Q&A

Can you really avoid "fiduciary liability"?

From an interview with attorneys Richard Naegele and Thomas Theado

It seems as if every investment advisor, trustee, or major 401(k) provider has developed programs to mitigate a plan official's "fiduciary liability." This ubiquitous term—"fiduciary liability"—is discussed as if it has a uniform and clear definition. In fact, the term is both broad and vague, encompassing a range of liabilities for those associated with plan operations. In addition, these liabilities can fall on just about anyone involved with managing the plan, not just the ERISA defined "fiduciary."

This month we will attach some clarity to this term and look at the possibility of mitigating exposure to such liability. We have asked two attorneys with extensive legal expertise to answer our questions this month: One of the attorneys specializes in ERISA, the other in litigation, including class-action ERISA litigation. Richard Naegele the ERISA specialist, is with Wickens, Herzer, Panza, Cook & Batista Co. in Avon, Ohio, and litigation specialist Thomas Theado is with the law firm of Gary, Naegele & Theado, LLC in Lorain, Ohio. Mr. Naegele (RN) can be reached at 440-695-8000, and Mr. Theado (TT) can be reached at 440-244-4809.

Q Are we seeing much litigation in the class-action arena?

A RN Yes, and that is probably a good way to start the discussion. Tom is a plaintiff's class-action litigator who has litigated a number of significant pension cases. He's had two different $50 million cases. One was a settlement, and one was a judgment.

TT As a plaintiff's attorney who primarily brings actions seeking additional pension benefits for participants under ERISA, I know very little about ERISA statutory liability insofar as filing requirements and plan compliance. Those rules are where Dick makes a living. I should note that, so far, participant-driven fiduciary actions have been difficult to develop, but that may be about to change, or it could get even more difficult. In May 2010, the Supreme Court declared in Hardt v. Reliance Standard Life Insurance that an ERISA claimant need not be the typical "prevailing party" in order to be eligible for an attorney's fee award. Under the *Hardt* decision, a party may be awarded fees if "some degree of success on the merits" is achieved. This is as opposed to the more stringent requirement imposed by some circuit courts that attorney fee awards against the opposing party are only available to a "prevailing party." The impact of this is that plaintiffs—say plan participants—might have to pay some of the defendant's legal fees if the defendant, in countering the suit, is even partially successful.

Q Will this cause some plaintiffs to reconsider suing a plan fiduciary?

A TT Maybe. First of all, ERISA 502(g)(1) did not require "prevailing party" status. Rather, a defendant who succeeded in defending the claim could successfully seek fees from a plaintiff. Now we know from the *Hardt* case that, so long as the person who is taking the fee award "has achieved some degree of success on their merits," then the statute would provide a fee-shifting award under this section. For example, consider a suit brought by a participant against a plan over, say, a missed allocation, and the decision in that case is remanded by the trial court to the plan administrator for an administrative determination. Does that action by the court equate to either party having "some degree of success" on the merits? It is a good question, and we will have to see where these things go in the court.

Thus, there is potentially a huge risk to bringing a suit, even where its merits are really not in question. That is why, in my opinion, it is unethical for an attorney to accept representation of an ERISA benefits claimant without saying to the ERISA claimant, "I've got some potential bad news. If the Plan is as mean spirited as you have described it to me, we can pretty well bet that, should we be unsuccessful, they're going to seek their attorney fees from you."

Q Can we start by defining what constitutes "fiduciary liability" with respect to a 401(k) plan?

A RN Okay, first, you look at who's the fiduciary under statute in ERISA 3(21)(a). This presents a very broad definition of who's a fiduciary. Basically, it is anyone who either has discretionary authority or control with respect to the plan or who has *any* authority with respect to the management or disposition of the plan's assets. This group includes the plan's trustee, the named plan administrator, and all service providers who render investment advice with respect to the plan assets for a fee. It also includes those who have discretionary authority or responsibility over the administration of the plan's benefits. Count as fiduciaries members of investment and administrative committees, investment managers, and also the people who appoint those fiduciaries. So most plans have a number of fiduciaries regardless of whether they're specifically signing on to

be a fiduciary. Here, titles don't generally matter. If a person exercises the authority of being a fiduciary or oversees the activities in ERISA 3(21)(A), he can be a fiduciary. That's from the Merton v. Hewitt Associates case of 1993. And note that even nonfiduciaries can be included in these suits.

Q Can individuals disclaim or waive their fiduciary status?

A RN No, and that is because the determination of fiduciary status is tied to a functional definition. It doesn't require you to *say* you're a fiduciary. You may well be a fiduciary when you say you are or are not. Once somebody *is* a fiduciary, then the primary fiduciary functions are those cited under ERISA 404. Basically, a fiduciary must act solely in the interest of the plan participants for the exclusive purpose of providing benefits and defraying the reasonable expenses to administering the plan. This requires the fiduciary to exercise the same care, skill, prudence, and diligence that a prudent person acting in a like capacity would exercise. It's referred to as the "Prudent Expert Rule." Here you're held to a very, very high standard with respect to the plan. This same duty requires plan officials to operate the plan both according to the law and to the plan document.

When an individual acting like a fiduciary does not meet the requirements of ERISA, then certain actions must be taken to fix any harm that was done. Those steps can involve engaging lawyers and actuaries to fix the problem, paying penalties for missed administrative filings, paying restitution for claimed losses, and paying an attorney to prepare a defense when sued. I would include all of these into what constitutes potential "fiduciary liabilities." This list is of course not all inclusive, but it should give your readers some feeling for this term.

Q How will the recent decision in Cigna v. Amara impact fiduciary liability?

A RN That is a good question, and it is an interesting case. Let me give your readers some background before answering the question. The Supreme Court decided in May in CIGNA v. Amara that the Summary Plan Description (SPD) is not to be treated as a plan document for purposes of determining benefits, eligibility, and other rights to benefits. That conclusion is not consistent with most circuits in the United States. The general rule had been that if the SPD said something, you were bound by it. Now the Supreme Court is saying, in effect, "Well, maybe not, because the SPD is not a plan document."

TT I would like to add a footnote to Dick's comment on this decision: Not only had most of the circuits entertained this issue, but all of those had concluded that not only was the SPD a plan document, but it also might trump the provisions to be found in the "plan" Itself. For example, the Sixth Circuit had the rule that, if there were a conflict between the plan document and the SPD, the claimant got the better of the two. One of the things I find peculiar in considerations of this type, before *Amara*, was the conflict between, on the one hand, construing the document against the drafter (which usually, of course, was the plan's administrator) but, on the other hand, giving extraordinary deference to the administrator in the interpretation of its own plan. And this case is still in conflict with what to do with those two options—construing against the administrator/drafter, and deferring to the interpretation provided by the administrator/drafter. But now we don't have to worry about that conflict, at least where SPDs are concerned because, since SPDs are not a part of the plan document, the interpretation of their text is inconsequential.

RN That particular decision was just astonishing. The SPD is the only document that anybody actually sees, so how could you not rely upon it? Tom and I litigated this issue back in the early 90s. Our case occurred because the Sixth Circuit had so strongly said that the SPD should be treated as controlling over the plan document if there was language in the SPD favorable to the participant.

TT To answer your question, CIGNA v. Amara is going to be significant so far as fiduciary liability because of how ERISA's enforcement provisions are liable to play themselves out after this decision. ERISA 502(a)(1)(B) permits a participant to bring a claim for benefits due under the terms of a plan. ERISA 502(a)(3) allows that participant to obtain appropriate equitable relief—today we won't go into what constitutes appropriate equitable relief. But in some cases a question frequently arises, "What if the document's provisions are purportedly illegal?" For example, consider a pension plan that provides for a calculation which case law would suggest is unlawful because it violates the actuarial-equivalency rule?

Well, arguably, in such a case you are not seeking benefits under the terms of the plan under 502(a)(1)(B) because the benefits were in fact awarded according to the terms of the plan—they're just illegal provisions. CIGNA v. Amara says, in effect, "That's not a problem, really." It used to be you did all sorts of stuff to avoid this argument—that you can't bring a claim for additional benefits under 502(a)(1)(B) if those benefits were awarded consistent with the plan's terms, albeit illegal terms. You would sue under ERISA 502(a)(3) for equitable reformation so that you could reform the plan

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to make the terms legal. Then you would continue suit under ERISA 502(a)(1)(B), under the reformed plan's new terms, seeking the benefits due you were the plan's terms legal in the first instance. Again, in a matter of a few sentences, the Supreme Court in effect said, "Oh, forget all that machination. You can seek under 502(a)(3) the recovery to which you are entitled, to the benefits that are due you."

A separate question is whether suit should be directed against the fiduciaries in equity to obtain equitable relief under 502(a)(3). The outcome of this decision could be to make the fiduciaries additional defendants. I will comment that, as a person who brings suits on behalf of participants, we frequently make decisions on whether to bring in the fiduciaries. You can just sue the plan, or maybe the plan and administrator. The only time you bring in fiduciaries is when you're seeking money from them, in my opinion. The *Amara* decision may change that conclusion.

Q Let me go back to our initial question, "What is fiduciary liability?"

ARN There is not a one specific provision in ERISA that says, "Such and such is a fiduciary liability." These liabilities generally arise because someone, the government or a participant, think you did something wrong. To that classification, I suppose you could attach this term to every potential penalty arising from plan mismanagement, reporting, or administration failures as well as the cost to defend yourself in court when sued.

There are a lot of different ways that a fiduciary can be personally liable for fixing plan failures. If you're delinquent in filing a Form 5500 a daily penalty can be assessed. Yes, that's a fiduciary liability. It generally is imposed on a fiduciary named as the Plan Administrator. With the DOL, this penalty could be $300 or more a day; for the IRS it is $25 a day. You could have huge penalties from that kind of fiduciary liability. If participants ask for the SPD or the other documents that they're entitled to and you don't provide them, participants can sue for $110 a day for each day that they don't get it after 30 days. These penalties are assessed against the fiduciaries and cannot be paid from plan assets. Payment of such penalties from the plan will constitute a separate fiduciary breach and possibly expose the fiduciary to criminal liability for misuse of plan assets.

These are specific fiduciary liabilities that are found in statute or regulations and they are more administrative. The penalties for their failure apply to those who are responsible for doing those things. More often, fiduciary liabilities are thought of as liabilities arising from participant lawsuits when a participant believes he or she hasn't gotten the right benefit, you've miscalculated that benefit, or you've done something else wrong.

TT As a practical rule, the determination whether a party is a fiduciary is a determination in the "eye of the beholder." You must also keep in mind that there are grounds for liability in many actions taken by individuals who work with the plan. Thus, it includes a spectrum of scenarios—from where a fiduciary may personally have pillaged the plan's funds to where it is just about bad decision making. The latter was alleged in stock-drop cases, where there was failure to be prudent or where it was imprudent to include company stock in the mix, on what advice should have been given to participants with regards to the company's stock. Then, there's the group of lawsuits that were brought in the past couple of years by Jerry Schlichter that are referred to as "revenue sharing" cases. There, he argued, fiduciaries had misspent plan assets by not obtaining lower fees from fund managers and had failed to be aware of, and capture for the plan, the fees being paid by various investment vehicles to participate in the portfolio. Transaction fee cost is another current issue, where the fiduciary typically pays little attention to how much the participant has to pay in transaction costs.

Another thing I will note is that the cost to mount a defense may be substantial for all parties brought into the lawsuit, and such costs are likely to be unpredictable and potentially sizable. These costs can apply to anyone whom the plaintiff believes to be a fiduciary, not just the individuals who sign on as a plan fiduciary. Most importantly, an intraplan agreement among its operatives that one or the other "is not" a fiduciary should be given as much weight as Clyde's letter to Bonnie, protesting that he wasn't a bank robber. ❖