ERISA Imposes Fiduciary Liability Upon Directors and Officers

By Sheldon M. Geller

The defendants in retirement plan fiduciary lawsuits—including directors and officers—often argue that they have no liability because they are not expressly named or appointed as plan fiduciaries. Courts, however, have routinely rejected these arguments based upon the extension of fiduciary liability under the Employee Retirement Income Security Act of 1974, as amended (ERISA) to functional fiduciaries who exercise authority or control over plan management.

A director or an officer may be a plan fiduciary with respect to certain matters but not to others, because fiduciary status is established only "to the extent" the person exercises authority or responsibility over plan assets or plan management. Courts do not distinguish between named fiduciaries and functional fiduciaries. Moreover, a plan fiduciary would be liable for the breach of fiduciary responsibility of another fiduciary, with respect to the same plan, if that plan fiduciary enabled the other fiduciary to commit a breach (if he has knowledge of the breach and makes no reasonable effort under the circumstances to remedy it).

Taking Action

Directors and officers acting, or deemed to have acted, as an ERISA fiduciary are strongly encouraged to take action to remedy perceived improprieties in actual plan operation in order to avoid personal liability. Cofiduciary liability is considered joint and several liability; therefore, plan fiduciaries are personally liable for breaches of duty. Courts have systematically found that a fiduciary has an ongoing duty to monitor the activities of a cofiduciary they have appointed or to whom they have delegated duties.

Courts have rejected the argument that individual directors who are named fiduciaries were no longer liable for fiduciary breaches because they had delegated their authority to a plan committee. Rather, plan fiduciaries delegating substantial authority appear to retain a substantive level of fiduciary responsibility, and possibly residual responsibility, which could subject them to liability for a breach of fiduciary duty. Courts are reluctant to discharge named fiduciaries from liability when damages to a plan are alleged; see, for example, *Defazio v. Hollister, Inc.*, 2008 WL 958185 (E.D. Cal. Apr. 8, 2008), or *Briscoe v. Fine*, 444 F. 3d 478, 486–87 (6th Cir. 2006).

Although cases do not generally discuss the scope and frequency of required performance reviews, courts have determined that an annual review of the performance of plan committee fiduciaries is sufficient to adequately discharge the duty to monitor. Nevertheless, the facts and circumstances may dictate more frequent and extensive reviews.

A Board's Responsibility

Courts recognize that corporate boards achieve greater efficiency by allocating specific responsibilities and delegating specific duties to specialized committees. Courts do not require boards to monitor a committee's individual decisions, which would undermine the rationale of creating specialized committees to govern effectively.

Because the primary exposure for companies and their boards and officers arises under ERISA, lawyers continue to create new theories to assign ERISA liability to directors and officers based upon the functional definition of fiduciary. Accordingly, boards and management need to understand how they can avoid fiduciary liability under ERISA.

Directors and officers who appoint plan committees have a duty to monitor their activities. Similarly, officers who hire employees to serve as plan fiduciaries also create a duty to monitor the activities of these employee fiduciaries.

A corporate director or an officer who exercises discretionary authority or control over fiduciary conduct is held to a fiduciary standard, but being an individual who is a director or an officer does not *de facto* make one a fiduciary. Nevertheless, courts have found that employers have sufficient control over plan assets and over fiduciary decision making to be considered a co-fiduciary.

ERISA—not common law agency principles—defines whether a company, and therefore its board of directors, is liable for its employees' actions. The duty to monitor requires the appointing fiduciary to follow a process to peri-

odically review the performance of the appointed fiduciary. Note that ERISA emphasizes the decision making process, not whether (in hindsight) the proper or best decision was made on behalf of the plan.

Lone Agents

In many instances, courts that have recognized a breach of the duty to monitor have also identified the fiduciary as participating in the fraud, self-dealing, or exercising influence over the fiduciary's decisions. Appointment power includes the duty to monitor and creates liability for cofiduciary breaches.

A director, officer, or employee who acts as an ERISA fiduciary does not act as an agent of the employer, and thus will be liable for any breach of fiduciary duty. Plan obligations are different than corporate obligations: For example, a corporation can be sued for failing to meet an obligation (i.e., pay a debt), whereas directors and officers can be sued personally for failing to meet an obligation to plan participants.

Fiduciary Duties

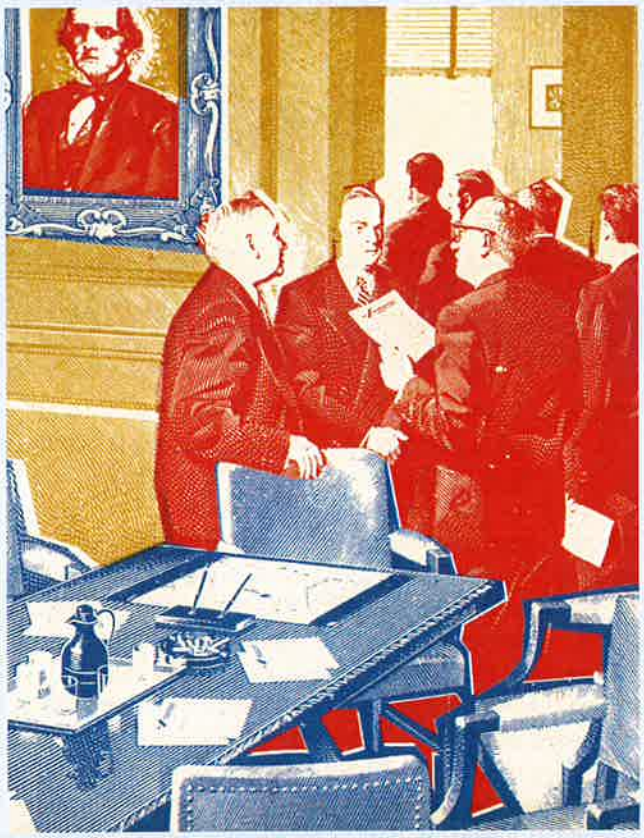
Plan fiduciaries must, as a matter of law, act in the best interest of the plan and for the exclusive benefit of plan participants. A corporation may receive an ancillary benefit, provided plan fiduciaries follow this exclusive benefit rule and comply with the duties of loyalty and prudence. These duties require 401(k) plan fiduciaries to avoid using plan assets to pay excessive fees; diversify plan asset investment by offering a diversified investment menu; and continue to monitor investment menu alternatives, including mutual funds, separate accounts, stable value funds, and employer securities.

The standard directors and officers (D&O) liability insurance policy does not customarily cover claims against directors and officers acting in their capacity as ERISA fiduciaries. Fiduciary liability policies are designed to cover a company, its directors and officers, all of its employees, and its retirement plans against loss for breach of fiduciary duty and wrongful administration.

Nevertheless, the cost of defending a lawsuit is significant, and therefore insurance is strongly recommended for any director or officer making fiduciary decisions. Claimants may allege errors in judgment, breaches of duty, or wrongful acts related to the D&O organizational activities. Wrongful administration includes any wrongful act, negligent errors and omissions in the administration of a retirement plan, selection of inappropriate advisors or service providers, and a failure to monitor plan asset investment alternatives.

Serving Two Masters

Directors and officers acting as plan fiduciaries serve two masters: the corporation and the plan. Accordingly, directors and



officers need to avoid engaging in a prohibited transaction providing the corporation or themselves with a benefit, such as a release of claims using plan assets or leveraging plan assets.

In some cases, boards and officers have been found liable for a breach of fiduciary responsibility as a result of a sudden and significant downturn in a company's stock price when employer securities are held by a plan. Boards and officers have been found liable for a breach of fiduciary responsibility as a result of the payment of excessive fees with plan assets. Many lawsuits have been filed against companies and plan fiduciaries because of their alleged mismanagement of fees charged by plan service providers.

To avoid or minimize fiduciary liability, employers should consider appointing independent fiduciaries to manage and monitor the plan's investment menu, the plan's fee arrangements, and the plan's investment in employer securities. These independent fiduciaries should have no actual or perceived relationship with the company, or its directors and officers, and these fiduciaries should assume responsibility for plan investment and plan administration. ❑

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