FIDUCIARY TUNE-UP

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1. **Does *Dudenhoeffer* Change Who Should Serve on a Fiduciary Committee**? When employer "stock drop" class action litigation heated up in the early 2000s, many companies, particularly public companies, began removing high level executives from their fiduciary committees for their qualified retirement plans. This was particularly true for 401(k) plans of companies with publicly traded stock where the plan included an employer stock fund as an investment option. So, for example, where a company's "C-level executives," such as its chief financial officer, chief operating officer, or, less likely, chief executive officer, had been serving on a retirement plan fiduciary committee, those individuals may have been replaced with capable management employees lower on the corporate chart.

   The motivation for not placing high level executives on fiduciary committees is a concern about how their superior knowledge about the company and its financial prospects may complicate committee operation. Specifically, the fear is that key executives' special knowledge about the company's financial circumstances and future prospects may lead to the <u>following types of claims</u> with respect to employer stock funds in the company's 401(k) or other defined contribution plan, particularly where participants have the right to choose how the monies in their accounts are to be invested:

   a. <u>Argument 1</u>: <u>The special knowledge of key executives serving as fiduciaries should be imputed to the fiduciary committee</u>, and on the basis of this information the fiduciary committee should have stopped purchases of employer stock, sold stock of the company currently held by the plan, or disclosed this special inside knowledge to participants (or all of the above). The fear is that there will be allegations that the fiduciary committee should, under the "fiduciary override principle," ignore the right of participants under plan documents to direct that monies in their plan accounts be invested in company stock or decide when such stock should be sold (the fiduciary override principle derives from ERISA Section 404(a)(1)(D), which directs a fiduciary to follow the terms of the plan document and instruments <u>except</u> to the extent they are inconsistent with the provisions of ERISA Title I and IV). This same type of claim could arise even if participants have no right to direct how their plan accounts are invested, such as under a plan that requires that certain employer contributions remain invested in company stock.

   b. <u>Argument 2</u>: <u>An executive</u> with special knowledge about the company's financial circumstances and prospects <u>has a duty to educate other committee members</u> by sharing any special knowledge relevant to the decision whether to stop making purchases of company stock (even when, under the plan documents, the plan directs the fiduciaries to honor participant directions to make purchases), sell company stock, or disclose special knowledge to participants (or all of the above).

c. Argument 3: Public statements made by these key executives about the company's financial circumstances and prospects are made in their capacity as fiduciaries, rather than in their corporate capacities, and these statements should therefore be subject to ERISA's fiduciary standards, particularly the duty of loyalty.

d. Argument 4: Committee members who would not otherwise have had inside information absent an executive on the fiduciary committee sharing special knowledge with them have engaged in insider trading.

The Supreme Court's decision in *Fifth Third Bancorp v. Dudenhoeffer*, 2014 US LEXIS 4495 (U.S. 2014), makes it worth asking whether the considerations in determining whether to exclude key executives from fiduciary committees have changed. On the one hand, *Dudenhoeffer* increases the risk of a successful fiduciary claim in a stock drop case by holding that there is no "presumption of prudence" that applies with respect to investment in employer stock. That is, the Supreme Court said the so-called *Moench* presumption is not a proper reading of ERISA. On the other hand, the Supreme Court, *in dicta*, has offered guidance on stock drop claims that may make them easier to defend in other ways.

Before considering whether *Dudenhoeffer* changes the analysis of whether key executives with special knowledge about a company's finances and prospects should be excluded from fiduciary committees, let me first describe the Supreme Court's decision itself. In *Dudenhoeffer*, the Supreme Court considered whether, when an ESOP fiduciary's decision to buy or hold the employer's stock is challenged in court, the fiduciary is entitled to a presumption that its investment of ESOP assets in employer stock is consistent with ERISA – that is, whether a "presumption of prudence" applies with respect to investments in employer stock. The Supreme Court held that no such presumption applies. It said ESOP fiduciaries are instead subject to the same duty of prudence that applies to ERISA fiduciaries in general, except they need not diversify the plan's assets to the extent those assets are invested in employer stock.

The case concerned a KSOP maintained by Fifth Third Bancorp, a large financial services firm. Employees were permitted to contribute a portion of their compensation, with Fifth Third matching contributions of up to four percent of an employee's compensation. The plan's assets were invested in 20 separate funds, including mutual funds and an ESOP. Participants could allocate their contributions among the funds in any way they wanted, except the company's matching contributions were always invested initially in the ESOP, after which participants could choose to move them to another fund.

Former employees and ESOP participants filed what they claimed was a class action asserting that the company and various of its officers were fiduciaries of the plan and violated their duties of loyalty and prudence. The Supreme Court considered only the duty of prudence claims, and not the duty of loyalty claims.

The plaintiffs argued that by July 2007 the fiduciaries knew or should have known that the company's stock was overvalued and excessively risky for two separate reasons. The first was that publicly available information, such as newspaper articles, provided early warning signs that subprime lending, which formed a large part of the company's business, would soon leave creditors "high and dry" as the housing market collapsed and subprime borrowers became unable to pay off their mortgages. The second reason the plaintiffs argued the fiduciaries should have known the company's stock was overvalued and excessively risky was because of nonpublic information. The plaintiffs claimed the fiduciaries who were insiders knew the company's officers had deceived the market by making material misstatements about the company's financial prospects. The plaintiffs said those misstatements led the market to overvalue the company's stock, so the plan was paying more for the stock than it was worth.

The plaintiffs argued that a prudent fiduciary would have responded to this public and nonpublic information in one or more of the following ways: (1) selling the employer stock owned by the ESOP before the value of those shares declined, (2) refraining from purchasing more employer stock, (3) "canceling" the plan's ESOP option, and (4) disclosing the inside information so the market would adjust its valuation of the company's stock downward, with the result that the ESOP would no longer be overpaying for that stock.

The company's stock price allegedly fell by 74 percent between July 2007 and September 2009, when the lawsuit was filed. The stock apparently had partially recovered to around half of its July 2007 price by the time the Supreme Court considered the case.

The Supreme Court first concluded as follows:

> [T]he law does not create a special presumption favoring ESOP fiduciaries. Rather, the same standard of prudence applies to all ERISA fiduciaries, including ESOP fiduciaries, except that an ESOP fiduciary is under no duty to diversify the ESOP's holdings.

Put another way, the Supreme Court said:

> Thus, ESOP fiduciaries, unlike ERISA fiduciaries generally, are not liable for losses that result from a failure to diversify. But aside from that distinction, because ESOP fiduciaries are ERISA fiduciaries and because [ERISA Section 404(a)(1)(B)'s] duty of prudence applies to all ERISA fiduciaries, ESOP fiduciaries are subject to the duty of prudence just as other ERISA fiduciaries are.

The court rejected the defendants' argument that a presumption of prudence was appropriate because in deciding what is prudent fiduciaries of an ESOP can consider that among an ESOP's goals are the promotion of employee ownership of employer stock. The defendants' argument was that given this nonpecuniary goal of encouraging employee ownership, an investment in employer stock would be imprudent only if the company were about to go out of business. The Supreme Court rejected the notion that nonpecuniary benefits of a qualified retirement plan, such as an ESOP, are a proper consideration when determining whether fiduciaries have acted prudently. Instead, the proper focus is on the financial benefits of the plan, such as retirement income, even where the plan is an ESOP.

After delivering this considerable blow to ESOP fiduciaries – by declaring there to be no presumption of prudence when ESOP fiduciaries make investment decisions relating to employer stock – the court provided guidance to courts considering claims of imprudent investment relating to employer stock that fiduciaries should find encouraging. This guidance related to what a plaintiff must allege to state a case that can go forward (that is, survive a motion to dismiss for failure to state a claim under Federal Rules of Civil Procedure § 12(b)(6)).

First, the Court was dismissive of potential claims that fiduciaries need to second guess the market's analysis of publicly available information as reflected in the stock price. The court put it is way:

> In our view, where a stock is publicly traded, allegations that a fiduciary should have recognized from publicly available information alone that the market was over- or undervaluing the stock are implausible as a general rule, at least in the absence of special circumstances.

That is, fiduciaries "may, as a general matter . . . prudently rely on the market price." So, a fiduciary usually "is not imprudent to assume that a major stock market . . . provides the best estimate of the value of the stocks traded on it that is available to him."

The Supreme Court left open the possibility that a plaintiff could plausibly allege imprudence on the basis of publicly available information by pointing to a "special circumstance" affecting the reliability of the market price as a fair assessment of the stock's value that would make reliance on the market's valuation of employer stock imprudent. Though acknowledging the possibility of such special circumstances, the Court gave no examples of when this might occur. One has the sense the Court was skeptical this would often occur.

The Court then offered guidance on claims that fiduciaries have behaved imprudently by failing to act on the basis of nonpublic information available to them because they were insiders. The Court said to state a claim for breach of the duty of prudence based on inside information, a plaintiff must "plausibly allege an alternative action that the defendant could have taken that would have been consistent with the securities laws and that a prudent fiduciary in the same circumstances would not have viewed as more likely to harm the fund than to help it." The Supreme Court said the following three points should help in making this determination:

1. ERISA's duty of prudence does not require a fiduciary to break the law. So, the duty of prudence cannot require an ESOP fiduciary to perform an action – such as divesting a plan's holdings of the employer's stock on the basis of inside information – that would violate the securities laws.

2. Where plaintiffs claim that fiduciaries should, on the basis of inside information, have refrained from making additional stock purchases, or disclosed that inside information to the public so the stock would no longer be overvalued, courts should consider whether doing so could "conflict with the complex insider trading and corporate disclosure requirements imposed by the federal securities laws or with the objectives of those laws." The Supreme Court did not seem ready to address these points further, noting that the SEC had not advised it of its views, which the Supreme Court noted "may well be relevant."

3. Courts considering prudence claims based on a fiduciary's inside information should consider whether a prudent fiduciary might have "concluded that stopping purchases – which the market might take as a sign that insider fiduciaries viewed the employer's stock as a bad investment – or publicly disclosing negative information would do more harm than good to the fund by causing a drop in the stock price and a concomitant drop in the value of the stock already held by the fund."

What does all this mean in terms of the risk of having key executives serve on fiduciary committees for plans that hold employer stock? As to public companies, where *Dudenhoeffer* likely has the greatest impact, the Supreme Court's decision, though eliminating the *Moench* presumption of prudence, potentially makes stock drop cases easier to defend in other respects. First, the Supreme Court confirmed what is not particularly surprising – fiduciaries are not required to violate the securities laws. The Supreme Court, though, confessed ignorance as to whether refraining from making additional stock purchases on the basis of inside information, or disclosing inside information to the public, would violate the securities laws.

Second, the Supreme Court said that to prevail plaintiffs must show there was some better course of action than what the fiduciaries did (or failed to do). The Court said, in this regard, that it is conceivable that actions frequently advocated by plaintiffs – selling company stock, refraining from future purchases, or disclosing additional information to participants – could be worse than the status quo, by causing the value of the stock held by the plan to drop. Courts considering prudence claims based on a fiduciary's inside information should consider in this connection whether a prudent fiduciary might have "concluded that stopping purchases – which the market might take as a sign that insider fiduciaries viewed the employer's stock as a bad investment – or publicly disclosing negative information would do more harm than good to the fund by causing a drop in the stock price and a concomitant drop in the value of the stock already held by the fund."

The Court summed up these two points by stating that a plaintiff must, to state a claim for breach of the duty of prudence based on inside information, "plausibly allege an alternative action that the defendant could have taken that would have been consistent with the securities laws and that a prudent fiduciary in the same circumstances would not have viewed as more likely to harm the fund than to help it."

Although the Supreme Court's direction to plaintiffs not simply to throw stones, but to show what a better path might have been, is helpful to fiduciary defendants, in a pre-

Dudenhoeffer case, *Harris v. Amgen, Inc.*, 738 F.3d 1026 (9th Cir. 2013), the Ninth Circuit did not seem overly sympathetic to fiduciaries' claims that removing a stock fund would have been detrimental to participants. The case included a pre-*Dudenhoeffer* holding relating to the presumption of prudence. Following *Dudenhoeffer*, the Supreme Court granted certiorari and remanded the case to the Ninth Circuit for further consideration in light of *Dudenhoeffer*. The Ninth Circuit's subsequent ruling, at 2014 U.S. App. LEXIS 20816 (9th Cir. 2014), is virtually identical to its decision prior to remand in all regards other than in its discussion of the presumption of prudence.

The fiduciary-defendants in *Harris* argued it would have hurt participants to eliminate the stock fund because it would have sent a negative signal to the market and resulted in a drop in the price of shares held by the plan. Interestingly, the Ninth Circuit said that where the defendant fiduciaries had inside information from the beginning (as was alleged), there would have been no such detrimental effect for participants if the fiduciaries had followed their fiduciary obligations. That is because they would have been obliged to act as soon as they knew or should have known the company's share price was artificially inflated, rather than long after they gained that knowledge and after participants had invested at an artificially inflated price. This was relevant because the defendants in *Harris* were alleged to have violated their fiduciary duties "at more or less the same time" some of them were alleged to have violated their duties under the federal securities laws. The court said if the fiduciaries had timely complied with their duties under ERISA, there would therefore have been "little or no artificial increase" in the share price before the company stock funds were removed as an investment option. For a fuller discussion of *Harris v. Amgen*, see Appendix A.

The Ninth Circuit's decision in *Harris* suggests that the reasons for excluding key executives from fiduciary committees for plans holding employer stock are just as solid as ever, in spite of somewhat encouraging statements from the Supreme Court in *Dudenhoeffer*. This is particularly true for plans of publicly traded companies. But what about private companies sponsoring ESOPs or other plans holding employer securities? The argument for their excluding key executives from fiduciary committees is probably less persuasive than for public companies. One reason it may be more appropriate for key executives of private companies to serve on a fiduciary committee is that although some private companies have very large workforces, many do not, and therefore do not have as deep a pool of management talent from which to draw for committee members as would a "typical" publicly-traded company.

In addition to the fact that a smaller workforce may leave a private company with fewer capable candidates for serving on a fiduciary committee, the stock drop litigation risk, though real, may be more *ad hoc* in nature and arise less frequently than for a public company. This is because there will typically be fewer decisions for fiduciaries of a private company's plan to make concerning the purchase or sale of shares than will be the case with respect to a public company's plan. In particular, after an initial purchase of stock by a private company's ESOP or other defined contribution plan, the plan's fiduciaries may have little opportunity to consider whether to <u>purchase</u> stock. Unlike with a public company, a private company's plan will not typically make routine, day-to-day, purchases, which means there will be fewer fiduciary decisions to be made with respect to those shares.

As a companion point, a fiduciary committee for a private company's plan will have relatively few opportunities to <u>sell</u> shares, because there will usually be no market for those shares, unless the plan has some right to put shares to the company or another shareholder. There is at least one notable exception to this relative lack of opportunity for a private company's plan to sell shares. That is where a distribution of stock is made from a plan to a participant, who then exercises his or her right to put the shares to the company. In that circumstance, the company will usually offer the plan the opportunity to purchase the shares. Assuming the plan does not own 100 percent of the company's stock, this question whether to purchase the shares put to the company may have real consequences for the plan. In contrast, in the case of a 100 percent ESOP-owned company, the aggregate value of the stock in the plan will typically be the total value of the company, so whether the plan purchases the shares put to the company will have little or no effect on the aggregate value of the stock held by the plan. This assumes the company would hold in treasury any shares put to (and purchased by) it, rather than selling those shares to another prospective shareholder. The plan's decision whether to buy the put shares may, though, well affect the relative value of participants' accounts. That is because a plan might (and typically would) allocate newly purchased shares to the accounts of all participants, whereas a simple increase in the value of shares resulting from the company holding put shares in treasury would increase the value of the shares already in participants' accounts. In the case of some plans, this could favor longer term participants over shorter term participants, because the latter may have fewer shares allocated to their accounts.

Fiduciaries of a private company's plan might also have a fiduciary decision to make with respect to shares of company stock where the plan enables the fiduciary committee to determine whether to distribute cash or stock.

When participants do not themselves make the investment decision whether to buy employer stock – which will typically be the case under a private company's plan (that typically will not be a KSOP) – there may be a lesser need to disclose "inside" information to participants, given that they are not making investment decisions with respect to employer stock. Nonetheless, participants may argue they have a need for that information to help them (a) decide when to terminate employment and become eligible for a distribution, (b) decide whether to put distributed shares to the company at their first opportunity, or instead wait for a later opportunity, which might be a year later, and (c) plan their retirement by taking into account the value of amounts to which they may become entitled under the plan.

On balance, for a private company, allowing key executives to serve on a fiduciary committee may seem imperative due to the typically smaller workforce talent pool, and may be slightly less dangerous from a fiduciary prospective than for a public company plan. The reasons that have developed over the last 10 to 15 years for excluding key executives from fiduciary committees for publicly traded companies are, however, probably still as strong as ever, in spite of the Supreme Court's somewhat soothing *dicta* in *Dudenhoeffer* (other than the bad news on the *Moench* presumption of prudence).

All of this begs the question whether a board of directors or other party with the power and duty to appoint and monitor members of a fiduciary committee breach their duties of loyalty or prudence by purposefully and categorically excluding certain key executives for consideration as committee members. Although one could fashion a theoretical argument that doing so constitutes a breach, I don't think such a policy should constitute a *per se* violation of the fiduciary obligations of the body appointing committee members. That is in part because I do not know of precedent establishing a fiduciary obligation to appoint the very "best" candidates to a fiduciary committee. In addition, one could easily argue that a key executive with much on his or her plate, and therefore less time to devote to his or her fiduciary obligations, might not be the "best" choice anyway. Further, the skill set of, say, a COO, may be less well-suited to serving on a fiduciary committee than might be the skill set of a benefits manager, HR vice president, plant manager, or director of investments for the employer's treasury department.

There are potentially so many qualified candidates to serve on a fiduciary committee, and so many factors to consider in terms of experience, tenure with the company, temperament, judgment, knowledge, and time to devote to one's fiduciary responsibilities, that it would seem hard to argue that a prohibition on appointing certain high level executives to fiduciary committees would in and of itself constitute a fiduciary breach. And in any event, such a prohibition is unlikely to be made written policy; instead, the disadvantages of including key executives on a fiduciary committee may simply be one of the considerations taken into account by the board (or other individual or body) appointing members of a fiduciary committee. Finally, one could argue that to the extent a key executive is unable to function as forthrightly and fully as another committee member due to concern about his or her use of inside information, the executive might well not be the ideal candidate to work well and candidly with his or her committee colleagues.

2. **What You Should Ask Investment Managers Following the Western Asset Management Company ("WAMCO") Settlement with the DOL**. Some securities, by the terms of their offering documents, are not available for purchase by plans subject to ERISA. Why might an issuer not want to sell to plans subject to ERISA? The concern is typically that the assets of the company issuing the security may become plan assets. In that event, the company issuing the stock, or in some case bonds, could become subject to ERISA fiduciary standards in dealing with its own company assets! This, of course, would generally be untenable because it would require, among other things, that the issuing company deal with its own company assets for the exclusive purpose of providing benefits and defraying reasonable plan expenses for the plans buying its securities. In addition, it could complicate or make impermissible dealings between the issuing company and any party in interest with respect to any of the investing plans. So, for example, if the company issuing the security were a manufacturer of widgets, it could not sell those widgets to an employer sponsoring a plan that has bought the security. That is because the widgets would be considered plan assets and the sale would be a prohibited sale of plan assets to a party in interest (an employer with employees covered under the plan). In addition, if the issuer were outside the United States, and its assets were considered plan assets of a plan investor, this may raise a question as to whether the investing plan's fiduciaries are impermissibly maintaining the indicia of ownership of plan assets (that is, the issuing company's assets)

outside the jurisdiction of the district courts of the United States, in violation of ERISA Section 404(b).

The concerns described above, which are all a consequence of the security issuer's assets being treated as assets of an investing plan, are inapplicable with respect to many, and perhaps most, plan investments. That is because the Department of Labor's regulations defining what constitutes a "plan asset" describe many types of investments with respect to which the issuer's underlying assets are not treated as assets of an investing plan. *See* 29 CFR § 2510.3-101. Specifically, the DOL regulations helpfully provide that "[g]enerally, when a plan invests in another entity, the plan's assets include its investment, but do not, solely by reason of such investment, include any of the underlying assets of the entity." 29 CFR § 2510.3-101(a)(3). This general, and favorable, rule, which avoids the worry that a plan's investment in a security will cause the issuer to become a fiduciary of the plan, or that the issuer's assets will become plan assets for prohibited transaction purposes, does not, however, apply in certain cases. Specifically, where a plan invests in an equity interest of an entity that is neither a publicly-offered security nor a security issued by an investment company registered under the Investment Company Act of 1940 (such as, a mutual fund), the plan's assets include not only the equity interest, but also an undivided interest in each of the underlying assets of the entity, unless either the entity is an "operating company" or equity participation in the entity by benefit plans investors is "not significant." The regulations expressly point out that in this circumstance any person who exercises authority or control respecting the management or disposition of the underlying assets of the entities in which the plan acquired an equity interest, and any person who provides investment advice with respect to those assets for a fee (direct or indirect), is a fiduciary of the investing plan. *Ibid*.

Note that this troublesome situation does not arise where the equity interest is in an entity that is an "operating company." An operating company is an entity that is primarily engaged, directly or through a majority-owned subsidiary or subsidiaries, in the production or sale of a product or service other than the investment of capital. 29 CFR § 2510.3-101(c)(1). In addition, the term "operating company" is considered to include "a venture capital operating company" and a "real estate operating company" as defined in 29 CFR §§ 2510.3-101(d) and (e).

Note also that the "plan asset" concern arises only where the plan invests in an "equity interest." The term "equity interest" means any interest in an entity other than an instrument that is treated as indebtedness under applicable local law and which has no substantial equity features. CFR § 2510.3-101(b)(1). Notably, a profits interest in a partnership, an undivided ownership interest in property and a beneficial interest in a trust <u>are</u> equity interests. *Ibid*.

Offering documents for securities sometimes warn potential plan investors of the risk that the issuer's assets will be treated as plan assets, but do not prohibit investment by plans subject to ERISA. In other circumstances, the offering documents may include a flat prohibition on investment by plans subject to ERISA, with a requirement that each investor represent that it is not a plan subject to ERISA (perhaps through a deemed representation, where the act of purchasing the security is deemed to be a representation that the purchaser is not a plan subject to ERISA). For this latter type of security, one presumes that the issuer is sufficiently concerned that its assets will be considered plan assets, and sufficiently worried about the potential fiduciary and prohibited transaction implications for the issuer itself that could result, that it does not wish to permit plan investors.

So here is the news: many investment managers have been paying insufficient, if any, attention to statements in issuers' offering documents prohibiting investment by plans subject to ERISA. This came to light most publicly in connection with the settlement of claims by the SEC and Department of Labor against Western Asset Management Company ("WAMCO"), a subsidiary of Legg Mason Inc. The Department of Labor, in an EBSA news release dated January 27, 2014, and the SEC, in orders instituting administrative and cease-and-desist proceedings (Investment Advisers Act of 1940 Releases Nos. 3762 and 3763, Investment Company Act of 1940 Release No. 30893, and Administrative Proceeding Files No. 3-15688 and 3-15689 (all dated January 27, 2014)), announced the settlement of two types of claims against WAMCO. The DOL settlement and related SEC charges required WAMCO to restore a total of more than $17.4 million to benefit plans and other accounts and required WAMCO to pay more than $3.6 million in penalties.

As to the first type of claim made by the DOL and SEC, the agencies asserted that over a period of roughly two and a half years, WAMCO used ERISA plan assets to purchase approximately $90 million in securities that were prohibited for purchase and ownership by plans subject to ERISA. These involved investments in a related set of securities for 99 accounts subject to ERISA. The DOL alleged that WAMCO's own compliance system recognized that the terms of the securities prohibited their ownership by plans subject to ERISA, but WAMCO overrode the system to permit their purchase.

The DOL also asserted that WAMCO's management and compliance personnel knew of this about 20 months after the purchases began, but did not immediately correct the error or inform clients, in violation of the company's own policies. Instead, the securities continued to be held for another nine months or so, at which time they were sold, resulting in significant losses.

The DOL and SEC also complained that WAMCO arranged for 514 cross-trades, in which WAMCO sold fixed income securities to various broker-dealers and then repurchased the same securities from the same broker-dealers on behalf of different clients at a markup and without obtaining independent offers. The DOL's complaint was that as a result of "unfair pricing" involving these cross-trades, some ERISA plans suffered more roughly $6.2 million in losses. The essence of the SEC's complaint was that because WAMCO arranged to cross the securities at the bid price, it allocated the full benefit of the roughly $12.4 million in market cost savings resulting from the cross-trading to its <u>buying</u> clients. As a result, WAMCO deprived its clients selling securities of their share of the market savings, which was roughly $6.2 million.

A number of investment managers have, in response to the WAMCO settlement, reviewed their investment records in an attempt to determine whether they purchased securities for plans subject to ERISA that, by their terms, were not available for purchase by such plans. In other cases, plan fiduciaries have themselves asked managers to review their records for purchases of those securities. In both cases, it has not been unusual to find that plans have made these purchases. Investment managers point out that this is a difficult issue for them as a practical matter because, particularly when they are not buying the initial issue of a security (such as a bond that may be treated as an equity interest under the DOL's regulations), but are instead buying the security on the secondary market, the offering documents may be hard to obtain, and the commercial services relied on by investment managers to flag securities that are not eligible for purchase by plans subject to ERISA have proven incomplete or inaccurate, or both.

In spite of a heightened sensitivity to the issue following the WAMCO settlement, these practical difficulties leave most investment managers with improved, but still potentially deficient, processes for safeguarding against investment in securities that, by their terms, are not to be held by plans subject to ERISA. In most cases managers seem to be paying particular attention to securities of types that, in their experience, are most likely to include an investment prohibition. These might include, for example, loan participation notes, perpetual capital securities, and credit-linked notes. For these types of securities, a manager might, under new procedures, not make new purchases if it is unable to both obtain the offering documents and search them to make certain they include no prohibitions on investment by plans subject to ERISA.

When an investment manager finds that it has securities the offering documents for which prohibit investment by plans subject to ERISA, the next question is what corrective steps should be taken. It appears that most managers have, since the WAMCO settlement, disposed of securities they have found that, by the terms of their offering documents, are not available for purchase by plans subject to ERISA. Most investment managers have error correction policies, consistent with the requirements applicable to them under the Investment Advisers Act of 1940. Plan fiduciaries may wish to address with investment managers whether their purchase and holding of these securities constituted errors under their error correction policies, and if so what those policies provide for in the way of correction. In addition, fiduciaries may wish to consider whether the plan was otherwise damaged. One measure of that damage might be by reference to how the plan's assets that were impermissibly invested would have performed had they been invested in other securities. This, of course, is a speculative question, but one proxy for that performance might be the performance of the balance of the portfolio managed by the investment manager (that is, disregarding the securities not available for purchase by plans subject to ERISA).

Many investment managers have argued that plans were not harmed by these investments in securities not available for purchase by plans subject to ERISA. Some have even argued that they did not act negligently and did not violate the terms of their investment management agreements by making these purchases. Part of their argument is that no prohibited transaction occurred, though it is often unclear how the manager has been able to make such a determination (and, in fact, whether it is true). A plan fiduciary, other than the investment manager, may not know until years later whether there has been (a) a prohibited transaction as a consequence of the investment, (b) a co-fiduciary breach by the plan fiduciary as a consequence of the issuer's actions that are themselves a breach, (c) an impermissible holding of the indicia of ownership of assets outside the jurisdiction of the district courts of the United States, or (d) some other legal concern. For this reason, plan fiduciaries may wish to determine to what degree indemnification provisions under their existing investment management agreement may provide them with protection from later claims, and perhaps ask the investment manager to waive any statute of limitations or laches defenses with respect to a later request for indemnification relating to investments in securities which, by the terms of their offering documents, may not be purchased by plans subject to ERISA.

Because many investment managers take the position that their investment in securities that, by the terms of their offering documents, were not available for purchase by plans subject to ERISA, were not negligent, did not violate the managers' contractual obligations under their investment management agreements, and did not violate fiduciary prudence requirements or other obligations, plans may wish to modify the investment guidelines under which their managers operate to expressly prohibit the purchase of a security if the terms of the security or the governing documents for that security prohibit investment by plans subject to ERISA and that prohibition is disclosed in the offering documents for the security.

3. **<u>Making Sure Investment Consultants are Subject to Fiduciary Standards</u>**. It is best to have a clear, written understanding as to whether those providing investment advice to an employee benefit plan are fiduciaries. The DOL regulations relating to the prohibited transaction exemption permitting plans to pay service providers reasonable amounts for necessary services require, in the case of pension plans, that the required fee disclosure information provided to the "responsible plan fiduciary" include a statement that the service provider will provide, or reasonably expects to provide, services as a fiduciary, assuming that is the case. 29 CFR § 2550.408b-2(c)(1)(iv)(B). This is helpful where the investment professional providing advice with respect to a pension plan agrees that it is a fiduciary (and will be paid by the plan or otherwise wants the protection of the Section 408(b)(2) prohibited transaction exemption).

The fee disclosure required under the 408(b)(2) regulations may not, however, cause a party providing investment advice to state in writing that it is a fiduciary where the investment advice is being provided with respect to a welfare, rather than pension, plan (because he fee disclosure requirement does not apply to welfare plans), or where the investment professional takes the position that it is not a fiduciary (whether with respect to a pension or welfare plan). Sometimes the latter occurs where the advisor is a broker-dealer, even if affiliated with a large broker-dealer organization. The broker-dealer may assert that he or she (or his or her organization) is not a fiduciary because he or she (a) does not have discretionary authority or control with respect to purchasing or selling securities or other property for the plan (a true statement, where the individual is not in fact making investment decisions), and (b) does not make investment recommendations causing the individual or firm to become a fiduciary under 29 CFR Section 2510.3-21(c)(1)(ii)(B). The second part of this argument is typically grounded in an assertion that there is no "mutual agreement" that the investment professional's services will serve as "a primary basis" for investment decisions or, less likely, that the individual or firm will not be rendering "individualized investment advice" based on the "particular needs of the plan." Although these assertions are often specious, an investment professional's position that he or she (or his or her organization) is not subject to fiduciary standards, and will not be subject to the prohibited transaction rules imposed on fiduciaries, should be a matter of concern for plan fiduciaries retaining the advisor. Further, should there be trouble down the road, this likely signals that there will be a need at that time to argue, perhaps in court, about whether the advisor served as a fiduciary.

For an example of a different concern about not having a clear written agreement that an investment professional is serving in a fiduciary capacity, see the article attached as Appendix B, which discusses the *Tiblier v. Dlabal* case. There, the Fifth Circuit held that an investment advisor was not a fiduciary under ERISA Section 3(21)(A)(ii) because even if he rendered investment advice for compensation, he did not receive a fee from the relevant plans. Instead, the advisor received his compensation in the form of a commission paid by the company issuing corporate bonds that were purchased by the plans, and which resulted in the dispute when the issuer failed.

4. **Fiduciaries' Ability to Rely on Advice of Counsel: *Clark v. Feder Semo & Bard, P.C.*** The D.C. Circuit Court of Appeals recently addressed the effect of a fiduciary's reliance on legal counsel when defending a claim that the fiduciary engaged in a fiduciary breach. The case is *Clark v. Feder Semo & Bard, P.C.*, 739 F.3d 28 (D.C. Cir. 2014). The lawsuit involved the closure of a law firm and termination of its cash balance pension plan. Ms. Clark, who had been an attorney at the firm for almost 10 years, was a participant in the plan. She filed a lawsuit alleging that the law firm's two directors who administered the retirement plan had breached their fiduciary duties.

Ms. Clark had at least a couple of complaints. One was that the plan had insufficient assets to pay all benefits at the time of its termination. A second was that Ms. Clark believed she was entitled to benefits under a better formula than the one used to calculate her distribution.

As to the first of these issues, the underfunding of the plan, Ms. Clark complained that the firm's founder had been paid in full and that doing so violated Tax Code Section 401(a)(4), the Code's general nondiscrimination rule for qualified retirement plans. The plan had apparently paid retirement benefits to the principal owner (and founder) of the firm in two lump sums that may have violated the "top 25 employee" rules set forth in Treasury Regulation Section 1.401(a)(4)-5(b)(3). This was of particular concern because the plan was alleged to have been underfunded at the time the payments were made, and other plan participants allegedly received only 53 percent of the present value of their retirement benefits. As to this first complaint, the court, not surprisingly, concluded that a participant has no right to force the plan to follow the Tax Code's qualified plan rules (that are not terms of the plan itself, and are not found elsewhere in the non-tax provisions of ERISA), because those rules relate only to whether the plan is qualified, not the rights of participants.

Ms. Clark also argued that it was a fiduciary breach to conclude that she was entitled to a lower level of benefits than was provided to one or more of the other participants. Specifically, in calculating Ms. Clark's distribution, the two plan fiduciaries placed her in a group of employees whose share was based on the firm's annual contribution to the retirement plan of 10 percent of their salary. Ms. Clark objected to this, asking that she be reassigned to the group of participants whose share was based on the firm's annual contribution of 20 percent of their salary. Notably, the fiduciaries relied on the advice of the plan's lawyer in denying this request. Ms. Clark argued that the fiduciaries were not entitled to rely on that legal advice because it was based on a mistake of fact they would have discovered had they undertaken an independent investigation.

The D.C. Circuit concluded that ERISA did not displace the common law principle under trust law that a fiduciary may rely on the advice of counsel "when reasonably justified under the circumstances." As to this common law principle of trust law (that is not displaced by ERISA), the court said the following:

> [I]t is a principle firmly rooted and founded in the common law of trusts that a fiduciary may rely on the advice of counsel when reasonably justified under the circumstances. The propriety of that reliance must be judged based on the circumstances at the time of the challenged decision. The fundamental question is always whether a prudent trustee in those particular circumstances would have acted in reliance on counsel's advice. If course, reliance would be improper if there were significant reasons to doubt the course counsel suggested.

The attorney on which the fiduciary relied consulted what he thought were the relevant documents, and concluded that both the plaintiff, Ms. Clark, and one of the fiduciaries, Mr. Bard, should be assigned to the same group – that is, both should have been placed in the 10 percent group or both should have been in the 20 percent group. Both these attorneys began work at the firm around the same time and both made partner in the same year. Legal counsel concluded that Mr. Bard had always been in the 10 percent group, so Ms. Clark should be in that group as well.

In recommending to the two fiduciaries, Messrs. Bard and Semo, that Ms. Clark be placed in the 10 percent group, legal counsel forwarded to the fiduciaries a memo written three months after Ms. Clark made partner that showed that Ms. Clark and Mr. Bard were in the 10 percent group. Mr. Bard thought he and Ms. Clark had been in the 10 percent group during all the years they worked at the firm, and therefore in Mr. Bard's mind the memo was consistent with his understanding of the facts. The memo was also consistent with the shared belief of the two fiduciaries, Messrs. Semo and Bard, that the 20 percent group was only for Mr. Semo, who was more senior than Ms. Clark and Mr. Bard.

Well, as it turns out, legal counsel "was mostly right but partly wrong" in his understanding of the facts. He was right that Ms. Clark and Mr. Bard had both been in the 10 percent group for most of their time at the firm, but was wrong in reporting that both had been in the 10 percent group for all of their years at the firm. That is because Mr. Bard was placed in the 20 percent group for a single year, though neither Mr. Bard nor Mr. Semo had requested, approved, or even known of this assignment of Mr. Bard to the 20 percent group.

The plaintiff, Ms. Clark, argued that the fiduciaries, Messrs. Semo and Bard, were not entitled to rely on legal counsel's recommendation that they conclude that Ms. Clark had properly been placed in the 10 percent group. The court said Ms. Clark seemed to assume that the fiduciaries had an "absolute duty to look behind [legal counsel's] advice and conduct their own investigation to see if it was grounded in fact." The court said there is no such "unyielding obligation." Ms. Clark's argument turned on legal counsel's advice being based in part on a mistake about who was in the 10 percent and 20 percent groups in the single year that Mr. Bard was in the 20 percent group. But the court held that the fiduciaries were justified in relying on legal counsel's advice because at the time it was given, they had no reason to know or even suspect legal counsel's mistake in understanding the facts.

The key conclusions of the D.C. Circuit in terms of a fiduciary's ability to rely on the advice of legal counsel in repelling a claim of fiduciary breach are as follows:

- With respect to claims of fiduciary breach, a fiduciary may rely on the advice of legal counsel when reasonably justified under the circumstances.

    - The propriety of that reliance is judged based on the circumstances at the time of the challenged decision.

    - The fundamental question is whether a prudent trustee in those circumstances would have acted in reliance on counsel's advice.

    - Reliance would be improper if there were significant reasons to doubt the course counsel suggested.

    - In this case, although legal counsel had misunderstood a potentially important fact, the fiduciaries had no obligation to investigate the propriety of counsel's advice because they had no reason to know or suspect legal counsel was relying on mistaken information, his recommendation appeared to be based on reasonable investigation, was accompanied by supporting documentation, and was consistent with the understanding the fiduciaries had about the way the plan's benefit groupings were structured.

The question the case raises, but does not answer in any satisfying way, is to what degree relying on the advice of counsel will defeat claims of fiduciary breach. Nonetheless, in wrestling with benefit claims, and in particular when interpreting plan provisions in that connection, a fiduciary's reliance on counsel may prove quite helpful, as seems to have been the case in *Clark*. In addition, to the extent courts considering prudence claims focus, as they often do, on whether the fiduciaries followed a good process – that is, whether they engaged in "procedural prudence" – justified reliance on the advice of legal counsel may prove very helpful to fiduciary defendants. The degree to which justified reliance on advice provided legal counsel will effectively protect fiduciaries with respect to other types of fiduciary claims, such as those relating to the duty of loyalty under the "exclusive purpose" provisions of ERISA Section 404(a)(1)(A), is less clear, other than by improving the odds the fiduciaries will have a better understanding of their fiduciary obligations under the law and thereby lessening the chance they will in fact breach their fiduciary duties.

5. **<u>IRS Emphasis on Internal Controls and What It Means for Fiduciaries</u>**. The IRS has indicated as follows:

> When auditing a retirement plan, the agent begins by evaluating the plan's internal controls to determine whether to perform a focused or expanded audit. In addition, if the agent finds plan errors, the strength of internal controls is a factor in the negotiation of the sanction amount under Audit Cap. The agent will make every effort to ensure that the plan has internal controls in place when the audit concludes.

The IRS has a special audit policy for benefit plans of large employers. These audits are handled through an Employee Plans Team Audit ("EPTA"). An EPTA audit is a special type of pension plan audit a team of more experienced IRS agents conducts of a plan or plans of a "large employer" (which generally means an employer with qualified pension plans that, in total, have at least 2,500 participants).

In an EPTA audit, agents conduct an in depth audit of what "internal controls" the employer has and how the employer applies those controls to a specific plan or plans for a specific open year or years. The IRS says the number of plans and years it examines depends upon what its agents find during the initial audit. In deciding whether to expand an investigation, a key consideration is whether the agents are able to conclude from their initial audit that the employer has sufficient internal controls in place to avoid major mistakes and to identify and correct quickly any mistakes the internal controls reveal.

If, in their initial review, agents find that the employer has checks and balances, whether automatic or mechanical, that are likely to prevent errors or quickly catch errors, the IRS will consider limiting the focus of the audit and not audit every plan in every year. Initially, EPTA audits involve only one year, and then the EPTA team decides whether to expand the audit depending on what it finds with respect to that year and the internal controls in place.

"Internal controls" are the methods that the employer has in place to minimize the risk of mistakes. They can be anything from electronic systems that "talk" to each other to peer cross checks to annual reviews. The concept is that internal controls will help avoid mistakes or at least catch them quickly.

To examine internal controls, at the beginning of an EPTA audit agents generally interview an employer's human resource staff, payroll staff, plan administrators, and other responsible parties such as recordkeepers and paying agents. EPTA agents also gather information with respect to electronic records and computer systems and how one system interrelates to another. The IRS says this process gives its agents a good idea, based on experience, of what problems are likely to exist, and forms the basis for the initial focused review. In conducting the focused review, agents look at whether the systems perform in the manner represented. If the employer indicates that it conducts regular self-audits or reviews, the agents give the employer the opportunity to share all or part of those self-audits and reviews. The EPTA website provides sample internal control questions EPTA agents could ask during their interviews and examination.

In public presentations, the IRS has indicated that as part of an audit – even non-EPTA audits – plan sponsors need to be prepared to explain the plan administrative processes, including internal controls. The IRS has said potential audit questions probing the strength of an employer's internal controls might include the following:

- Who is responsible for making timely amendments to the plan for changes in the law?
- If there has been a merger or acquisition, and the plans are merged, who verifies that the language of the resulting plan is correct as intended?
- Who determines the participants' compensation amount for plan purposes from the payroll records?
- Who verifies that participants' compensation used for all plan purposes is according to the definitions in the plan document?
- Who determines when an employee is eligible to participate in the plan?
- Who verifies the plan's loan provisions?
- Who verifies that correct data was used to complete the annual testing?
- Who verifies deferrals allocated to participants' accounts are correct?
- Who ensures that each participant receives the correct matching and/or nonelective contribution?

It is notable also that to self-correct plan defects under the IRS' qualified retirement plan correction program – which is called the Employee Plans Compliance Resolution System (and which is sometimes referred to by the acronym "EPCRS") – a plan must have "established practices and procedures (formal or informal) reasonably designed to promote and facilitate overall compliance with applicable [Tax] Code requirements."

In a PowerPoint presentation from August 2013, IRS representatives (Monika Templeman and Janice Gore), indicated that good internal controls will impact Audit Closing Agreement Program ("Audit Cap") sanction negotiations. The same PowerPoint says an EP agent will evaluate the effectiveness of a plan's internal controls to determine whether to perform a focused audit (just looking at three to five issues), or instead expand its scope of the examination. Further, the PowerPoint says if a self-correction action is more than 65 percent complete, even if the error is significant, it can be self-corrected during the audit.

6. **Rollovers: To Whom Are You Giving Access to Terminating Participants**? Rollovers to IRAs have in recent months received quite a bit of attention from regulators and policymakers. Perhaps this should come as no surprise given that IRAs are estimated to have held $7.2 trillion as of June 30, 2014, meaningfully more than the $6.6 trillion then

held in employer-sponsored defined contribution plans (including both plans sponsored by private sector and government employers). Investment Company Institute Release dated September 25, 2014 ("Retirement Assets Total $24.0 Trillion in Second Quarter 2014"). It appears the overwhelming majority of IRA assets have come from rollovers from qualified plans. In 2010, for example, rollovers were made in an amount totally almost 12 times the total amount added to IRAs through non-rollover contributions. Craig Copeland, "Individual Retirement Account Balances, Contributions, and Rollovers, 2010: The EBRI IRA Database,™" *EBRI Issue Brief*, No. 371, May 2012, p. 10. Similarly, in 2008 rollovers totaled more than 10 times the amount contributed to IRAs in non-rollover contributions. Craig Copeland, "IRA Balances and Contributions, An Overview of the EBRI IRA Database," *EBRI Issue Brief*, No. 346, September 2010.

The advice provided to qualified plan participants eligible for a distribution as to whether to roll over benefits to an IRA has come under considerable scrutiny, and to some extent criticism, over the past couple of years. The Government Accountability Office ("GAO") issued a report in March 2013 entitled "401(k) Plans: Labor and IRS Could Improve the Rollover Process for Participants" (GAO-13-30), in which the GAO said the following:

> Many experts told us that much of the information and assistance participants receives is through the marketing efforts of service providers touting the benefits of IRA rollovers and is not always objective. Plan participants are often subject to biased information and aggressive marketing of IRAs when seeking assistance and information regarding what to do with their 401(k) plan savings when they separate or have separation from employment with a plan sponsor. In many cases, such information and marketing come from plan service providers. As we have reported in the past, the opportunity for service providers to sell participants their own retirement investment products and services, such as IRAs, may create an incentive for service providers to steer participants toward the purchase of such products and services even when they may not serve the participants' best interests.

The Financial Industry Regulatory Authority Inc. ("FINRA"), the brokerage industry's self-regulatory organization, has warned broker-dealers that their advice concerning the suitability of rolling over monies from a 401(k) plan into an IRA should "never be compromised by their financial interests in recommending an IRA rollover or another action." FINRA Regulatory Notice 13-45 (December 2013), ¶ 6. As a general matter, broker-dealers are regulated as salespersons under the Securities Exchange Act of 1934. In contrast, investment advisors are regulated as advisers under the Investment Advisers Act of 1940. For this reason, different legal standards apply to broker-dealers and investment advisors when they are offering advisory services. In general, a "suitability" standard applies in the case of advice offered by a broker-dealer. In contrast, a fiduciary duty applies to investment advisors. Yet a number of observers have noted that broker-dealers offer investment planning and retirement planning services that are similar to those offered by investment advisors.

One might argue that FINRA has effectively warned its member firms that they should not recommend a rollover from a 401(k) plan if it is better for the participant to leave the money in the plan or transfer it to a new employer's plan. That is because FINRA has said, in the context of rollover advice, "any recommendation to sell, purchase or hold securities must be suitable for the customer and the information that investors receive must be fair, balanced, and not misleading." FINRA Regulatory Notice 13-45, Text Accompanying Note 8. One may argue whether this guidance marks a change from the normal suitability standard, but some commentators have suggested FINRA's goal, in part, is to get in front of the expected re-proposal of the DOL's regulation on the definition of the term "fiduciary," in which the DOL may be eager to apply a fiduciary duty to brokers who sell IRAs as rollover vehicles.

In addition to the FINRA regulatory notice quoted in the paragraph above, the Securities and Exchange Commission announced in its 2014 examination priorities that it "shared the [Government Accountability Office's] concerns that investers may be misled about the benefits of rolling over assets . . . to an IRA." The SEC's examination priorities document says the SEC will focus attention on the practices of broker-dealers, as well as investment advisers, with respect to IRA rollovers. In particular, the SEC said it will examine investment advisers and broker-dealers for "possible improper or misleading marketing and advertising, conflicts, suitability, churning, and potentially misleading professional designations" when recommending IRA rollovers. SEC, Examination Priorities for 2014 ¶ II, "Retirement Vehicles and Rollovers."

The Department of Labor, in Advisory Opinion 2005-23A, considered whether a financial planner or advisor who gives advice to plan participants on whether to roll over their account balance to an IRA to take advantage of investment options not available under the plan, is giving investment advice with respect to those plan assets within the meaning of 29 CFR § 2510-3.21(c). If so, this could result in the financial planner or advisor being a plan fiduciary. The DOL concluded that this advice, in and of itself, would not make an advisor a fiduciary with respect to a 401(k) plan or other retirement program. Specifically, the Department concluded that merely advising a plan participant to take an otherwise permissible plan distribution, even when that advice is combined with a recommendation as to how the distribution should be invested, does not constitute "investment advice" within the meaning of the cited regulation (that is, the regulation that defines when a person is a fiduciary by virtue of providing investment advice with respect to the assets of an employee benefit plan.) The Department's view in its advisory opinion was that a recommendation to take a distribution was not advice or a recommendation concerning a particular investment (that is, purchasing or selling securities or other property) as contemplated by the regulation. And any investment recommendation regarding the proceeds of the distribution would be advice with respect to funds that are no longer assets of the plan, but are instead assets of an IRA.

This notion that giving advice on whether to rollover monies to an IRA is not investment advice is interesting in the way it contrasts with FINRA's conclusion in its notice mentioned above, advising broker-dealers about their responsibilities when giving rollover-related advice. In its notice, FINRA concluded that a recommendation about the type of retirement account in which a customer should hold his or her retirement investments typically involves a "recommended securities transaction," which makes the recommendation subject to FINRA's Rule 2111. In particular, the FINRA Notice said the following:

> A recommendation concerning the type of retirement account in which a customer should hold his retirement investments typically involves a recommended securities transaction, and thus is subject to Rule 2111. For example, a firm may recommend that an investor sell his plan assets and roll over the cash proceeds into an IRA. Recommendations to sell securities in the plan or to purchase securities for a newly-opened IRA are subject to Rule 2111.

FINRA Regulatory Notice 13-45, ¶ 4.

The DOL Advisory Opinion's conclusion that a financial planner or advisory who was not a plan fiduciary would not, by reason of recommending a rollover to an IRA, become a plan fiduciary has prohibited transaction implications. Specifically, the DOL ruled that an advisor who is not otherwise a plan fiduciary and who recommends that a participant withdraw funds from the plan and invest them in an IRA, would not engage in a prohibited transaction if the advisor were to earn management or other investment fees related to the IRA. That, again, is because of the DOL's view that a recommendation by someone not connected with the plan to a participant to take an otherwise permissible distribution, is not investment advice within the meaning of the fiduciary regulation, even when combined with a recommendation as to how to invest distributed funds, nor is the recommendation, in and of itself, an exercise of authority or control over plan assets that would make a person a fiduciary within the meaning of ERISA Section 3(21)(A). Because a person making such recommendations would not be a fiduciary solely on the basis of making those recommendations, this non-fiduciary advisor would not engage in a prohibited act of self-dealing under ERISA where he or she advises the participant to roll over the participant's account balance from the plan to an IRA that will pay management or other investment fees to the advisor.

The DOL warned, however, that these conclusions apply only to advice provided by a person who is not a plan fiduciary on some other basis. So, for example, if a plan officer or someone who was already a plan fiduciary were to respond to participant questions concerning the advisability of taking a distribution, or the investment of amounts withdrawn from the plan, that fiduciary would be exercising discretionary authority respecting management of the plan and must act prudently and solely in the interest of the participant. (Note, interestingly, that this conclusion is that the fiduciary would be exercising discretionary authority respecting <u>management of the plan</u>, not management or disposition of its <u>assets</u>.) In addition, the DOL warned that if a fiduciary were to exercise control over plan <u>assets</u> to cause the participant to take a distribution and then invest the proceeds in an IRA account managed by the fiduciary, the fiduciary may be using plan assets in his or her own interest, in violation of ERISA Section 406(b)(1).

All of this is interesting as a policy matter, but the practical concern that may more commonly arise in connection with rollovers is to what degree plan fiduciaries should be concerned about contacts a plan's trustee, or other existing fiduciary, may have with participants who are poised to receive a distribution. Consider, for example, a financial institution serving as trustee that communicates with participants about IRAs it offers. One arguably prudent approach may be (a) to prohibit trustees and other fiduciaries from providing participants with any materials relating to their proprietary IRAs, or otherwise discussing or promoting, or even proactively educating participants about, the fiduciary's IRA options, but (b) not prohibit the fiduciary from responding to participants' unsolicited requests for information. In the event of an unsolicited request for information, it may be best to limit the fiduciary to providing those materials only in the form of generally available promotional materials, rather than providing specific advice to a participant about the advantages to that participant of the fiduciary's proprietary IRAs.

This is a tricky terrain to traverse, but a fiduciary may argue that the prudent course is not to entirely prohibit a trustee or other fiduciary from responding to an unprompted request from a participant for information about the fiduciary's IRA products. That is because the best chance to keep distributed assets in the "retirement system," so as ultimately to provide retirement income to participants, may be through a rollover to an IRA product of an incumbent plan vendor. That may be the case given the relative ease with which a participant may roll over to the fiduciary's IRA product and the participant's familiarity with the incumbent plan vendor. In the case of distributions that are not the result of an involuntary cash out, the analysis is even trickier because often the better option for a participant will be to leave his or her monies in the 401(k) or other plan itself, rather than rolling over those monies to an IRA that may carry higher investment management or other charges than those applicable under the plan. Although permitting a trustee or other fiduciary to provide materials about its proprietary IRA products on request might be supportable, it is harder to argue for allowing a trustee or other fiduciary to proactively provide participants with those materials, or encourage participants to roll over a distribution, rather than retain assets in the plan.

7. **Lessons from *Tussey v. ABB, Inc*.** The Eighth Circuit Court of Appeals issued a notable ruling in a 401(k) "excessive fee" class action in *Tussey v. ABB, Inc*., 746 F.3d 327 (8th Cir. 2014). The court considered appeals from a district court decision in which the district court, following a 16 day bench trial, entered judgment against ABB, Inc. ("ABB"), the plan sponsor, various fiduciaries associated with ABB, and a couple of Fidelity entities. The claims related to two 401(k) plans, one for union employees and the other for non-union employees. The chief Fidelity defendants were Fidelity Management Trust Company, which served as the trustee and recordkeeper for the plans, and Fidelity Management and Research Company, which was the investment advisor to certain Fidelity mutual funds included as investment options under the plans. Like the court, I will use the term "Fidelity" to refer to either of these entities, despite the lack of precision doing so will entail. I will treat as accurate the facts as recited by the Eighth Circuit.

The Eighth Circuit considered three general topics. The first was whether ABB and its fiduciaries paid too much in 401(k) plan fees and whether they allowed 401(k) fees to improperly subsidize the costs of services provided by Fidelity to other plans and the company. The second concerned the propriety of removing the Vanguard Wellington Fund, a balanced fund, from the investment platform and at the same time adding target date funds, the Fidelity Freedom Funds. The third issue was whether Fidelity acted improperly with respect to its handling of float income.

ABB plan participants were permitted to choose how monies in their accounts were to be invested among investment options selected by the plan fiduciaries. The company matched a portion of each contribution, up to six percent of a participant's compensation. Most of the investment options were mutual funds, including a number of Fidelity funds. The plan was large. As of 2000, it held more than $1.4 billion in assets and had more than 14,000 participants.

Fidelity became the recordkeeper in 1995, ABB initially paid Fidelity a flat fee for each plan participant for its recordkeeping services. Beginning in 2000, Fidelity was primarily paid through revenue sharing, receiving a percentage of the income the plan investment options were paid by plan participants. By 2001, compensation for the non-union plan came solely from revenue sharing, whereas ABB paid Fidelity $8 per participant and some revenue sharing for the union plan.

Importantly, Fidelity provided other administrative services to ABB that were unrelated to the 401(k) plans. These included processing ABB's payroll and acting as recordkeeper for ABB's defined benefit plans and health and welfare plans. The Eighth Circuit said Fidelity incurred losses from these additional services, but made substantial profits from its services to the 401(k) plans.

In 2005, ABB and Fidelity negotiated a comprehensive agreement covering not only Fidelity's services to the 401(k) plans, but also other services it provided to ABB. During the course of these negotiations, Fidelity advised ABB that Fidelity provided services for the company's health and welfare plans at below market costs and did not charge for administering other ABB plans. An outside consulting firm advised ABB that it was overpaying for 401(k) plan recordkeeping services and cautioned that the revenue sharing Fidelity received under the 401(k) plans might have been subsidizing the other services Fidelity provided to ABB. ABB did not act on this advice.

The fiduciary committee with responsibility for selecting and monitoring the plans' investment options adopted an investment policy statement in 2000. It called for three tiers of investments, based on participants' willingness and ability to make personal asset allocation decisions. The director of the ABB group of employees that served as the staff for this investment fiduciary committee recommended that the plans offer participants a life-cycle or target date fund. The director also suggested that the investment fiduciary committee remove Vanguard Wellington Fund, a balanced fund, from the investment platform as a result of "deteriorating performance and because participants would be empowered to create their own balanced fund" under the new investment option framework.

The investment fiduciary committee considered three of the "few" target date funds available at the time. The director of the staff serving the committee favored the Fidelity Freedom Funds because of their investment allocation glide path. The committee did, in fact, replace the Wellington Fund with the Freedom Funds, and decided to map funds from the Wellington Fund to the age-appropriate Freedom Fund (except for participants who affirmatively chose a different investment option).

The Eighth Circuit described some of the complexities and subtleties relating to the generation of float income. Notably, Fidelity, which had been faulted by the district court for providing float income to the mutual funds (or other investment funds) as a whole, rather than providing that float income only for the benefit of participants in the 401(k) plans, did not receive any float income itself. The court described the flow of money, and how float income was generated, saying float could be generated in either of two ways. One was when contributions were made, which the court referred to as "depository" float. The other was when distributions were made, which the court referred to as "redemption" float. The Eighth Circuit described the flow of monies into and out of the plans in this fashion:

> When a Plan participant or ABB made a contribution to the Plan, Fidelity processed the contribution to the Plan investment option designated by the participant and credited the participant's account with shares in that investment option based on the closing share price on the date of the contribution. The Plan became the owner of the selected investment option as of the date the contribution was made and the order was placed, entitling the Plan to any dividends or any other change in the fund that day. The contribution flowed into a depository account held at Deutsche Bank for the benefit of the Plan investment options. For logistical reasons, the contribution could not be distributed to the investment option until the next day. Money sitting in the depository account overnight before it is distributed to the Plan investment options is often described as "float."*
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>> * Fidelity draws a key distinction between "depository" float--the money contributed to purchase shares in a Plan investment option--and "redemption" float--the money withdrawn from a Plan investment option by a participant requesting payment by check while the check remains uncashed. Disbursements are transferred to a redemption account held for the benefit of the investment options and treated in a similar manner to depository float, subject to federal and state tax withholding.
>
> As is common practice for such accounts, Fidelity temporarily transferred the funds from the depository account overnight to secured investment vehicles to earn interest often called "float interest" or "float income." The following day Fidelity transferred the principal back to the depository account. Fidelity used the float income to pay fees on float accounts before allocating the remaining income to each investment option choosing to receive it in proportion to the option's share of the overnight account balance. The float income benefitted all the shareholders of the investment option receiving it. Fidelity did not receive the float or float interest.

The Eighth Circuit included from the district court opinion the following summary of the district court's finding:

> (1) ABB [fiduciaries] violated their fiduciary duties to the Plan when they failed to monitor recordkeeping costs, failed to negotiate rebates for the Plan from either Fidelity or other investment companies chosen to be on the [Plan] platform, selected more expensive share classes for the [] Plan's investment platform when less expensive share classes were available, and removed the Vanguard Wellington Fund and replaced it with Fidelity's Freedom Funds; (2) ABB[] and the [EBC] violated their fiduciary duties to the Plan when they agreed to pay to Fidelity an amount that exceeded market costs for Plan services in order to subsidize the corporate services provided to ABB by Fidelity, such as ABB's payroll and recordkeeping for ABB's health and welfare plan and its defined benefit plan; (3) Fidelity [] breached its fiduciary duties to the Plan when it failed to distribute float income solely for the interest of the Plan; and (4) Fidelity [] violated its fiduciary duties when it transferred float income to the Plan's investment options instead of the Plan.

The district court awarded the plaintiffs $13.4 million from the ABB fiduciaries for failing to control recordkeeping costs, and also from the ABB fiduciaries $21.8 million for losses resulting from the mapping from the Wellington Fund to the Freedom Funds. The district court awarded $1.7 million against Fidelity for lost float income. Finally, the district court held that the ABB fiduciaries and Fidelity were jointly and severally liable for more than $13.4 million in attorney's fees and costs.

The Eighth Circuit began its analysis by discussing the degree to which the district court should have paid deference to decisions made by the plan fiduciaries. Specifically, it addressed whether the *Firestone* abuse of discretion standard should apply to the plan administrator's interpretation of plan documents, even though the dispute did not involve a benefit claim, but instead involved fiduciary and prohibited transaction allegations. The ABB fiduciaries complained that the district court did not afford any discretion to the plan administrator (which was an employee benefits committee appointed by ABB's board to oversee the company's benefit program), particularly with respect to interpreting the investment policy statement. The Eighth Circuit thought this a fair concern, noting that the district court's opinion was silent with respect to the standard of review, and much of the district court's analysis seemed to give little, if any, deference to the plan administrator's determinations under the plan documents. (The Eighth Circuit refused to declare whether the investment policy statement was a binding plan document, finding it unnecessary to do so because the district court had found breaches of the fiduciary duties of loyalty and prudence independent of the policy statement.) The Eighth Circuit concluded that *Firestone* deference is not limited to benefit claims, and the district court should have reviewed the plan administrator's determinations under the plans for abuse of discretion.

Although the Eighth Circuit criticized the district court with respect to its failure to clearly apply an abuse of discretion standard to the plan administrator's interpretation of the relevant plan documents, it affirmed the district court's judgment and award against the ABB fiduciaries with respect to the recordkeeping fee claims.

Recordkeeping Fee Claims. The Eighth Circuit began its discussion of the recordkeeping "excessive fee" claims by quoting its earlier excessive fee decision in *Braden v. Wal-Mart Stores, Inc.*, 588 F.3d 585 (8th Cir. 2009), where it referred to fiduciaries' "twin duties of loyalty and prudence," as follows:

> ERISA imposes upon fiduciaries twin duties of loyalty and prudence, requiring them to act "solely in the interest of [plan] participants and beneficiaries" and to carry out their duties "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."

As to prudence, the Eighth Circuit said the prudent person standard is an "objective standard that focuses on the fiduciary's conduct preceding the challenged decision," not the result of that decision (citing its decision in *Roth v. Sawyer-Cleator Lumber Co.*, 16 F.3d 915, 917-18 (8th Cir. 1994)). Further, "[e]ven if a trustee failed to conduct an investigation before making a decision, he is insulated from liability if a hypothetical prudent fiduciary would have made the same decision anyway." (Again, quoting *Roth v. Sawyer-Cleator Lumber Co.*, at 919.)

The court rejected the ABB fiduciaries' argument that they could not be liable for excessive fees because they had offered participants a wide range of investment options with a broad array of fees, including low priced funds. In doing so, the court rejected a broad application of the Seventh Circuit's decision in *Hecker v. Deere & Co.*, ("Hecker I") 556 F.3d 575, 586 (7th Cir. 2009), noting that even the Seventh Circuit later explained that Hecker I was "tethered closely to the facts." The Eighth Circuit did not think the facts in *Tussey*, which involved "significant allegations of wrongdoing, including allegations that ABB used revenue sharing to benefit ABB and Fidelity at the Plan's expense," offered the right context in which to insulate the fiduciaries from excessive fee claims merely because a broad array of investment options had been offered to participants.

The Eighth Circuit said the district court did not condemn the bundling of services or revenue sharing in the abstract, which the court described as common and "acceptable" investment industry practices that frequently benefit plans. As to the recordkeeping fee claims, the Eighth Circuit held that the district court's conclusion that the ABB fiduciaries breached their fiduciary duties was not in error, and the district court's failure to afford discretion to the plan administrator's interpretation of the plans with respect to the recordkeeping fee and revenue sharing issue was harmless under the circumstances.

The district court's conclusions on these recordkeeping and revenue sharing fees, which the Eighth Circuit upheld, were that the ABB fiduciaries breached their duties by failing diligently to investigate Fidelity and monitor plan recordkeeping costs, and in particular, that the ABB fiduciaries failed to (1) calculate the amount the plans were paying Fidelity for recordkeeping through revenue sharing, (2) determine whether Fidelity's pricing was competitive, (3) adequately leverage the plans' size to reduce fees, and (4) "make a good faith effort to prevent the subsidization of administration costs of ABB corporate services" with plan assets, even after ABB's own outside consultant notified ABB the plans were overpaying for recordkeeping and might be subsidizing ABB's other corporate services.

Removal of Wellington Fund. The Eighth Circuit was more critical of the district court with respect to the claims involving the removal of the Wellington Fund and selection of the Freedom Funds. The Eighth Circuit had sympathy for the ABB fiduciaries' contention that the district court applied an "improper hindsight bias" in criticizing the change in investment lineup, observing in particular that the district court had noted that the actual performance of the Wellington Fund between 2000 and 2008 was better than that of the Freedom Funds. The Eighth Circuit agreed that the district court's opinion shows "clear signs of hindsight influence," and reminded that the "prudence person standard is not concerned with results; rather, it is a test of how the fiduciary acted viewed from the perspective of the time of the challenged decision rather than from the vantage point of hindsight." (Quoting the court's opinion in *Roth, supra,* at 918.) The court observed, in this connection, that "selecting an investment beforehand is difficult," and the plan administrator "deserves discretion to the extent its *ex ante* investment choices were reasonable given what it knew at the time." The Eighth Circuit said the district court should have, and may not have, afforded deference to the plan administrator's determinations under the plan documents in connection with these investment decisions. The Eighth Circuit remanded to the district court for further consideration the question whether the ABB fiduciaries breached their duties in implementing the redesign of investment choices, and in evaluating and selecting investment options, in accordance with the plan. Presumably the district court will need to consider to what degree the required deferential standard of review applies in this context, and that will presumably turn in part on the degree to which the fiduciaries' investment decisions involved their interpretative authority with respect to the plan documents, or were instead decisions involving no interpretation of those documents.

Measuring Investment Damages. The Eighth Circuit provided the district court with some direction as to its determination of the damages, if any, for the participants' investment selection and mapping claims. If, on remand, the district court determines that the ABB fiduciaries have liability on those claims, the Eighth Circuit told the district court it should calculate damages in a fashion different than it did in its initial ruling. The district court had awarded as damages the amount participants who had invested in the Wellington Fund presumably would have accumulated if (1) ABB had not replaced the Wellington Fund with the Freedom Funds, and (2) the participants had remained invested in the Wellington Fund for the entire period at issue. The Eighth Circuit had two problems with this approach. First, it did not think the Wellington Fund was the correct fund against which to measure performance. That is because the investment policy statement required the addition of a managed allocation fund, and the Eighth Circuit therefore thought the participants' mapping damages, if any, would be more accurately measured by comparing the difference between the performance of the Freedom Funds and the minimum return of the subset of managed allocation funds the fiduciaries could have chosen without breaching their fiduciary obligations.

The Eighth Circuit's second objection to the district court's method for calculating any damages relating to the investment selection and mapping claims concerned its assumption that participants would have remained invested in the Wellington Fund. The Eighth Circuit found the district court's $21.8 million damage award for the mapping claim to be speculative because the district court thought it a reasonable inference that participants who invested in the Freedom Funds would instead have invested in the Wellington Fund had it not been removed. The Eighth Circuit said this inference appeared to ignore the investment provisions of the investment policy statement, participant choice under the plans, and the popularity of managed allocation funds. The plaintiffs failed to cite any evidentiary support for inferring that participants' voluntary, post-mapping investments in the Freedom Funds would instead have been made in the Wellington Fund (had that fund remained an investment option).

<u>Float Claims</u>. At this point, the Eighth Circuit had scored one for the plaintiffs (and the district court), and remanded one decision to the district court with instructive criticism. On the third and final issue, concerning Fidelity's approach to float income, the Eighth Circuit reversed the district court's judgment against Fidelity. Because Fidelity was not liable, the Eighth Circuit also held that it was not liable for any of the attorney's fees the district court had held were to be paid jointly and severally by the ABB defendants and Fidelity.

As to float income, Fidelity argued it was not required to credit the plan with income earned on overnight investments of float because float was not a plan asset. Fidelity said it was paid nothing for the float – no fees and none of the float earnings. And it maintained that, as a matter of basic property rights, the mutual funds (or other investment options), and not the plans, owned the float and bore the risk of loss with respect to the float accounts, and therefore were entitled to any benefits of ownership. The Eighth Circuit agreed. The court concluded that the plaintiffs had not produced evidence that the plans had any property rights in the float or float income. As to depository float, this made sense to the court since when a contribution was made, Fidelity credited the participant's plan account and the plan became the owner of the shares of the selected investment option (usually shares of a mutual fund) on the same day the contribution was received. In this way, the plan received the full benefit of ownership, including any capital gains or dividends from the purchased shares, as of the purchase date. The Eighth Circuit concluded that the mutual funds (or other plan investment options) held the property rights in the depository float and were entitled to the float income, and Fidelity did not breach any fiduciary duties with respect to the depository account.

As to the redemption account, the Eighth Circuit similarly concluded that the plaintiffs had failed to establish that the plans had any rights in the redemption account balance. Like the depository account, these amounts were registered for the benefit of the mutual funds and other investment options. Fidelity, citing to the Uniform Commercial Code, argued that the payee of an uncashed check has no title in or right to interest on the account funds. That is, a negotiable instrument of this type is not "payable with interest" unless it specifically says so. Fidelity argued that when a participant chose to receive a check rather than an electronic disbursement, the relevant plan mutual funds (or other investment options) retained all rights to the redemption float until the disbursement check was cashed.

The plaintiffs, while agreeing that "the funder of the check owns the funds in the checking account until the check is presented, and thus is entitled to any interest earned on that float," argued that in fact the owner of the funds was the plans, and therefore the float income was a plan asset. The Eighth Circuit said the plaintiffs could not cite any evidence establishing that the plans were in fact "the funder of the check" or the owner of the funds in the redemption account. Without any proof of ownership rights to the funds in the redemption account, the plans had no right to float income from that account.

The court's opinion was unanimous, except with respect to the float issue. On the float issue, the court was split 2 to 1. A dissenting judge argued that float was, in fact, a plan asset. This led the dissenter to conclude that Fidelity breached its fiduciary duty of loyalty by transferring float income to the depository account for the benefit of the mutual funds (and other investment options) and by using float income to pay bank expenses. In reaching this conclusion, the dissenting judge cited to the Department of Labor's plan asset regulations in concluding that the contributions were plan assets as soon as they were placed in Fidelity's depository account and this made the depository float a plan asset. The dissenter also concluded that redemption float was a plan asset, and criticized Fidelity for failing to have "openly negotiated" its retention of float income "as part of its overall compensation," citing to DOL Field Assistance Bulletin 2002-3.

It was pleasing to see the Eighth Circuit reverse and remand the district court's rather muddled analysis with respect to the fiduciaries' decision to eliminate the Vanguard Wellington Fund and map assets to the Fidelity target date funds. The loudest message from the Eighth Circuit's opinion in *Tussey*, though, is that fiduciaries should be careful to avoid overpaying fees for services to one plan in exchange for paying lower fees with respect to another plan or services provided to the employer. That is, fiduciaries should be careful to observe the "exclusive purpose" rule of ERISA Section 404(a)(1)(A) and the proscriptions under the prohibited transaction rules on acting on behalf of a party whose interests are adverse to the plan or its participants or beneficiaries, or receiving consideration for the fiduciaries' own personal account from a party dealing with the plan in connection with a transaction involving plan assets, under ERISA Section 406(b)(2) and (3).

8. **Signature Authority on Corporate Bank Account May Make One a Fiduciary: *Perez v. Geopharma, Inc*.** In one of its more peculiar pieces of guidance, the Department of Labor announced in Technical Release 92-01 a nonenforcement policy with respect to ERISA's trust requirement as it relates to cafeteria plans. This was a successor to an earlier Technical Release, 88-1 (which was superseded by the 1992 release). Under Technical Release 92-01, the DOL will not, in the case of a cafeteria plan, assert a violation in an enforcement proceeding solely because of a failure to hold participant contributions in trust.

In the same release, the DOL announced that it would not enforce ERISA's trust requirement with respect to fully insured welfare plans meeting certain requirements. These are plans that provide benefits exclusively through insurance contracts or policies issued by an insurance company (or similar organization) qualified to do business in a state, or through a qualified HMO, as described at 29 CFR §§ 2520.104-20(b)(2)(ii) and

2520.104-44(b)(1)(ii). To enjoy this nonenforcement policy, premiums must be paid directly by the employer (or a union) from its general assets, or partly from its general assets and partly from contributions by its employees (or union members). Contributions made by participants must be forwarded by the employer (or union) to the insurer within three months of receipt.

Technical Release 92-01 does not relieve plan sponsors and fiduciaries of their obligation to ensure that participant contributions are applied only to the payment of benefits and reasonable administrative expenses. The DOL reminded employers in the technical release that the utilization of participant contributions for any other purpose may result not only in civil sanctions but also in criminal sanctions under 18 USC § 664. For more on the DOL's position that participant contributions constitute plan assets and the nonenforcement policy for cafeteria plan assets and fully insured plans, see Appendix C.

As a consequence of Technical Release 92-01, many employers do not put in trust participant contributions relating to cafeteria plans and fully insured health plans. A recent federal district court decision, if upheld on appeal or adopted by other courts, may cause employers and fiduciaries to reconsider the wisdom of this practice (of not holding participant contributions to cafeteria plans or fully insured health plans in trust). The case is *Perez v. Geopharma, Inc.*, 2014 U.S. Dist. LEXIS 101766 (M.D. Fla. 2014). In *Geopharma*, the district court ruled on a motion to dismiss by a defendant who asserted that he was not a fiduciary with respect to a health plan. The context of the lawsuit underscores the very reason for using a trust, even when the DOL nonenforcement policy would apply. Specifically, the Secretary of Labor alleged that various welfare benefits had not been paid. When benefits have not been paid there is every motivation for participants to sue for the failure to hold their contributions in trust. Remember, the DOL nonenforcement position relates only to the position the DOL will take in an enforcement action, and not the position participants or other litigants may wish to assert in court. If a company is in dire financial condition, fiduciaries would be wise to hold participant contributions, and any other plan assets, in trust, even as they relate to a cafeteria plan.

The *Geopharma* decision, though only a district court decision concerning a motion to dismiss, is troubling. The DOL argued that the employer, Geopharma, established a plan in 1985 to provide medical, dental, prescription drug, life insurance and short-term disability benefits to its employees. The plan, according to the complaint, was funded by employer contributions, employee premium contributions deducted from payroll, and former employees' premium payments for COBRA coverage. Allegedly, Geopharma contracted with various entities to administer its plan, and two of these entities terminated their contracts, one for nonpayment of premiums, and the other for nonpayment of approved claims.

Over a period of about a year, from the fall of 2009 to the fall of 2010, Geopharma allegedly withheld employees' premium contributions from payroll in an amount totaling roughly $225,000, failed to segregate those contributions from company assets as soon as it reasonably could have done so, and failed to use the funds to pay claims. The company allegedly received another roughly $16,000 in COBRA premiums, again failing to segregate these premiums from company assets as soon as it reasonably could have done so, and failing to use the funds to pay claims.

One of the defendants was the CEO and secretary of the company, and a member of the company's board of directors. The DOL alleged that the CEO had signature authority on the company's corporate bank accounts and that each check issued by the company required two signatures. The DOL sought to hold the company, its CEO, and other individual defendants jointly liable for: (a) participating knowingly in an act of another fiduciary, knowing that act was a breach, in violation of ERISA Section 405(a)(1), (b) failing to monitor or supervise another fiduciary and thereby enabling a breach, in violation of ERISA Section 405(a)(2), or (c) having knowledge of a breach by another fiduciary and failing to make reasonable efforts under the circumstances to remedy the breach, in violation of ERISA Section 405(a)(3).

The district court cited the Eleventh Circuit's decision in *Cotton v. Massachusetts Mutual Life Ins. Co.*, for the proposition that in determining whether one is a fiduciary, "a court must ask whether a person is a fiduciary <u>with respect to the particular activity at issue</u>." 402 F.3d 1267, 1277 (11th Cir. 2005) (emphasis added). The court cataloged the ways in which an individual may become a fiduciary, as follows: (1) being a "named fiduciary" in the plan instrument, (2) exercising discretionary authority or control over the management of the plan, (3) exercising *any* authority or control over the management or disposition of plan assets, (4) rendering investment advice for a fee or having authority or responsibility to do so, or (5) having any discretionary authority or responsibility over plan administration.

The CEO asserted that the complaint did not establish that he performed any function or exercise any authority with respect to the "particular activity" of remittance of employee premium contributions to the plan. He argued that the mere fact he allegedly possessed signature authority on the company's corporate bank account should not make him a plan fiduciary. Indeed, the complaint did not assert that the CEO had signature authority over any account associated with the plan. It only alleged he had general signature authority on the company's bank accounts. To impress upon the court the implications of treating him as a fiduciary merely by having signature authority on corporate bank accounts, the CEO argued that "[i]f this alone were sufficient to trigger ERISA fiduciary responsibilities on the part of corporate officers, it would transform nearly every member of senior management of any corporation into an ERISA fiduciary."

The CEO also argued that he could only become a fiduciary by being a named fiduciary (which was not alleged) or by exercising <u>discretionary</u> control or authority over the plan or the management of its assets.

The DOL's response was that the CEO exercised authority or control over plan assets. As the CEO, secretary, and a director of the company, he had signature authority on corporate bank accounts. When employee contributions were commingled with corporate general assets and never remitted or used to pay claims, the CEO, the DOL asserted, exercised fiduciary authority or control over both the company's assets and plan assets simultaneously. And the DOL argued that the plain language of ERISA allows one to become a fiduciary by exercising authority or control over the management or disposition of plan assets, without requiring any "discretionary" authority or control.

The DOL also argued that because the company was named as the plan administrator and fiduciary in the plan document itself, the company had a duty to monitor the actions of those administering the plan on its behalf. And as the CEO, secretary, a director, and signatory on the company's bank accounts the CEO, the DOL asserted, had a fiduciary duty to monitor other fiduciaries, as well as the company's management and administration of the plan.

The DOL alleged that the CEO knew or should have known that the company was having cashflow issues and was using employee compensation and COBRA payments to fund operations rather than using those amounts to pay medical claims. The DOL said this knowledge should have triggered an investigation to determine whether the company and its fiduciaries were administering the plan in accordance with ERISA and the terms of the plan.

The district court denied the CEO's motion to dismiss. It concluded that the Secretary of Labor alleged facts sufficient to establish that the CEO was a fiduciary. Specifically, the court noted that the complaint alleged that the CEO had signature authority on the company's corporate bank accounts, and that employee premiums were commingled with the company's general assets and never remitted or used to pay claims. This allowed the district court to "reasonably infer" that the CEO exercised authority or control over plan assets as an ERISA fiduciary when employee premiums were commingled with the company's general assets.

The court observed that the plain language of ERISA supports the Secretary of Labor's position that a person can become a fiduciary even without discretion, if he or she exercises <u>any</u> authority or control respecting management or disposition of its assets. But in spite of this "plain" statutory language, the court nonetheless said at this stage of the proceedings it would decline to decide whether a person with authority or control over plan assets must also exercise "discretion" over those assets in order to become an ERISA fiduciary. It said that determination would be more appropriately decided at the summary judgment stage of the proceedings.

Finally, the court dealt with the claim that the CEO had a fiduciary duty to monitor the actions of the company and those appointed as fiduciaries. The Secretary of Labor, recall, claimed that the company was a fiduciary and that the company had a duty to monitor the actions of those who administered the plan on its behalf. The court concluded that the CEO, who also was a signatory on the company's bank accounts, plausibly had a fiduciary duty to monitor the actions of the company and those appointed to act as fiduciaries on its behalf.

If *Geopharma* is upheld on an appeal to the Eleventh Circuit, or other courts adopt the position that merely having signature authority on a corporate bank account makes one a fiduciary when plan assets are not kept separate from company assets, it may make sense for employers and fiduciaries to go back to the practice of the mid-1980s, when participant contributions to cafeteria plans and insured health plans were commonly held in trust. In that event, it may make most sense to make use of a trust exempt from federal income tax under IRC Section 501(c)(9) – that is, a "voluntary employees' beneficiary association," or "VEBA."

9. **Fresh Consideration of Money Market Funds?** Retirement plan fiduciaries, particularly those for defined contribution plans that permit participants to direct how the assets in their accounts will be invested, may wish to visit with their investment consultants about the implications of changes to the money market rules adopted by the Securities and Exchange Commission on July 23, 2014. In Release No. 33-9616, the SEC adopted a final rule providing for money market fund reform. The Release raises a number of issues that may be of interest to fiduciaries of defined contribution plans offering participants a money market fund as an investment option. One of the questions the Release raises for these fiduciaries is whether they should retain their current money market fund offering, or instead replace it with a different money market fund, a stable value fund, a short-term low duration bond fund, or some other fund. Some considerations fiduciaries may wish to bear in mind in making that decision are the following:

   1. Government funds, which hold at least 99.5 percent of their assets in cash and in Treasury securities, will largely be unaffected by the changes made by the Release's new rules.

   2. As to non-government funds, "retail" money market funds, which include money markets offered in participant-directed defined contribution plans, will be permitted, should they wish, to impose liquidity fees and "redemption dates," (under which redemptions are temporarily suspended) when a fund's level of "weekly liquid assets" falls below a certain threshold. A liquidity fee could be as large as two percent on all redemptions, when the fund's level of weekly liquid assets falls below 30 percent of its total assets. If a fund's level of weekly assets falls below 10 percent, the fund would be required to impose a liquidity fee of one percent on all redemptions. The fee would not be imposed, however, if the fund's board of directors determines that the fee is not in the best interest of the fund or that a lower or higher (up to two percent) liquidity fee is in the best interest of the fund. Weekly liquid assets generally include cash, U.S. Treasury securities, certain other government securities with remaining maturities of 60 days or less, and securities that convert into cash within one week.

      As to redemption dates, if a fund's level of weekly liquid assets falls below 30 percent, the fund's board can, in its discretion, temporarily suspend redemptions, if the board finds that imposing such a gate is in the fund's best interest. A money market fund that imposes a gate will be required to lift that gate within 10 business days, although the board can determine to lift the gate earlier. Funds would not be able to impose a gate for more than 10 business days in any 90-day period.

   3. "Institutional" money market funds, such as non-government funds purchased by defined benefit plans, will be required to use a floating net asset value ("nav"),

rather than a stable nav of $1 per share. The liquidity fee and redemption gate rules apply both to institutional and retail non-government money market funds.

4. The new rules may impose a complication for defined contribution plans that use a money market fund as a QDIA (that is, as a capital preservation product for the first 120 days of an individual's participation). That is because 29 CFR § 2550.404(c)-5(c)(5)(ii) generally requires that, for a 90-day period following the first investment in a QDIA, any transfer or withdrawal of assets from the QDIA by a participant or beneficiary not be subject to any restrictions, fees, or expenses (including surrender charges, liquidation, or exchange fees, redemption fees and similar expenses charged in connection with the liquidation of, or transfer from, the investment). *See also* DOL Field Assistance Bulletin No. 2008-03, Q&A 11. The SEC, in its discussion of its new rule, suggests that even if a liquidity fee or gate were applied with respect to a liquidation or transfer request within the 90-day period, the QDIA rules could be satisfied because the liquidity fee could be paid by the plan sponsor or a service provider, and not by the participant, beneficiary or plan, citing to DOL FAB 2008-03, Q&A 11 (Apr. 29, 2008). Further, the SEC suggested that a plan sponsor or other party in interest could loan funds to the plan for the payment of ordinary operating expenses of the plan or for a purpose incidental to the ordinary operation of the plan to avoid the effect of a gate, citing to Prohibited Transaction Class Exemption 80-26. Rel. No. 33-9616, pp. 272-73. Fiduciaries may, however, well conclude that these work-arounds would add an unsatisfactory level of complication, and may raise potential concerns for tax-qualified plans, such as the possibility the plan sponsor's payment of the fees would be considered an annual addition for Section 415 purposes or a contribution for IRC Section 401(a)(4) nondiscrimination purposes. *See, e.g.*, PLRs 200317048 and PLR 200137064, where an employer's payment of contingent deferred sales charges or withdrawal charges under annuity contracts was treated as a contribution subject to Section 415 (and, in the case of the latter ruling, also treated as a contribution under Section 401(a)(4)).

5. In the case of an automatic rollover of a mandatory distribution described in IRC Section 401(a)(31)(B), or a mandatory distribution of $1,000 or less described in IRC Section 411(a)(11) where there is no affirmative distribution election by the participant, Prohibited Transaction Class Exemption 2004-16 permits a bank or other regulated financial institution, with respect to plans for its own employees, to establish IRAs at the employer financial institution itself for these automatic rollovers of distributions, and to utilize its own investment products in doing so. In addition, Prohibited Transaction Class Exemption 2006-06, permits a "qualified termination administrator" with respect to an abandoned plan to select itself or an affiliate to provide services in connection with the termination of the plan, and to designate itself or an affiliate as a provider of an IRA to receive plan distributions.

   Both of these class exemptions, however, require that the IRA holder have the ability, within a "reasonable period of time" after making a request and without penalty to the principal amount of the investment, to transfer the IRA to a different investment offered by the IRA provider, or to transfer the IRA to another IRA sponsored at a different financial institution. The SEC said in its discussion of its new rule that the DOL has indicated that a gate of no longer than 10 business days would not amount to an unreasonable period of time for this purpose. However, for a fiduciary to rely on these prohibited transaction exemptions in the context of an initial decision to roll over amounts to a money market fund sponsored by or affiliated with the fiduciary, "additional steps would need to be taken to protect the principal amount rolled over in the event that a liquidity fee is imposed." For example, it might be necessary to include a contractual commitment by the fiduciary or its affiliate to pay any liquidity fee that would otherwise be assessed to the IRA, to the extent that fee would otherwise be deducted from the principal amount rolled over. To the extent fiduciaries do not wish to take those steps, they could instead select government money market funds as the investment vehicle, because they are not subject to the fees and gate amendments made by the new rule, or other funds that do not raise prohibited transaction concerns.

6. As to the need to make <u>minimum distributions</u> or process <u>other mandatory distributions</u> or refunds on a timely basis, the SEC indicated that it believes the gates will, in practice, be unlikely to impose a difficulty since participants are unlikely to have their entire account invested in non-government money market funds imposing a gate. To the extent a gate does prevent a timely minimum distribution, the SEC said its understanding is that a plan could take steps to avoid the negative consequences that might result from this failure to make the minimum distribution. It suggested, for example, that a recipient who fails to receive a minimum distribution as a result of a gate would be entitled to request a waiver of potential excise taxes by filing a Form 5329 with the IRS and explaining the rationale for the waiver, under IRC Section 4974(d). And as to any violation with respect to the plan itself, the SEC suggested that a plan sponsor could make use of the IRS' EPCRS system to correct the minimum distribution failure.

The considerations above, together with the potential communication complications associated with notifying participants of the imposition (or potential imposition) of liquidity fees and gates, suggest that fiduciaries will want to carefully consider whether non-government money market funds remain a good investment option under a participant-directed defined contribution plan. This is a decision with respect to which fiduciaries will very likely wish to seek advice from their investment consultants. The matter is complicated by the potential disadvantages of alternative capital preservation funds. In the case of stable value funds, these would include considerations relating to insurance wrappers, which may include insurer-imposed investment or other restrictions.

APPENDIX A

Fiduciary Standards for Purchasing Employer Stock: *Harris v. Amgen, Inc*.

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Excerpt from 2014 outline titled "Employee Stock Ownership Plans: Legal and Regulatory Update."

Fiduciary Standards for Purchasing Employer Stock: *Harris v. Amgen, Inc*. The Ninth Circuit Court of Appeals, in a ruling issued prior to the Supreme Court's decision in *Dudenhoeffer*, held that the presumption of prudence the Ninth Circuit has applied under standards it set forth in *Quan v. Computer Sciences Corp.*, 623 F.3d 870 (9th Cir. 2010), did not apply because the plan did not "require or encourage" the appropriate plan fiduciary to invest primarily in employer stock. Instead, although the plan permitted the establishment of an employer stock fund, the court did not consider the plan to require or even encourage the establishment of such a fund. *Harris v. Amgen, Inc.*, 738 F.3d 1026 (9th Cir. 2013). This portion of the court's analysis – concerning the prior "presumption of prudence" – has been superseded by the Supreme Court's decision in *Dudenhoeffer*. Other aspects of the decision, noted below, retain validity. That is because following *Dudenhoeffer*, the Supreme Court granted certiorari and remanded *Harris* to the Ninth Circuit for further consideration in light of *Dudenhoeffer*, and the Ninth Circuit's decision following remand, which is found at 2014 U.S. App. LEXIS 20816 (9th Cir. 2014), is virtually identical to its pre-remand opinion described below (except as to its discussion of the presumption of prudence).

The Ninth Circuit's pre-remand decision in *Harris*, which replaced an earlier opinion (at 717 F.3d 1042, which the court withdrew), ruled on a motion by the defendants to dismiss the lawsuit. This meant the court was required to assume the allegations made by the plaintiffs were true in deciding whether the case should be permitted to continue to trial. The court held that the plaintiffs' claims should not be dismissed, paving the way for the case to proceed to trial. Although the court merely assumed that the allegations made by the plaintiffs were accurate, it did note that in a separate class action pending at the same time and before the same federal district judge, that judge had concluded that investors in Amgen common stock had sufficiently alleged material misrepresentations and omissions, scienter, reliance, and resulting economic loss to state claims under Section 10(b) and 20(a) of the 1934 Securities Exchange Act. The district court certified a class based on the facts alleged in that securities law complaint, and the Ninth Circuit affirmed the district court's class certification at 660 F.3d 1170 (9th Cir. 2011), in a case called *Conn. Ret. Plans & Trust Funds v. Amgen, Inc.*

As to the plaintiffs' allegations that the fiduciaries had violated ERISA's fiduciary obligation to act prudently, by allowing the investment of plan assets in company stock, the court noted that its focus should properly be on the fiduciary's process. The court said the question was whether the fiduciaries "at the time they engaged in the challenged transactions, employed the appropriate methods to investigate the merits of the investment and to structure the investment." (*Quoting*

Quan, 623 F.3d at 879 (which in turn quotes *Wright v. Oregon Metallurgical Corp.*, 360 F.3d 1090, 1097).)

In response to the defendants' contention that if the stock fund had been removed as an investment option this might have resulted in a drop in the stock price, the court surmised it was unlikely that failing to make future investments, as opposed to removing the stock fund altogether, would have had an "appreciable negative" impact on the share price. That is because of the relatively small number of Amgen shares that would have been purchased by the plan in comparison to the "enormous" number of actively traded shares. [The essence of the plaintiffs' complaint was that the fiduciaries should not have continued to provide the company common stock as an investment alternative when "they knew or should have known" that the stock was being sold at an artificially inflated price due to various alleged false or misleading statements about the company's products.]

As to removing the stock fund as an investment option altogether, the Ninth Circuit conceded that this would have sent a "negative signal to the wider investing public," and might well have caused a drop in the share price. But the court said several factors mitigated this effect. First, the court said the efficient market hypothesis ordinarily applies, and in the case of stock fraud the ultimate decline in price would therefore have been no more than the amount by which the price was artificially inflated. In addition, once the stock funds were removed as an investment option, employees would have been prevented from making additional investments while the price remained artificially inflated. Third and finally, the fiduciaries' obligations to remove the fund as an investment option would have been triggered as soon as they knew or should have known the share price was artificially inflated, rather than long after they gained this knowledge and participants would have invested at an artificially inflated price. The court said the defendants were alleged to have violated their fiduciary duties under ERISA at "more or less the same time" some of them violated their duties under the federal securities laws. If they had timely complied with their duties under ERISA, there would have been "little or no artificial increase" in the share price before the company stock funds were removed as an investment option.

As to arguments that the fiduciaries' hands were tied to some degree by their obligation to comply with securities laws, the Ninth Circuit said, as the Supreme Court did in *Dudenhoeffer*, that fiduciaries are under no obligation to violate federal securities laws. The defendants argued that the fiduciaries could not have removed the stock fund based on undisclosed alleged adverse material information because doing so would have been a potentially illegal course of action. The court said the following about this:

> The central problem in this case is that Amgen officials, many of whom are defendants here, made material misrepresentations and omissions in violation of the federal securities laws. Compliance with ERISA would not have required defendants to violate those laws; indeed, compliance with ERISA would likely have resulted in compliance with the securities laws. If defendants had revealed material information in a timely fashion to the general public (including plan participants), thereby allowing informed plan participants to decide whether to invest in the Amgen Common Stock Fund, they would have simultaneously satisfied their duties under both the securities laws and ERISA.

* * * * * *

> Alternatively, if defendants had made no disclosures but had simply not allowed additional investments in the Fund while the price of Amgen stock was artificially inflated, they would not thereby have violated the prohibition against insider trading, for there is no violation absent purchase or sale of stock.

In addition to prudence arguments, the plaintiffs argued that the defendants violated their duty of loyalty and care by failing to provide material information to plan participants about investments in the company stock fund. The defendants countered that they had limited obligations under ERISA to disclose information to plan participants, and that their disclosure obligations did not extend to information that is material under the federal securities laws. The defendants also argued that the plaintiffs had not alleged detrimental reliance on the defendants' omissions and misrepresentations. Finally, the defendants contended that their omissions and misrepresentations, if there were any, were not made in their fiduciary capacity. The Ninth Circuit rejected each of these claims.

As to the first contention, that the defendants owed no duty under ERISA to provide material information about the company stock to plan participants who must decide whether to invest in that stock, the court said this was not the case. Instead, quoting *Quan*, the court said:

> We have recognized [that] . . . [a] fiduciary has an obligation to convey complete and accurate information material to the beneficiary's circumstance, even when a beneficiary has not specifically asked for the information. [T]he same duty applies to "alleged material misrepresentations made by fiduciaries to participants regarding the risks attendant to fund investment." (Case names and citations omitted.)

As to what constitutes a material misrepresentation, the court again quoted its earlier opinion in *Quan* as follows:

> [A] misrepresentation is "material" if there was a substantial likelihood that it would have misled a reasonable participant in making an adequately informed decision about whether to place or maintain monies in a particular fund.

As to the defendants' contention the plaintiffs failed to show they relied on the defendants' material omissions and misrepresentations, the court borrowed from federal securities law decisions under Section 10(b) establishing that a defrauded investor need not show actual reliance on the particular omissions or representations of the defendant. Instead, an investor can rely on a rebuttable presumption of reliance based on a "fraud-on-the-market" theory.

Under this theory, the market price of shares traded on "well-developed markets" reflects all publicly available information and therefore any material misrepresentations. Because the market effectively transmits information to a potential investor in the form of the market price, the Supreme Court had held in a 2011 decision (*Erica P. John Fund, Inc. v. Halliburton Co.*, 131 S. Ct. 2179 (2011)) that an investor effectively relies on public misstatements whenever he or she buys or sells stock at the price set by the market. The Ninth Circuit said it saw no reason why ERISA plan participants who invested in an employer stock fund the assets of which consisted solely of publicly traded common stock should not be able to rely on the fraud-on-the-market theory in the same manner as any other investor in publicly traded stock.

The defendants contended that statements made to the Securities and Exchange Commission in documents required by the federal securities laws were not made in a fiduciary capacity, and therefore could not be considered in an ERISA suit for breach of fiduciary duty. The Ninth Circuit said it had not decided this issue, and that the defendants might be correct if the documents had only been filed and distributed as required under the securities laws. In that event, the acts might well have been performed only in a corporate capacity. Here, however, the defendants had in the summary plan descriptions for the two ESOPs at issue incorporated by reference the SEC filings. The court held that the defendants' preparation and distribution of the SPDs, including their incorporation of the company's SEC filings by reference, were acts performed in their fiduciary duties.

Finally the court held that the company could not be dismissed as a defendant on the ground that it was not a plan fiduciary. Amgen argued it was not a fiduciary because it had delegated its discretionary authority. The court seemed to accept that where a company grants to another the exclusive authority to take action the company could otherwise take, the company might effectively avoid fiduciary liability (other than as to any obligation it might have to monitor and possibly replace a party to which it had delegated authority). But the court said the company was a named fiduciary under the plans under consideration (and was the "administrator" and "plan sponsor"). Further the plans indicated that where an action was to be taken by the company, the fiduciary committee "shall be authorized to act on behalf of the company." This provision authorizing the fiduciary committee to take action on behalf of the company did not, the court said, preclude fiduciary status for Amgen because the company had not given the committee the exclusive right to make decisions under the plan. Instead, the plan merely authorized the fiduciary committee to act on behalf of the company. It neither provided exclusive authority to the committee, nor precluded the company from acting on its own behalf.

APPENDIX B

INVESTMENT ADVISOR NOT FIDUCIARY WHEN PAID BY BROKER-DEALER

by
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The Department of Labor has drawn quite a bit of flak over the past few years concerning its project to partially redefine who is a fiduciary. One of the legitimately tough questions, and one that seems to have the DOL's attention, is how to distinguish between a salesperson trying to convince fiduciaries to purchase a particular investment – where the salesperson would presumably not be acting as a fiduciary – from an investment advisor paid to regularly provide independent and impartial advice to a plan's fiduciaries about how to invest plan monies – where the investment advisor may well be a fiduciary. We were a bit surprised where the Fifth Circuit recently drew the line between those selling investments, on the one hand, and investment advisors acting as fiduciaries, on the other, in the case of *Tiblier v. Dlabal*,[1] which was decided by Judges Edith H. Jones, Jennifer Walker Elrod, and Catherina Haynes.

COMPENSATION, DIRECT OR INDIRECT

One of the statutory requirements for becoming a fiduciary by reason of giving investment advice is that the advisor render investment advice for a fee or other compensation.[2] So, if someone offers investment advice with respect to a plan's monies, but does so gratuitously, receiving absolutely no compensation whatsoever, she or he would not be a fiduciary by reason of offering that advice. But the statute does not require that an investment advisor receive "direct" compensation to become a fiduciary (the statute does not explain what it means by "direct," but presumably this means compensation from the plan itself). Instead, receiving "indirect" compensation may cause an investment advisor to become a fiduciary. That is because the relevant portion of the definition of the term "fiduciary" states as follows:

> [A] person is a fiduciary with respect to a plan to the extent . . . (ii) he renders investment advice for a fee or other compensation, <u>direct or indirect</u>, with respect to any moneys or other property of such plan, or has any authority or responsibility to do so . . . . (Emphasis added.)

We aren't fully confident we know what the term "indirect" means in the context of compensation received for rendering investment advice, but we would certainly have thought it was intended to include at least certain types of compensation received not from the plan, but instead from some party other than the plan. To our surprise, in *Tiblier* the Fifth Circuit, in an

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[1] 743 F.3d 1004, 57 EBC 2159 (5th Cir. 2014).
[2] ERISA § 3(21)(A)(ii).

opinion by Judge Elrod, held that an individual who discussed with the trustees of two qualified retirement plans investments in bonds issued by an oil and gas start-up company could not be a fiduciary because he received compensation from the managing broker-dealer for the bonds, and not from the plan itself. Not to put too fine a point on it, this conclusion that the investment advisor could not be a fiduciary because he did not receive a fee directly from the plans seems, at a minimum, overly broad, and probably not right in the context of the dispute at hand.

WOULD YOU LIKE A MUNI WITH YOUR STRESS TEST?

The plaintiffs in the lawsuit were a cardiologist named Eric Tiblier and his wife, who managed the cardiology medical practice in Austin, Texas. Dr. Tiblier and his wife were suing another physician and a former medical colleague of Dr. Tiblier, named Dr. Paul Dlabal. Why, you might wonder, was one cardiologist suing another cardiologist over investment advice? The answer is that Dr. Dlabal, in addition to having practiced medicine, was a licensed broker and registered investment advisor representative. Conveniently, Dr. Tiblier's medical practice leased space to Dr. Dlabal for Dr. Dlabal to use one day a week. Dr. Dlabal's licenses did not allow him to individually serve as either a broker or an investment advisor, so he affiliated with a firm that served clients in those capacities. That firm was defunct by the time the lawsuit was filed, and though it was a defendant in the litigation, it did not answer the complaint.

Dr. Tiblier's practice apparently maintained two qualified retirement plans, a cash balance plan and a 401(k) plan. Dr. Tiblier and his wife acted as the trustees for those plans. They asserted that the plans were intended to be conservatively invested.

Dr. Tiblier signed an investment management agreement with CACH Capital Management, LLC ("CACH"), the firm with which Dr. Dlabal had affiliated himself. In that agreement, CACH was designated as the "advisor," and Dr. Dlabal was designated as the "registered representative."

OIL AND GAS (IT'S TEXAS)

Dr. Dlabal and CACH proposed a number of investments to Dr. Tiblier and his wife, the plans' trustees. The trustees rejected some of the proposed investments, but accepted others. A number of the proposed investments performed satisfactorily, but at least one did not. This was a $100,000 investment in the corporate bonds of an oil and gas start-up company called Adageo Energy Partners, L.P. ("Adageo").

Adageo, the oil and gas start-up, intended to generate profits by purchasing under-utilized oil and gas investments and making them more productive. To help raise the $50 million it needed to make those purchases, the company issued bonds that promised to pay 12 percent interest. The trustees invested in these bonds in two $50,000 increments, approximately six months apart.

The trustees claimed Dr. Dlabal orally represented that the Adageo investment was a safe "petro bond," that was sure to provide a safe return on investment unless the oil market "completely crashed" to below $30 or $40 per barrel, which the trustees claimed the parties understood to be an "impossibility." The trustees asserted that this investment was presented as a very safe, conservative investment, and was secured by Adageo's assets. But Adageo allegedly had essentially no assets when Dr. Dlabal recommended the bonds. And the trustees asserted that although Dr. Dlabal claimed CACH had done a thorough due diligence review of Adageo, Dr. Dlabal failed to disclose that Adageo, during at least a part of the time period in question, was under investigation by the SEC as a possible ponzi scheme (the SEC investigation was subsequently dropped).

DON'T POINT THE FINGER, LOOK IN THE MIRROR

There seemed little question that Dr. Dlabal was talking to the plan trustees about possible investments for the retirement plans' assets, and that he had done so with respect to a number of potential investments. The question that mattered was whether Dr. Dlabal served as a fiduciary of the plan, and if so whether he breached his fiduciary duties, for example by making misrepresentations to the trustees or recommending bonds that were not prudent investments for the plans. The district court considered a host of claims brought by the trustees, including some grounded in the federal securities laws and others for fiduciary breach. The district court, on a motion for summary judgment, held that there was a disputed issue of material fact as to whether Dr. Dlabal was an ERISA fiduciary, but whether or not he was a fiduciary, he was entitled to summary judgment on all claims. Fundamentally, this was because the district court concluded that the real and substantial risks associated with the Adageo investment had been disclosed to the trustees in advance, as had a potential conflict of interest that could have affected the advice. The conflict of interest was that the CEO of CACH, the investment firm with which Dr. Dlabal was affiliated, controlled indirectly the managing broker-dealer for the sale. As a consequence, the CEO of CACH and his family members would benefit from payments made from the gross proceeds of the bond offering. At bottom, the district court's view was that the trustees could not blame another fiduciary (if Dr. Dlabal was, in fact, a fiduciary) for their own failure to pay attention to the disclosures offered to them in connection with the investment.

DOL: DISCLOSURE IS NO EXCUSE

The district court's conclusion drew the attention of the Department of Labor, which filed an *amicus* brief with the Fifth Circuit. The DOL argued, in part, that a fiduciary, such as an investment advisor who is a fiduciary, cannot avoid liability for violating his duty of prudence regarding plan investments merely by describing the riskiness of those investments in documents received and signed by the plans' trustees.

Similarly, the DOL argued that an investment advisor who is a fiduciary cannot avoid a prohibited transaction by reason of his receipt of compensation from an investment's promoters that is in addition to (or in excess of) the fees charged to the plan, merely by disclosing his conflict of interest in investment documents. The compensation received by Dr. Dlabal from the managing broker-dealer for the bonds apparently either served to offset the fees owed by the plans or was in lieu of those fees, but – and this was critical – this compensation from the broker-dealer appears to have exceeded, or had the potential to exceed, the fees agreed to by the plan. This, of course, could have provided a financial incentive to the advisor to favor the investment.

THE FIFTH CIRCUIT SURPRISE: ADVISOR NOT A FIDUIARY

The DOL brief seemed to assume that Dr. Dlabal, the investment advisor, was a fiduciary. But the Fifth Circuit probably caught the DOL by surprise, as it did us, by upholding the grant of summary judgment in favor of the investment advisor, Dr. Dlabal, based not on the grounds on which the district court relied, but instead by concluding that Dr. Dlabal did not act as a fiduciary with respect to the Adageo bond investments. Even though the district court refused to grant summary judgment on that question – because it held that there was a disputed issue of material fact as to whether Dr. Dlabal did, in fact, act as a fiduciary – the Fifth Circuit indicated that in reviewing a district court's grant of summary judgment it is not limited only to the grounds relied upon by the district court below, nor is it limited to only those issues raised on appeal by the plaintiffs. Instead, the Fifth Circuit said it could affirm the district court's grant of summary judgment if any of the independent grounds offered by Dr. Dlabal at the trial level supported the district court's decision.

THE COMPENSATION NITTY-GRITTY

Interestingly and importantly, Dr. Dlabal was entitled under the investment management agreement to receive a 1.5 percent recurring annual fee from the plans for the Adageo investment. But Dr. Dlabal declined this compensation, instead choosing to take a portion of a commission Adageo paid to the third party broker-dealer Dr. Dlabal and CACH used to make the private placement investment (which the DOL seems to have referred to as the "promoter"). Dr. Dlabal's portion of that commission was roughly 2 to 2.5 percent of the plans' investment, or about $2,500. This commission was disclosed in the first line of a disclosure form the trustees signed.

THE CONFLICT

If Dr. Dlabal were a fiduciary with respect to the transaction, this compensation arrangement would seem to be precisely the type of self-dealing prohibited under ERISA Section 406(b), and the type of potential conflict fiduciaries generally guard against by using the fee leveling construct described in DOL Advisory Opinion 97-15A,[3] commonly referred to as the "Frost Letter." As the DOL put it in its *amicus* brief, Dr. Dlabal appeared to have a direct financial interest in recommending the plans' purchase of the Adageo bonds, rather than other investments, because his financial arrangement with Adageo would allow him to earn larger compensation than under the normal 1.5 percent formula. Well, actually, it may not initially have been entirely clear that this alternative compensation arrangement was preferable, because the $2,500 Dr. Dlabal received from the managing broker-dealer was presumably a one-time only payment, while the 1.5 percent payment under the normal provisions of the investment management agreement was a recurring annual payment. But the salient point, and one on which the Fifth Circuit did not need to comment because of its holding that Dr. Dlabal was not a fiduciary, was whether Dr. Dlabal's judgment might have been affected by whether it was better to take $2,500 today or roughly $1,500 annually. Leaving aside the need for any present value calculation to determine the current value of a 1.5 percent annual fee, the investment was poor enough that it might have been rational for Dr. Dlabal to assume a $2,500 bird in the hand beat two in the bush (at 1.5 percent annually).

The investment failed quickly. The plans made investments in two $50,000 increments, one in July 2009, and the second in December 2009. By mid-2010, Adageo had ceased making interest payments on the bonds, and Wells Fargo, acting as trustee of the debentures, sought to

[3] May 22, 1997.

liquidate the company in an action in state court. As it turns out, the $2,500 in hand was, in fact, probably the better deal for Dr. Dlabal.

FEES NOT FROM PLANS

Now back to our original gripe, which is the Fifth Circuit's analysis as to whether Dr. Dlabal was a fiduciary. The court concluded that he was not a fiduciary as an investment advisor under ERISA Section 3(21)(A)(2) because he did not receive a fee from the plans in connection with the Adageo investment. Instead, the only compensation Dr. Dlabal received came from a third party, namely the broker-dealer used to make the investment. The Fifth Circuit looked to its decision in *Am. Fed'n of Unions Local 102 Health & Welfare Fund v. Equitable Life Assurance Soc'y of the U.S.*[4] as precedent for its conclusion that this type of third party commission is not a fee within the meaning of ERISA's fiduciary definitional provisions for investment advisors.

To us this seems like the wrong conclusion. We would have thought the compensation received from the broker-dealer would have constituted "indirect" compensation for the investment advice provided by Dr. Dlabal. We recognize there may have been other questions to answer before concluding that Dr. Dlabal was a fiduciary, for example ones concerning the nature of Dr. Dlabal's investment advising relationship with the plans, but we would not have thought the source of his compensation would have excused him from fiduciary status.

Sure enough, the Fifth Circuit did conclude in *Equitable Life*, the precedent it cited, that an individual was not paid a fee for investment advice within the meaning of the fiduciary definitional terms where he was not paid a fee by the benefit fund at issue, but was instead paid commissions from an insurance company. The circumstances, though, were very different from those in *Tiblier*. The relevant holding in *Equitable Life* concerned a defendant's "unsound advice" to fiduciaries of a health and welfare fund to self-insure health benefits. Though we understand that the decision whether to self-insure health benefits is one that may involve plan assets, we would not have thought of it as "investment advice," and giving investment advice is a prerequisite to becoming a fiduciary under the relevant statutory provision. To be clear, we have no gripe with the conclusion in *Equitable Life* that the defendant there was not a fiduciary by reason of providing "investment advice" to the health and welfare fund. We agree with that conclusion, however, not because the defendant's compensation came from an insurance company, but instead because a recommendation to self-insure does not strike us as investment advice.

We are not sure where *Tiblier* leaves the state of the law in the Fifth Circuit with respect to those giving investment advice. If the Fifth Circuit means what it has said – and it has now said it at least twice, if one counts *Equitable Life* – a party that regularly provides investment advice to plan fiduciaries upon which both the advisor and the fiduciaries understand the fiduciaries are going to place primary reliance can avoid becoming a fiduciary by taking all her or his compensation from commissions or from alternative sources other than the plan. If the Department of Labor does re-propose, and then make final, a new regulation defining what it means to be a fiduciary, that new regulation might serve a means for the Fifth Circuit in some future case to think

[4] 841 F.2d 658 (5th Cir. 1998).

a second time about its conclusion that absent compensation from the plan itself a party giving investment advice cannot become a fiduciary by reason of that advice.

APPENDIX C

Excerpt from 2008 outline on Voluntary Employees' Beneficiary Associations ("VEBAs")

by
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I. Why Use A Trust? The primary federal labor law governing private (as opposed to governmental) employers' benefit programs is the Employee Retirement Income Security Act of 1974, known as "ERISA." ERISA governs most benefit programs offered by private sector employers. ERISA generally does not, however, apply to employee benefit programs maintained by governments nor to plans maintained by churches or church controlled organizations.

ERISA requires that all assets of an employee benefit program be held in trust. *ERISA § 403(a)*. There is some uncertainty concerning what constitutes a "plan asset" for this purpose. The Department of Labor (the "DOL") - the agency with authority to enforce most of ERISA's provisions, including ERISA's trust requirement – has, however, issued regulations describing what constitutes a plan asset (a) with respect to a plan's investment in other entities, and (b) with respect to participant contributions. *29 CFR §§ 2510.3-101 and 2510.3-102*, respectively.

For a case in which the court found that the named fiduciary of a plan failed to hold plan assets in trust, thereby violating the trust requirement of ERISA Section 403(a), see Chao v. Crouse, 346 F.Supp.2d 975, 986, 34 EBC 1084 (S.D. Ind. 2004). In that case, the court found that an organization that was the named fiduciary of a multiple employer welfare arrangement violated the trust requirement because it failed to hold premiums received from employers (which presumably included employee contributions) in trust.

A. Participant Contributions. The DOL takes the position that where a participant or beneficiary is required to make contributions to receive coverage under a self-insured health or welfare plan, those contributions will constitute plan assets. That will be the case whether the participant or beneficiary pays the contribution directly to the employer, or instead has it withheld from his or her wages. These amounts will constitute plan assets as of the earliest date on which the contributions can reasonably be segregated from the employer's general assets. *29 CFR § 2510.3-102(a)*. See also *ERISA Tech. Rel. 92-01; DOL Adv. Op. 92-24A;* Bannistor v. Ullman, 287 F.3d 394, 402 (5th Cir. 2002) (plan assets include employee contributions to benefit plans withheld from employees' paychecks for deposit to their benefit plans, even though not yet delivered to those plans); Navarre v. Luna (In re Luna), 406 F.3d 1192, 1199 (10th Cir. 2005) (unremitted contributions are plan assets); U.S. v. Grizzle, 933 F.2d 943, 14 EBC 1650 (11th Cir. 1991) (unremitted employee contributions to a vacation fund were plan assets); In re Lexington Healthcare Group, Inc., 335 BR 570, 36 EBC 2034 (Bankr. D. Del. 2005) (unremitted 401(k) elective deferrals were plan assets); In re College Bound, Inc., 172 BR 399, 404 (Bankr. S.D. Fla. 1994) (once employee wages are withheld for purposes of contribution to a plan, those wages become plan assets held in trust by the employer).

As noted in E.1 below, a plan may be considered to have assets even where no employee contributions are made. That will be the case, for example, where there is property in which the plan has a beneficial interest or if there is any property which the employer represents to participants or beneficiaries will be used solely to provide plan benefits. There may also be plan assets if there is any asset of the employer which, under the terms of the plan, constitutes the sole source of contributions for the plan.

<u>How Quickly Must Participant Contributions Be Deposited In Trust?</u> With respect to welfare plans, DOL regulations provide that participant contributions become plan assets, and therefore must be placed in trust, by the earliest date on which they can reasonably be segregated from the employer's general assets, but in no event later than 90 days from the date on which those participant contributions are received or withheld by the employer. *29 CFR § 2510.3-102(a) and (c).*

The regulations offer the following example:

> Employer Y is a medium-sized company which maintains a self-insured contributory group health plan. Several former employees have elected, pursuant to the provisions of ERISA Section 602, 29 U.S.C. 1162 [the COBRA rules], to pay Y for continuance of their coverage under the plan. These checks arrive at various times during the month and are deposited in the employer's general account at Bank Z . . . . [T]he assets of the plan include the former employees' payments as soon after the checks have cleared the bank as Y could reasonably be expected to segregate the payments from its general assets, but in no event later than the 90 days after a participant or beneficiary, including a former employee, pays to an employer, or has withheld from his wages by an employer, money for contribution to the plan.

29 CFR § 2510.3-102(f)(4).

In the example above, once the COBRA premiums have become plan assets, they presumably need to be immediately held in trust or, in the case of a plan enjoying the trust exemption for insured health plans (described in C below) need to be paid as a premium to the insurer.

As noted above, under DOL regulations, participant contributions become plan assets, and therefore must be placed in trust, by the earliest date on which they can reasonably be segregated from the employer's general assets (but in no event later than the 90 day deadline for welfare plans, or the 15th business day of a following month deadline for pension plans). As to the requirement that participant contributions be placed in trust by the earliest date on which they can reasonably be segregated from the employer's general assets, the Department of Labor, in 2008, proposed a safe harbor period of seven business days during which amounts that an employer has received from employees, or withheld from wages, for contribution to employee benefit plans with fewer than 100 participants will not be considered to constitute plan assets. *DOL Prop. Reg. § 2510.3-102*, 73 Fed. Reg. 11072 (Feb. 29, 2008).

The Fourth Circuit considered the treatment of participant contributions in Phelps v. CT Enterprises, 194 Fed. Appx. 120, 2006 WL 2310665, 38 EBC 2127 (4th Cir. 2006) (unpublished). The court concluded that participant contributions for health plan coverage were not required to be held in trust, where those contributions were made under the terms of a cafeteria plan. The court, citing ERISA Technical Release 92-01, said this does not, however, relieve fiduciaries "of an obligation to ensure that participant contributions are applied only to the payment of benefits and reasonable administrative expenses of the plan." In the case of an employer which failed financially, the court found that there was no fiduciary breach because the company forwarded participant contributions to the plan within 90 days of each weekly paycheck (though to a third party administrator, not to a trust).

In the case of a pension plan, the 90-day rule is shortened. Participant contributions to a pension plan become plan assets on the earliest date they can reasonably be segregated from the employer's general assets, but in no event later than the 15th business day of the month following the month in which the participant contributions are withheld or received by the employer.

B. DOL Non-Enforcement Policy for Cafeteria Plan Assets. Because employee (or other participant or beneficiary) contributions are plan assets they must be held in trust. Even so, the Department of Labor has agreed not to enforce the trust requirement with respect to cafeteria plan assets (until the adoption of final regulations providing relief from ERISA's trust requirement). *ERISA Tech. Rel. 92-01; DOL News Release 93-363*. Plan participants, as opposed to the Labor Department, could, presumably, still enforce the trust requirement, even with respect to cafeteria plan assets. But see Phelps v. CT Enterprises, 194 Fed. Appx. 120, 2006 WL 2310665, 38 EBC 2127 (4th Cir. 2006), where the Fourth Circuit stated that participant contributions made pursuant to a cafeteria plan were not required to be held in trust, and did so in the context of a lawsuit that had been filed by participants, rather than the DOL. Participants had alleged a breach of fiduciary duty where the employer failed, and health plan claims were not paid as a consequence of the health plans having insufficient assets.

The Department of Labor indicated in the preamble to its participant contribution plan asset regulations that the mere receipt by a cafeteria plan of COBRA contributions or other after-tax participant contributions (such as retiree contributions) would not, by itself, cause the cafeteria plan to lose the benefit of the DOL's non-enforcement policy. *Preamble to 29 CFR 2510.3-102, 61 FR 41220 (8/7/96).* Accord, *2007 Instructions for Form 5500, § 1, "Welfare Benefit Plan*."

C. Exceptions to ERISA's Trust Requirement for Insurance Contracts and Assets of Insurance Companies. ERISA sets forth certain exceptions to the requirement that plan assets be held in trust. In particular, ERISA's trust requirement does not apply to:

- Any assets of a plan which consist of insurance contracts or policies issued by an insurance company qualified to do business in a state; and

- Any assets of an insurance company qualified to do business in a state and any assets of a plan which are held by such an insurance company.

D. <u>DOL Non-Enforcement Policy for Fully Insured Plans</u>. Even though insurance contracts themselves need not be held in trust, a plan providing benefits through insurance contracts may still have other plan assets which must be held in trust. The Department of Labor has announced, however, that it will not enforce ERISA's trust requirement with respect to fully insured welfare plans meeting certain requirements (until the adoption of final regulations providing relief from the trust requirement). *ERISA Tech. Rel. 92-01; DOL News Release 93-363*. These are plans which provide benefits exclusively through insurance contracts or policies issued by an insurance company (or similar organization) qualified to do business in a state, or through a qualified HMO. *29 CFR §§ 2520.104-20(b)(2)(ii) and 2520.104-44(b)(1)(ii)*. To enjoy the non-enforcement policy, premiums must be paid directly by the employer (or a union) from its general assets, or partly from its general assets and partly from contributions by its employees (or union members). This is a requirement borrowed from a reporting and disclosure regulation. Interpreting that regulation, the Department of Labor concluded in *Advisory Opinion 79-63A* that the requirement was not met where premium amounts were not forwarded directly to the insurer, but were first sent by employers to an organization that served as their agent in their dealings with the insurer. The organization, in its capacity as an agent, collected premiums for participating employees, handled new enrollments, and paid premiums to the insurer. The DOL concluded that because the employers did not forward premium payments directly to the insurer, the limited reporting and disclosure exemption under 29 CFR Section 2520.104-20 would not be available for those employers. Though the ruling predates the DOL's non-enforcement policy with respect to ERISA's trust requirement, the obligation that premiums be paid directly to the insurer under the reporting and disclosure regulation is identical to the requirement under the non-enforcement policy. As a result, if premiums are paid to an intermediary organization for forwarding to the insurer, this would seem to make the non-enforcement policy inapplicable, with the result that the Department would enforce ERISA's trust requirement.

To enjoy the relief under the non-enforcement policy, any plan assets held by the insurance company must be held solely in the general account of that company. Contributions made by participants must be forwarded by the employer (or union) within three months of receipt and, in the case of a plan that provides for the return of refunds to contributing participants, those refunds must be returned to participants within three months of receipt by the employer (or union).

One consequence of these rules is that there is no need for most insured plans to maintain a "dunking trust" (at least to avoid enforcement action by the DOL, as opposed to a lawsuit brought by participants) - that is, a trust through which premium payments are deposited briefly before being paid to the insurance company as a premium. Fastidious attention must, however, be paid to the requirement that premiums be paid only from the employer's general assets or partly from its general assets and partly from contributions by employees. If, instead, premiums are paid in part from assets separately set-aside by the employer and designated and described to employees as being for the purpose of paying premiums, the Department of Labor's relief from ERISA's trust requirement would presumably be unavailable. Those separately set-aside assets, about which plan participants were told, would then need to be held in trust.

The Department of Labor's *Technical Release 92-01* notes that it does not relieve plan sponsors and fiduciaries of their obligation to ensure that participant contributions are applied only to the payment of benefits and reasonable administrative expenses. The Technical Release reminds employers that the utilization of participant contributions for any other purpose may result not only in civil sanctions but also in criminal sanctions under 18 U.S.C. Section 664. For a case in which the Fourth Circuit concluded that forwarding participant contributions within 90 days of each weekly paycheck to a health plan's third party administrator satisfied this obligation, see Phelps v. CT Enterprises, 194 Fed. Appx. 120, 2006 WL 2310665, 38 EBC 2127 (4th Cir. 2006). For a criminal conviction involving the failure to forward employee contributions, see U.S. v. Grizzle, 933 F.2d 943, 14 EBC 1650 (11th Cir. 1991).

E. What Constitutes a Plan Asset

1. DOL Advisory Opinion 92-24A. The Department of Labor provided guidance on what constitutes a plan asset in *Advisory Opinion 92-24A*. That ruling makes clear that all self-insured plans requiring employee contributions will be considered to have plan assets. Those assets will, therefore, need to be held in trust (except in the case of a cafeteria plan). The Department noted that the use of a third-party administrator to pay benefit claims does not avoid the need for a trust.

Beneficial Interest In Property/"Mere Segregation" of Employer Funds. The Advisory Opinion also notes that a welfare plan will be considered to have assets if there is any property in which the plan has a beneficial ownership interest. This would be the case, for example, if the employer were to establish a separate account with a bank or other third party in the name of the plan, or if plan documents were to indicate that separately maintained funds belong to the plan. The Department said, however, that the "mere segregation of employer funds" to facilitate plan administration would not create a plan asset. That segregation therefore would not cause a noncontributory plan otherwise paying benefits solely from general assets of the employer to be required to maintain a trust.

See also Department of Labor *Advisory Opinion 93-14A*, which provides that "[i]n general, the assets of a welfare plan would include any property, tangible or intangible, in which the plan has a beneficial ownership interest."

Separate Checking Account for TPA. Under the "mere segregation" principle, it appears that employers' common practice of establishing separate checking accounts from which a TPA pays claims does not, in and of itself, cause the monies in those accounts to constitute plan assets. (The separate checking account is created so the TPA will not have check writing authority against the employer's full array of assets.) Presumably, the result would be different if the employer made representations to participants that the checking account had been set aside for the payment of plan benefits, or the checking account were established in the plan's name.

TPA's Commingled Account. The Department of Labor declined to rule on the direct question raised by the party seeking the ruling. A third-party administrator had asked whether the maintenance of a single bank account from which benefits would be paid for a number of employers' plans would cause those plans to have plan assets. If so, those assets would need to be held in trust. The Department's refusal to rule was based on the factual nature of the question.

Contributory Self-Insured Plans With Reinsurance. The Department indicated its view that the trust exemption for insured arrangements is available only for plans actually paying benefits from insurance contracts. Stop-loss policies, which normally insure liabilities for benefits but do not insure benefits directly, would not provide benefits through insurance as required to enjoy the regulatory exemption from ERISA's trust requirement. The Department's view is contrary to the position taken by some employers that no trust is required where a contributory plan uses employee contributions to pay stop-loss premiums within three months.

2. Reinsurance Not Plan Asset. In an earlier *Advisory Opinion, Number 92-02A*, the Department had dealt with plans providing benefits exclusively from an employer's general assets, but where the sponsoring employer purchased stop-loss insurance. The Department indicated that such a stop-loss policy would not be considered a plan asset, and would therefore not itself need to be held in trust, where:

- the insurance proceeds are payable only to the employer, which is the named insured under the policy;
- the employer has all rights of ownership under the policy, and the policy is subject to the claims of the employer's creditors;
- neither the plan nor any participant or beneficiary has any preferential claim against the policy or any beneficial interest in it;
- no representations are made to participants or beneficiaries that the policy will be used to provide benefits under the plan or that the policy in any way represents security for the payment of benefits; and
- the benefits associated with the plan are not limited or governed in any way by the amount of insurance proceeds received by the employer.

See also *DOL Advisory Opinion 81-11A*. In a footnote, the Department suggested that where the plan document or other relevant documents, such as a collective bargaining agreement, require that the employer purchase an insurance policy, or where the documents identify an insurance policy to be used to satisfy liabilities of the plan, the resulting stop-loss policy could constitute a plan asset.

The upshot of these two Department of Labor rulings (Numbers 92-24A and 92-02A) is this: Employee contributions for health or welfare coverage under a plan which is completely or partially self-insured, must be held in trust. This is true even if employee contributions are promptly used to pay reinsurance premiums. These rulings do not, however, prevent a cafeteria plan from continuing to take advantage of the DOL non-enforcement policy relating to ERISA's trust requirement for salary reduction elections. It seems this need to hold participant contributions in trust will apply even where the employer can argue that participant contributions only serve to reimburse the employer for benefits it has previously paid. *DOL Advisory Opinion 92-24A.*

Patelco. Note that the Ninth Circuit, in Patelco Credit Union v. Sahni, 262 F.3d 897, 26 EBC 2060 (9th Cir. 2001), concluded that two checks from a stop-loss insurer made payable to the employer sponsoring the health plan were plan assets. Notably, the court did not seem to base its conclusion on any distinction between checks from the stop-loss insurer (plan assets), and the stop-loss policy itself (not a plan asset). Instead, the court seemed to reject DOL Advisory Opinion 92-02A. It dismissed the DOL opinion, saying simply that "this authority is not binding." In doing so, the court observed that advisory opinions by their terms may be relied on only by the parties described in the opinion letter request.

The employer in Patelco had established a health plan for its employees. The plan was initially fully insured. On the advice of an insurance broker, the employer later decided to partially self-fund the plan in order to avoid paying rising premiums. Under the new arrangement, employees would continue to pay the annual deductible in effect under the prior fully insured arrangement ($50), but the employer would self-insure claims between $50 and $500, after which the insurance policy would cover the remainder.

The insurance broker had control over the assets. In particular, he selected the insurer for claims in excess of $500. Each month the employer paid to the insurance broker, at the broker's direction, an amount of money that the broker estimated would be necessary to cover (1) benefit checks he would write to medical care providers, (2) insurance premiums for the insurance policy, and (3) the administrative fee the broker alleged the employer had agreed to pay him. The insurance broker's accounting for the assets was, at best, "sloppy." The broker maintained three accounts: one for "premiums" that came in from clients like the employer; one for paying claims; and one for his own company. The money of many plans was comingled in the accounts for premiums and claims. As to the employer at issue, the entire amount received each month pursuant to the broker's estimate (which included money for premiums, money to pay claims, and the broker's alleged administrative fee) was initially placed in the premiums account. Later, the broker would transfer money from the premiums account to the claims account to cover the checks he had written to medical care providers. The broker had sole control over these accounts; the employer's employees did not have check-writing authority, nor did they even know the account number or location of the accounts. The plan later became self-funded, with stop-loss coverage for annual losses exceeding $10,000 per employee or $100,000 for the plan. The broker was the party who shopped for a stop-loss carrier to replace the insurer and made the ultimate selection of the carrier.

The employer sued the broker for breach of fiduciary duty and violations of the self-dealing prohibited transaction provisions of ERISA Section 406(b). In holding for the employer, the court rejected the broker's argument that he did not violate ERISA Section 406(b) because he received only reasonable compensation and had provided disclosure of those amounts, and therefore qualified for the prohibited transaction exemptions under ERISA Sections 408(b)(2) and 408(c) for the payment of reasonable compensation for services rendered. The court concluded, as do DOL regulations, that the 408(b)(2) exemption does not provide an exemption from the Section 406(b) self-dealing proscriptions (instead, providing relief from the Section 406(a) requirements), and that the ERISA Section 408(c)(2) provision regarding reasonable compensation does not establish an independent prohibited transaction exemption, but rather only modifies Section 408(b).

Bank of Louisiana. The Fifth Circuit cited *DOL Advisory Opinion 92-02A* approvingly for the notion that a stop-loss policy is not a plan asset in Bank of Louisiana v. Aetna US Healthcare Inc., 459 F.3d 610, 616, 38 EBC 1809 (5th Cir. 2006). The Fifth Circuit did so in the course of concluding that a stop-loss insurer was not acting in a fiduciary capacity when it represented to an employer which claims would be covered by a policy extension. Importantly, it was the employer that had contracted with the insurance company to provide stop-loss insurance for its self-funded health plan. As a result, the court indicated that the duties the insurer allegedly breached in negotiating the policy were owed to the employer, and the benefits of the stop-loss insurance inured solely to the employer. The insurer cited no evidence that the stop-loss policy was a plan asset or was purchased with plan assets. (The issue arose because the insurer asserted that it was a fiduciary so it could argue that various claims made by the employer were preempted by ERISA.) Although the Court cited the DOL advisory opinion, it also noted that the Ninth Circuit in Patelco had concluded that checks for stop-loss benefits are plan assets.

For another decision in which a court concluded that a stop-loss insurer was not a fiduciary under ERISA, see Union Healthcare, Inc. v. John Alden Life Insurance Co., 908 F.Supp 429 (S.D. Miss. 1995).

3. DOL Advisory Opinion 2005-08A: Payments or Distributions from Insurers. The Department of Labor included in *Advisory Opinion 2005-08A* a substantial discussion of what constitutes a plan asset. The Department had been asked whether litigation proceeds received by one of the Blue Cross organizations in settlement of claims against the tobacco industry, and which were subsequently paid out to certain group insurance policyholders that maintained welfare benefit plans, were subject to ERISA. The Department noted that ERISA does not expressly define what property will be regarded as "assets of an employee benefit plan." It observed that the Department has, however, issued regulations describing what constitutes a plan asset with respect to a plan's investment in other entities, and with respect to participant contributions, at *29 CFR §§ 2510.3-101 and 2510.3-102*, respectively. The Department said it has indicated that in other situations (that is, other than with respect to a plan's investment in other entities and with respect to participant contributions) the assets of an employee benefit plan generally are to be identified on the basis of ordinary notions of property rights, citing *DOL Adv. Ops. 94-31 and 2001-02A.*

As noted, the ruling concerned the distribution by one of the Blue Cross and Blue Shield organizations (Blue Cross and Blue Shield of Minnesota ("Blue Cross")) of settlement proceeds the organization received in settlement of claims against the tobacco industry. The settlement Blue Cross received caused it to have surplus assets in excess of the amount it was permitted to retain under state law. Blue Cross initially filed a plan with the state insurance commissioner for the removal of this excess surplus in a way that did not include payments to Blue Cross' fully insured groups. The insurance commissioner rejected the proposal. Blue Cross then proposed to distribute a portion of the excess to certain group insurance policyholders. The state insurance commissioner tentatively approved this approach, so long as the distribution would not violate ERISA. In the plan approved by the insurance commissioner, Blue Cross would distribute $30 million of the excess to certain group insurance policyholders. Blue Cross was then sued by certain insured individuals and groups seeking a portion of the settlement. In a settlement of that class action, Blue Cross agreed to pay to certain group insurance policyholders $41 million based on specific criteria determined by Blue Cross. This revised payment became part of Blue Cross' amended plan for removing its excess surplus, which gained tentative approval from the insurance commissioner.

The advisory opinion described the proposed method for allocating the distribution of excess surplus to policyholders in this way:

> You represent that not all current Blue Cross policyholders will receive a portion of the Payment and that there are approximately 38,000 Policyholders that may receive a portion of the Payment amount. You represent that Blue Cross's distribution of the Payment is not based on the amount of premiums paid by Policyholders, nor is it based on the actual health care experience of any Policyholder. Rather, you represent that the distribution of the Payment is based entirely on the following criteria: (1) whether the Policyholder had a fully-insured contract with Blue Cross at any time from January 1, 1978 through June 15, 2001 (Relevant Period); (2) the greatest number of covered employees in the last month in which the Policyholder was fully insured during the Relevant Period; and (3) the length of time that a Policyholder contracted with Blue Cross during the Relevant Period.

> You represent that the Blue Cross distribution formula will distinguish Policyholders in narrowly drawn groupings in terms of group size. You further represent that the Blue Cross distribution formula ignores any actuarial differences in premiums paid for similarly-sized insured groups. As a result, Policyholders that have the same number of insured individuals for the same amount of time will receive the same distribution amount despite the fact that one Policyholder may have paid a significantly larger amount in premiums than the other during the Relevant Period.
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> You represent that the Policyholders, as employers, provided health insurance benefits through their Blue Cross group insurance policies to their employees pursuant to welfare benefit plans that are governed by ERISA. Under typical contracts, Blue Cross requires that the employer contribute at least 50 percent of the premiums and, in fact, Blue Cross believes that most employers contributed in excess of 50 percent over the years. You also represent that some Policyholders may have terminated the welfare plan associated with Blue Cross's group insurance policy for which a portion of the Payment is to be made. You further represent that no Policyholder will receive a portion of the Payment in excess of its total premiums paid to Blue Cross and that because $41 million is such a small portion of overall premiums paid over the years by employers, employers will recover only a relatively small portion of their premium payment. You ask whether any amounts paid to Policyholders constitute plan assets.

The Department noted in a footnote that because Blue Cross sued the tobacco companies on its own behalf for damages suffered by it, and not on behalf of any of its policyholders, the Department's view was that none of the settlement amount would constitute plan assets while it remained in the possession and control of Blue Cross.

The Department then launched into its discussion of when distributions from insurance companies to policyholders are considered to be plan assets under ERISA, as follows:

> Distributions from insurance companies to their policyholders take a variety of forms, including refunds, dividends, demutualization payments and excess surplus distributions, such as the Payment. To the extent that a distribution, such as the Payment, is considered to be plan assets, it becomes subject to the requirements of Title I of ERISA. Anyone with authority or control over plan assets is a fiduciary and subject to, among other things, the fiduciary responsibility provisions of ERISA section 404, the prohibited transaction provisions of ERISA section 406 and the bonding requirements of section 412. Also, under ERISA section 403 plan

assets must generally be held in trust and may not inure to the benefit of the employer. Section 403(a) of ERISA provides that all assets of an employee benefit plan shall be held in trust by one or more trustees. ERISA does not expressly define what property will be regarded as “assets of an employee benefit plan.” The Department of Labor (the Department) has issued regulations describing what constitutes plan assets with respect to a plan's investment in other entities and with respect to participant contributions. See 29 C.F.R.2510.3-101 and 29 C.F.R. 2510.3-102, respectively. The Department has indicated that the assets of an employee benefit plan generally are to be identified in other situations on the basis of ordinary notions of property rights.

Generally, a distribution such as the Payment, will be a plan asset if a plan has a beneficial interest in the distribution under ordinary notions of property rights. Under this approach the primary factors in determining beneficial interest would be the types of benefits, the terms of the governing instruments and the source of funds for the insurance contract. In the case where any type of plan or trust is the policyholder, or where the premium is paid entirely out of trust assets, it is the view of the Department that the entire distribution amount received by such policyholder constitutes plan assets. [At this point, the Department noted in a footnote that: “If an employer takes steps that cause the plan to gain a beneficial interest in particular assets, under ordinary notions of property rights (*e.g.*, causing the plan to be the named policyholder or using trust assets to pay the entire premium) such assets would become plan assets. *See*, Advisory Opinion 99-08A (May 20, 1999), Advisory Opinion 94-31A (September 9, 1994), and Advisory Opinion 2001-02A (February 15, 2001).”] However, if instead the employer is the policyholder or the owner of the policy, this fact would not, by itself, indicate that the employer may retain the entire distribution amount. If an employer is the named policyholder, additional evidence of the parties' intent would be needed to determine whether amounts received by the employer should be allocated to the plan because plan participants and beneficiaries are considered beneficiaries of the policy that underwrites plan benefits.

If the insurance policy or contract, together with other instruments governing the plan, is fairly read to provide for ownership of distributions, such as the Payment, then that language governs subject to the provisions of section 403 of ERISA. In the absence of more direct evidence of ownership, the Department believes that the allocation of a Policyholder's portion of the Payment between a plan and its sponsoring employer may be based on the sources of the insurance policies premium payments and other plan expenses.

Under this approach the portion of a distribution that is attributable to participant contributions would be considered plan assets. In this regard, it is the Department's opinion that, if a contract is ambiguous, and an employer paid the entire cost of the insurance coverage, then no part of the distribution with respect to this particular policy would be attributable to participant contributions. Likewise, if instead participants paid the entire cost of the insurance coverage then the entire amount of the distribution to such policyholder would be attributable to participant contributions and considered to be plan assets. If the participants and the employer each paid a fixed percentage of the cost, a percentage of the distribution equal to the percentage of the cost paid by participants would be attributable to participant contributions. If employers were required to pay a fixed amount and participants were responsible for paying any additional costs, then the portion of the distribution under such a policy that does not exceed the participants' total amount of prior contributions would be attributable to participant contributions. Finally, if participants paid a fixed amount and the employer were responsible for paying any additional costs then the portion of the distribution under such a policy that did not exceed the employer's total amount of prior contributions would not be attributable to participant contributions.

In any case, employers that sponsor employee benefit plans that use insurance policies to provide benefits under such plans would be prohibited by ERISA section 403(c)(1) from receiving a distribution amount greater than the total amount of premiums and other plan expenses previously paid by the employer out of its general assets. To the extent that a policyholder's portion of the distribution exceeds the amount of such policyholder's total amount of premiums and other plan expenses previously paid, that excess amount must be held in trust for the exclusive benefit of participants. In addition, if the welfare plan of a policyholder was properly terminated and all obligations and claims under such plan were satisfied prior to the termination, there is no obligation under Title I of ERISA to treat any portion of the distribution received by such policyholder as plan assets.

Therefore, no violation of Title I of ERISA would occur if such policyholder retains its portion of the Payment. It should also be noted that the other fiduciary obligations under Title I of ERISA, including those in sections 404 and 406 of ERISA, apply to dealing with any portions of the Payment amount that constitute plan assets.

> Consistent with the provisions of ERISA section 403, Policyholders receiving a portion of the Payment constituting plan assets could place those assets in trust until appropriately expended in accordance with the terms of the plan. Alternatively, the Department believes that, prior to or simultaneous with the distribution of the Payment constituting plan assets, such assets could be applied to enhancing plan benefits under existing, supplemental or new insurance policies or contracts; or applied toward future participant premium payments without violating the requirements of section 40.
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> You represent that many of the Policyholders do not currently maintain trusts to hold plan assets because their plans are funded solely by insurance contracts, and therefore, are exempt from the trust requirement. This is generally true for welfare plan Policyholders and smaller employers holding group annuity contracts to fund retirement benefits. In recognition of the unique circumstances giving rise to the distribution of the Payment (where a portion of the Payment is considered to be plan assets by a Policyholder), the Department has determined that, pending the issuance of further guidance, it will not assert a violation in any enforcement proceeding solely because of a failure to hold plan assets in trust, provided that: such assets consist solely of proceeds received by the Policyholder in connection with the Payment; such assets, and any earnings thereon, are placed in the name of the plan in an interest-bearing account as soon as reasonably possible following receipt and such proceeds are applied for the payment of participant premiums or applied to plan benefit enhancements or distributed to plan participants as soon as reasonably possible but no later than twelve (12) months following receipt; such assets are subject to the control of a designated plan fiduciary; the plan is not otherwise required to maintain a trust under section 403 of ERISA; and the designated fiduciary maintains such documents and records as are necessary under ERISA with respect to the foregoing. Nor, with respect to plans satisfying the foregoing, will the Department assert a violation in any enforcement proceeding or assess a civil penalty with respect to such plans because of a failure to meet the reporting requirements by reason of not coming within the limited exemptions set forth in 29 C.F.R. §§2520.104-20 and 2520.104-44 solely as a result of receiving a portion of the Payment constituting, in whole or in part, plan assets.

Demutualization Proceeds. In a footnote to the advisory opinion, the Department addressed the proper allocation of demutualization proceeds received by a policyholder where a mutual insurance company becomes a stock company. In that context, the Department drew a distinction with its general conclusion in the advisory opinion that where participants pay a fixed amount for coverage (and the employer is responsible for any additional costs), the portion of any distribution under the policy that does not exceed the employer's total amount of prior contributions will not be attributable to participant contributions. With respect to demutualization proceeds, the Department stated a different rule, as follows:

> The Department believes, however, that in the case of a policyholder's receipt of demutualization proceeds, members of a mutual insurance company are required to legally exchange, and thereby extinguish, their equity interests for such proceeds. In this context, and unless it is clear from the contract and other plan documents how the proceeds should be allocated, the policyholder's ownership/equity interest in the insurance company relates directly to the amount of premiums paid. As a result, when participants contribute towards insurance premiums that produce an inchoate equity/ownership interest, it is the view of the Department that a pro-rata portion of the resulting demutualization proceeds is properly attributable to participant contributions. See Advisory Opinion 2001-02A and Information Letter to Theodore Groom (February 15, 2001).

The DOL, in a footnote to *Advisory Opinion 2001-02A* had described the proper method for allocating demutualization proceeds as follows:

> See Advisory Opinion 92–02A, Jan. 17, 1992 (assets of a plan generally are to be identified on the basis of ordinary notions of property rights under non–ERISA law). It is the view of the Department that, in the case of an employee welfare benefit plan with respect to which participants pay a portion of the premiums, the appropriate plan fiduciary must treat as plan assets the portion of the demutualization proceeds attributable to participant contributions. In determining what portion of the proceeds are attributable to participant contributions, the plan fiduciary should give appropriate consideration to those facts and circumstances that the fiduciary knows or should know are relevant to the determination, including the documents and instruments governing the plan and the proportion of total participant contributions to the total premiums paid over an appropriate time period. In the case . . . where any type of plan or trust is the policyholder, or where the policy is paid for out of trust assets, it is the view of the Department that all of the proceeds received by the policyholder in connection with a demutualization would constitute plan assets.

Note, incidentally, that the IRS ruled that each of 10 demutualization trusts qualified as VEBAs under Code Section 501(c)(9) in Dominion Chevrolet Co v. CBS Demutualization Trust, G.L. Howard, Inc. BCBS Demutualization Trust, and Others (8/13/99), reported at 163 DTR K-5, August 24, 1999.

4. **Revocable Trust**. The Department of Labor has indicated that the assets of a revocable trust established by an employer would not constitute plan assets where the trust assets were subject to the claims of the employer's general creditors and were used by the employer as a discretionary source for paying premiums for medical insurance. *DOL Advisory Opinion 93-14A.*

5. **Trusts for FAS 106 Funding**. The Department of Labor held that the assets of an irrevocable trust intended to be used by an employer to offset its benefit obligations for purposes of financial reporting under FAS 106 are plan assets under ERISA. *DOL Adv. Op. 94-31A.* The Department said this was the case because the treatment or use of a trust's assets as a benefit obligation offset for employer financial reporting purposes is tantamount to a representation that those assets separately secure the benefits promised under the plan. In that regard, the Department noted that to serve as an offset under FAS 106, assets must be segregated and restricted for the payment of post-retirement benefits.

In contrast, where a utility, as part of a ratemaking case, was permitted to recover post-retirement benefit costs from ratepayers on a current basis, those monies, which were to be contributed to a grantor trust, would not constitute plan assets. *DOL Adv. Op. 99-08A.* That was because the assets accumulated in the trust would not be restricted to the payment of post-retirement benefits. Instead, the company could eventually either (1) contribute the monies accumulated in the trust to one or more VEBAs to fund post-retirement health and life insurance benefits provided to its employees and former employees, or (2) apply those monies to such other business purposes as would be consistent with the applicable rate orders of the state public service commission. The company intended to contribute to the trust amounts recovered from ratepayers in excess of the maximum deductible contributions permitted to be made to its VEBAs, or otherwise in excess of the amount the company deemed advisable to contribute to the VEBAs. The trust assets were not to be treated by the company, or by any other participating employer, as a "restricted and segregated fund" for purposes of FAS 106. The trust agreement would provide that trust assets could be used for any business or regulatory purpose that the company determined not to be inconsistent with the orders or decisions of the state public service commission. The trust agreement would also state specifically that nothing would entitle any participant or beneficiary of any employee benefit plan to any payments from, or create any interest on their part in, the assets of the trust fund, and that the trust was not intended to fund any employee benefit plan or program, but rather was intended to be depository arrangement with the trustee for the setting aside of cash and other assets for meeting all or part of the company's and any participating employer's obligations, including any obligations that the company might have with respect to any rate orders issued by the state public service commission. Neither the VEBAs nor the participants or beneficiaries would have any preference or claim against, or any beneficial interest in, the assets of the trust.

6. **Split-Dollar Life Insurance**. The Department of Labor ruled that the cash value portion of a split-dollar life insurance policy did not constitute a plan asset, where the employer had all rights of ownership to that cash value, and neither the split-dollar plan nor the employee had any preferred claims against or any beneficial interest in the cash value. This was true in part because the cash value was not used to provide, or secure, the employees' life insurance benefits. *DOL Advisory Opinion 92-22A.*

7. Unremitted Contributions.

a. Employee Contributions (Including 401(k) Elective Deferrals. The Eleventh Circuit held that where an employer withheld monies from employees' paychecks, those amounts constituted plan assets even though the employer failed to deposit the amounts in the union vacation trust in which they were required to be deposited. The funds were embezzled before being deposited in the trust. A DOL conclusion that the amounts were plan assets even before their deposit in the trust was important in obtaining a criminal conviction under 18 U.S.C. Section 664. U.S. v. Grizzle, 933 F.2d 943, 14 EBC 1650 (11th Cir. 1991). Accord, Navarre v. Luna (In re Luna), 406 F.3d 1192, 1199 (10th Cir. 2005) (unremitted employee contributions were plan assets, while unremitted employer contributions were not plan assets); Eskelin v. Ranson Companies, 121 F.3d 715 (9th Cir 1997) (unpublished) (contributions deducted from an employee's wages become plan assets as soon as they can feasibly be segregated from the employer's other assets, but not later than 90 days after withholding, citing 29 CFR § 2510.3-102(a))); Bannistor v. Ullman, 287 F.3d 394, 402 (5th Cir. 2002) (plan assets include employee contributions to benefit plans withheld from employees' paychecks for deposit to those benefit plans, even though not yet delivered to the plans); In re Lexington Healthcare Group, Inc., 335 BR 570, 36 EBC 2034 (Bankr. D. Del. 2005) (unremitted 401(k) elective deferrals were plan assets); In re College Bound, Inc., 172 BR 399, 404 (Bankr. S.D. Fla. 1994) (once employee wages are withheld for purposes of contribution to a plan, those wages become plan assets held in trust by the employer).

The Department of Labor's regulations defining the term "plan assets" provide that:

> The assets of the plan include amounts (other than union dues) that a participant or beneficiary pays to an employer, or amounts that a participant has withheld from his wages by an employer, for contribution to the plan as of the earliest date on which such contributions can reasonably be segregated from the employer's general assets. (emphasis added)

29 CFR § 2510.3-102.

The Eleventh Circuit concluded, however, that until contributions were actually paid to a plan, the monies were not plan assets. Local Union 2134 v. Powhatan Fuel Inc., 828 F.2d 710 (11th Cir. 1987).

b. Employer Contributions. Although, as described above, most authority indicates that unremitted employee contributions are plan assets, the conclusion may be different with respect to employer contributions. See, e.g., Trustees of National Elevator Industry Pension v. Lutyk, 140 F.Supp.2d 447, 456, 26 EBC 1294 (E.D. Pa. 2001), *aff'd on other grounds*, 332 F.3d 188, 30 EBC 1845 (3d Cir. 2003) (unremitted employer contributions were not plan assets); Navarre v. Luna (In re Luna), 406 F.3d 1192, 1199 (10th Cir. 2005) (unremitted employee contributions were plan assets, while unremitted employer contributions were not); Cline v. Industrial Maintenance Engineering & Contracting Co., 200 F.3d 1223, 1234 (9th Cir. 2000); Central Illinois Carpenters Health & Welfare Trust Fund v. S & S Fashion Floors, Inc., 516 F.Supp.2d 931, 42 EBC 2380 (C.D. Ill. 2007) (unremitted employee contributions were plan assets, while unremitted employer contributions were not).

In some cases, courts have looked to the specific language of plan documents, collective bargaining agreements, or other governing trust documents to determine when amounts become plan assets. See, e.g., ITPE Pension Fund v. Hall, 334 F.3d 1011, 1014 (11th Cir. 2003) (plan language overrides general rule that unpaid employer contributions are not plan assets); Chicago Dist. Council of Carpenters Pension Fund v. Angulo, 150 F.Supp.2d 976, 978 (contract language implicitly led to holding that employer contributions were plan assets); Laborers Combined Funds of Western Pennsylvania v. Cioppa, 346 F.Supp.2d 765 (W.D. Pa. 2004) (language in trust fund caused contributions due under collective bargaining agreements to constitute plan assets); Galgay v. Gangloff, 677 F.Supp. 295 (M.D. Pa. 1987), *aff'd*, 932 F.2d 959 (3d Cir. 1991) (agreement creating funds stated that "title to all monies paid into and/or due and owing said fund shall be vested in and remain exclusively in the trustees of the fund," which caused money that was owed to become an asset of the plan); Connors v. Paybra Mining Co., 807 F.Supp 1242, 1246 (S.D. W.Va. 1992) (agreement vested title in ERISA fund for all "due and owing" contributions, which caused delinquent contributions to be plan assets).

In at least one case, it appears a court concluded that both employer and employee wage deductions were plan assets, regardless of the language of benefit plan documents or whether the funds were ever conveyed to the plan. Board of Trustees of the Airconditioning & Refrigeration Industry Health & Welfare Trust Fund v. J.R.D. Mechanical Services, Inc., 99 F.Supp.2d 1115, 1120 n. 4 (C.D. Cal. 1999). Another court appears to have reached the same conclusion in Ironworkers' Local No. 25 Pension Fund v. McGuire Steel Erection, Inc., 352 F.Supp.2d 794 (E.D. Mich. 2004) (whether or not the court were to consider language of the trust agreement providing that employer contributions become vested plan assets at the time they become due and owing to the fund, unpaid employer contributions became vested plan assets when they became due).

Many of the cases addressing whether unremitted employee or employer contributions are plan assets concern whether a party acted as a fiduciary when failing to forward monies to the plan.

c. **Payments from Union to Employer**. The Third Circuit held that payments made by a union to an employer were for the purpose of reimbursing the employer for its expenses in providing pension benefits to employees temporarily working for the union, rather than as contributions to a pension trust fund. As a result, those payments did not constitute plan assets required to be contributed to the trust fund for the pension plan. Bottle Beer Drivers, Warehousemen & Helpers Teamsters Local 843 v. Anheuser Busch Inc., 96 Fed. Appx. 831, 2004 WL 938462, 32 EBC 2229 (3d Cir. 2004). In prior years the employer had made contributions to the pension plan pursuant to the terms of a collective bargaining agreement. It did not, however, make contributions for employees on leave to serve the local. Instead, the union contributed directly to the trustee for those employees, contributing the same amount the employer contributed on behalf of other employees. Later, however, because of the well-funded status of the pension plan, the employer successfully negotiated for making no set contributions to the pension plan, but instead making contributions at the time and amount the employer thought appropriate. The employer determined that contributions were not necessary and stopped making them. At that time, the union also stopped making payments to the trustee, but began making payments to the employer at the employer's request. The employer had determined that if the union made no payments whatsoever, the company could be liable for giving a "thing of value" to union employees, in violation of Section 302(a) of the Labor Management Relations Act of 1947 ("LMRA"), *29 USC § 186(a)*. The court was influenced in its thinking by the Third Circuit's decision in Trailways Lines Inc. v. Trailways, Inc. Joint Council of Amalgamated Transit Union, AFL-CIO, 785 F.2d 101 (3d Cir. 1986), in which the Third Circuit held that employees who take leaves of absence to perform union service are not employees for purposes of the statutory exemption for payments to trust funds established for the benefit of employees. The Third Circuit concluded that collective bargaining agreements which allow for employer contributions on behalf of those individuals therefore violate the LMRA.

F. **Multiple Employer Trusts**. ERISA does not prohibit a trust from holding the assets of more than one plan. That is, ERISA's trust requirement is not violated by the commingling of assets. *DOL Advisory Opinion 81-62A*. It is, however, necessary to separately account for the interest of each plan in a common trust or other common vehicle, in order to avoid using the assets of one plan to pay benefits to participants or beneficiaries of another plan. Absent such separate accounting, ERISA's exclusive benefit rule, which is set forth in ERISA Section 404(a)(1), would be violated. *Ibid*. Separate accounting is, presumably, not required where employees of several employers are covered under a single plan. The separate accounting requirement seems to arise only where the assets of several plans are commingled in a single trust.