciary, and thus they do not bear the legal obligations that go along with fiduciary status.).

Moreover, employers are generally afforded wide latitude to design the plan, including the mechanism for distributing benefits, as they see fit without ERISA fiduciary implications. *See, e.g., Hughes Aircraft Co. v. Jacobson*, 525 U.S. 432, 444, 1119 S. Ct. 755, 142 L. Ed. 2d 881 (1999) (plan sponsor not an ERISA fiduciary in making decisions regarding design of the plan); *Curtiss-Wright Corp. v. Schoonejongen*, 514 U.S. 73, 78, 131 L. Ed. 2d 94, 115 S. Ct. 1223 (1995) (holding that "employers or other plan sponsors are generally free under ERISA, for any reason at any time, to adopt, modify, or terminate welfare plans.").

Additionally, mere influence as an employer over decision-making fiduciaries is not enough to establish fiduciary status. *See In re La.-Pac. Corp. ERISA Litig.*, No. 02-1023-KI, 2003 U.S. Dist. LEXIS 7645, at *16 (D. Or. Apr. 24, 2003) (exercising influence on officers who are themselves fiduciaries is insufficient to trigger fiduciary status, as "courts have held that fiduciary status is based on actual decision-making power" rather than on influence over decisions made by a plan trustee (citations omitted)). *See also Crowley v. Corning, Inc.*, 234 F. Supp. 2d 222, 228-29 (W.D.N.Y. 2002) (dismissing claim against company based on respondeat superior liability where a plan committee comprised of company officers was responsible for managing plan assets); *Gelardi v. Pertec Computer Corp.*, 761 F.2d 1323, 1325 (9th Cir. 1985) overruled on other grounds, *Cyr v. Reliance Std. Life Ins. Co.*, 642 F.3d 1202, 1207 (9th Cir. 2011) ("ERISA anticipates that employees will serve on fiduciary committees but the statute imposes liability on the employer only when and to the extent that the employer himself exercises the fiduciary responsibility allegedly breached.").

ESOP Rules

A different standard applies for determining fiduciary status pertaining to an Employee Stock Ownership Plan, or ESOP. As the court stated in *Eckelkamp v. Beste*, 201 F. Supp. 2d 1012, 1021-22 (E.D. Mo. 2002), this is because all-important business decisions necessarily have an effect on the company's stock:

> ESOPs are unique creatures in that there will always exist an overlap between corporate conduct and fiduciary duties. Since the nature of ESOPs requires it to be heavily invested in the corporate employer's stock, rarely will a corporate act not have some impact upon the value of the stock held by the ESOP and therefore, on the value of the ESOP plan assets.

For example, while setting compensation levels is generally considered to be a ministerial business function and does not implicate ERISA fiduciary duties, in the context of an ESOP, courts have not been consistent. Some courts have held that setting compensation levels of employees and officers do not specifically involve the management or disposition of the ERISA plans assets and therefore do not give rise to fiduciary status. *See, e.g., Bendaoud*, 578 F. Supp. 2d at 276 (finding that "[s]etting and receiving executive compensation falls outside the purview of ERISA because it does not directly involve the 'management or disposition of [the plan's] assets.'"); *Eckelkamp*, 201 F. Supp. 2d at 1022 (holding that "[a]n employer's discretion in determining salaries

is a business judgment which does not involve the administration of an ERISA plan or the investment of an ERISA plan's assets. Such a decision may ultimately affect a plan indirectly but it does not implicate fiduciary concerns regarding plan administration or assets."). But, at least one other court has held that setting compensation levels does give rise to fiduciary status under ERISA. *See, e.g., Johnson v. Couturier*, 572 F.3d 1067, 1077 (9th Cir. 2009) (holding that "where … 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 an unworkable rule.").

Delegating Fiduciary Status

In order to alleviate the possibility of establishing fiduciary status on its actions, some employers opt to delegate fiduciary responsibilities to a third-party. ERISA permits an employer to do this, but if the plan documents do not provide "a procedure for the designation of persons who are not named fiduciaries to carry out fiduciary responsibilities," any such designation will not alleviate a named fiduciary from its duties. 29 C.F.R. § 2509.75-8 FR-14. The selection of a third-party administrator does create a fiduciary status, and the employer must act "with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in like capacity and familiar with such matters would use in the conduct of an enterprise of like character and with like aims" in choosing an appropriate provider. 29 U.S.C. § 1104(a)(1)(B).

Similarly, not all actions by third-party administrators of a pension or retirement plan give rise to fiduciary status. Again, the focus must be on the act performed by the third-party plan administrator and only actions that relate to transactions dealing with a pool of assets, such as "selecting investments [or] exchanging one instrument or asset for another," *Johnson v. Georgia-Pacific Corp.*, 19 F.3d 1184, 1189 (7th Cir. 1994), are the type of actions that give rise to fiduciary status. Purely

ministerial functions do not create fiduciary status. *Pacificare v. Martin*, 34 F.3d 834, 837 (9th Cir. 1994). Indeed, the Department of Labor guidelines clearly state that persons "processing claims, applying plan eligibility rules, communicating with employees and calculating benefits" are not fiduciaries under ERISA. *Baxter v. C.A. Muer Corp.*, 941 F.2d 451, 455 (6th Cir. 1991) (citing 29 C.F.R. § 2509.75-8 D-2).

Additionally, third-party administrators who are merely the depositories for the funds, act only at the direction of another, and have no authority to manage or dispose of assets without such direction, do not have "practical control or authority" over the assets to implicate fiduciary status. *David P. Coldesina, DDS PC, Employee Profit Sharing Plan and Trust*, 407 F.3d 1126, 1133-34 (10th Cir. 2005); *CSA 401(k) Plan v. Pension Professionals, Inc.*, 195 F.3d 1135 (9th Cir. 1999) (holding that the third-party administrator did not step outside the scope of rendering administrative services and create a fiduciary relationship when it discovered apparent embezzlement while preparing financial statements, notified the plan's trustees and entered into a repayment agreement with the embezzler).

Financial Advisors

With regard to financial advisors, the statute states that fiduciary status will be created if investment advice for a fee is rendered. 29 U.S.C. § 1002(21)(A)(3). The federal regulation provides some guidance as to what constitutes the rendering of investment advice:

> For advice to constitute ``investment advice,'' an adviser who does not have discretionary authority or control with respect to the purchase or sale of securities or other property for the plan must--
>
> 1. Render advice as to the value of securities or other property, or make recommendations as to the advisability of investing in, purchasing or selling securities or other property
> 2. On a regular basis
> 3. Pursuant to a mutual agreement, arrangement or understanding, with the plan or a plan fiduciary, that
> 4. The advice will serve as a primary basis for investment decisions with respect to plan assets, and that
> 5. The advice will be individualized based on the particular needs of the plan.

29 C.F.R. § 2510.3-31(c). Federal courts will apply this regulation in determining fiduciary status, and each element set forth in the regulation must be satisfied before the court finds fiduciary status to exist. *Farm King Supply, Inc. v. Edward D. Jones & Co.*, 884 F.2d 288, 293 (7th Cir. 1989); *Thomas, Head & Greisen Employees Trust v. Buster*, 24 F.3d 1114, 1118-1120 (9th Cir. 1994).

Certainly, if you are an investment advisor retained on behalf of a retirement or pension plan, the first requirement is not difficult to meet. With regard to the second requirement, the rendering of one isolated piece of advice does not rise to the level of a fiduciary. *Damasco & Assocs. 401(K) Profit Sharing Plan v. Mfrs. Life Ins. Co.*, No. C 99-2135 CRB, 1999 U.S. Dist. LEXIS 13654, *15, (Aug. 20, 1999) (finding one alleged instance of investment advice is insufficient to confer fiduciary status); *see also Am. Fed. of Unions Local 105 Health Assurance & Welfare Fund v. Equitable Life Assurance Soc'y of the U.S.*, 841 F.2d 658, 664 (5th Cir. 1988) (holding the "regular basis" requirement is not met by urging purchase of insurance products and not providing additional investment advice after purchase).

With regard to the third requirement, courts have held that the agreement need not be in writing nor must it specify that the party was to act as a fiduciary. *Olson v. E.F. Hutton & Co., Inc.*, 957 F.2d 622, 627 (8th Cir. 1992); *Thomas, Head & Griesen*, 24 F.3d at 1119.

With regard to the fourth requirement, courts have found that the advice rendered does not have to be "the" primary basis for the plan's investment decisions, but rather only "a" primary basis. *See, e.g., Ellis v. Rycenga Homes, Inc.*, 484 F. Supp. 2d 694, 710 (W.D. Mich. 2007); *Thomas, Head & Griesen*, 24 F.3d at 1119. In determining whether the fifth requirement is met, courts have consistently held that any compensation, including commissions, satisfies the requirement. *Thomas, Head & Griesen*, 24 F.3d at 1120; Reich v. McManus, 883 F. Supp. 1144, 1153 (N.D. Ill. 1995).

The final requirement is that the advice must be individualized and based on the particular need of the plan. The *Ellis* court has explained this does not include the general promotion of a product or service, which might be recommended to all of the financial advisor's customers:

> To be individualized within the meaning of the regulation, advice must pertain to investment policies or strategy or portfolio composition or diversification …
>
> Obviously, the writers of the regulation were attempting to differentiate individualized investment advice, which is based upon the particular needs of the plan, from the general promotion of a product or service, pursuant to which a stockbroker might "recommend" a security to its customers at large. To be sure, the line between sales activity on the one hand and advice on the other may be indistinct in some circumstances. In the present case, however, the record clearly establishes that Baetens was advising the plan and not merely subjecting it to generalized sales efforts.

484 F. Supp. 2d at 709 n.2. Moreover, if an advisor merely gave its typical sales pitch regarding investment options that were available for the plan, but never explicitly or impliedly represented that they were suitable for the particular plan, that does not constitute individualized investment advice. *Farm King Supply, Inc.*, 884 F.2d at 293-294. Finally, computer-generated investment recommendations will not be considered individualized investment advice as long as the financial advisor is merely performing a ministerial or clerical function and not inserting his or her own thought process into the results provided. *See* DOL Advisory Opinion 2001-09.

Conclusion

In summary, when not a named fiduciary, it is often difficult to determine whether fiduciary status under ERISA has been conferred based on the action undertaken. When faced with a decision that relates to an ERISA-governed retirement or pension plan, it is advisable to make sure that you are acting under the prudent man standard and to document each step you take in making your decision in order to be able to defend your actions if it is determined that fiduciary status was created.

SELECT CASE SUMMARIES

by: Michael R. Holzman, Christopher T. Horner II and Timothy M. Iannettoni

U.S.D.C., E.D. Pennsylvania

ESOP Fiduciary Liability – Duty to Diversify

Ragan v. Advanta Corporation, 2011 U.S. Dist. LEXIS 112495 (September 30, 2011)

In this Employee Stock Ownership Plan ("ESOP") fiduciary liability dispute, the court upheld claims that Advanta Corporation directors and committee members breached their duties of prudence, loyalty, and monitoring by investing in Advanta stock. However, the court dismissed the claim that the directors failed to disclose complete and accurate information regarding Advanta's financial condition.

A. Duty to Prudently and Loyally Manage

The Court concluded that the complaint alleged sufficient facts to rebut the Moench presumption and to withstand the defendants' motion to dismiss. The participants alleged Advanta consistently misrepresented the quality of its accounts, executives sold their own stock knowing that the business was deteriorating, the share price plummeted, and Advanta eventually filed for bankruptcy.

In addition, the Court found sufficient facts to support the conclusion that the defendants knew that Advanta's stock was an imprudent investment. The participants alleged that Advanta's share price fell precipitously, federal regulators commenced an investigation, and executives sold significant blocks of their own Advanta stock while publicly stating the company's future was secure. The defendants contended that they did not violate ERISA because the Plan Document required them to invest in employer securities. The Court disagreed, finding the Plan Document contained no such requirement, and noting that such a requirement could not completely shield a fiduciary from liability.

B. Duty to Disclose

The participants alleged the directors failed to disclose that Advanta was concealing a significant number of impaired credit card receivables. In addition, they claimed Advanta failed to verify customers' ability to pay and failed to properly account for delinquent customer and credit trends. The Court dismissed this claim on the grounds that participants could not establish loss. The Court relied on a Third Circuit decision upholding a district court's determinations that financial markets would react too swiftly to public disclosure of negative information to allow plans to sell stock to avoid losses, and that the directors risked liability for insider trading for any decision to divest the plan of company stock based on nonpublic information.

C. Duty to Avoid Conflicts of Interests

The Court rejected the defendants' contention that the claim should have been dismissed for failing to identify any specific breach arising from the conflict. The participants alleged executive compensation was often tied to Advanta's share price, and that some of the directors sold their own stock while failing to protect the participants. The Court acknowledged a split in authorities on this issue, with some courts holding that allegations that executives would benefit from an inflated stock price at the expense of participants holding stock for retirement are sufficient to state a claim, while others holding that the holding of stock by fiduciaries does not sufficiently allege that the personal investments caused the fiduciary to take or fail to take any actions detrimental to the plan while acting as a fiduciary. Ultimately, the Court upheld the claim, concluding that a more developed record was necessary to determine whether the defendants' actions constituted a conflict of interest.

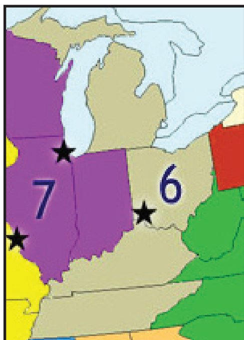
D. Duty to Monitor

The Court also rejected the directors' contention that the participants failed to specify circumstances that should have triggered a duty to monitor other fiduciaries. The participants alleged the directors had a duty to ensure that the plan administrators had all relevant information about the problems affecting Advanta, including the allegations that the company concealed large amount of impaired credit card receivables, failed to verify its customers' ability to pay and, improperly accounted for delinquent customers and credit trends. The Court concluded the allegations were sufficient to state a claim.

Sixth Circuit

ERISA and Subject Matter Jurisdiction

Daft et. al. v. Advest Inc., 658 F.3d. 583 (6th Cir. 2011)



In *Daft*, a group of beneficiaries brought suit concerning a denial of pension benefits, alleging that the plan violated ERISA's vesting requirements. For the first time on appeal, the defendants argued that the court lacked subject matter jurisdiction over the case because the plan did not satisfy ERISA's definition of an employee pension benefits plan. Alternatively, the defendants argued that the plan did not violate ERISA's vesting requirements because it was a top-hat plan, and therefore exempt from ERISA's substantive protections.

The court rejected the defendant's jurisdictional claim based on *Arbaugh v. Y&H Corp.*, 546 U.S. 500 (2006), explaining that the existence of an ERISA plan is not a jurisdictional issue, but rather speaks to whether the plaintiffs can state a claim upon which relief may be granted. Accordingly, the court held that the defendants waived their jurisdictional argument. With respect to the issue of whether the plan was a top-hat plan, the court held that the issue should be remanded to the plan committee for further development of the administrative record.

Seventh Circuit

Discretion To Interpret Ambiguous Plan Provisions

Frye v. Thompson Steel Co. Inc., 657 F.3d 488 (7th Cir. 2011)

In *Frye*, a pension plan participant claimed the administrator's offset of his worker's compensation benefits violated the terms of the plan. The court disagreed and found the plan to contain a "real ambiguity that the Committee [plan administrator] had to face and resolve", in turn affording the plan administrator considerable discretion in deciding whether the plan's language allowed for offsetting worker's compensation benefits. Therefore, because the plan administrator's resolution of the ambiguity was reasonable under the terms of the plan, the participant failed to meet his burden of demonstrating that there was "no rational support in the record for the Committee's determination…."

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Limitation On Benefits For Disability Based On Self-Reported Symptoms

Weitzenkamp v. Unum Life Ins. Co., 2011 U.S. App. LEXIS 19283 (7th Cir. Sept. 20, 2011)

In this long term disability benefit dispute, the participant who suffered from fibromyalgia, chronic pain and depression, challenged the claim administrator's decision to terminate benefits at the conclusion of the 24 month limitation period for payment of benefits related to disabilities based on self-reported symptoms. The participant also argued that the plan was not entitled to recoup overpayments resulting from a retroactive award of social security disability benefits.

The court concluded that Unum's interpretation of the plan was unreasonable and determined that the self reported symptoms limitation did not apply because the participant's fibromyalgia diagnosis was based on objective evidence and findings. The court also dismissed the participant's argument that Unum's claim for recoupment was barred by the Social Security Act.