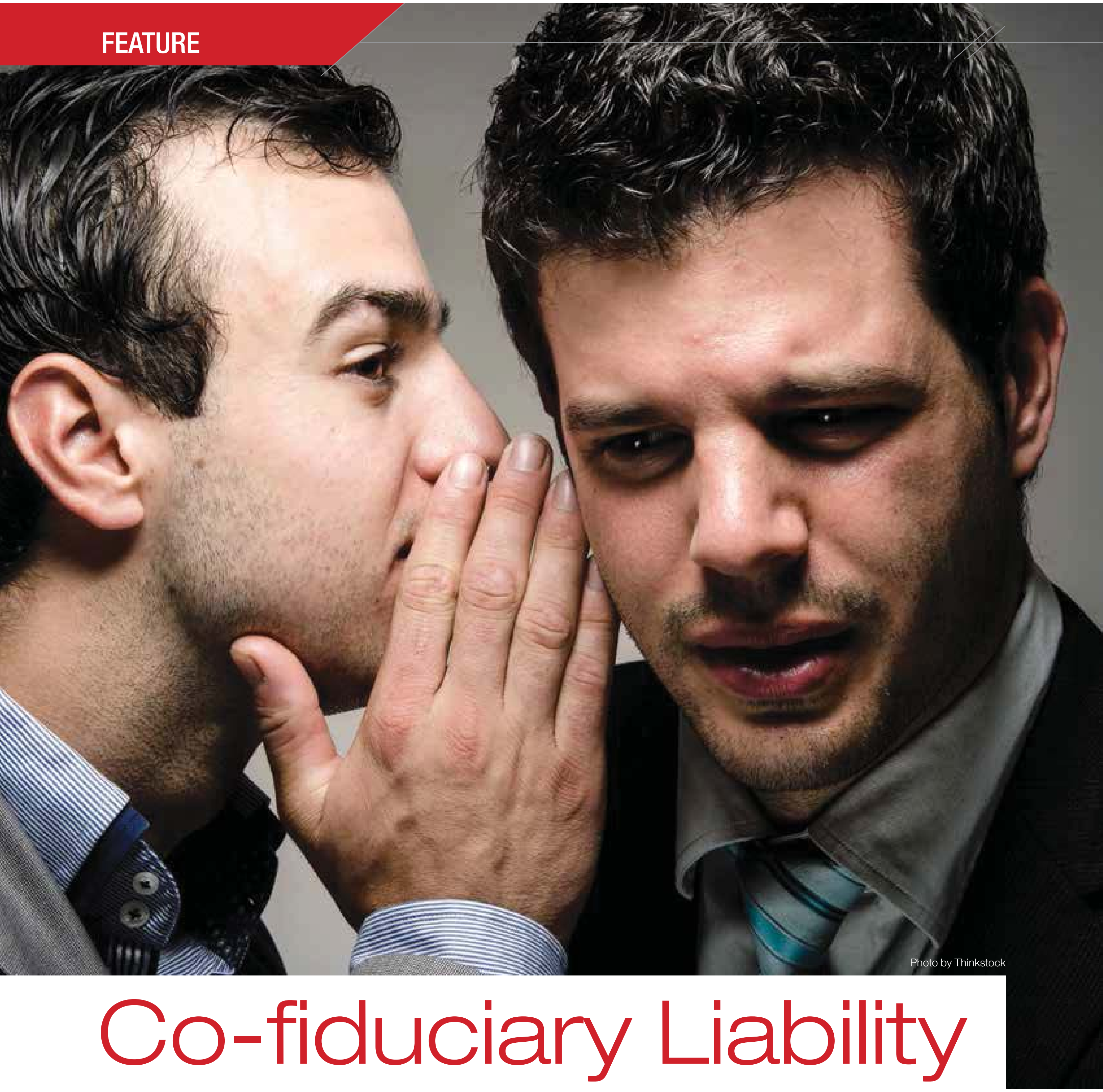

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Co-fiduciary Liability Under ERISA

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Fiduciaries can't afford to mind their own business.

Among the many pearls of wisdom we receive from our elders is the admonition to "mind your own business!" — in other words, respect other people's privacy; don't stick your nose in their affairs. It is probably fair to say that in the experience of most of us, this is sound advice.

However, if you are an ERISA plan fiduciary, minding your own business can be a big mistake! Why? Because ERISA, through its co-fiduciary rules, imposes on plan fiduciaries a duty to mind the business of their fellow fiduciaries and to take action when they become aware of facts indicating that those individuals have, or may have, engaged in a breach of their fiduciary duties. Under the co-fiduciary rules, an "innocent" fiduciary who has knowledge of another's fiduciary breach can be held liable for that breach, even if they are not a fiduciary with respect to the matter giving rise to the breach.

Before delving into a discussion of ERISA's co-fiduciary rules and the unique obligations they impose, we will first provide some background on how one becomes a plan fiduciary and what that status entails in terms of fundamental duties.

BACKGROUND

Who Are the ERISA Plan Fiduciaries?

Under ERISA, an individual can attain fiduciary status in three ways:

1. The individual can be named as a fiduciary in the plan document (*i.e.*, the plan specifically states that the employer will be the ERISA §3(16) plan administrator).
2. The individual can be named pursuant to a procedure specified in the plan document (*i.e.,* being appointed as the investment manager who has the discretion to select the plan's investment choices).[1]
3. The individual is a "functional" fiduciary because of the actions they take with respect to a plan. Specifically, ERISA §3(21) defines the term fiduciary in terms of a functional test as follows:

   a person is a fiduciary with respect to a plan *to the extent*

   i. he exercises any discretionary authority or discretionary control respecting management of such plan or exercises any authority or controls respecting management or disposition of its assets,

   ii. he 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

   iii. he has any discretionary authority or discretionary responsibility in the administration of such plan. (emphasis added)

Thus, regardless of their title or whether they are mentioned directly or indirectly in the plan document, individuals can become fiduciaries by virtue of the plan functions they perform. For example, members of a company's board of directors may themselves be fiduciaries to the extent they are responsible for appointing the plan's fiduciaries, since they have discretionary authority or discretionary control with respect to the management of the plan. As a result, the plan sponsor, officers appointed to the plan committees or otherwise designated to make plan decisions, and the directors who appoint plan fiduciaries, are all fiduciaries under ERISA. Therefore, they are subject to the law's fiduciary rules in their administrative and investment decisions.

Because an entity or individual can be either a named or functional fiduciary, they can be a fiduciary for one plan purpose, but not another.[2] For this reason, in making their determinations regarding fiduciary status under ERISA, courts have to carefully evaluate not only the plan's documents, but all of the facts and circumstances of the individual's relationship with the plan. This specifically includes an analysis of the extent to which the individual exercises discretionary authority or control over the plan or its assets and, thus, whether the individual is a functional fiduciary for one or more plan purposes.

What Are a Fiduciary's Fundamental Duties?

ERISA imposes high standards upon plan fiduciaries. The courts have referred to those duties as "the highest known to law.[3] ERISA §404(a) sets forth the primary duties of fiduciaries as follows:

> ". . . a fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and
> (A) for the exclusive purpose of: (i) providing benefits to participants and their beneficiaries, and (ii) defraying the reasonable expenses of administering the plan;
> (B) 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 a like character and with like aims . . ."

In summary, ERISA §404(a) provides that fiduciaries have a duty to act with absolute loyalty to the plan

1 *See* ERISA §402(a)(2) and *Glazier & Glassworkers v. Newbridge Securities,* 93 F.3d 1171, 1179 (3d Cir. 1996).

2 "[I]t is settled that '[a] person may be a fiduciary with respect to certain matters, but not others, for he has that status only to the extent that he has or exercises the described authority or responsibility." *Severstal Wheeling Inc. v. WPN Corp.,* No, 10 Civ. 954(GWG), 2011 WL 3849482, at *12 (S.D.N.Y. Sep. 1, 2011) (quoting *F.H. Krear & Co. v. Nineteen Named Trs.,* 810 F.2d 1250, 1259 (2d Cir. 1987).

3 *Sommers Drug Stores Co. Employee Profit Sharing Trust v. Corrigan,* 793 F.2d 1456, 1468 (5th Cir. 1986); *Donovan v. Bierwirth,* 680 F.2d 263, 272 n. 8 (2d Cir.), *cert. denied,* 459 U.S. 1069, 103 S.Ct. 488, 34 L. Ed. 2d 631 (1982).]

> Under the co-fiduciary rules, an "innocent" fiduciary who has knowledge of another's fiduciary breach can be held liable for that breach, even if they are not a fiduciary with respect to the matter giving rise to the breach."

participants and beneficiaries, for the exclusive purpose of providing for their benefits, and these things must be accomplished under a "prudent person" standard, which is the level of an expert. And, if the fiduciary does not have the ability to carry out his or her duties at that level, then ERISA's prudent person standard requires the fiduciary to go out and retain the requisite expertise for the plan.[4] ERISA does not specifically describe how fiduciaries must fulfill their duties. Rather, for such guidance fiduciaries must turn to advisory opinions and regulations issued by the Department of Labor (DOL) and court decisions.

CO-FIDUCIARY LIABILITY

Law and Guidance

As if the "burdens" of fiduciary status were not enough, "[E]very ERISA fiduciary, regardless of the parameters of its duties, is subject to the co-fiduciary liability provisions of [ERISA] §405(a)."[5] Specifically, ERISA §405(a) imposes co-fiduciary liability on all plan fiduciaries as follows:

> "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 404(a)(1) 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.[6]

Under circumstances 1 and 2,

4 *Liss v. Smith,* 991 F.Supp. 278, 297 (S.D.N.Y. 1998).

5 *In Re WorldCom, Inc. ERISA Litig.,* 354 F. Supp. 2d 423, 445 (S.D.N.Y. 2005).

6 Notwithstanding the use of the term "co-fiduciary," the ERISA statute does not contemplate a sharing or delegation of fiduciary responsibility. In fact, each co-fiduciary remains at all times fully responsible for fulfilling the particular duties giving rise to their own fiduciary status. (A common misconception, based upon some recent marketing techniques, is that a "co-fiduciary" can relieve another fiduciary from liability, when in fact that can happen only in the circumstance of a delegation by a plan trustee of plan investment authority to a bank, an insurance company or an advisor registered under the Investment Advisor Act of 1940, that specifically accepts fiduciary status in this regard in writing, sometimes referred to as a "Section 3(38) fiduciary." The duty to monitor and, if necessary, replace such a fiduciary can never be delegated.) Rather, co-fiduciary status or liability imposes a duty on ERISA plan fiduciaries not to engage in acts that facilitate breaches by their fellow fiduciaries, and to take reasonable remedial action when it is known such breaches have occurred. The circuit courts are split on the issue of whether co-fiduciaries can sue each other for indemnity or contribution in making a plan whole for losses resulting from a fiduciary breach.

co-fiduciary liability applies when a fiduciary knowingly participates in and/or conceals, or otherwise enables another fiduciary's breach. That probably makes sense and would be expected by most of us. That is, if you are a fiduciary and you act improperly with respect to another fiduciary's breach, you should be held responsible for doing so. However, circumstance No. 3 may be somewhat of a surprise … and perhaps even a shock to some of us! This is because it provides for the possibility of liability when a fiduciary merely has knowledge of the facts and circumstances of another's fiduciary breach, even if that breach involves an aspect of the plan over which the fiduciary has no fiduciary responsibility. That is, liability can be had even if the individual is not a *named* or *functional* fiduciary with respect to the plan matters giving rise to the breach. To some, this may seem somewhat illogical or otherwise unfair, but it is the law.

Once a plan fiduciary has knowledge of another fiduciary's breach (or an imminent breach), the only way the fiduciary can avoid liability is to undertake "reasonable efforts" to remedy the breach. Court cases make clear that one cannot avoid co-fiduciary liability "by simply doing nothing."[7] The co-fiduciary rules impose this duty regardless of whether the individual has fiduciary status with respect to the subject matter of the breach.[8]

According to the DOL, reasonable efforts might include reporting the breach to other plan fiduciaries and/or the DOL.[9] On the other hand, simply resigning as a plan trustee is likely not a reasonable course of action in response to becoming aware of a fellow fiduciary's breach. In Interpretive Bulletin 75-5, FR-10, the DOL addressed the situation of plan trustees proposing to use plan assets to construct a building to house the plan's administrative functions. One of the trustees proposed that the building be constructed by a particular contractor without competitive bidding. When another trustee questioned the choice of contractors, the bid amount, the impact on the plan's administrative costs and the absence of competitive bidding, no satisfactory answers were provided. Several of the trustees voiced concerns that going forward on this basis might be a violation of their fiduciary duties; however, a majority of the trustees were ready to vote to construct the building as proposed. In response to the question of what the minority trustees should do in this case to protect themselves from liability for a fiduciary breach, the DOL stated:

> "[I]t is incumbent on the minority trustees to take all reasonable and legal steps to prevent the action. Such steps might include preparations to obtain an injunction from a Federal District court under section 502(a)(3) of the Act, to notify the Labor Department, or to publicize the vote if the decision is to proceed as proposed. If, having taken all reasonable and legal steps to prevent the imprudent action, the minority trustees have not succeeded, they will not incur liability for the action of the majority. Mere resignation, however, without taking steps to prevent the imprudent action, will not suffice to avoid liability for the minority trustees once they have knowledge that the imprudent action is under consideration.

The Duty to Mind Your Co-Fiduciary's Business: A Case Study

The full impact of ERISA's co-fiduciary rules came into play in a federal court case in New York. In *Smith v. Stockwell Construction Co.* (W.D.N.Y, December 10, 2011), Kevin Smith was an employee of Stockwell Construction, Inc. and a participant in Stockwell's profit sharing plan. Smith executed a beneficiary designation form naming his then-spouse, Dawn Smith, and his father as beneficiaries of his plan account. Dawn did not consent to the designation of the father. The Smiths later divorced. As part of the marital settlement agreement, they each waived any interest they had in the other's retirement plans. Kevin died a couple of years later without ever having changed his plan beneficiary designation.

Kevin's father applied to Stockwell, as the plan's ERISA administrator, for the balance of Kevin's plan account. His claim was based on the fact that he was a designated beneficiary and also that the Smiths had waived any interest in each other's retirement plans as part of their divorce. The company determined that the waiver in the divorce decree was enforceable and that it also constituted a qualified domestic relations order (QDRO). On that basis, the company approved the father's claim for benefits and paid him the entire balance in Kevin's plan account.

When Dawn filed a claim for Kevin's plan benefits, the company denied it. Dawn then filed suit in federal court against the company; Harry Stockwell, Jr., who was the plan trustee; and the plan's TPA. Dawn alleged, among other causes of action, that the defendants breached their fiduciary duties under ERISA by failing to pay plan benefits in accordance with the plan's written terms.

The facts were undisputed when it came to the fiduciary status of the company. Pursuant to the plan

7 *Free v. Briody,* 732 F.2d 1331, 1336 (7th Cir. 1984).
8 ERISA §405(a)(3).
9 Field Assistance Bulletin 2004-03 (December 17, 2004).

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documents, the company was the plan administrator under ERISA §3(16), and as such, it was the fiduciary responsibility for determining plan claims, which it did in this case. Similarly, it was undisputed that Stockwell, Jr. was a fiduciary, since he was the plan trustee; however, his fiduciary duties were limited to selecting and monitoring the plan's investments. Under the plan's written terms, he did not have authority to determine claims for benefits and there was no allegation that he had attempted to exercise such authority in this case. Rather, he simply paid benefits as directed by the company. Finally, it was undisputed that the TPA's functions were limited to ministerial and other non-fiduciary functions and, therefore, it was not a plan fiduciary. It was the TPA that provided Dawn with a copy of the company's written denial of her claim. And Stockwell, Jr. was copied on that correspondence.

The court dismissed the breach of fiduciary duty claim against the TPA, easily concluding that it was not a plan fiduciary. The court refused to dismiss the claim against the company, finding that as the ERISA §3(16) plan administrator, it was a fiduciary. The court also found that Dawn Smith had plead facts sufficient to support a claim that it had breached its fiduciary duty in this case.

But what about Stockwell, Jr.? He argued that the breach of fiduciary duty claim against him should be dismissed because he took no action in denying Dawn's claim; he paid benefits as directed by the company in writing; and his fiduciary duties were limited to selecting and monitoring the plan's investments. Therefore, since he was not a named or functional fiduciary with respect to any aspect of the plan other than selecting and monitoring the investments, Stockwell, Jr. argued that he could not be held liable for a fiduciary breach occurring outside his plan-designated position, such as a breach with respect to the determination of claims.

The court disagreed. While acknowledging that Dawn's complaint "describes no behavior by Stockwell, Jr. that would amount to a breach of fiduciary duty to Plaintiff," the court noted that Dawn had also argued that Stockwell, Jr. was liable for the actions of its co-fiduciary, the company, pursuant to ERISA §405(a). The court explained that, as the plan trustee, Stockwell, Jr. could not be held liable "merely for having been copied on the letter to [the TPA] sent to Plaintiff, informing her of the plan administrator's decision not to pay benefits."

However, the pleadings showed that Stockwell, Jr. was aware of the company's decision not to pay benefits to Dawn. Specifically, Dawn had alleged that correspondence was exchanged with the company and the TPA, which requested information concerning the denial of benefits, and this would have put Stockwell, Jr. on notice that the company was denying Dawn's benefits. The court found that this knowledge could establish liability for a breach co-fiduciary basis and, therefore, Dawn was entitled to pursue her complaint against Stockwell, Jr. The court explained:

> That Stockwell, Jr. did not have discretion over the payment of these benefits does not shield him from liability under [ERISA §405(a)]. '[A] fiduciary may be liable for the known breach of a co-fiduciary, even when the breach occurs in connection with a function which does not fall within the fiduciary's designated or undertaken responsibilities.' *Magnuson*, 2006 WL 2934391, at *21; *In re Pfizer Inc.,* ERISA Litig., No. 04 Civ. 1007 (LTS) (JFE), 2009 WL 749545, at *14 (S.D.N.Y. Mar. 20, 2009); *In re Polaroid* ERISA Litig., 362 F. Supp. 2d 461, 480 (S.D.N.Y. 2005) ("Fiduciaries may be liable under ERISA section 405(a) even if their co-fiduciary's breach is beyond the scope of their own discretionary authority."); *In re WorldCom,* Inc., ERISA Litig., 354 F. Supp 2d 423, 445 (S.D.N.Y. 2005); see also *Silberman v. Mut. Benefit Life Ins. Co.,* 138 F.3d 98, 106 (2d Cir. 1998) (Jacobs, J., concurring) ("[A] co-fiduciary . . . may be held liable for another trustee's breach with respect to assets over which the defendant co-fiduciary never exercised dominion or control."). As a result, Stockwell, Jr.'s awareness of the alleged breach is sufficient to preserve Plaintiff's fiduciary claim against him pursuant to ERISA §405(a)(3).

On this basis, the court denied Stockwell, Jr.'s motion to dismiss. This meant that even though he did not have authority regarding the determination of plan benefits and did not participate in any decisions in this regard, he could be held liable for the alleged breach, provided Dawn establishes that: (1) the company breached its duty to properly pay

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benefits (an antecedent fiduciary breach is required for co-fiduciary liability to apply),[10] (2) Stockwell, Jr. was aware of the breach (actual knowledge of a fiduciary breach is required), and (3) he took no action to correct it.[11] "Actual knowledge" of an ERISA fiduciary breach has been defined as "knowledge of all relevant facts at least sufficient to give ... knowledge that a fiduciary duty has been breached or an ERISA provision violated."[12]

CONCLUSION

The impact of ERISA's co-fiduciary rules can be somewhat counterintuitive. That is, you can meet ERISA's high standards within the scope of your own fiduciary responsibilities, but still be liable for the breaches of other fiduciaries committed with respect to an aspect of the plan over which you do not have fiduciary status. This is because ERISA's co-fiduciary rules operate such that you are not afforded the luxury of minding your own fiduciary business. Plan fiduciaries have an affirmative duty to keep their eyes open and to take reasonable remedial action when they become aware of actual or potential breaches committed by their fellow fiduciaries. **PC**

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10 ERISA §405(a).
11 ERISA §405(a)(3).
12 *Richard B. Roush, Inc. Profit Sharing Plan v. New England Mut. Life Ins. Co.*, 311 F.3d 581, 585 (3d Cir. 2002).