

LEGAL DEVELOPMENTS

The Fable of Fiduciary Liability and 404(c) Plan Design

By DAVID R. LEVIN

ERISA provisions on fiduciary liability can be very confusing. This article looks at the blurred lines surrounding plan design and fiduciary liability—or are they blurred?

Once upon a time, a wizard was hired by an employer. Truth be known, the wizard was studying nights to become a lawyer. One morning, after a particularly trying all-night effort to understand ERISA, the wizard exclaimed to the employer: “Eureka! It could be a breach of fiduciary duty to permit participant-directed investments, if employees lack the knowledge and sophistication to manage the investment of retirement funds!”

Stunned but not silenced, the employer asked: “Must an employer establish a pension plan? Must the plan be a defined contribution plan? Must the plan provide for participant-directed investments?” The wizard answered “no” to all of the questions.

The employer asked: “Why not?” The wizard answered: “These are questions of plan design. Plan design is a settlor function, not a fiduciary function. In other words, plan design is

left to the employer as the sponsor of the plan; it is not left to the employer functioning as a fiduciary.”

The employer asked: “Must the employer offer investment education or investment advice to the participants?” The wizard answered: “No, there is no fiduciary duty to offer these.”

The employer was puzzled. “If there is no fiduciary duty to offer investment education or investment advice and if plan design is not the function of a fiduciary, then how can you exclaim that it may be a breach of fiduciary duty to permit participant-directed investments, even if the employees lack the knowledge and sophistication to manage the investment of retirement funds?”

Stunned and silenced by the employer’s logic, the wizard answered: “I don’t know.” The wizard set out to discover where the truth lies—in his own revelation or in the employer’s logic.

COURTS APPLY A FUNCTIONAL TEST WHEN TRYING TO DETERMINE IF A PERSON IS A FIDUCIARY

The United States Supreme Court stressed in *Lockheed Corporation v. Spink* [517 US 882 (1996)] that there cannot be a transgression by a fiduciary, until a determination is reached that the transgressor is acting as a fiduciary with respect to the challenged transaction. [See also *Harris Trust & Savings Bank v Salomon Smith Barney*, 24 EBC 1654 (2000), *rev’g*

sub nom Harris Trust & Savings Bank Salomon Brothers, Inc v Ameritech Corp, 184 F3d 646 (7th Cir 1999) (prohibited transaction cannot be committed without the involvement of a fiduciary, even though nonfiduciary party-in-interest may be liable for equitable relief in connection with the commission of the transaction)]

ERISA defines the term “fiduciary” in functional terms. [Mertens v Hewitt Assoc, 508 US 248 (1993)] ERISA Section 3(21)(A) provides that a person is a fiduciary only to the extent

(i) he exercises any discretionary authority or discretionary control respecting management of such plan or exercises any authority or control respecting management or disposition of its assets, (ii) he renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan, or has any authority to do so, or (iii) he has any discretionary authority or discretionary responsibility in the administration of such plan.

Accordingly, courts determine if a person is a fiduciary under ERISA by looking at the function a person is performing at the time in question. [See, e.g., *LoPresti v Terwilliger*, 126 F3d 34 (2d Cir 1997); *Glaziers & Glassworkers Local 252 Annuity Fund v Newbridge Securities, Inc*, 93 F3d 1171 (3d Cir 1996); *Olsen v EF Hutton & Co*, 957 F2d 622 (8th

David R. Levin, Esq., is a partner in the Washington, D.C., office of Kilpatrick Stockton, L.L.P. He specializes in ERISA litigation and consulting.

Cir 1992); *Donovan v Mercer*, 747 F2d 304 (5th Cir 1984)]

A FIDUCIARY FOR ALL PURPOSES? NOT NECESSARILY

Fiduciary status, however, is not an all or nothing proposition. ERISA Section 3(21)(A), expressly and as interpreted by the courts, provides a limitation on the scope of the definition of fiduciary. ERISA Section 3(21)(A) states that a person is a fiduciary with respect to a plan only “to the extent” that the person performs certain functions. Therefore, even though a person may be a fiduciary for some purposes, that same person is not necessarily a fiduciary for all purposes.

The limited nature of fiduciary status is underscored by ERISA Section 408(c)(3). This statutory section expressly provides that a fiduciary may serve in more than one capacity with respect to a plan. In particular, the fiduciary may also be an officer, employee, agent, “or other representative” of a party-in interest. [*See, e.g., John Hancock Mutual Life Ins Co v Harris Trust & Savings Bank*, 510 US 86 (1993) (“[a] person is a fiduciary ‘to the extent that’ he performs one of the described duties; people may be fiduciaries when they do certain things but be entitled to act in their own interests when they do others”)] If a person is not acting as a fiduciary, then that person’s actions are not required to satisfy ERISA’s fiduciary standards. [*See, e.g., Hughes Aircraft Co v Jacobson*, 525 US 432 (1999)] Thus, determining whether a particular activity is measured under ERISA fiduciary standards requires a determination whether the particular activity constitutes a fiduciary function.

PLAN DESIGN IS NOT A FIDUCIARY FUNCTION

The types of activities that have been found to be fiduciary functions include spending assets of the plan, investing plan assets, denying or approving benefit claims, selecting service providers, and interpreting plan provisions. On the other hand, plan design—which includes, but is not limited to, establishing, amending, or terminating a plan—has, as a general rule, not been deemed to be a fiduciary function.

In the single-employer plan context, courts have consistently held that decisions relating to the design of a plan are settlor acts, even if the design decisions are being made by a person who is a plan fiduciary with respect to other activities. The Supreme Court has stated consistently that “plan sponsors” are generally free to take actions with respect to plan design, and that when plan sponsors take those actions, they do not act as fiduciaries and, therefore, are not subject to ERISA’s fiduciary duties. [*See, e.g., Curtiss Wright Corp v Schoonejongen*, 514 US 73 (1995) (holding that this principle is true in the welfare plan context); *Lockheed Corp v Spink*, 517 US at 889, (holding that the principle applies with equal force in the pension plan context); *Varity Corp v Howe*, 516 US 489, 504 (1996) (“amending or terminating a plan ... cannot be an act of plan ‘management’ or ‘administration’”)] As the Court explained in *Lockheed Corp. v. Spink*, because ERISA’s functional definition of fiduciary does not include “plan design,” a plan sponsor may perform a design function without being subject to scrutiny under ERISA’s fiduciary standards.

[*Spink*, 517 US at 889, quoting *Siskind v Sperry Retirement Program, Unisys*, 47 F3d 498, 505 (2d Cir 1995)]

The Supreme Court has determined that plan design includes actions, among others, that affect the terms of the benefits offered under the plan (e.g., *Lockheed Corp. v. Spink*) and the availability of contributions to fund benefits, (e.g., *Hughes Aircraft Corp. v. Jacobson*). In the area of plan design, the Supreme Court holds that settlor concerns are allowed to take precedence (rather than fiduciary concerns), because plan design is not a fiduciary function. [*Id.*]

Moreover, these Supreme Court decisions, as well as earlier decisions of the Court [*see, e.g., NLRB v Amax Coal Co*, 453 US 322 (1981); *Mine Workers Health and Retirement Funds v Robinson*, 455 US 562 (1982)], recognize the tension between settlor concerns (which often involve considerations other than the sole interest of participants *qua* participants) and fiduciary functions. Consider ERISA Section 404(a)(1)(A), which states that a fiduciary must act solely in the interest of a plan’s participants and beneficiaries and for the exclusive purpose of providing benefits to them and defraying reasonable administrative expenses of the plan. This duty of undivided loyalty forbids a fiduciary from, among other things, favoring the interests of a party-in-interest over the interests of plan participants and beneficiaries. [*E.g., Donovan v Bierwirth*, 680 F2d 263 (2d Cir), *cert denied*, 459 US 1069 (1982)]

It is well settled that a fiduciary must act with an “eye single” to the interests of the plan’s participants and beneficiaries. [*Id.*]

Yet, the flexibilities required by plan sponsors in making plan design decisions—for example, either whether to amend or terminate a plan, or whether and when to change the contribution formula—are often inconsistent with this duty of undivided loyalty. This inconsistency does not prohibit the plan sponsor from acting in a nonfiduciary capacity. As the court of appeals explained in *Donovan v. Cunningham* [716 F2d 1455, 1473 n38 (5th Cir 1983), *cert denied*, 467 US 1251 (1984)] (citations omitted):

ERISA does not relieve plan fiduciaries of obligations arising out of nonplan relationships. For example, the board of directors and administrators of the employer have responsibilities to others, such as shareholders, that they cannot disregard in favor of plan participants and beneficiaries. Similarly, we are unwilling to subject the dealings of such fiduciaries with their own stock to the rigors of scrutiny under ERISA without express congressional direction. We doubt that many potential fiduciaries would be willing to serve if required to deal with their own assets and conduct their own affairs “with an eye single to the interests of the participants and beneficiaries.”

In the same vein, consider a defined benefit pension plan, which may be established or amended to provide that excess assets revert to the employer upon termination of the plan. [See ERISA § 4044(d)] If the design issue were dictated by the fiduciary duty of acting solely in the interest of participants, the person who determined the plan design would be acting as a fiduciary and would have to provide that excess assets could only be used

for the participants. However, case law recognizes that excess assets can revert to plan sponsors without triggering the fiduciary breach provisions and without the commission of a prohibited transaction. [See, e.g., *Hughes Aircraft Co v Jacobson*] In short, these judicial decisions support the proposition that establishing or amending a plan to have a reversion provision is permissible. [See, e.g., *Hughes Aircraft Co v Jacobson*; *LLC Corp v PBGC*, 703 F2d 301, 304 (8th Cir 1983)] These cases hold that the design function cannot be a fiduciary function measured by ERISA’s fiduciary standards.

PLAN DESIGN FUNCTIONS MADE BY A PLAN SPONSOR ARE NOT SUBJECT TO REVIEW UNDER ERISA FIDUCIARY STANDARDS

This rule does not depend upon the identity of the plan sponsor or the kind of plan. The ERISA fiduciary rules are applicable not only to the fiduciaries of single-employer plans, but also to the trustees of multiemployer plans when they are performing fiduciary functions. [E.g., *Central States, Southeast & Southwest Areas Pension Fund v Central Transport, Inc*, 472 US 559 (1985)]

The definition of fiduciary under ERISA Section 3(21)(A), the fiduciary rules under ERISA Section 404, and the prohibited transaction rules under ERISA Section 406 make no distinction between fiduciaries performing fiduciary functions under single-employer and multiemployer plans. Moreover, these ERISA rules are equally applicable to the trustees of a multiemployer plan to the extent they are acting as fiduciaries, regardless of whether the employer or union appointed

them as trustees. [See *NLRB v Amax Coal Co*]

Similarly, ERISA Section 408(c)(3)—expressly permitting an officer, employee, agent, or other representative of a party-in-interest to serve as a fiduciary of an ERISA plan—is, by its terms, no less applicable in the multiemployer plan context than it is in the single-employer plan context. [See, e.g., *NLRB v Amax Coal Co*, 453 US at 334; *Curren v Freitag*, 432 F Supp 668, 672 (SD Ill 1977)]

In *Hawkins v. Bennett* [704 F2d 1157, 1159 (9th Cir 1983)], the court distinguished the process of setting employer contributions through bargaining, which is not within a trustee’s fiduciary power, from a trustee’s fiduciary functions in administering the trust. Relying on the Supreme Court’s decision in *NLRB v. Amax Coal Co.*, the court in *Hawkins v. Bennett* determined that trustees, in their role as fiduciaries, “do not bargain with each other to set the terms of the employer-employee contract; they can neither require employer contributions not required by the original collectively bargained contract, nor compromise the claims of the union or the employer with regard to the latter’s contributions.” [*Hawkins v Bennett*, 704 F2d at 1159 n 1; see also *Professional Administrators Ltd v Kopper-Glo Fuel*, 189 F2d 639, 644 (6th Cir 1987)]

In *Evans v. Bexley* [750 F2d 1498 (11th Cir 1985)], the court held that the officers of a union and the officers of an employer association could serve as fiduciaries of two ERISA plans and still represent their respective organizations in collective bargaining with respect to plan funding. The court ruled that there was no breach of the duty of loyalty and

there was no ERISA Section 406(b)(2) violation. ERISA Section 406(b)(2) provides that a fiduciary “shall not . . . in his individual or in any other capacity act in any transaction involving the plan on behalf of a party (or represent a party) whose interests are adverse to the interests of the plan or the interests of its participants or beneficiaries . . .” Among other things, the court looked at ERISA Section 408, which explicitly permits a fiduciary to serve as an officer, employee, agent, or other representative of a union or an employer:

Logic demands that if a fiduciary may hold such positions, then he may fulfill the concomitant responsibilities. . . . Thus, a Trustee of an employee benefit plan does not violate ERISA merely by also serving in a position with an employee organization or employer that requires him to represent such entity in the collective bargaining negotiations that determines the funding of the plan. [Evans v Bexley, at 1499] (citations omitted)

[See *Curren v Freitag*; see also *Donovan v Cunningham* (ERISA fiduciaries who are also managers of corporate employer are not bound to manage corporation in the interest of plan beneficiaries)]

By definition, a multiemployer plan must arise from collective bargaining. [29 USC § 1002(37)] However, the plan sponsor of a multiemployer plan is not the union or the association representing the contributing employers. By definition, the plan sponsor is the “joint board of trustees, or other similar group of representatives of the parties who establish or maintain the plan.”

[29 USC § 1002(16)(B)] Consistent with the statutory definition of the term “plan sponsor” and the case law holding that plan design activities are plan sponsor (not fiduciary) functions, the court of appeals in *Walling v. Brady* [125 F3d 114 (3d Cir 1997)] ruled that plan design functions performed by plan sponsors (including plan sponsors of multiemployer plans) are not subject to ERISA’s fiduciary standards.

In this same vein, in *Lockheed Corp. v. Spink*, the Supreme Court held that plan sponsors that make plan design decisions are not acting as fiduciaries. The Supreme Court concluded that its reasoning did not depend upon the kind of plan at issue, because “[t]he definition of fiduciary makes no distinction between persons exercising authority over” the different types of plans. [517 US at 890–891] In *Hughes Aircraft Co. v. Jacobson*, the Supreme Court held that “our conclusion [in *Spink*, that design functions are settlor functions not subject to ERISA’s fiduciary standards] applies with equal force to persons exercising authority over a contributory plan, a noncontributory plan, or any other type of plan. Our holding [in *Spink*] did not turn, as the Court of Appeals below thought, on the type of plan being amended for the simple reason that the plain language of the statute defining fiduciary makes no distinction.” [525 US at 432] (emphasis added)

Recently, in the case of *Hartline, et al. v. Sheet Metal Workers’ National Pension Fund, et al.* [Civil Action No. 1998-1274 (RMU) (DDC)], the court concluded that the holdings in *Curtiss Wright*, *Spink*, and *Jacobson* are best read to support the proposition that multiemployer plan

trustees do not engage in a fiduciary function when they design or amend a pension plan. The court ruled:

In further support for the proposition that *establishing the contribution rate system did not constitute managing or administering the investment or use of trust assets*, this court finds instructive the distinction between “settlor functions” and “fiduciary functions.” [Hartline, Slip Op at 14] (emphasis added)

The court in *Hartline* explained, “plan design may be accomplished through a variety of means besides the formal adoption of a plan or an amendment to an existing plan.” [Hartline, Slip Op at 17] The court refused to put form over substance, ruling that “[w]hether a party acts as a fiduciary under ERISA is determined by reference to the nature of the particular activity at issue.” [Id.] In addition, in *Hartline* the court recognized the tension between settlor and fiduciary functions.

NO FIDUCIARY DUTY TO PROVIDE INVESTMENT EDUCATION TO PARTICIPANTS WHO CAN SELF-DIRECT INVESTMENTS

Under ERISA Section 3(21)(A)(ii) a person is a fiduciary with respect to a plan to the extent that person “renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan, or has any authority or responsibility to do so.” With the growth of plans allowing participant-directed investment, there was a growing interest in providing participants with some form of investment education. However, there was also a growing

concern that there may be a blurring of the lines between the fiduciary function of providing investment advice and the nonfiduciary function of providing investment education.

In response to these concerns, the Department of Labor (DOL) issued Interpretive Bulletin 96-1, now codified as a regulation, explaining the difference between investment education and investment advice in the context of a plan that allows participant-directed investments. [See 29 CFR § 2509.96-1] The DOL's regulation, at 29 CFR § 2550.404c-1, describes the kinds of plans to which ERISA Section 404(c) applies, the circumstances under which a participant will be considered to have exercised independent control over the assets in his or her account, and the consequences of a participant's exercise of such control.

The DOL has explained that relief from fiduciary liability under ERISA Section 404(c) is conditioned on, among other things, the participant "being provided or having the opportunity to obtain sufficient investment information regarding the investment alternatives available under the plan in order to make informed investment decisions." [Preamble to 29 CFR § 2509.96-1] The DOL has also stressed "[c]ompliance with this condition, however, does not require that participants and beneficiaries be offered or provided either investment advice or investment education, e.g. regarding general investment principles and strategies, to assist them in making investment decisions." [*Id.*] This point is stated expressly in the regulation itself:

"[A] fiduciary has no obligation under part 4 of Title I of the Act to provide investment advice to a participant or beneficiary under an ERISA section 404(c) plan." [29 CFR § 2550.404c-1(c)(4)] Part 4 of Title I sets forth the duties of a fiduciary. In sum, there simply is no fiduciary obligation to provide participants with investment advice or investment education.

ALMOST THE CONCLUSION

Tired by all that he had learned from his studies since his exclamation to his employer, our wizard stopped off at the Annual Conference of the American Society of Pension Actuaries. As he walked into the conference, representatives of the Department of Labor were answering questions. Someone in the audience asked: "What is the DOL's view of the extent of ERISA Section 404(c) compliance? What problems has it seen in the 404(c) compliance area in conducting its investigations?"

The DOL's representative answered: "In general, compliance with the ERISA Section 404(c) regulations is not reviewed by the Department, as this is viewed as mainly a defense for the fiduciary. There may be an issue if a fiduciary is representing to plan participants that the plan is a 404(c) plan, but the fiduciary is clearly not complying with the 404(c) regulations. In general, enforcement by the Department is focused on the mandatory requirements imposed by ERISA but not on the voluntary aspects, unless it rises to the level of misrepresentation to plan participants."

The wizard stood up to leave. The DOL's representative continued: "*The Department does have a concern with the broader issue of whether a 404(c) plan is appropriate given the nature of a particular employer's workforce.*" Our wizard nodded. Certainly, the DOL may have a concern, but not a concern about any fiduciary breach from a plan design. The appropriateness of a plan design is still a settlor function, not a fiduciary function. ERISA, the courts, and the Department of Labor itself provide no basis for a contrary conclusion.

The wizard was glad, too, because he knew a lot of the members of the audience—people who provide nonfiduciary services to plans, people who help set up participant-directed plans. If plan design were a fiduciary function, their help might be construed as participating in a fiduciary function, and none of the people he knew had insurance coverage for liability from fiduciary functions.

CONCLUSION

The wizard hurried back to his employer to confirm that the employer's logic had been impeccable. The wizard had guessed, having forgotten one of the two cardinal rules: If you don't know the answer, don't guess. The odds of guessing wrong and the stakes for guessing wrong are too great. Fortunately, the wizard had remembered the other cardinal rule: If you do not understand something, ask questions, make inquiries. The only foolish question is the one you do not ask.