Aspen Publishers VOL. 22, NO. 1 SPRING 2009

Benefits Law Journal

Litigation

A Fiduciary by Any Other Name … Thoughts on Properly Delegating Fiduciary Duties

James P. Baker and David M. Abbey

We all know that being an Employee Retirement Income Security Act of 1974 (ERISA) fiduciary is not all that it is cracked up to be. Ask Bernie Ebbers. Bernie Ebbers, the former WorldCom CEO, was an accidental ERISA plan fiduciary. Not dotting the "i's" and crossing the "t's" of the WorldCom plan documents made Bernie a defendant in an ERISA class action lawsuit. In the aftermath of the ERISA lawsuit and the companion securities fraud lawsuit, Mr. Ebbers lost his personal fortune and is now serving time in federal prison for securities fraud. No plan fiduciary wants to end up like Bernie. Recognizing the high anxiety of today's ERISA fiduciaries, some plan service providers are offering to "share the fiduciary load" by stating in their service agreements that they

James P. Baker is an ERISA litigation partner in the San Francisco office of Jones Day. He co-chairs Jones Day's employee benefits and executive compensation practice. David M. Abbey is vice president and managing counsel for T. Rowe Price Group, Inc., and its family of companies, where he is responsible for legal matters associated with the provision of investment, record keeping, and trust services to pension plans and other institutional investors.

The views set forth herein are the personal views of the authors and do not necessarily reflect those of the law firm or company with which they are associated.

are co-fiduciaries. But what does that really mean? As we will explain below, co-fiduciary status is, at best, a half measure.

Before describing the shortcomings of "co-fiduciary" service provider agreements, we first provide a brief overview of how one becomes an ERISA fiduciary.

Fiduciary Status 101

When bad things happen to retirement plan assets, the federal district courts have applied a laser-like focus to the question of who is an ERISA fiduciary. How does someone become a fiduciary to a retirement plan? Fiduciaries are, of course, people who stand in a position of trust representing the best interests of retirement plan participants. They are usually responsible for controlling or managing a retirement plan's assets or operations. The federal law regulating retirement plans, ERISA, states fiduciary status can be acquired in three ways:

1. Being named as a fiduciary in the instrument establishing the employee benefit plan;

2. Being named as a fiduciary pursuant to a procedure specified in the plan documents (*e.g.,* being appointed an investment manager for a retirement plan brings with it ERISA-regulated fiduciary duties); or

3. Being a "functional" fiduciary.[1]

The ERISA statute defines "fiduciary" not in terms of formal trusteeship, but in functional terms of control and authority over the plan.[2] An ERISA "functional" fiduciary, according to the federal courts, includes anyone who exercises discretionary authority over the plan's management, anyone who exercises authority or control over the plan's assets, and anyone having discretionary authority or responsibility in the plan's administration.[3]

Whether or not a person is a fiduciary is of critical importance. When economic disasters befall companies and retirement plan accounts become worthless, ERISA fiduciaries can be held personally liable to make good on retirement plan losses resulting from their actions or from their inactions.[4]

What has become apparent from recent court decisions is that a court reviewing an employee benefit plan disaster will carefully sift through the governing plan's language and its service provider agreements concerning the allocation and delegation of fiduciary responsibility to determine who is a plan fiduciary and who is potentially liable to make good the retirement plan's losses.

Worldcom *Revisited*

While failing to effectively delegate fiduciary duties is bad, not delegating at all is worse, as demonstrated by *In Re WorldCom, Inc. ERISA Litig.*[5] WorldCom became infamous in 2002 by announcing that it had improperly capitalized more than $3.8 billion in ordinary expenditures and had overstated earnings from 1999 though the first quarter of 2002 by approximately $3.3 billion. The price of WorldCom stock suddenly and predictably collapsed following these disclosures, and WorldCom filed for bankruptcy protection shortly thereafter.[6] WorldCom was the sponsor of the WorldCom 401(k) Salary Savings Plan. Among the different funds in which WorldCom plan participants could invest were several which invested in whole or in part in WorldCom stock; however, under the terms of the WorldCom plan, investments in WorldCom stock were not restricted and participants were free to continue or eliminate their investments in WorldCom stock at anytime.

The WorldCom plan's delegation language is what ERISA lawyers call "Less Than Optimal." It identified WorldCom as the named fiduciary, the plan administrator, and the investment fiduciary, and charged WorldCom with the responsibility for overseeing and reviewing the status of investment alternatives and the investment policy. To make matters worse, the plan's default mechanism stated that if WorldCom failed to appoint individuals to carry out duties of the plan administrator or investment fiduciary, "any officer" of WorldCom would have the authority to do so.[7] Ouch.

Predictably, the WorldCom plaintiffs' argued that "any officer" meant "all officers" and they sought to impose fiduciary liability on every person they could think of who had any conceivable relationship to the WorldCom plan including the CEO, CFO, board of directors, trustee, accounting firm, various corporate officers (such as the vice-president of human resources), the tax director, and the benefits manager. The plaintiffs claimed defendants breached their fiduciary duties under ERISA by allowing WorldCom stock held in the WorldCom plan to become worthless. Indeed, the heart of the plaintiffs' allegations against WorldCom's fiduciaries throbs with assertions that these fiduciaries disseminated materially false and misleading public statements about WorldCom during 1999, 2000, 2001, and 2002, that allegedly fooled plan participants about the true value of WorldCom stock.

Faced with unlimited plan language and a host of potential plan fiduciaries, the court weeded through the list of defendants by applying ERISA's functional fiduciary test. The court ultimately decided that WorldCom's former president and CEO, Bernie Ebbers, as well as WorldCom's former employee benefits director, Dona

Miller, could be sued as ERISA fiduciaries. In connection with the finding, the court allowed numerous fiduciary breach claims to continue against Ebbers, including the alleged failure to monitor the plan's other fiduciaries, failure to disclose material facts to the plan about WorldCom's financial condition, and making material misrepresentations about the soundness of WorldCom stock contained in SEC filings.

The *WorldCom* judge did, however, dismiss claims against Merrill Lynch & Co., as it acted as a directed trustee for the WorldCom 401(k) plan. Citing Department of Labor Field Assistance Bulletin 2004-03, the judge ruled that directed trustees are not liable as co-fiduciaries for determining the prudence of company stock as a 401(k) plan investment unless they have access to material nonpublic information about the company.[8] In rendering the decision about the limited duties of a directed trustee, the WorldCom court correctly observed: "[E]very ERISA fiduciary, regardless of the parameters of its duties, is subject to the co-fiduciary liability provision of [ERISA] Section 405(a)."[9]

The Co-Fiduciary Spin

Well aware of the increasing but healthy paranoia felt by plan fiduciaries about their potential exposure to fiduciary breach lawsuits, an increasingly popular practice by consultants and other service providers to retirement plans is marketing their services as "co-fiduciary" in nature. They do so because co-fiduciary liability is much more limited than fiduciary liability. Some plan fiduciaries are under the impression that by assuming co-fiduciary status under ERISA, the service provider is actually assuming, or at the very least sharing, fiduciary responsibility for the particular activities being performed. These plan sponsors believe that by hiring a provider to assist it in selecting, monitoring, advising, or otherwise providing expertise on plan investments, they will either be relieved of those fiduciary obligations or that their responsibility for complying with such obligations will be reduced by the provider's purported acceptance of shared responsibility. Given the sophistication of such marketing programs, it is understandable why plan sponsors are led to such a conclusion. They are likely to be disappointed, however, if they engage a provider thinking that the provider's acknowledgement of "co-fiduciary" status has somehow reduced the plan sponsor's fiduciary obligations to the plan.

Co-Fiduciary Status

In fact, if the service provider intended to assume or share the fiduciary obligations of the plan sponsor, it would acknowledge in writing that it is performing its responsibilities as a "fiduciary" not as a "co-fiduciary." This is because co-fiduciary status is very different from that of fiduciary status. And, while retaining a consultant or other service provider who proclaims its role as a co-fiduciary to assist it in performing its duties may be helpful to the plan sponsor in meeting its fiduciary obligations to the plan, it does not eliminate or reduce the plan sponsor's obligations. In this respect, co-fiduciary status is something that every fiduciary has simply by being a fiduciary. ERISA Section 405(a) imposes co-fiduciary liability on any fiduciary who does the following:

- Participates "knowingly in, or knowingly undertakes to conceal … [a breach of fiduciary duty] knowing [it] is a breach";
- Fails to comply with his or her own duties under ERISA Section 404(a)(1) and thus enables another fiduciary to commit a breach; or
- Knows that a breach has occurred but fails to make reasonable efforts to remedy it.

Thus, a co-fiduciary does not generally share responsibility with the plan fiduciary, rather it only has a duty to act when it knows that the plan fiduciary has breached its fiduciary duty. In other words, generally some other fiduciary must have committed a breach and the co-fiduciary must know about the other person's breach before co-fiduciary liability comes into play.

One positive aspect of a relationship in which co-fiduciary status is claimed is that it suggests that the consultant is a fiduciary for at least some aspect of the plan. But plan sponsors need to examine the service agreement with the consultant carefully. Typically the consultant's role as a fiduciary will be limited to the management of proprietary funds or nondiscretionary roles such as the handling of the plan's assets in the form of distribution or directed trustee services. ERISA makes clear that a person assumes fiduciary status only for those specific services which it provides as a fiduciary despite the fact that numerous other services might be provided under the relationship. Although somewhat illogical, when a consultant or other service provider says that it is performing duties as a co-fiduciary, it is distinguishing such duties from those it is providing as a "fiduciary."

Delegating Fiduciary Authority

The only way in which a plan sponsor with fiduciary responsibility can delegate its responsibility for a plan's investments to a third party, such as a consultant, is if the plan sponsor hires an investment advisor registered under the Investment Advisors' Act of 1940, a bank, or an insurance company that acknowledges in writing that it is a "fiduciary" with respect to the plan. It is only when the investment advisor, bank, or insurance company acknowledges its fiduciary status in writing that the plan sponsor is relieved of fiduciary liability for the plan's investments. ERISA provides this limited relief simply to encourage plan sponsors who may not be sophisticated investors to hire that expertise for the benefit of the plan and its participants. The exception only applies to the action of the registered investment advisor. Should the plan sponsor or other fiduciary delegate investment responsibility to a friend or neighbor, or if they actually undertake any investment-related activity themselves, the plan sponsor, or that fiduciary, will be liable if the investments go south.

A plan sponsor or other fiduciary who engages the services of a registered investment adviser or any other fiduciary or "co-fiduciary" service provider remains liable for proper selection and monitoring to determine whether its continued engagement is still appropriate. This is considered a primary fiduciary function and may never be delegated away or indemnified against.

Seeking Clarity Regarding Co-Fiduciary Services

Plan fiduciaries who are considering the retention of a consultant or other service provider who describes its role as co-fiduciary in nature need to understand that, by using the term "co-fiduciary" instead of "fiduciary," the consultant is attempting to limit, not increase, its fiduciary obligations to the plan. This does not necessarily mean that such services will not be helpful to the plan fiduciary in the performance of its duties. Rather, the retention simply might not meet the intended purpose of the plan fiduciary. Of course, if the retention causes the plan fiduciary to mistakenly believe that the provider is performing a fiduciary function that the plan fiduciary continues to have, the potential for fiduciary exposure is likely to be increased.

To avoid any misunderstanding as to the true nature of the services provided under a relationship described as "co-fiduciary" in nature, plan fiduciaries should do the following:

- Ask the service provider to separately identify in writing those services that it is providing as a "fiduciary" and those services it is providing as a "co-fiduciary."

- Review the terms of the service agreement to ensure a complete understanding of those responsibilities that the plan fiduciaries will retain under the relationship. Thus, for example, we often see service agreements in which the consultant may take a limited role in monitoring the plan's investment lineup (typically nondiscretionary functions such as compiling due diligence reports, reviewing fund performance, *etc.*), but the plan sponsor remains fully responsible for those duties for which most fiduciary exposure is found, that is, the actual selection of the investment option and determination that due diligence practices are appropriate.

- Finally, if the intention is to fully delegate fiduciary responsibility, make sure that plan terms are followed in completing the delegation, that the consultant is qualified to accept the delegation, and that the consultant acknowledges its role as a "fiduciary" to the plan.

Conclusion

In general, co-fiduciary liability occurs if the plaintiff can show that the co-fiduciary who knew of a breach failed to take action to correct it.[10] Obviously, if the co-fiduciary's own misconduct caused the losses, then the co-fiduciary can be liable.[11] What happens if a negligent service provider who is a co-fiduciary causes the plan to experience losses, and you are forced to pay money to make the plan whole? Can you then sue your ERISA co-fiduciary for contribution? The circuit courts are split on this issue. The Ninth Circuit has rejected the idea that there is a right of contribution among ERISA co-fiduciaries.[12] The Second Circuit, on the other hand, recognizes a right of contribution among co-fiduciaries.[13] Because the issue of co-fiduciary liability is fraught with so much uncertainty, a service provider's offer to be an ERISA plan co-fiduciary may not mean much.

Notes

1. 29 U.S.C. § 1102(a)(2); Glazier & Glassworkers v. Newbridge Sec., 93 F.3d 1171, 1179 (3d Cir. 2996).

2. Mertens v. Hewitt Assoc., 508 U.S. 248, 262 (1993).

3. Credit Managers Ass'n v. Kenesaw Life & Accident Ins. Co., 809 F.2d 617, 625–626 (9th Cir. 1987).

4. 29 U.S.C. § 1109.

5. 263 F. Supp. 2d 745 (S.D.N.Y 2003).

6. *Id.* at 752.

7. Section 14.02 of the WorldCom plan provides in pertinent part that "If WorldCom does not appoint individuals to carry out the duties of the Administrator or Investment

Fiduciary … then *any officer* of WorldCom, Inc. shall have the authority to carry out, on behalf of WorldCom, Inc., the duties of the Administrator and the Investment Fiduciary." *Id.* at 754. (emphasis in original).

8. 354 F. Supp. 2d at 445–451.

9. *Id.* at 445.

10. ERISA §§ 405(a)(1) and 405(a)(3).

11. ERISA § 405(a)(2).

12. Kim v. Fujikawa, 871 F.2d 1427, 1432–1433 (9th Cir. 1989).

13. Chemung Canal Trust Co. v. Sovran Bank, 939 F.2d 12, 15 (2d Cir. 1991).

Reprinted from *Benefits Law Journal* Spring 2009, Volume 22, Number 1, pages 92-98, with permission from Aspen Publishers, Inc., Wolters Kluwer Law & Business, New York, NY, 1-800-638-8437, www.aspenpublishers.com