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Fiduciary Standards as Applied Under ERISA

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I. Introduction

In 1974 Congress passed the Employee Retirement Income Security Act (ERISA),[1] which effected significant changes in the law governing the private pension industry. In view of the size of this industry, which by 1980 will comprise more than two hundred billion dollars representing the pension assets of some forty-two million employees,[2] these changes are of considerable importance not only for the employees whose assets are affected but also for the American economy generally.

Seeking to secure financial integrity in the private pension industry,[3] ERISA's framers struck at abuses that had long pervaded the management of pension assets.[4] Central to this reform program are provisions regulating the functions of pension trustees, who control the investment of the assets of the pension plans.[5]

The relationship of trustee and trust beneficiaries has historically been characterized as a fiduciary one.[6] Resting on the trust instrument as supplemented by various statutory provisions and common law principles,[7] the trustee's position is one of personal confidence; his responsibilities may not be delegated.[8] These responsibilities include preserving trust property, maintaining its productivity, and pressing valid claims on its behalf. As a fiduciary, the trustee must account for his actions on a regular basis, and he must exercise the care and skill of a reasonably prudent person.[9]

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1. Employee Retirement Income Security Act of 1974, Pub. L. No. 93-406, 88 Stat. 829 (1974) (codified in scattered sections of Titles 5, 26, 29, 31, & 42 of the United States Code) [hereinafter cited as ERISA].
2. S. Rep. No. 93-383, 93d Cong., 1st Sess. 3, *reprinted in* [1974] U.S. Code & Ad. News 4890, 4891.
3. Renfrew, *Fiduciary Responsibilities under the Pension Reform Act*, 32 Bus. Law. 1829, 1831 (1977).
4. Reference is made to such abuses as self-dealing, imprudent investments, and misappropriation of plan funds. Statement by the Hon. Harrison A. Williams, Jr., chairman of the Sen. Comm. on Labor and Public Welfare upon introducing the Conf. Rep. on H.R. 2, *reprinted in* [1974] U.S. Code Cong. & Ad. News 5177, 5186.
5. ERISA §§ 401-32, 29 U.S.C. §§ 1101-32 (1974).
6. A. Loring, A Trustee's Handbook (1962).
7. *Id.* at 5.
8. *Id.* at 6.
9. *Id.*

These usual requirements notwithstanding, trustees have often vitiated their fiduciary obligations by inserting exculpatory or indemnification provisions into the governing trust instruments. Courts have generally enforced these clauses to the extent that they insulated the trustee from liability for acts and omissions not characterized by gross neglect, willfull misconduct, or lack of good faith.[10] As a result, beneficiaries have often been without effective recourse against their fiduciaries—a problem that ERISA was intended to remedy in the area of private pensions by enhancing the stringency of fiduciary requirements for pension trustees. ERISA's fiduciary provisions proscribe the use of exculpatory clauses,[11] permit the use of qualified indemnification clauses,[12] identify certain transactions in which pension trustees are prohibited from engaging,[13] and delineate standards to which these trustees must adhere.[14] This Comment will primarily examine judicial interpretation of these provisions. It will also address their relation to several clauses in the Taft-Hartley Act. As a prelude to this discussion, however, this Comment will review the statutory language of the fiduciary provisions of ERISA.

II. Statutory Language

ERISA requires that pension plans subject to its provisions be established in trust form.[15] A written agreement must be drawn naming, among other things, the fiduciary who will manage and control the plan.[16] Thus one must initially determine who is a fiduciary.

ERISA's definition of a fiduciary encompasses two categories of individuals: those who render investment advice for a fee and those who have discretionary control or management over the plan or its assets.[17] To qualify as a fiduciary it is essential that a person possess

10. J. Fuller, *Fiduciary Liability Insurance*, N.Y.U. Institute on Federal Taxation, Annual Conference on ERISA (1977).

11. ERISA § 410, 29 U.S.C. § 1110 (Supp. IV 1974).

12. *Id.*

13. *Id.* § 406, 29 U.S.C. § 1106.

14. *Id.* § 404, 29 U.S.C. § 1104.

15. *Id.* § 403(a), 29 U.S.C. § 1103(a).

16. *Id.* § 402(a)(1), 29 U.S.C. § 1102(a)(1).

17. *Id.* § 3(21)(A), 29 U.S.C. § 1002(21)(A) reads as follows:

(21)(A) Except as otherwise provided in subparagraph (B), a person is a fiduciary with respect to a plan to the extent (i) he exercises any discretionary authority or discretion-a requisite degree of discretion,[18] for those who merely perform certain routine administrative or ministerial functions do not assume fiduciary status.[19] There are usually several people who exercise discretionary authority over every pension plan established; ERISA's definition of a fiduciary is, therefore, very broad.[20] Pension fund administrators in the past were not always subject to common law trust principles and those who were found various means by which to vitiate their fiduciary responsibilities.[21] Congress enacted this broad definition of a fiduciary in order to ensure that all persons who had the requisite discretionary dealings with pension assets would conduct themselves with the utmost integrity, be answerable to the beneficiaries, and be accountable for any breach of the obligations they had assumed.[22]

A person who qualifies as a fiduciary under ERISA assumes many duties and faces enormous potential personal liability for the breach of those duties. These duties must be discharged solely in the interest[23] of and for the exclusive benefit[24] of plan participants and beneficiaries.

> ary 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 or responsibility to do so, or (iii) he has any discretionary authority or discretionary responsibility in the administration of such plan. Such term includes any person designated under section 405(c)(1)(B) [29 U.S.C. § 1105(c)(1)(B)].

Id.

18. However, Congress made it clear that fiduciary status was not to be conferred where the discretionary control rested with the participants themselves; *e.g.*, where a participant has sole discretion over an individual account established in his name. S. REP. No. 93-127, 93d Cong., 1st Sess. 29 (1973), *reprinted in* 1 LEGISLATIVE HISTORY OF THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974, at 615 (1976) [hereinafter cited as LEGISLATIVE HISTORY].

19. 29 C.F.R. § 2509.75-8, Question D-2 (1978).

20. For a discussion of who may be considered a fiduciary, see Little & Thrailkill, *Fiduciaries Under ERISA: A Narrow Path to Tread*, 30 VANDERBILT L. REV. 1, 4-5 (1977).

21. S. REP. No. 93-127, 93d Cong., 1st Sess. 29 (1973), *reprinted in* 1 LEGISLATIVE HISTORY, *supra* note 18, at 615.

22. *Id.* Common law fiduciary principles developed in the context of testamentary and inter vivos trusts with their attendant emphasis on fulfilling the directions of the settlor. Thus the settlor's direction that a fiduciary be insulated from liability for wrongdoings was generally enforced. Congress felt that fiduciary principles and procedures developed in that context were not sufficient guidelines for trustees in the pension field and, therefore, drafted the more stringent provisions of ERISA.

23. ERISA § 404(a)(1), 29 U.S.C. § 1104(a)(1) reads as follows:

> (a)(1) [A] fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and—

In order to equip a participant with the necessary means to protect his pension rights, Congress included reporting and disclosure provisions so that the participant could easily acquire information about his pension plan.[25] Congress also established a fiduciary standard by which a participant could measure a fiduciary's actions.[26] This standard is contained in section 404 (a)(1)(B) and requires that a fiduciary discharge his duties "with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent [person] 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."[27] Congress expected the courts to interpret this "prudent person" standard bearing in mind the special nature and purpose of employee benefit plans.[28]

Fiduciaries are forbidden to engage in certain transactions which are enumerated in section 406.[29] Congress intended this list of pro-

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(A) for the exclusive purpose of:

(i) providing benefits to participants and their beneficiaries; and

(ii) defraying reasonable expenses of administering the plan;

(B) with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims;

(C) by diversifying the investments of the plan so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so; and

(D) in accordance with the documents and instruments governing the plan insofar as such documents and instruments are consistent with the provisions of this title.

Id.

24. *Id.* § 404(a)(1)(A)(i), 29 U.S.C. § 1104(a)(1)(A)(i).

25. S. Rep. No. 93-127, 93d Cong., 1st Sess., 29 (1973), *reprinted in* Legislative History, *supra* note 18, at 615.

26. Although in the text of the Act this is denominated as the "prudent man" standard, this Comment will refer to it as the "prudent *person*" standard.

27. ERISA § 404(a)(1)(B), 29 U.S.C. § 1104(a)(1)(B). For full text see note 23 *supra.*

28. Joint Explanatory Statement of the Committee of Conference, *reprinted in* 3 Legislative History, *supra* note 18, at 4569.

29. ERISA § 406, 29 U.S.C. § 1106 reads as follows:

(a) Except as provided in section 408 [29 U.S.C. § 1108]:

(1) A fiduciary with respect to a plan shall not cause the plan to engage in a transaction, if he knows or should know that such transaction constitutes a direct or indirect—

(A) sale or exchange, or leasing, of any property between the plan and a party in interest;

(B) lending of money or other extension of credit between the plan and a party in interest;

hibited transactions to represent the most serious misconduct in which pension fiduciaries have engaged in the past.[30] A fiduciary will incur liability for engaging in a prohibited transaction only if he knew or should have known that the transaction was prohibited.[31] Application of the prudent person standard will determine whether a fiduciary should have known that a transaction was prohibited.[32] The extent of the investigation necessary to satisfy this prudence test will vary depending on the circumstances.

Section 408 provides a means by which a fiduciary can obtain an exemption from the prohibited transaction provisions of section 406.[33] This exemption clause gives the fiduciary greater flexibility if he finds a transaction proscribed by section 406 would prove beneficial to the participants and beneficiaries of his pension plan.[34]

ERISA provides an array of sanctions which may be invoked if a fiduciary breaches his duties under ERISA. Civil penalties[35] include personal liability to make good any losses the plan incurred as a

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(C) furnishing of goods, services, or facilities between the plan and a party in interest;

(D) transfer to, or use by or for the benefit of, a party in interest, of any assets of the plan; or

(E) acquisition, on behalf of the plan, of any employer security or employer real property in violation of section 407(a) [29 U.S.C. § 1107(a)].

(2) No fiduciary who has authority or discretion to control or manage the assets of a plan shall permit the plan to hold any employer security or employer real property if he knows or should know that holding such security or real property violates section 407(a) [29 U.S.C. § 1107(a)].

(b) A fiduciary with respect to a plan shall not—

(1) deal with the assets of the plan in his own interest or for his own account,

(2) 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, or

(3) receive any consideration for his own personal account from any party dealing with such plan in connection with a transaction involving the assets of the plan.

Id.

30. S. REP. No. 93-127, 93d Cong., 1st Sess. 31 (1973), *reprinted in* 3 LEGISLATIVE HISTORY, *supra* note 18, at 4573. "[W]hile the magnitude of these improper practices is small in relation to the total number of plans in existence, the seriousness of the improper practices disclosed indicates the need for additional precautions to insure that these specific examples do not become general conditions." H.R. REP. No. 93-533, 93d Cong., 2d Sess., *reprinted in* [1974] U.S. CODE CONG. & AD. NEWS 4639, 4651.

31. Joint Explanatory Statement of the Committee of Conference, *reprinted in* 3 LEGISLATIVE HISTORY, *supra* note 18, at 4573.

32. *Id.* at 4574.

33. ERISA § 408, 29 U.S.C. § 1108 (1974).

34. *See* notes 85-95 *infra* and accompanying text.

35. ERISA § 409, 29 U.S.C. § 1109 (1974).

result of the breach and a restoration of profits which the fiduciary may have made as a result of the breach. Criminal sanctions[36] include a fine or imprisonment or both. Moreover, an excise tax[37] may be levied upon a fiduciary who engages in a prohibited transaction.

These broad fiduciary provisions form a yardstick by which the federal courts have measured fiduciary action in the private pension field.

III. Judicial Interpretations of ERISA's Fiduciary Provisions

A. Preliminary Issues

Litigation[38] involving fiduciary obligations under ERISA will necessarily raise the threshold question of the precise scope of the Act, that is, to whom do these requirements apply.

Section 3 of ERISA defines the word fiduciary to include any person who exercises discretionary authority or control over the management of the plan or the disposition of the assets. A fiduciary is also one who has discretionary authority or responsibility in the plan's administration or who has authority or responsibility to render investment advice to the plan for a fee.[39]

Fiduciary status entails a host of obligations that are both stringent and conscientiously enforced. Because of the burden of these concomitant obligations, fiduciary status is not lightly conferred.

Existence of fiduciary status was the major issue before a California district court in *Hibernia Bank v. International Brotherhood of*

36. *Id.* § 431, 29 U.S.C. § 1131 (1974).

37. 26 U.S.C. § 4975. A fiduciary will not be subject to an excise tax unless he participates in a prohibited transaction in another disqualified person capacity.

38. Although parties who bring an action pursuant to ERISA clearly have standing to sue in federal court, ERISA does not envision a lawsuit as the only means by which to settle a controversy which arises under its provisions. This was the holding of a federal district court in Feagan v. Lang, 416 F. Supp. 53 (S.D. Fla. 1976). Plaintiff trustees brought an action against an individual carpenter as employer for delinquent contributions to the pension fund. Although out of court settlement had been considered, plaintiff trustees, as fiduciaries, were concerned that any out of court settlement which involved a compromise of amounts allegedly due would subject them to liability under ERISA §§ 404(a)(1)(B), 405(a)(2), 29 U.S.C. §§ 1104(a)(1)(B), 1105(a)(2) for failure to maximize fund assets. The district court while rendering judgment for the plaintiffs held that ERISA contemplates amicable resolutions of disputes for "[p]rudent persons do compromise their position in appropriate circumstances." 416 F. Supp. at 54. In Judge Roettger's view this would have been an appropriate case for out of court settlement.

39. ERISA § 3(21)(A), 29 U.S.C. § 1002(21)(A). *See* notes 17-22 *supra* and accompanying text.

Teamsters.[40] Hibernia Bank was suing[41] for losses exceeding $700,000 that it incurred when the Teamsters Security Fund failed to repay overdrafts in its commercial account with the bank.[42] The bank brought suit under ERISA, relying on its status as a fiduciary.[43] Rejecting the bank's basic premise, the court drew a distinction between a fiduciary and a custodian. Under ERISA, a fiduciary must possess the requisite discretionary authority either by having control of the management of the plan or control of the management or disposition of the assets of the plan.[44] The district court concluded that the bank, merely serving in its capacity as a repository of plan assets, was not to be deemed a fiduciary.[45] The court's declination to view Hibernia Bank as a fiduciary was fatal to the suit, since the bank's standing to sue was premised on its status as such.[46] Accordingly, the case was dismissed.[47]

Although the definition of a fiduciary under ERISA was broadly drawn, it is nevertheless essential that the criteria enumerated therein be strictly observed. The court's unwillingness to readily grant fiduciary status was prudent in light of the fact that enormous potential for liability accrues with the conferral of that status.

Courts that have reviewed conduct challenged under the fiduciary provisions of ERISA have limited their scope of review to the ques-

40. 411 F. Supp. 478 (N.D. Cal. 1976).

41. The defendants were the Teamsters Union, one of its local unions, two of its joint councils and trustees of the Teamsters Security Fund.

42. 411 F. Supp. at 481.

43. The court dismissed the bank's contention that it also had standing to sue under the Labor Management Relations Act. *Id.* at 488.

44. ERISA § 3(21)(A), 29 U.S.C. § 1002(21)(A). The Hibernia Bank claimed it was a fiduciary as a result of its agency relationship with the trustees of the pension plan, who were acknowledged fiduciaries. The court rejected this proposition as there was no evidence that the bank had any discretionary authority. The relationship between the bank and trustees was precisely set out in their agreement in which the trustees directed the bank to perform seven basic duties none of which were discretionary. 411 F. Supp. at 489-90.

45. The bank also claimed that ERISA recognized a custodian as a fiduciary. This claim was rejected although the court acknowledged that a custodian could also be a fiduciary, if the custodian possessed the requisite discretionary authority and control. 411 F. Supp. at 490.

46. Four categories of persons are entitled to sue under ERISA. They are: (1) Secretary of Labor, (2) participants in ERISA trusts, (3) beneficiaries of ERISA trusts, or (4) fiduciaries of ERISA trusts. ERISA § 432, 29 U.S.C. § 1132 (1974). The court disposed quickly of the bank's claim that it was a beneficiary. As to the bank's claim that it was a fiduciary see note 44 *supra*.

47. The district court may have been more disposed to perceive Hibernia Bank as a fiduciary if the bank had taken action that compromised or endangered the plan assets which resulted in detrimental consequences for the plan participants.

tion of whether the fiduciary acted arbitrarily, capriciously or in bad faith.[48] They have declined to consider whether the trustees conducted themselves as ideal trustees or as the courts themselves would have acted in like circumstances.

In *Bueneman v. Pension Fund,*[49] the Court of Appeals for the Eighth Circuit considered whether a district court had applied the appropriate standard of review for actions involving violations of fiduciary duty. Everett Bueneman, a truck driver, sued the trustees of his union's pension fund after his claim for a pension had been denied.[50] The trustees of the pension fund denied Bueneman's claim for a pension after they ascertained that the plaintiff's employer, Jim's Express, Inc., had not made payments to the fund during the plaintiff's employment. As a result Jim's Express was not an employer as that term was defined by the plan instrument. Since Jim's Express was not an employer, Bueneman's claim was barred.[51]

The United States District Court for the Eastern District of Missouri had inquired as to the reasons for the denial of the pension as well as the trustees' past practice when confronted with similar circumstances. It found that the trustees consistently denied retroactive coverage and retroactive employer participation.[52] The district court also examined the participation agreement and found its terms were in accordance with the trustees' action.[53] The trustees'

48. *See* notes 49-59 *infra* and accompanying text. This standard was also applied in non-ERISA cases. *See, e.g.*, Norton v. I.A.M. Nat'l Pension Fund, 553 F.2d 1352, 1356 (D.C. Cir. 1977), where the court held that the union pension fund's denial of retirement benefits to plaintiff was arbitrary and capricious since the denial was based on the fact that other employees had chosen another union and in view of the fact that the plaintiff's rights had fully matured and vested.; *see also* Rehmas v. Smith, 555 F.2d 1362, 1371 (9th Cir. 1976), a suit brought to compel payment of survivor's benefits allegedly due. The *Rehmas* court used the arbitrary or capricious standard in reviewing the trustees' action saying: "We find this standard of judicial review, which leads neither to abdication of traditional judicial control of fiduciaries nor to excessive judicial intervention in trust operations, in harmony with federal labor policy." 555 F.2d at 1371. This standard of review was also applied in pre-ERISA cases also. *See, e.g.*, Danti v. Lewis, 312 F.2d 345, 348 (D.C. Cir. 1962) where the court held that the trustees had acted arbitrarily and capriciously in denying retirement benefits to an employee when the trustees based their decision on the fact that the employee had not complied with a resolution which was not in existence when the employee's application was filed.

49. 97 L.R.R.M. 2745 (8th Cir. 1978).

50. *Id.* at 2746.

51. *Id.*

52. This denial of retroactive participation was based on a desire "to achieve economic stability in order to maintain maximum earning potential for the fund." *Id.* at 2747.

53. *Id.* The participation agreement to which both the company and union were parties, explicitly stated that it would not be binding upon the fund until the trustee accepted it.

consistent policy regarding retroactive participation coupled with the explicit language of the participation agreement convinced the district court that the trustees had not acted capriciously or arbitrarily in denying the pension.[54] The trustees denial of the pension was therefore upheld.[55]

The court of appeals reviewed the lower court's decison and affirmed its ruling that a reviewing court is "limited to determining whether [the trustee's] action has been arbitrary or capricious, or an abuse of discretion."[56] The court of appeals concluded that the district court had chosen the appropriate standard[57] and applied it properly.[58]

The United States Courts of Appeals for the District of Columbia and Ninth Circuits have applied substantially equivalent standards of review to fiduciary actions.[59]

B. Substantive Requirements

1. *Prudent Person Standard*

The prudent person standard[60] was established to guide the fiduciary in the discharge of his duties and to provide the beneficiary with a means by which to measure the fiduciary's actions.

In *Morrissey v. Curran*[61] the Court of Appeals for the Second Circuit applied this prudent person standard to a trustee's actions and found them unacceptable. The pension fund in question was established prior to the enactment of ERISA, and the original trustees improperly administered the plan by using plan assets for their personal use and by making improper investments.[62] Denying liability for wrongs perpetrated prior to the enactment of ERISA, the defendant who was the current trustee, contended that ERISA was not retroactive.[63] The court found that the violation occurred when the trustee, following the enactment of ERISA, did not dispose of

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54. *Id.*
55. *Id.* at 2745.
56. *Id.* at 2746.
57. *Id.*
58. *Id.* at 2747.
59. *See* note 48 *supra* and accompanying text.
60. *See* notes 25-28 *supra* and accompanying text.
61. 567 F.2d 546 (2d Cir. 1977).
62. *Id.* at 547.
63. *Id.* at 548.

the inherited imprudent investment within a reasonable time.[64] Retention of that investment was unwise and inconsistent with the care, skill, prudence, and diligence that would be used by a prudent person acting in a like capacity and familiar with such matters.[65]

The prudent person rule was also the cornerstone of the decision in *Eaves v. Penn.*[66] Here the owners of Glen's Inc., who were also trustees of the restaurant's pension plan, sold some of their stock to a third party after agreeing to resign as trustees of the plan and designate as successors persons selected by the buyer.[67] The successor trustee converted the plan to an Employee Stock Ownership Plan, which then purchased the remaining stock of the restaurant.[68]

The district court found, *inter alia,* that all trustees have a duty to act as prudent persons, and the trustees of the restaurant had failed to act as such.[69] This court used its broad remedial powers to rescind the transaction, restore lost profits and income to the plan, and appoint a trustee of its own choosing in order to preserve the interests of the plan beneficiaries.[70] Writing for the court, Judge Thompson confined his ruling to the facts of the case at hand. He noted that it might not always be imprudent for a retirement plan to use its cash assets to invest in qualified employer securities but that "the effect of such action in this particular case, and the manner in which that decision was made and carried out . . . is clearly violative of the protections intended to be derived from ERISA."[71]

These cases demonstrate that the prudent person rule is a flexible tool for ensuring the preservation of the rights and interests of beneficiaries. It is not the decision in isolation which must be judged but the decision in the context in which it arises, with all its attendant ramifications and implications. At present the federal courts show no tendency to bar all instances of particular transactions *per se*; instead, they appear to inquire whether given transactions are inap-

64. *Id.* at 548-49.

65. *Id.* at 548-49 & n.8.

66. 426 F. Supp. 830 (W.D. Okla. 1976).

67. *Id.* at 833.

68. *Id.* at 834-35.

69. This was a violation of ERISA § 404(a)(1)(B), 29 U.S.C. § 1104(a)(1)(B). *Id.* at 836-37.

70. 426 F. Supp. at 838.

71. *Id.* The original trustees made no effort to ascertain the quality or credentials of their successor trustees. They acted not in the interests of plan participants and beneficiaries but in the interest of the purchaser of the restaurant. When converting the plan to an ESOP the successor trustees were oblivious to the effect of that change on the plan and its participants.

propriate in light of their surrounding circumstances.[72] Regrettably, the dearth of rulings in this area make any future predictions impossible. There are several pending lawsuits,[73] however, in which the plaintiffs allege violations by fiduciaries of the prudent person standard and failure to act solely in the interests of plan participants;[74] the decisions in these cases will doubtless shed further light on the shape which the federal judiciary will give to the prudent person standard.

2. *Prohibited Actions*

ERISA not only provides the fiduciary with a standard by which to guide his actions but also enumerates certain transactions in which the fiduciary is forbidden to engage in the absence of a specific exemption.[75]

In *Marshall v. Snyder*[76] the defendants flagrantly violated ERISA's prohibition of transactions involving the furnishing of goods, services or facilities between the plan and a party in interest.[77] The trustees' actions were inappropriate to the extent that they were responsible for "causing and permitting the improper expenditure of plan assets and making payments . . . far in excess of any reasonable expense of administering plans of this size and kind."[78]

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72. *See* notes 66-71 *supra* and accompanying text.

73. The following cases are presently pending in the federal courts: Usery v. Whatley, CA No. N 6004 A (E.D. Va.) (Department of Labor has alleged that by converting the plan to an ESOP without adequately considering effects this change would have on plan and its participants, defendant trustees acted imprudently and in their own interests); Marshall v. DeKeyser, CA No. 77 C 276 (W.D. Wis.) (newly appointed trustees of plan allegedly violated prudent person rule by failing to rectify previous trustees' improper investment decisions which included making inadequately secured or unsecured loans of virtually all plan's assets to employer); Harris v. Tappan Co., C-77-192 (N.D. Ohio) (trustees' fiduciary duties allegedly breached by failure to correct improper action by prior investment manager); Marshall v. Edison Brothers Stores Pension Plan, No. 77-0894C(1) (E.D. Mo.) (fiduciaries breached ERISA § 404 by denying to two plan participants benefits to which they were entitled); Marshall v. Deep South Electric, Inc., CA No. 77-1079 (S.D. Fla. 1977) (violation of prudent person rule for making improper loan which was inadequately secured to party in interest, and for failure to enforce valid claims for repayment of loans); O'Neill v. Marriott Corp., CA No. M-77-495 (D. Md.) (breach of fiduciary duty alleged for investing plan assets in qualifying employer securities which was in the best interests of the plan sponsor and not the plan participants).

74. ERISA § 404(a)(1), 29 U.S.C. § 1104(a)(1).

75. *See* notes 29-34 *supra* and accompanying text.

76. 430 F. Supp. 1224 (E.D.N.Y. 1977).

77. The party in interest with whom the business was transacted was the union.

78. 430 F. Supp. at 1232.

A wholly-owned subsidiary[79] of the union's health and welfare fund was paying (1) salaries of field representatives who performed substantial work for the union but received no remuneration from it, (2) the salary of an employee who chauffeured union leaders but was not paid by the union, and (3) rent for office space that was used primarily by the union.[80] Moreover, the rental payments were far in excess of any reasonable requirements for plan administration.[81]

This case exemplifies the situation where the interests of the union and the fund are inseparable—a circumstance that markedly increases the chances that fund assets will not be used solely in the interest of plan participants and beneficiaries.[82] Such an overlapping of relationships and sharing of assets constitutes a transaction specifically forbidden by section 406(a)(1)(C).[83] Accordingly, the court took measures to ensure that the plan would be administered in conformity with the terms of the plan instrument and the provisions of ERISA.[84]

In *Cutaiar v. Marshall*,[85] the Court of Appeals for the Third Circuit found that the trustees of a Teamsters Welfare Fund had engaged in a prohibited transaction[86] as defined in section 406 by borrowing four million dollars from a Teamsters Pension Fund.[87] These welfare and pension funds were jointly administered. Three of the joint trustees expressed concern about their fiduciary responsibility and objected to authorizing the loan.[88] Consequently the loan was submitted to an impartial referee[89] who held that it did not

79. 806 Record Processors, Inc. was a wholly-owned subsidiary of the welfare plan.

80. 430 F. Supp. at 1232.

81. *Id.*

82. *Id.*

83. *Id.* at 1231.

84. *Id.* at 1232. The court suspended the trustee pending the final outcome of the action and appointed a receiver to manage the fund.

85. No. 78-1380 (3d Cir. 1979).

86. *Id.* at 11. The trustees violated section 406(b)(2) of ERISA.

87. The welfare fund had a cash flow problem and had to borrow four million dollars to meet current claims. As the pension fund had ample liquid assets, it seemed advantageous for those two parties to effect a loan transaction. It was undisputed that the terms of the transaction were fair and reasonable with respect to both plans. *Id.* at 3, 9.

88. *Id.* at 4.

89. *Id.* This was submitted to an impartial referee pursuant to section 186(c)(5)(B) of the Labor-Management Relations [Taft-Hartley] Act which states that

> representatives shall be appointed together with such neutral persons as the representatives of the employers and the representatives of employees may agree upon and in the event the employer and employee groups deadlock on the administration of such

contravene the provisions of ERISA. Following a subsequent investigation the Secretary of Labor determined that the loan violated ERISA and so notified the plan trustees.[90] The trustees brought suit in the district court seeking a declaratory judgment that the Secretary of Labor's finding was null and void. When the district court granted the requested relief, the Secretary of Labor filed an appeal.[91]

Acknowledging that there was no hint of scandal or self-dealing in the loan transaction, the court nevertheless found a violation, albeit a technical one.[92] Seeing the issue as one of basic statutory construction, the court questioned whether "[section] 406(b)(2) prohibit[s] transactions adverse in the technical sense . . . or must a transaction exhibit fiduciary misconduct, reflecting harm to the beneficiaries, before the statute is violated?"[93] Using unequivocal language, the court held that a technical violation was sufficient.

The apparent harshness of this rule is mitigated by section 408(a) which permits the Secretary of Labor to grant exemptions from the prohibitions of section 406. Certain criteria must be met before an exemption is granted, and the extensive procedures which the Secretary must follow before granting an exemption "indicates an intent to create, in § 406(b), a blanket prohibition of certain transactions, no matter how fair, unless the statutory exemption procedures are followed."[94] Absent these procedures, plan participants and beneficiaries are entitled to a trustee's undivided loyalty and in a commercial transaction the trustee should be free to negotiate the terms

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> fund and there are no neutral persons empowered to break such deadlock, such agreement provides that the two groups shall agree on an impartial umpire to decide such dispute, or in event of their failure to agree within a reasonable length of time, an impartial umpire to decide such dispute shall, on petition of either group, be appointed by the district court of the United States for the district where the trust fund has its principle office. . . .

Id.

90. No. 78-1380, slip op at 4-5. The Secretary's letter to the trustees read in part:

> while you were fiduciaries with respect to the Pension Trust, you acted in a 'transaction involving the plan on behalf of a party (the Welfare Trust) whose interests are adverse to the interests of the plan or the interests of its participants or beneficiaries' . . . For your future guidance, please be advised that we are of the view that any sale or loan between the two plans as presently administered is violative of 406, and exemptions under 408 . . . should be sought with regard thereto.

Id.

91. *Id.* at 5.
92. *Id.* at 9, 11.
93. *Id.* at 11.
94. *Id.* at 13.

most beneficial to his fund.[95]

As a result of this decision fiduciaries should carefully evaluate the basic language of a transaction and not merely appraise the situation in terms of fairness or sound business practice. For, if the potential transaction contravenes a literal reading of ERISA, it will be to no avail that the trustee thought it's terms to be in the best interests of plan participants. To avoid liability for engaging in a questionable prohibited transaction, a trustee should take the precaution and apply for an exemption under section 408.

3. *Nonfeasance*

Although directly engaging in a prohibited transaction obviously transgresses the law, section 406 can be violated indirectly by a trustee's failure to act in circumstances calling for positive action. In *Huge v. Old Home Manor, Inc.*,[96] the employer had made all the royalty payments that were due to the trustees of his benefit plan, but he was consistently late in doing so.[77] The trustees of the plan sued to compel the employer to pay on a timely basis. The District Court for the Western District of Pennsylvania found that the plan clearly and unequivocally required payment by the tenth of each month and that the employer should, therefore, not deviate from that fixed schedule.[98]

It was noted by the court that the trustees had properly brought suit to compel the employer to make prompt payments to the fund.[99] Failure to strictly enforce the fund agreement would have given rise to the inference that the trustees were extending credit to a party in interest in violation of section 406(a)(1)(B), or using funds for the benefit of a party in interest in violation of section 406(a)(1)(D).[100]

As this case suggests, trustees can be liable for breaches of fiduciary duty that arise from nonfeasance as well as malfeasance. ERISA is concerned with preserving the financial soundness of the pension system in order to protect the individual pensioner, and affirmative conduct is not the only means by which these interests may be compromised. If the trustee fails to promote the best inter-

95. *Id.*
96. 419 F. Supp. 1019 (W.D. Pa. 1976).
97. *Id.* at 1021.
98. *Id.*
99. *Id.* at 1020-21.
100. *Id.* at 1021.

ests of the plan, that his lapse from duty is passive rather than active could hardly be said to justify insulating him from liability, nor have the courts held otherwise.

C. Taft-Hartley Trustees

Regulation of pension and welfare plans was not a novel concept introduced by ERISA; the Labor-Management Relations Act of 1947 (Taft-Hartley Act)[101] recognized that pension and welfare plans had become an important factor in employment stability and the development of industrial relations. To protect the plan participants and interstate commerce the Act required periodic disclosures and reporting of financial and other information to the plan participants and beneficiaries.[102] Although these particular provisions of the Taft-Hartley Act were preempted with the enactment of ERISA,[103] section 186 of that Act was not affected.

Section 186 broadly proscribes an offer of payment by the employer to his employee representative as well as a request for such payment. There are several exemptions from this proscription.

For example, under section 186(c)(5) payment may be rendered to a trust fund established by an employee representative if certain conditions are met. The trust fund must be for the exclusive benefit of the employees, payments must be held in trust for the benefit of the employees, a written agreement must exist detailing the manner of payment, and the employers and employees must be equally represented in the administration of the fund. Provision is made for an impartial third party who will resolve disputes in case of a deadlock among the trustees.[104]

Confusion has arisen in pension plans, established pursuant to a collective bargaining agreement, regarding the capacity in which the trustee serves the plans and its participants. Both ERISA and the Taft-Hartley Act impose requirements on these trustees. Arguably, the requirements of these Acts are inconsistent. Under ERISA the trustees clearly owe their allegiance to plan participants and beneficiaries.[105] Under the Taft-Hartley Act, in contrast, trustees

101. 29 U.S.C. §§ 141 *et seq.* (1970).

102. *Id.* §§ 301-09 (now repealed).

103. ERISA § 444, 29 U.S.C. § 1144, which specifically repeals sections 301-09 of the Taft-Hartley Act.

104. 29 U.S.C. § 186(c)(5). *See* note 89 *supra.*

105. ERISA § 404, 29 U.S.C. § 1104 (1974).

serve as representatives of the parties who appointed them in the collective bargaining context[106] for section 186(c)(5) of that Act mandates equal representation of employees and employers in the administration of pension plan funds.[107] Questions have arisen as to whether the trustee is to play the dual role of collective bargaining agent and trustee with ERISA fiduciary obligations. The uncertainty this situation engendered has left a Taft-Hartley trustee with no definite guidelines as to the propriety of any particular action. Several lawsuits have emerged in the wake of this uncertainty and have yielded differing results.

In *Associated Contractors v. Laborers International Union,*[108] which involved a challenge by employer-appointed trustees of the validity of certain pension plan amendments, the Court of Appeals for the Third Circuit recognized the trustees as fiduciaries for the plan's beneficiaries under ERISA. However, the court also recognized them as collective bargaining agents under the Taft-Hartley Act to the extent that such status did not interfere with their fiduciary obligations.[109] To the extent that fiduciary principles are consistent with collective bargaining aims, the trustee should further the goals of the negotiating party of which he is representative and by whom he has been appointed.[110]

This same reasoning governed the outcome in *Curren v. Freitag,*[111] in which the employer-appointed trustees of a pension fund sued the employee-appointed trustees of the same fund.[112] Counter allegations of improper conduct[113] were made by the defendants against plaintiff Curren, who served in the dual capacity as fund trustee and as Director of Labor Relations for one of the employer-contractors.[114] Specifically, the defendants accused Curren of violating section 406(b)(2),[115] which prohibits a trustee from acting in any transaction

106. *See* notes 108-35 *infra* and accompanying text.

107. *See* note 104 *supra.*

108. 559 F.2d 222 (3d Cir. 1977).

109. *Id.* at 228.

110. *Id.*

111. 432 F. Supp. 668 (S.D. Ill. 1977).

112. Plaintiffs, employer-appointed trustees brought this suit challenging an audit which had been allegedly authorized by the fund. Plaintiffs were averring that the audit and subsequent lawsuits were not properly authorized but were being used to apply pressure during labor negotiations.

113. 432 F. Supp. at 670-71.

114. *Id.* at 671.

115. *See* note 29 *supra.*

involving a pension plan as the representative of a party whose interests are adverse to the interests of the plan or to the interests of its participants. Curren had allegedly violated his fiduciary duty to plan members by improperly advising and counseling various employer-contractors who were resisting audits and refusing to pay amounts deemed owing to the pension fund.[116] The defendants also averred that by prosecuting this lawsuit, the plaintiff-trustees had violated section 406(b)(2)[117] because the benefits derived therefrom inured to the employers and not the plan beneficiaries.[118]

Curren highlights the inherent conflict among the ERISA fiduciary provisions,[119] the ERISA provisions on prohibited transactions,[120] and Taft-Hartley section 186(c)(5), the equal representation provision of that Act.[121] Whether these clauses are reconcilable with one another was the initial issue to be resolved in *Curren*. The court relied heavily on section 408(c)(3) of ERISA, which provides, "[n]othing in section [406] of this title shall be construed to prohibit any fiduciary from . . . serving as a fiduciary in addition to being an officer, employee, agent, or other representative of a party in interest."[122] It concluded that Curren had committed no improprieties by performing duties both as a trustee for the fund and as Director of Labor Relations.[123]

Next the court considered the question of whether the activities that Curren had undertaken for the employer constituted acting on behalf of an adverse party in a transaction involving the plan pursuant to section 406(b)(2).[124] Here the court drew a novel distinction, ruling that unless a fiduciary is actually implementing the interests of a party adverse to the plan,[125] as opposed to merely giving advice

116. 432 F. Supp. at 671.

117. *See* note 29 *supra*.

118. 432 F. Supp. at 673.

119. ERISA § 404, 29 U.S.C. § 1104 (1974); *see* note 23 *supra*.

120. ERISA § 406, 29 U.S.C. § 1106 (1974); *see* note 29 *supra*.

121. Labor-Management Relations [Taft-Hartley] Act, 29 U.S.C. § 186(c)(5); *see* note 104 *supra*.

122. ERISA § 408(c)(3), 29 U.S.C. § 1108(c)(3) (1974).

123. 432 F. Supp. at 671.

124. *Id.* at 672.

125. The court was cognizant of the Conference Committee's Report which said that the purpose of section 1106(b)(2) was to prevent "a fiduciary from being put in a position where he has dual loyalties, and, therefore, he cannot act exclusively for the benefit of a plan's participants and beneficiaries." *Id.* The court decided the correct interpretation to be given section 1106(b)(2) was found in section 1108(c)(3) and not the legislative history. *Id.*

or counsel to such a party, there is no breach of section 406(b)(2).[126]

The court then addressed the second counterclaim, which alleged that the plaintiffs had an improper motive for bringing this lawsuit[127] and therefore were barred from asserting their claim. Viewing it as unlikely that Congress intended a plaintiff's motivation to have any significance in a lawsuit where a valid claim was asserted,[128] Judge Ackerman stated,

> I believe as a matter of law, a fiduciary who seeks to remedy at least colorable breaches of fiduciary duty by his co-fiduciaries through civil litigation cannot be said to have violated 29 U.S.C. §1106(b)(2) [section 406(b)(2)] regardless of this motivation for bringing the action. ERISA does not require a fiduciary to stand mute because calling attention to breaches of fiduciary duty would inure to the benefit of the party in interest who secured his position as a fiduciary.[129]

Finally, the court dismissed a claim based on section 406(b)(3),[130] holding that although Curren drew a salary from the employer-contractor, this alone could not support a complaint under section 406(b)(3) that Curren had received consideration for his own personal account from a third party in a transaction involving the assets of the plan.[131] To run afoul of the proscription of section 406(b)(3), the trustee must accept consideration which is in excess of his usual remuneration as an employee.

Essentially, the *Associated Contractors* and *Curren* courts endorsed the view that the Taft-Hartley trustee has a dual personality. As long as the trustee honors his fiduciary obligations he should be free to pursue the interests of his employer even in a collective bargaining context.[132] The purpose of ERISA was to clarify and emphasize the fact that common law fiduciary principles apply to all pension trustees[133] and to cure fiduciary abuses that had arisen in the industry.[134] These aims would be more easily accomplished by

126. *Id.*

127. The defendants felt the lawsuit was commenced for the benefit of the employers who were the only ones who stood to gain if the court were to rule that the audits were improperly authorized.

128. 432 F. Supp. at 673.

129. *Id.*

130. *See* note 29 *supra.*

131. 432 F. Supp. at 671-72.

132. 559 F.2d at 228.

133. H.R. REP. No. 93-533, 93d Cong., 2d Sess. (1974), *reprinted in* [1974] U.S. CODE CONG. & AD. NEWS, 4649-50.

134. *Id.* at 5186.

viewing the Taft-Hartley trustee as a fiduciary with a duty to plan participants and beneficiaries only. In reality, however, this could prove impractical particularly since ERISA allows a fiduciary to function not only in that capacity but also as an officer, employee, agent, or other representative of a party in interest.[135] The trustee's fiduciary obligations are of paramount importance, but to require that he forsake all other interests when they have no relation to his fiduciary duties is unnecessary. Although this dichotomy of roles was perhaps inevitable for the Taft-Hartley trustee, it should be emphasized that the trustee's fiduciary duties should nevertheless be his preeminent concern.

This view of the Taft-Hartley trustee was not espoused by the Department of Labor, which successfully argued before the National Labor Relations Board (NLRB) in *Sheet Metal Workers*[136] that the trustees of a Taft-Hartley pension plan were not collective bargaining agents.[137] The Department of Labor opined that the fiduciary obligations of a trustee under ERISA were diametrically opposed to the obligations of a collective bargaining agent.[138] Acknowledging that as a fiduciary the trustee possessed discretionary authority, the respondents argued that these discretionary decisions constituted an extension of the collective bargaining process.[139] In exercising his discretion the trustee would undoubtedly consider the opinions of the party who appointed him, and perhaps incorporate that thinking in his decision. Since the employer and union trustees would often have disparate views, the trustees' deliberations constituted a form of negotiation between the parties.[140]

In support of its conclusion that the trustees were not collective

135. ERISA § 408(c)(3), 29 U.S.C. § 1108(c)(3) (1974).

136. 97 L.R.R.M. 1476 (1977).

137. The petitioners alleged a violation of section 8(b)(1)(B) of the National Labor Relations Act which states: "It shall be an unfair labor practice for a labor organization or its agents (1) to restrain or coerce . . . (B) an employer in the selection of his representatives for the purpose of collective bargaining or the adjustment of grievances . . . The petitioner association alleged that by striking to force the inclusion of the pension fund in the collective bargaining agreement, the respondents coerced the association in its choice of a collective bargaining representative. The court found that if the trustees of the plan were indeed collective bargaining agents there was an undisputed violation of 8(b)(1)(B). The status which the trustees had in relation to the plan, then, was of paramount consideration in the deliberations of the Board. *Id.* at 1484 n.29.

138. *Id.* at 1485.

139. *Id.*

140. *Id.*

bargaining agents, the NLRB reasoned that if Congress had intended trustees of Taft-Hartley pension plans to be collective bargaining agents, it would have so specified and applied a different standard to them,[141] instead, in enacting ERISA, Congress chose to apply the strict fiduciary standards to all trustees, standards that emphasize absolute and undivided loyalty to the plan's participants and beneficiaries.[142]

Stating that most courts view Taft-Hartley trustees as fiduciaries rather than as collective bargaining agents,[143] the NLRB unequivocally subscribed to this view.[144] Not only were the fiduciary standards of ERISA applicable to these trustees,[145] but "there is nothing in Labor-Management Relations Act [Tart-Hartley Act] or other federal statutes or in their legislative history which can be said to alleviate the otherwise strict common-law fiduciary responsibilities of trustees appointed for employee welfare or pension funds developed by collective bargaining."[146]

Because ERISA permits a trustee to function, then, as an officer, employee, agent or other representative of a party in interest,[147] ambiguity exists as to the legal position of one who functions in a dual capacity. ERISA's emphasis on fiduciary responsibilities, coupled with its avowed purpose to make the law of trusts applicable to the pension industry,[148] leads to the conclusion that a trustee's foremost duty is to satisfy his fiduciary obligations. If these obligations are conscientiously fulfilled, there should be no legal obstacle to a trustee's involvement in other pursuits.

IV. Conclusion

Tremendous growth has characterized the private pension industry during the last decades and increasing numbers of working people participate in pension and welfare plans. ERISA was enacted to preserve the financial integrity of these working people and to ensure that American laborers are aware of their pension rights and

141. *Id.* at 1477.
142. *Id.*
143. *Id.* at 1485. *See, e.g.*, Toensing v. Brown, 528 F.2d 69 (9th Cir. 1975); Lamb v. Carey, 498 F.2d 789 (D.C. Cir.), *cert. denied*, 419 U.S. 869 (1974).
144. 97 L.R.R.M. at 1486.
145. *Id.*
146. *Id.* at 1485.
147. ERISA § 408(c)(3), 29 U.S.C. § 1108(c)(3) (1974).
148. Conference Report on H.R. 2, *reprinted in* 120 CONG. REC. 29932 (1974).

of the standards by which to judge their fiduciary's actions.

The federal courts' initial venture into litigation involving ERISA's fiduciary provisions has been cautious, a reflection perhaps of the uncharted terrain of the fiduciary area and of the courts' awareness of the potential liabilities inherent in the provisions. If one thread unites these diverse decisions, however, it is the courts' concern for plan participants and beneficiaries and for the protection of their plan assets. In this regard the judicial decisions have been harmonious with ERISA's legislative intent to benefit plan participants and guard plan assets. It may be that the cornerstone of federal decisions will be the continued integrity of the pension system; flexible use of ERISA's fiduciary provisions will help to achieve that goal. Although a dearth of decisions in this area frustrates any prediction of future trends, the willingness of the courts to protect the assets and participants of pension and welfare funds seems assured.

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