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NON-FIDUCIARY LIABILITY UNDER THE EMPLOYEE RETIREMENT INCOME SECURITY ACT

JONATHAN D. SCHWARTZ*

I. INTRODUCTION

There is approximately \$1 trillion currently invested in America's employee benefit plans, and a figure that may rise to more than \$4 trillion by the turn of the century.¹ Benefit plans are a tempting target for legislators searching for a quick fix for the federal deficit, for corporations searching for cash, and for entrepreneurs searching for venture capital.² Not surprisingly, such enormous sums of money have also attracted individuals who misappropriate benefit plan assets.³ As the Seventh Circuit lamented, there is "a pattern which seems distressingly prevalent today: the savings of working men and women are pilfered, embezzled, parlayed, mismanaged and outright stolen by unscrupulous persons."⁴ These unscrupulous persons are benefit plan officials violating their fiduciary duties under the Employee Retirement Income Security Act (ERISA),⁵ and non-fiduciaries who participate in and profit from these breaches of fiduciary duties.

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1. See FEDERAL RESERVE SYSTEM, FLOW OF FUNDS — 1985 THIRD QUARTER LEVELS 553; see also N.Y. Times, July 27, 1985, § 1, at 46, col. 5.

2. See N.Y. Times, July 15, 1984, at C4, col. 3.

3. See generally PERMANENT SUBCOMM. ON INVESTIGATIONS OF THE SENATE COMM. ON GOVERNMENTAL AFFAIRS, HOTEL EMPLOYEES & RESTAURANT EMPLOYEES INTERNATIONAL UNION, S. REP. NO. 595, 98th Cong., 2d Sess. (1984) [hereinafter cited as HEREIU REPORT]. For a discussion of the findings of the HEREIU REPORT, see *infra* note 104.

4. Thornton v. Evans, 692 F.2d 1064, 1065 (7th Cir. 1982).

5. ERISA was enacted in 1974, Pub. L. No. 93-406, 88 Stat. 832, (codified at 29 U.S.C. §§ 1001, 1461 (1982 & Supp. 1983)). More recent amendments can be found at 29 U.S.C.A. §§ 1001 (West 1985). ERISA covers both pension plans and welfare plans. 29 U.S.C. §§ 1002(1)-1002(2) (1982). Pension plans provide for retirement income, and welfare plans provide for benefits such as health care, dental care, disability and accident benefits. See B. COLEMAN, PRIMER ON EMPLOYEE RETIREMENT INCOME SECURITY ACT (1985). For the purposes of this article, "benefit plan" refers to either type of plan.

ERISA is a "comprehensive remedial statute designed to 'protect . . . the interests of participants in employee benefit plans and their beneficiaries.'"⁶ ERISA protects these interests by imposing fiduciary obligations on benefit plan trustees and other officials who exercise discretionary authority or control over the management of benefit plans or the disposition of their assets.⁷ Fiduciaries are required to act solely in the interest of plan participants and beneficiaries with the skill, care and diligence that a prudent person acting in a like capacity would exercise.⁸ While the text of ERISA and its voluminous legislative history are replete with references to fiduciary obligations, there is no mention of obligations for

6. *Eaves v. Penn*, 587 F.2d 453, 457 (10th Cir. 1978) (quoting 29 U.S.C.A. § 1001(b) (West 1985)). See also *Pompano v. Michael Schiavone & Sons, Inc.*, 680 F.2d 911, 914 (2d Cir.), cert. denied, 459 U.S. 1039 (1982); *Marshall v. Glass/Metal Assoc. Plan*, 507 F. Supp. 378, 383 (D. Hawaii 1980).

7. ERISA sets forth the definition of a fiduciary. It states, in pertinent part: [A] person is a fiduciary with respect to a plan to the extent (i) he exercises any discretionary authority or discretionary control respecting management of such plan or exercises any authority or control respecting management or disposition of its assets, (ii) he rendered 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. 29 U.S.C. § 1002(21)(A) (1982).

A benefit plan's governing documents will name certain individuals as "trustees." In nearly all cases, plan trustees will qualify as fiduciaries under ERISA. For this reason, the word "trustee" and the word "fiduciary" are often used interchangeably, as are the phrases "breach of trust" and "breach of fiduciary duties." It should be emphasized, however, that persons who are not trustees may be fiduciaries under ERISA. See 29 U.S.C. § 1002(14)(A) (1982). Determining who is a fiduciary is an important issue under ERISA, but is beyond the scope of this article. See generally Annot., 67 A.L.R. FED. 186 (1984).

8. The fundamental obligations imposed on fiduciaries are provided by ERISA. It states, in pertinent part:

[A] fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and 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 are consistent with the provisions of this subchapter or subchapter III of this chapter.

non-fiduciaries.⁹ Nevertheless, every court¹⁰ that has considered the question has concluded that non-fiduciaries can be held liable under ERISA for their involvement in breaches of fiduciary duties.¹¹

The enforcement powers granted by ERISA have not been limited to actions against fiduciaries since it would be inconsistent with Congress' stated intention "to provide both the Secretary [of Labor] and participants and beneficiaries with broad remedies for redressing or preventing violations of [ERISA]." ¹² As one court stated: "[N]o sound reason appears why ERISA should be emasculated by a construction which precludes civil actions against non-fiduciaries."¹³ This view takes on added force when one recognizes that from the perspective of plan participants and beneficiaries, it matters little from whom restitution is made after a breach of fiduciary duties has been committed.¹⁴

29 U.S.C. § 1104(a)(1) (1982). Additional limitations on fiduciaries can be found at 29 U.S.C.A. § 1106(b) (West 1985). See also Little & Thrailkill, *Fiduciaries Under ERISA: A Narrow Path to Tread*, 30 VAND. L. REV. 1 (1977).

9. "Non-fiduciary" is not defined in ERISA. For the purposes of this article, "non-fiduciary" refers to a person, partnership, or corporation without fiduciary obligations under ERISA.

10. See, e.g., *Fink v. National Sav. & Trust Co.*, 772 F.2d 951 (D.C. Cir. 1985); *Fremont v. McGraw-Edison Co.*, 606 F.2d 752 (7th Cir. 1979), cert. denied, 445 U.S. 951 (1980); *Donovan v. Schmoutey*, 592 F. Supp. 1361 (D. Nev. 1984); *Donovan v. Bryans*, 566 F. Supp. 1258 (E.D. Pa. 1983); *Donovan v. Daugherty*, 550 F. Supp. 390 (S.D. Ala. 1982); *Donovan v. Unicorn Group*, 3 EMPL. BEN. CAS. (P-H) 1665 (S.D.N.Y. 1982); *McDougall v. Donovan*, 539 F. Supp. 596 (N.D. Ill. 1982); *Freund v. Marshall & Ilsley Bank*, 485 F. Supp. 629 (W.D. Wis. 1979).

11. 29 U.S.C.A. § 1132(a) (West 1985). Section 1132(a) provides that the Secretary of Labor, participants and beneficiaries may bring civil actions "to enjoin any act or practice which violates any provision of this subchapter or . . . to obtain other appropriate equitable relief (i) to redress such violations or (ii) to enforce any provisions of this subchapter." *Id.* (emphasis added). Section 502(a) is the numbered section within ERISA corresponding to section 1132(a) in the official code. Like other remedial legislation, ERISA has been given a broad construction in order to effectuate its goals. See, e.g., *Kuntz v. Reese*, 760 F.2d 926, 932 (9th Cir. 1985); *Authier v. Ginsberg*, 757 F.2d 796, 799-800 (6th Cir.), cert. denied, 106 S. Ct. 208 (1985); *Connolly v. Pension Benefit Guar. Corp.*, 581 F.2d 729, 732 (9th Cir. 1978), cert. denied, 440 U.S. 935 (1979); *Marshall v. Kelly*, 465 F. Supp. 341, 349 (W.D. Okla. 1978).

12. S. REP. NO. 127, 93d Cong., 1st Sess. 35, reprinted in 1974 U.S. CODE CONG. & AD. NEWS 4639, 4838, 4871. Throughout this article the word "Secretary" refers to the Secretary of Labor.

13. *Unicorn Group*, 3 EMPL. BEN. CAS. (P-H) at 1667.

14. See *McDougall*, 539 F. Supp. at 598 n.5. The *McDougall* court held that ERISA empowered it to seek relief from a non-fiduciary "party in interest" who participated in a breach of fiduciary duties. *Id.* at 598-99. "Parties in interest" include, for

Once a court decides that ERISA's reach is broad enough to encompass non-fiduciaries, the more difficult task becomes articulating a theory of liability given Congress' lack of guidance. So far, courts have relied either on a theory of "knowing participation" in a fiduciary's breach or on a conspiracy rationale. Regardless of their approach, however, the analyses are so cursory that it is difficult to discern the elements of these theories of liability, let alone their applicability to other factual situations.

This article first analyzes these theories of non-fiduciary liability in order to determine their relative efficacy in addressing issues implicated by breaches of fiduciary duties. This article contends that the "knowing participation" rationale is superior to the conspiracy approach. But in applying this common law theory, courts should bear in mind the problems that are peculiar to modern benefit plans and the broad powers they have been given by Congress to handle them. This article will then explore the special issues raised by prepaid benefit plans, one type of employee benefit plan that has acted as a magnet for organized crime.¹⁵ This article concludes by suggesting legislative changes that not only will make prepaid benefit plans less attractive to organized crime, but also will help eliminate other forms of non-fiduciary involvement in breaches of fiduciary duties.

II. KNOWING PARTICIPATION AND THE COMMON LAW OF TRUSTS

In several ERISA cases, courts have relied on the well-established common law trust principle that liability may be imposed on persons who knowingly participate in a breach of trust.¹⁶ This rule is set forth in Professor Bogert's treatise, *Trusts and Trustees*:

example, fiduciaries, persons providing services to the plan, employers, employee organizations, and the relatives, officers, employees and beneficial owners of such individuals or entities. 29 U.S.C. § 1002(14) (1982). The court noted that non-fiduciaries who are not parties in interest could also be held liable under ERISA. This article does not differentiate between those who are parties in interest and those who are not.

15. HEREIU REPORT, *supra* note 3, at 9.

16. Congress intended courts to look to common law trust principles when deciding issues involving breaches of fiduciary duties. See H.R. REP. NO. 533, 93d Cong., 1st Sess. 13, reprinted in 1974 U.S. CODE CONG. & AD. NEWS 4639, 4649, 4651; S. REP.

Just as every owner of a legal interest has the right that others shall not, without lawful excuse, interfere with his possession or enjoyment of the property or adversely affect its value, so the beneficiary, as equitable owner of the trust res has the right that third persons shall not knowingly join with the trustee in a breach of trust.¹⁷

The Supreme Court stated this more succinctly in *Smith v. Ayer*: “[T]he law exacts the most perfect good faith from all parties dealing with a trustee respecting trust property. . . . The doctrine pervades the whole law of trusts.”¹⁸ This section examines the common law roots of this theory and suggests how it can be adapted so it retains its vitality when used by courts in ERISA actions.

A. Knowledge

Should courts applying the “knowing participation” rationale in ERISA actions require that a non-fiduciary have actual knowledge of a breach of trust, or should constructive knowledge suffice? The participants and beneficiaries would be afforded a greater degree of protection if courts required only a showing of constructive knowledge. On the other hand, since ERISA does not explicitly impose any requirements on non-fiduciaries, it is arguable that liability should be imposed only when actual knowledge of the breach can be shown. This would be, in effect, a consolation prize for non-fiduciaries who believe that courts have no jurisdiction over them in the first place.

In *Ayer*, a trustee breached his fiduciary duties when he pledged notes belonging to the trust as collateral for loans to a company in which he was an owner.¹⁹ In deciding whether

No. 127, 93d Cong., 1st Sess. 29, reprinted in 1974 U.S. CODE CONG. & AD. NEWS 4639, 4838, 4865; see also *Leigh v. Engle*, 727 F.2d 113, 122-23 (7th Cir. 1984); *Donovan v. Cunningham*, 716 F.2d 1455, 1464 (5th Cir. 1983), cert. denied, 104 S. Ct. 3533 (1984); *Marshall v. Teamsters Local 1282 Pension Trust*, 458 F. Supp. 986, 990 (E.D.N.Y. 1978).

17. G. BOGERT, TRUSTS AND TRUSTEES § 901 (2d ed. 1982), quoted in *Freund v. Marshall & Isley Bank*, 485 F. Supp. 629, 642 (W.D. Wis. 1979). See also *Lawrence Warehouse Co. v. Twohig*, 224 F.2d 493, 498 (8th Cir. 1955); *Sexton v. Sword S.S. Line, Inc.*, 118 F.2d 708, 710 (2d Cir. 1941); RESTATEMENT (SECOND) OF TRUSTS §§ 291, 295, 326 (1959).

18. *Smith v. Ayer*, 101 U.S. 320, 327 (1879).

19. *Id.* at 323-25.

relief could be sought from the lenders, the Court emphasized that the plaintiffs would only have to establish that the lenders had constructive knowledge of the breach: “[H]owever free from intentional wrong, [the lenders] must bear the responsibility of a mistaken judgment.”²⁰ The Court found that the lenders were “acquainted . . . with such matters as upon inquiry would have given them information” about the breach.²¹ The Court’s willingness to hold the lenders liable to the trust without a showing of actual knowledge is the accepted common law rule, and was followed in *Freund v. Marshall & Ilsey Bank*,²² the first case holding non-fiduciaries liable under ERISA.

In *Freund*, the trustees of a benefit plan and their relatives were the controlling shareholders of several interrelated companies whose employees were covered by the plan. The court found that the trustees violated their fiduciary duties under ERISA by making unsecured loans of almost all of the plan’s assets to the companies sponsoring the plan.²³ The trustees also breached their fiduciary duties by not providing for the plan’s management after they and their relatives sold the companies to a buyer who subsequently bankrupted the consolidated entity.²⁴

As for the relatives, who were non-fiduciaries under ERISA, the court recognized that under the common law of trusts, “non-fiduciaries who knowingly participate, either directly or through an agent, in a breach of trust . . . could be held liable in an action brought by the beneficiary.”²⁵ The court stated that this theory of liability has two elements: “(1) an act or omission which furthers or completes the breach of trust by the trustee; and (2) knowledge that the transaction amounted to a breach of trust, or the legal equivalent of such knowledge.”²⁶

In *Freund*, the second factor was satisfied because “the uncontradicted evidence establishe[d] that the sellers were made

20. *Id.* at 325, quoted in *Schmouley*, 592 F. Supp. at 1396.

21. 101 U.S. at 326.

22. 485 F. Supp. at 642.

23. *Id.* at 636.

24. *Id.* at 639-40.

25. *Id.* at 642.

26. *Id.* (quoting G. BOGERT, *supra* note 17, at § 901).

aware, prior to the consummation of the sale, not only [of] facts from which the impending harm to the Plan ought to have been clear, but also of the actually foreseen harm to the Plan."²⁷ Even though the court found that the relatives possessed actual knowledge of the breach of trust, the court's two-part test makes clear that it would have held them liable solely on a showing of constructive knowledge.

Constructive knowledge was affirmatively recognized as a basis for liability in *Donovan v. Schmoutey*,²⁸ a case involving the Southern Nevada Culinary and Bartenders Pension Trust, casinos, hotels, and related companies with overlapping ownership and management. The Secretary of Labor alleged that the plan's trustees violated their fiduciary duties by making imprudent loans to companies controlled by Morris Shenker,²⁹ who allegedly acted as a middleman between organized crime and the plan.³⁰ Shenker and his companies were non-fiduciaries under ERISA.³¹

Prior to trial, the Secretary settled with all but one of the trustees.³² A trial was held on the Secretary's claims against the remaining trustee and against Shenker and the companies he controlled for "knowingly participat[ing] in these breaches of fiduciary obligations of the defendant trustees."³³ After finding that the trustees had violated their fiduciary duties under ERISA for the reasons stated above, the court held that Shenker and his companies either had actual or constructive knowledge of the fiduciaries' breaches of trust since they knew of the plan's precarious financial condition, they knew of their own precarious financial conditions, they knew the loan proceeds were being misapplied, they knew they had made misrepresentations to the plan, and they knew the collateral securing the loans was insufficient.³⁴

27. 485 F. Supp. at 642.

28. 592 F. Supp. 1361, 1368-74 (D. Nev. 1984).

29. *Id.* at 1368. Since the loans were very large, the Secretary also alleged that the trustees violated their fiduciary duties by failing to diversify the investments of the plan. *Id.*

30. See HEREIU REPORT, *supra* note 3, at 25-27, 70-72.

31. See *Schmoutey*, 592 F. Supp. at 1390-91.

32. *Id.* at 1368-69.

33. *Id.* at 1368.

34. *Id.* at 1398-99.

Despite its awkward holding that the non-fiduciaries had actual *or* constructive knowledge, the court emphasized that constructive knowledge would suffice.³⁵ Unlike the court in *Freund*, however, which found support for its use of a constructive knowledge standard in the common law, the *Schmoutey* court's justification for its use is mystifying. The court cites Section 406 of ERISA, which states that a fiduciary shall not cause a plan to engage in transactions which "he knows or should know" amounts to a "prohibited transaction" under that section.³⁶ Even though "know or should know" language is commonly associated with a constructive knowledge standard, the court does not explain why a standard applied to *fiduciaries* should also be applied to non-fiduciaries. The court noted that constructive knowledge is the rule at common law, but inexplicably remarked that its conclusion "that these defendants were knowing participants in the fiduciary breaches of the trustees . . . does not rely to any extent on the foregoing trust principles."³⁷

While the courts in *Freund* and *Schmoutey* offer no coherent reasons why a constructive knowledge test is appropriate in ERISA cases, they did reach the best result. It is always difficult to establish actual knowledge, and this will be particularly true when benefit plans are involved. The large amounts of money in these plans will often attract sophisticated and well-organized individuals whose ability to cover their tracks should not be underestimated. Plaintiffs will rarely find evidence of admitted wrongdoing, nor should they expect non-fiduciaries to acknowledge their transgressions

35. *See id.* at 1393, 1395, 1398-99.

36. *Id.* at 1393. Section 406(a) prohibits a fiduciary from causing a benefit plan to enter into five types of "prohibited transactions" with a "party in interest", *see supra* note 14, unless an exemption is procured from the Secretary. 29 U.S.C. § 1106(a) (1985). Since Shenker and several of his companies were "parties in interest," *Schmoutey*, 592 F. Supp. at 1390-91, the Secretary also alleged that this section of ERISA was violated. The court, however, did not distinguish between non-fiduciaries who were "parties in interest" and those who were not when it held all of them liable for participating in the breaches of fiduciary duties.

The court also cited *M & R Inv. Co., Inc. v. Fitzsimmons*, 484 F. Supp. 1041, 1057 (D. Nev. 1980), *aff'd*, 685 F.2d 283 (9th Cir. 1982), which only adds to the confusion since the court in that case pointed out that an analogous provision to Section 406 which appears in the Internal Revenue Code does not contain a knowledge requirement. *Id.* (citing 26 U.S.C. § 4975 (1980 & Supp. 1985)).

37. *Schmoutey*, 592 F. Supp. at 1396.

during the discovery process or in a court of law.³⁸ At most, intelligent non-fiduciaries, or non-fiduciaries with intelligent counsel, will admit that they were aware of the fiduciary's actions, but were unaware that these actions amounted to breaches of fiduciary duties under such a "complicated" statute.

Regardless of the standard of knowledge applied, complications will arise when the non-fiduciaries are corporations. Corporations will often be used to give an impression of legitimacy, to conceal identities, to hide assets, and to elude taxes.³⁹ In *Schmoutey*, for example, all but one of the non-fiduciaries were corporations. While it is difficult to think that legal entities have any type of knowledge, courts in ERISA actions should follow the general rule that "the knowledge of a director, officer, sole shareholder or controlling person of a corporation is imputable to that corporation."⁴⁰ Some courts in non-ERISA cases have not imputed knowledge to a corporation unless the officer or director possessed "substantial" corporate responsibilities.⁴¹ This amorphous standard should be avoided in ERISA actions since legal wrangling over the definition of "substantial" will permit some non-fiduciaries to hide successfully behind the corporate veil.

B. Participation

Once knowledge has been established, what constitutes "participation" in a breach of trust? In *Freund*, for example, the court found that the relatives of the trustees who were personally involved in the relevant negotiations for the sale of the companies, or were represented at the negotiations by their agents, "participated" in the breach.⁴² It would be impossible to list every conceivable way that a non-fiduciary could participate in a breach of trust. This probably explains

38. See HEREIU REPORT, *supra* note 3, at 141-43.

39. See generally *Fraud and Abuse in Pensions and Related Employee Benefit Plans: Hearings Before the House Select Comm. on Aging*, H.R. REP. NO. 324, 97th Cong., 1st Sess. (1981) [hereinafter cited as SELECT COMM. HEARINGS].

40. *Schmoutey*, 592 F. Supp. at 1399 (citations omitted).

41. See, e.g., *Continental Oil Co. v. Bonanza Corp.*, 706 F.2d 1365, 1376 (5th Cir. 1983).

42. *Freund v. Marshall & Isley Bank*, 485 F. Supp. 629, 642 (W.D. Wis. 1979). The court stated that the agent's "conduct and knowledge is to be attributed to their principals." *Id.*

why the court in *Freund* defined participation as broadly as any "act or omission that furthers or completes the breach of trust."⁴³

The easiest case for finding participation is when the non-fiduciary personally interacts with a fiduciary who breaches his position of trust. Some have argued that this should be a prerequisite for non-fiduciary liability under ERISA because the common law cases speak of knowing participation *with* a trustee in a breach of trust.⁴⁴ Restrictive interpretations of this type are precisely those that must be avoided in ERISA actions. If non-fiduciaries know they can escape liability by never directly dealing with perfidious fiduciaries, they will do just that. They may still be active in the breach of fiduciary duties, however, but only through their dealings with other non-fiduciaries. Common sense suggests that non-fiduciaries should not escape liability for having the good sense to use an intermediary, nor should less cautious non-fiduciaries reap a windfall when they have the good fortune never to meet a fiduciary.

The more difficult case is when non-fiduciaries do nothing more than receive plan assets with knowledge of its illicit source. Is receiving tainted assets an act or omission that furthers or completes the breach of trust? Arguably, the non-fiduciaries have a duty to inform the plan's participants and beneficiaries of the breach when they are offered the assets. If they fail to notify them, one could say that there is an omission which furthers the breach. While this omission might "be reprehensible under the highest standard of ethics,"⁴⁵ no such duty probably exists under American law. Moreover, the imposition of a duty of notification could transform the non-fiduciaries into *de facto* fiduciaries.⁴⁶

While these "recipients with knowledge" may not have a duty of notification, their actions make it more difficult to

43. *Id.* at 642 (quoting G. BOGERT, *supra* note 17, at § 901).

44. See, e.g., Defendant's Notice of Motion to Dismiss at 7-8, 11, Brock v. Gerace, No. 85-3669 (D.N.J. filed July 25, 1985).

45. G. BOGERT, *supra* note 17, at § 901.

46. See *Freund*, 485 F. Supp. at 641.

trace plan assets once they have been misappropriated.⁴⁷ In this sense, receiving plan assets is an act which furthers the breach, if not completes it. These recipients with knowledge are culpable parties and should not be beyond the reach of the courts. If the first recipient with knowledge passes the assets on to another recipient with knowledge, and so on, the result should be the same: they all should be held liable to the plan. A more restrictive theory, under which liability is only imposed on persons who help *cause* a breach of trust, would result in inconsistent treatment. Non-fiduciaries who helped cause a breach of trust would be held liable, while their transferees would not.

The common law has always looked unfavorably on recipients with knowledge. The general rule is as follows:

If the transferee has notice of the existence of a trust and of the terms of the trust, and after using due diligence to ascertain whether the transfer is in breach of trust reasonably believes that the facts are such that the transfer is not in breach of trust, he takes free of the trust If, however, the [transferee] knows or should know that the trustee is abusing his discretion and therefore is committing a breach of trust . . . he takes subject to the trust.⁴⁸

In *Leake v. Watson*,⁴⁹ for example, investment brokers invested the assets of a trust that were improperly conveyed to them by a trustee. The brokers, and their transferees who took possession of the assets with knowledge of the trustee's breach, were held liable to the trust: "So long as trust prop-

47. Trust assets may be commingled with other funds or converted into other assets. The problems with tracing and identifying trust assets are beyond the scope of this article. See generally G. BOGERT, *supra* note 17, at §§ 866, 868, 901, 921-30.

48. RESTATEMENT (SECOND) OF TRUSTS § 297 comment 1 (1959). See also *United States v. Dunn*, 268 U.S. 121, 132 (1925) ("[T]he beneficiary of a trust may . . . follow the trust *res* fraudulently diverted until it reaches the hands of an innocent purchaser for value.") (emphasis in original); *In re Van Meter*, 135 F. Supp. 781, 785-86 (W.D. Ark. 1955).

A non-fiduciary who receives plan assets but neither participates in nor has knowledge of a breach of trust should, in most cases, be permitted to retain the assets. An exception should be made when the non-fiduciary is a donee who did not give any consideration for the assets. This will not leave the plan remediless, however, since plaintiffs can still pursue the fiduciaries and non-fiduciaries who participated in the breach.

49. 58 Conn. 332, 20 A. 343 (1890).

erty improperly sold can be traced and identified, the holder taking it with knowledge, it remains trust property."⁵⁰

Even if a court were convinced that common law principles require that non-fiduciaries must personally participate with the trustee or help cause the breach of trust to occur in order to be found liable, a court is free to ignore these principles in deciding who is liable under ERISA. The "knowing participation" rationale is simply a starting point. Courts have been given broad authority to decide questions of liability in the way they see best, and it should be exercised with "the special nature and purpose of employee benefit plans"⁵¹ borne in mind. Courts should not allow the formal requirements of any common law theory to place them in judicial straitjackets, to the detriment of plan participants and beneficiaries.

C. Remedies

Once liability is established, courts should fashion a remedy with two goals in mind. The benefit plan should be made whole, and future transgressions should be deterred. At a minimum, each fiduciary and non-fiduciary who receives plan assets as the result of a breach of trust ought to be required to restore to the plan all of their illicit profits.⁵² This is consistent with the common law rule that trustees and non-fiducia-

50. *Id.*

51. H.R. REP. NO. 1280, 93d Cong., 2d Sess. 302, reprinted in 1974 U.S. CODE CONG. & AD. NEWS 4639, 5038, 5083. See, e.g., *Morse v. Stanley*, 732 F.2d 1139, 1143 (2d Cir. 1984); *Donovan v. Cunningham*, 716 F.2d 1455, 1464 (5th Cir. 1983).

52. This article focuses on monetary remedies. It should be emphasized, however, that ERISA empowers courts to remove fiduciaries, issue injunctions, place plans in receivership, and seek other appropriate equitable relief. See 29 U.S.C.A. § 1109 (West 1985). If non-fiduciaries are involved in breaches of fiduciary duties, courts should prohibit them from having any dealings with plan assets, trustees or other fiduciaries. The court in *Schmoutey*, which permanently enjoined Shenker and his companies from using or borrowing plan assets, is the only court to impose a non-monetary remedy on non-fiduciaries who were involved in breaches of fiduciary duties. *Donovan v. Schmoutey*, 1361 F. Supp. 1361, 1405 (D. Nev. 1984).

Short of placing plans in receivership, courts might appoint trustees to participate in the management of a plan with the trustees already in place. The court-appointed trustees should have the same rights as ordinary trustees to gain access to plan documents and files, to participate in discussions and meetings and to vote on plan business. While it will be possible for the trustees already there to conceal matters from court-appointed trustees and to outvote them, their presence should serve as a deterrent of some corrupt activities. Other equitable remedies are beyond the scope of this article.

ries should "disgorge their ill-gotten gains."⁵³ A problem with this remedy is that some fiduciaries and non-fiduciaries may be judgment-proof, outside of a court's jurisdiction or deceased, and therefore, some of the trust assets will not be recoverable. Moreover, even if everyone is able to restore to the plan the assets they received, little deterrence will be achieved. Defendants will face an attractive "heads I win, tails I break even" situation.

Thus most courts applying the "knowing participation" rationale in ERISA cases have imposed joint and several liability on both fiduciaries and non-fiduciaries. If one person cannot restore what they took, then others are forced to shoulder an extra burden. There is an increased chance of making the plan whole, and deterrence is greatly enhanced. But even if joint and several liability is imposed, some parties will break even. In order to insure that defendants will not be tempted to flip the aforementioned coin again, courts should impose additional penalties pursuant to their authority under Section 502(a) of ERISA.

Should exceptions be made for non-fiduciaries who do *not* profit from their participation in a breach of trust? Although these non-fiduciaries may be less culpable than those who profit from the breach, their primary wrong is participation in the breach. Non-fiduciaries may not have profited because of a bad scheme or greedy accomplices. Some may have profited, but will succeed in concealing their ill-gotten gains. Moreover, it would be ridiculous for non-fiduciaries who make no profits to elude sanctions, while those who make a single dollar face joint and several liability.

Non-fiduciaries at common law faced joint and several liability regardless of whether profits were made.⁵⁴ In *Duckett v. National Mechanic's Bank of Baltimore*,⁵⁵ for example, a

53. *Hunter v. Shell Oil*, 198 F.2d 485, 489 (5th Cir. 1952). See also *Crites v. Prudential Ins. Co.*, 322 U.S. 408, 414 (1944) ("[T]he profits of others who knowingly joined him in pursuing an illegal course of action . . . would have to be disgorged and applied to the estate.") (citations omitted).

54. G. BOGERT, *supra* note 17, at §§ 868, 901. See also *Olin Cemetary Ass'n v. Citizen's Sav. Bank*, 222 Iowa 1053, 1061-62, 270 N.W. 455, 459-60 (1937). Non-fiduciaries must also remit to the trust any profits made on the assets which were misappropriated. *Jackson v. Smith*, 254 U.S. 586 (1921).

55. 86 Md. 400, 409-10, 38 A. 983, 986 (1897).

trustee embezzled trust funds that were improperly credited to his personal account by a bank that maintained his personal account, but not the trust account. As to the relative culpability of the bank and trustee, the court stated:

There can be no doubt that as a general principle, all persons who knowingly participate or aid in committing a breach of trust are responsible for the money . . . they have been instrumental in diverting. . . . There is in such instances no primary or secondary liability as respects the parties . . . participating in . . . the breach of trust, because all are equally amenable.⁵⁶

The court found that the bank "deliberately participated" in the trustee's breach⁵⁷ and held it jointly and severally liable with the trustee, even though it reaped no gain from the breach of trust.⁵⁸

While courts in ERISA actions must not hesitate in imposing joint and several liability on all non-fiduciaries who participate in a breach of trust, they should be careful to insure that they are not holding some non-fiduciaries liable for breaches of trust unrelated to those in which they participated.⁵⁹

D. Attorneys Representing Employee Benefit Plans: A Special Class of Non-Fiduciaries

In *Donovan v. Daugherty*,⁶⁰ the court held that the trustees of a benefit plan violated ERISA by improperly extending benefits to themselves and the plan's general counsel at a rate

56. *Id.* at 403, 38 A. at 984.

57. *Id.* at 410, 38 A. at 986.

58. *Id.* at 412, 38 A. at 987.

59. The court in *Freund*, for example, held all of the defendants jointly and severally liable for \$465,000, the amount the companies owed to the plan. The problem is that the court had not held the non-fiduciaries liable for participating in the improper loans to the companies. *Freund v. Marshall & Isley Bank*, 485 F. Supp. 629, 644 (W.D. Wis. 1979).

The court may have thought that the breach of fiduciary duties that the non-fiduciary did in fact participate in, namely not providing for the plan's financial well-being after sales of the companies, was inextricably related to the loans. Therefore, it may have been too difficult to separate how much the plan lost on account of loans from how much it lost as a result of the sale. This conclusion, however, ignores the fact that the loans were made prior to the sale of the companies and may not have been paid off even if the sales had not been consummated.

60. 550 F. Supp. 390 (S.D. Ala. 1982).

more favorable than that given to the participants.⁶¹ The court also held that the general counsel, a non-fiduciary, participated in this breach of trust since he advised the fiduciaries that the extension of coverage to them, and to himself, was legal under ERISA.⁶² Even though the court stated that the general counsel "knowingly participated" in the decision to extend benefits, it did not say whether he had actual or constructive knowledge of the breach of trust. Did the court imply, therefore, that plan attorneys should be held liable whenever their advice is incorrect and there is a breach of trust?

If courts assume that plan attorneys have constructive knowledge of a breach of trust whenever their advice is incorrect, the constructive knowledge standard would be nothing more than a rule of strict liability. Few attorneys would welcome the opportunity to act as insurance policies for benefit plans that are unable to recover from breaching fiduciaries. The court in *Daugherty* would probably not have supported a strict liability rule. It held at an earlier point in its opinion that the general counsel should not be faulted for his incorrect interpretation of an another provision of ERISA: "A lawyer he is, but a sorcerer he is not."⁶³ Nevertheless, the court did not reveal how it arrived at its conclusion that the general counsel had knowledge of the breach.

Given that constructive knowledge should be established, to what level of expertise should plan attorneys be held in deciding whether they "should have known" of a breach of fiduciary duties? Since benefit plans often engage in highly complex transactions involving the earnings and savings of thousands of workers, courts should hold plan attorneys to the level of expertise exhibited by attorneys who are members of the section of the bar that specializes in ERISA work. If courts only require that plan attorneys exercise the legal and financial skills of the average lawyer, or the average layperson for that matter, benefit plans will not be adequately protected from mismanagement and incompetence. A higher standard

61. *Id.* at 409.

62. *Id.* at 411.

63. *Id.* at 409. See also *Donovan v. Unicorn Group*, 3 EMPL. BEN. CAS. (P-H) 1665, 1667 (S.D.N.Y. 1982).

of care would come as no surprise since lawyers are aware of the traditional emphasis placed on protecting the interests of trust beneficiaries.

Plan attorneys should face an additional responsibility not placed on other non-fiduciaries. As discussed above, laypersons probably have no duty to report a breach of trust when they have knowledge of its commission. But a different standard should apply when the non-fiduciary is an attorney representing a benefit plan. Even without participating in any way in the breach of trust, if the attorney has knowledge of its commission there is a duty, as a member of the bar, and more important, as the paid representative of the participants and beneficiaries, to report the breach to the Secretary, to the participants and to the beneficiaries. It is not enough that the attorney keeps silent or withdraws as plan counsel.

III. CONSPIRACY

A few courts have relied on a conspiracy theory of non-fiduciary liability in ERISA actions. Unfortunately, these courts do not explain why they use it or how it would best protect the interests of benefit plan participants and beneficiaries. The courts do not say whether the common law elements of a civil conspiracy must be proven in order to establish liability, nor do they explain their oblique references to the "knowing participation" theory of liability.

Thornton v. Evans,⁶⁴ for example, involved the Teamsters' Central States, Southeast and Southwest Areas Health and Welfare Fund, and individuals linked to organized crime. Through a "complex web of dubious financial arrangements,"⁶⁵ \$1.1 million of life insurance premiums which the plan paid to its insurer, Old Security Life Insurance Company ("Old Security") was illegally channelled through two companies to Joseph Hauser, the driving force behind the scheme.⁶⁶ The Seventh Circuit held that the district court had improperly dismissed complaints that charged Hauser, his associates, and lawyers representing the companies with conspiring with a plan fiduciary to falsely represent that the money had been

64. 692 F.2d 1064 (7th Cir. 1982).

65. *Id.* at 1066.

66. *Id.* at 1066-71.

returned.⁶⁷ After recognizing that Congress did not explicitly address the issue of non-fiduciary liability, the court stated that liability for persons “who conspire with fiduciaries . . . is a necessary development of the law ERISA,” and that it was empowered to “develop substantive legal principles that accommodate the statute.”⁶⁸

Unfortunately, the court had little to say about the “substantive legal principles” it believed it was developing.⁶⁹ To guide the district court to which the case was remanded, it remarked with some circularity that non-fiduciaries have a “duty . . . to refrain from conspiracy to facilitate actions by . . . fiduciaries constituting fraud on the [plan].”⁷⁰ To add to the confusion, the court referred to “knowing participation” and the “relief available in traditional trust law.”⁷¹

The court’s repeated use of the word “conspiracy” when referring to non-fiduciary liability suggests that it did not use the word carelessly. But this is difficult to say with certainty since the court neglected to say anything about how to establish a conspiracy in the context of benefit plans.⁷² This section explores how the conspiracy doctrine might be used in ERISA actions and concludes that it is ill-suited for such actions because it permits many culpable non-fiduciaries to avoid liability.

67. *Id.* at 1083.

68. *Id.* at 1079 (citations omitted).

69. The court did, however, elaborate on the procedural requirements of a derivative suit against non-fiduciaries. *Id.* at 1077-83.

70. *Id.* at 1082 n.42.

71. *Id.* at 1078.

72. The Seventh Circuit had another opportunity to articulate the requirements of its conspiracy theory of non-fiduciary liability in *Fremont v. McGraw-Edison Co.*, 606 F.2d 752 (7th Cir. 1979), where former employees of the defendant-company sued to recover benefits allegedly owed to them under the company’s benefit plan. One plaintiff had been a plan trustee, and the other had been a non-fiduciary employee of the company. *Id.* at 753-54. The company counterclaimed alleging that the plaintiffs should be denied benefits because they had stolen property and trade secrets from the company. *Id.* at 758. The court stated that “in an ordinary action against a trustee, others who have aided him, or conspired with him, in a breach of fiduciary duty may . . . be [held] liable.” *Id.* at 759 (citing RESTATEMENT (SECOND) OF TRUSTS § 256 (1959)). It held, however, that this was not an ordinary action since the employee had “legislatively granted rights” to receive his benefits. *Fremont*, 606 F.2d at 759. This probably explains why the court had nothing else to say about its conspiracy theory of liability.

A. *The Agreement and Fiduciary Conspirators*

The court in *Thornton* did require that plaintiffs prove one thing at trial: “[a] necessary element of plaintiffs’ claims against the non-fiduciary defendants is that they conspired with fiduciaries (who need not be defendants in this action), and if this element is lacking, the court is without ERISA jurisdiction over these defendants.”⁷³ At first glance, this appears to be consistent with the “knowing participation” cases, where liability is predicated on involvement in a fiduciary’s breach of trust. However, when the elements of a conspiracy are examined, it turns out that this requirement is inconsistent with these cases and unnecessarily limits a court’s ability to seek relief from non-fiduciaries.

The elements of a civil conspiracy are “two or more persons, an object to be accomplished, a meeting of the minds on the object of the course of action, one or more unlawful acts, and damages proximately resulting therefrom.”⁷⁴ A “meeting of the minds” has been defined as “an agreement or understanding between two or more persons to inflict a wrong or injury upon another.”⁷⁵ There is no requirement that the agreement be manifested in words or in writing.⁷⁶ Instead, it is “sufficient that the minds of the parties meet understandingly” on the action to be taken.⁷⁷ Given such a broad interpretation, it will often be easy to establish that a fiduciary and non-fiduciary had an agreement to commit a breach of trust. On the other hand, there will be times when it will be impossible to say that there was any agreement at all, and under the rule announced in *Thornton*, a court would not be able to seek relief from the non-fiduciary.

For example, assume that an incompetent yet honest benefit plan fiduciary violated fiduciary duties under ERISA by failing to check the financial background of a non-fiduciary who borrowed money from the plan. Also, assume that the

73. 692 F.2d at 1078 n.34.

74. 15A C.J.S. *Conspiracy* § 1(2) (1967).

75. *Reid v. Brechet*, 117 Neb. 411, 415, 220 N.W. 590, 591, *reh’g denied*, 117 Neb. 418, 221 N.W. 17 (1928).

76. 15A C.J.S. *Conspiracy* §§ 2, 17 (1967). *See also* 16 AM. JUR. 2D *Conspiracy* § 50 (1979).

77. 15A C.J.S. *Conspiracy* §§ 2, 17 (1967). *See also* 16 AM. JUR. 2D *Conspiracy* § 50 (1979).

non-fiduciary knew that the loan would not have been received if even the most cursory review of its financial history had been undertaken. Under *Thorton*, the non-fiduciary would escape liability since there would be no evidence of any agreement between the fiduciary and the non-fiduciary.

The Seventh Circuit inadvertently stumbled upon a significant weakness with a conspiracy approach to ERISA non-fiduciary liability. There are two broad categories into which all breaches of trust fall. In the first are breaches where the fiduciary is corrupt and intentionally violates statutory duties. In the other category, the fiduciary is incompetent or lazy and is not aware of the statutory violation. If a non-fiduciary knowingly participates in the first type of breach, an agreement will often, but not always, be found. But if a non-fiduciary participates in the latter type of breach, no agreement will be found. This distinction may be important in conspiracy actions, but is irrelevant under ERISA, where the emphasis is on the breach of trust, not the agreement. In both categories of cases, the non-fiduciary is involved in a breach of trust, and would be held liable under the "knowing participation" rationale.

It should be emphasized that an agreement will not always be found whenever the fiduciary is corrupt. For example, a corrupt fiduciary may breach fiduciary duties by secretly transferring plan assets into a non-fiduciary's bank account. The fiduciary may believe that the non-fiduciary is unaware of the breach of trust, when in fact, the non-fiduciary is fully cognizant of it. It would be difficult to argue that there was an agreement between the two parties. Yet, the non-fiduciary in this example is the "recipient with knowledge" encountered in Section II, whose liability should not turn on whether or not there was an agreement.⁷⁸

A more interesting situation is when there is an agreement, but no breach of fiduciary duties. Assume that in the first example, there was not one but two non-fiduciaries who received a loan from the plan. Also assume that the fiduciary fulfilled its obligations under ERISA by making an extensive check of their financial backgrounds, but the non-fiduciaries falsified their records in order to appear to be good lending risks.

78. See *supra* notes 45-50 and accompanying text.

While there was a meeting of the minds between the non-fiduciaries, there was none with the fiduciary. Since the non-fiduciaries are culpable parties, however, it would be tempting to hold them liable under ERISA in order to protect the interests of plan participants and beneficiaries.

The problem is that courts have no authority over non-fiduciaries independent of the authority granted to them in Section 502(a) of ERISA, which only applies when there is a violation of the statute. In the example directly above, there is no violation of the statute by the fiduciary, or anyone else for that matter. If the non-fiduciaries were held liable, there would be no limit on the courts' ability to seek relief from non-fiduciaries whenever a benefit plan had been wronged. Section 502(a) is a vehicle through which courts can derive a great deal of power when proceeding against non-fiduciaries, but that power is nonexistent if there is no underlying fiduciary breach.

This view is consistent with the "knowing participation" cases where, by definition, there must be participation in a *fiduciary's* breach. Plaintiffs would not be remediless, however, when there is no breach of trust. They could seek relief under several common law theories, including fraud, theft, conversion, and of course, conspiracy. Unfortunately, these common law theories, and the statutes that codify them, may present substantive and procedural obstacles that will be difficult to overcome. ERISA was designed in large part to overcome these obstacles, but only insofar as they relate to fiduciaries.⁷⁹ Given the considerable problems that courts have had in interpreting fiduciary obligations under ERISA, it is unlikely that Congress could take on the formidable task of formulating independent duties for non-fiduciaries.

B. The Agreement and the Knowledge Requirement

In a conspiratorial agreement, the parties involved must have the "wrongful intent" to commit an unlawful act.⁸⁰ In-

79. See, e.g., *Van Orman v. American Ins. Co.*, 680 F.2d 301, 311 (3d Cir. 1982); *Dependahl v. Falstaff Brewing Co.*, 653 F.2d 1208, 1214-15 (8th Cir.), cert. denied, 454 U.S. 968 (1981).

80. 15A C.J.S. *Conspiracy* §§ 2, 17 (1967). See also 16 AM. JUR. 2D *Conspiracy* § 50 (1979).

tent suggests actual knowledge, but actual knowledge of what? If it refers to the breach of trust, courts that strictly apply a conspiracy rationale in ERISA cases will deal many plaintiffs a fatal blow. As discussed above, it will often be difficult to prove that intelligent, well-organized non-fiduciaries had actual knowledge of a breach of trust.

Plaintiffs will be able to avoid this insuperable burden if courts carefully apply the conspiracy doctrine. There can be a civil conspiracy to commit almost any unlawful act.⁸¹ Some unlawful acts, like breaches of trust, have a knowledge requirement, while other unlawful acts, like misbranding drugs, are strict liability offenses. The knowledge requirement, if any, of these unlawful acts does not change simply because it is part of a conspiracy action. Conversely, the actual knowledge requirement in conspiracy cases applies to the *agreement*, not to the unlawful act, which retains its own standards of proof. The risk in ERISA actions is that courts applying the conspiracy rationale will blur this distinction and apply an actual knowledge standard to both the agreement and the details of an unlawful act.

In *Blankenship v. Boyle*,⁸² a case decided prior to the enactment of ERISA, the court properly maintained this distinction. The trustees of a benefit plan violated their common law fiduciary duties by permitting the plan's assets to remain uninvested in non-interest bearing checking accounts of a bank which was owned and controlled by a union whose members were covered by the plan.⁸³ The plaintiffs alleged that the union, the bank, and the bank's former president conspired with the trustees in their breach of fiduciary duties.

Before deciding that these non-fiduciaries could be held liable, the court stated: "[T]he civil wrong alleged to have been done pursuant to the agreement . . . is a breach of trust; and it is settled that where a third person 'has knowingly assisted the trustee in committing a breach of trust, he is liable for participation in the breach of trust.'"⁸⁴ The court later stated that actual or constructive knowledge would satisfy the "know-

81. See 15A C.J.S. *Conspiracy* § 20 (1967).

82. 329 F. Supp. 1089 (D.D.C. 1971).

83. *Id.* at 1095-99.

84. *Id.* at 1099 (quoting 4 SCOTT ON TRUSTS § 326 (3d ed. 1967)).

ingly assisted" standard.⁸⁵ Thus, after finding an "agreement," the court was willing to hold the non-fiduciaries liable if they only had constructive knowledge of the who-what-and-where of the breach. This may explain why the court in *Thornton* quoted common law trust language after emphasizing that the plaintiffs would have to prove there was a conspiracy.

C. *Withdrawal and the Late Joiner*

Conspiracy doctrine provides at least two ways to expand the potential liability of non-fiduciaries *after* it has been shown that they agreed to be involved in a breach of trust. There is the presumption that a conspiracy continues once an agreement has been consummated, and to escape liability "a party must affirmatively withdraw from the conspiracy and seek to avoid its effects."⁸⁶ The withdrawal must be complete and voluntary, and must bring "home the fact of [the] withdrawal to [the] confederates."⁸⁷ The converse situation involves the late joiner.⁸⁸ Conspiracy doctrine states that "[p]ersons having knowledge of a conspiracy who enter into it after its inception . . . are liable for all acts previously . . . done in pursuance thereof."⁸⁹ In other words, a person joining a conspiracy "takes [it] as he finds it."⁹⁰

As tempting as the withdrawal and late joiner rules might be, for their deterrent value if nothing else, they should not be applied in ERISA actions if non-fiduciaries would be held liable for breaches of trust in which they did not participate. The crux of a case brought against non-fiduciaries under ERISA is the breach of fiduciary duties; the existence of an agreement is irrelevant. If a non-fiduciary agrees to become

85. 329 F. Supp. at 1103 (citations omitted).

86. *Id.* at 1101 (citing *Hyde v. United States*, 225 U.S. 347, 369 (1912); *South-East Coal Co. v. Consolidation Coal Co.*, 434 F.2d 767, 784 (6th Cir. 1970), *cert. denied*, 402 U.S. 983 (1971)).

87. *Tabb v. Norred*, 27 So. 2d 223, 229 (La. Ct. App.), *cert. denied*, 279 So. 2d 694 (La. 1973).

88. *Chemetron Co. v. Business Funds, Inc.*, 682 F.2d 1149, 1180, *reh'g denied*, 689 F.2d 190 (5th Cir. 1982), *vacated on other grounds*, 460 U.S. 1007, *cert. denied*, 460 U.S. 1013 (1983).

89. 15A C.J.S. *Conspiracy* § 19 (1967).

90. *Myzel v. Fields*, 386 F.2d 718, 738 n.12 (8th Cir. 1967), *cert. denied*, 390 U.S. 951 (1968).

involved in a breach of trust, but retreats from that position before the breach occurs, the non-fiduciary is outside the purview of ERISA unless it can be shown that even before withdrawing, the non-fiduciary somehow facilitated the breach. The same is true in the converse situation, where the breach may occur before the non-fiduciary meets the parties involved, or even knows which plan was bilked. This is not to say that the non-fiduciary should escape all sanctions, but the sanctions should come from the law of conspiracy, where the agreement is key. Even though a purpose of this article is to encourage courts to look to common law principles which best serve the participants and beneficiaries, it must be done with the limitations of ERISA borne in mind.

D. Remedies

The parties to a common law conspiracy are usually held jointly and severally liable for all damages resulting from the conspiracy,⁹¹ the result reached in most "knowing participation" cases. In *Fremont v. McGraw-Edison Co.*,⁹² however, the court indicated that it might be appropriate to limit the remedy "to the extent that [the non-fiduciary] profited from the breach."⁹³ Similarly, the court in *Donovan v. Bryans*,⁹⁴ another ERISA action, simply ordered the non-fiduciary to "make restitution to the Plan for the benefit received."⁹⁵ Neither court offered any reasons why joint and several liability should not be imposed.

If courts hope to deter future involvement in breaches of trust, and increase the likelihood that plans will be made whole, restitution alone is a poor choice. In fact, the court in *Bryans* indicated that it might settle for even less. It explained that it was seeking restitution from the non-fiduciary since the "fiduciary violations . . . could not have occurred but for his assistance."⁹⁶ This suggests that in future cases the court

91. See AM. JUR. 2D *Conspiracy* § 56 (1979).

92. 606 F.2d 752 (7th Cir. 1979); see *supra* note 72.

93. *Id.* at 759.

94. 566 F. Supp. 1258 (E.D. Pa. 1983).

95. *Id.* at 1267 (citing RESTATEMENT OF RESTITUTION §§ 138(2), 150, 156 (1937)).

96. 566 F. Supp. at 1267. In *Bryans*, two trustees of a benefit plan violated their fiduciary duties under ERISA by loaning plan assets to a non-fiduciary who was their

might not seek relief from a non-fiduciary who was not the "but for" cause of the breach. If this were the general rule, some non-fiduciaries would escape liability.

For the reasons discussed in Section II, joint and several liability should be imposed "whether or not the conspirator profited from the result of the conspiracy," and "regardless of whether [the conspirator] took a prominent or an inconspicuous part in the execution of the conspiracy."⁹⁷ For example in *Old Security Life Insurance Co. v. Continental Illinois National Bank and Trust Company*,⁹⁸ a non-ERISA case involving the same insurance scheme discussed in *Thornton*, the Seventh Circuit held that Old Security conspired with Hauser, and the other defendants in that case, to exploit an "inside connection" that Hauser had with the plan's insurance advisor in order to secure the insurance contract.⁹⁹ Even though Old Security did not make a single dollar from the scheme, and did not know the identity of Hauser's "inside connection," it was held liable for the full \$1.5 million the plan lost.¹⁰⁰

While the court's holding is consistent with common law conspiracy principles, the court relied on a trust principle instead: "[A] party receiv[ing] money as the result of . . . [a] breach of fiduciary duty . . . is imposed with the status of

business associate in another company. *Id.* at 1260-64. In deciding that the non-fiduciary could be held liable under ERISA, the court haphazardly combined conspiracy and "knowing participation" language. The court stated that the non-fiduciary "actively collaborated" with the fiduciaries in the breach of trust. *Id.* at 1267. While collaboration or collusion are words typically associated with a conspiracy, see 15A C.J.S. *Conspiracy* § 1(1), the court avoided any problems that the collaboration/conspiracy approach might pose by stating in the next paragraph that the non-fiduciary "knowingly assisted [the fiduciaries] in violating their trust," and that "the path toward relief is . . . guided by the law of trusts." *Bryans*, 566 F. Supp. at 1267.

The fiduciaries were held liable for the loan to the non-fiduciary. *Id.* at 1269. However, the court stated that to the extent the fiduciaries were "called upon to satisfy what primarily is [the non-fiduciary's] obligation to the Plan, [the fiduciaries] will be subrogated to the rights of the Plan to proceed against [the non-fiduciaries]." *Id.* at 1267-68. Since the trustees, and not the non-fiduciary, owed the "primary" obligation to the Plan, this right of subrogation was undeserved.

97. 16 AM. JUR. 2D *Conspiracy* § 56 (1979); see also *Blankenship*, 337 F. Supp. at 303 ("It is . . . [irrelevant] that the impact of any judgment may be far more severe on an individual than it is on an entity such as the Bank or the Union.").

98. 740 F.2d 1384 (7th Cir. 1984).

99. *Id.* at 1396-97.

100. *Id.* at 1390, 1397-98.

trustee *ex maleficio*, and holds the property in constructive trust for the benefit of the beneficiary."¹⁰¹ Not only does the court rely on a trust principle, but it relies on the wrong one since Old Security did not have any plan assets on which to impose a constructive trust.¹⁰²

IV. PREPAID BENEFIT PLANS AND ORGANIZED CRIME

The cases above demonstrate that breaches of fiduciary duties come in many guises, as do the non-fiduciaries who participate in their commission. Non-fiduciaries run the gamut from local business people taking advantage of small benefit plans in their community to professional criminals bilking the benefit plans of the largest unions in the country. This section examines whether the "knowing participation" rationale, which provides a more coherent framework in which to decide questions of non-fiduciary liability than conspiracy doctrine, may be useful in reducing the abuses of prepaid benefit plans by the latter group of non-fiduciaries.¹⁰³ While organized crime's influence over unions and their benefit plans manifests itself in diverse ways, some of which were seen in the *Schmoutey* and *Thornton* cases, prepaid benefit plans are favorite targets.¹⁰⁴

101. *Id.* at 1397.

102. *Id.* at 1390. The common law principles to which the court refers apply when a person is in possession of trust assets. See *United States v. Dunn*, 268 U.S. 684, 691 (1889); 76 AM. JUR. 2D *Trusts* § 256 (1975).

103. See HEREIU REPORT, *supra* note 3, at 9 ("Prepaid [benefit] plans are a magnet for criminal schemes due to their methods of cash receipt and disbursement.").

104. The Permanent Subcommittee on Investigations of the Senate Committee on Governmental Affairs (PSI) held hearings periodically from 1982 to 1984 in order to determine the extent to which organized crime controlled the Hotel Employees & Restaurant Employees International Union (HEREIU). The PSI concurred with the conclusion reached by the Department of Justice in an unreleased 1977 report. "[HEREIU is] completely dominated by men who either have strong ties or are members of the organized crime syndicate. . . . [HEREIU] has been infiltrated from the top . . . [and] represents the classic example of an organized crime take-over of a major union." HEREIU REPORT, *supra* note 3, at 19. The PSI determined that organized crime was responsible for improper loans, increased salaries for HEREIU officials, lifetime employment contracts, increased expenditures for tangible and intangible items, manipulation of local chapters and abuse of prepaid benefit plans. See HEREIU REPORT, *supra* note 3.

The PSI emphasized that it had no reason to believe that these problems were limited to HEREIU. As PSI Chairman William Roth lamented, "[The] three other large international unions — the Teamsters, the Laborers, and the Longshoreman . . . have [also] been riddled with corruption and mismanagement at their highest levels." *Hotel*

A. Magnets for Criminal Schemes

Prepaid benefit plans (PBPs), also known as closed panel capitation plans, are fringe benefit programs agreed upon by labor and management during collective bargaining.¹⁰⁵ PBPs cover five types of benefits for eligible union members: dental, hospital, medical, optical and pharmaceutical.¹⁰⁶ An employer or employer group will pay a fixed amount into a trust fund to cover the cost of the PBPs.¹⁰⁷ The trust fund trustees will hire a "trust administrator," a fiduciary under ERISA,¹⁰⁸ that will be responsible for organizing all of the PBPs.¹⁰⁹ Since this task is normally too large for one trust administrator, it will subcontract to "plan administrators" to organize the individual PBP's.¹¹⁰ The plan administrators will identify "service providers," to whom the union members must go for their medical care in order to be covered, and will manage the PBP's day-to-day operations.¹¹¹

If a PBP is legitimately run, the trustees will solicit bids from potential trust administrators and make their selection solely on the basis of cost, experience and quality of services. The trust administrator selected will then solicit bids from po-

Employees & Restaurant Employees International Union: Hearings Before the Subcomm. on Investigations of the Senate Comm. on Governmental Affairs, 97th Cong., 2d Sess., pt. 1, at 2 (1982). The HEREIU materials cited in this section, which primarily deal with prepaid dental plans, provide an excellent example of the types of problems which are not limited to this type of organized crime activity or to this union.

105. *HEREIU Hearings*, 98th Cong., 1st Sess., pt. 4, at 407 (1983) (statement of Dennis Cook, Department of Labor).

106. *Id.* at 5. There has been increasing use of PBPs for legal assistance; indeed, almost any service could be provided in the form of a PBP. *Id.* at 13.

107. *HEREIU REPORT*, *supra* note 3, at 103.

108. 29 U.S.C.A. §§ 1002(14)(A), 1002(16)(A) (West 1985).

109. *HEREIU REPORT*, *supra* note 3, at 103. Since administrators, service providers, and support suppliers are often corporations, each will be referred to as "it" rather than "he" or "she."

110. *HEREIU Hearings*, 98th Cong., 1st Sess., pt. 4, at 7 (1983) (statement of Dennis Cook, Department of Labor). Arguably, plan administrators are also fiduciaries under ERISA. See *supra* note 7 and accompanying text. For purposes of this article however, it will be assumed that plan administrators are non-fiduciaries.

111. *HEREIU REPORT*, *supra* note 3, at 103. PBPs should be distinguished from open panel plans which are typically associated with health insurance companies like Blue Cross-Blue Shield. Under open plans, the employer or employer group will pay the premiums, participants visit the service provider of their choice, and bills are paid by the insurance company, subject to deductibles and exemptions. *Id.*

tential plan administrators,¹¹² who in turn, will solicit bids from potential service providers.¹¹³ Unlike the trust and plan administrators, whose fees will be a percentage of the total employer contributions to the trust fund,¹¹⁴ the service provider selected will receive a fixed per capita fee which is multiplied each month by the number of eligible union members.¹¹⁵ The service provider's profits, therefore, will depend upon the number of people that use its services and the type of work performed.¹¹⁶

Ideally, a competitive bidding process will produce a PBP that provides quality care at the lowest possible price. Unfortunately, the entire process is often rigged to provide organized crime with the highest possible profits for the least possible work.¹¹⁷ It first exerts its influence when the trustees contract with the trust administrator — the “critical step in a fraudulent plan.”¹¹⁸ Organized crime figures may serve as trustees, but more often they will control those who do¹¹⁹ by resorting to unsavory tactics in order to dominate the selection process.¹²⁰ As a result, there either is “non-competitive bidding or competitive bidding which is inherently suspect,”¹²¹ and organized crime will have the trust administrator of its choice.

Since it controls the selection of the trust administrator, organized crime will also control the selection of the plan administrator. The plan administrator will be required to kick-back a large portion of its fees in return for being selected by

112. *HEREIU Hearings*, 98th Cong., 1st Sess., pt. 4, at 7 (1983) (statement of Dennis Cook).

113. See *HEREIU REPORT*, *supra* note 3, at 103-07.

114. *HEREIU Hearings*, 98th Cong., 1st Sess., pt. 4, at 7 (1983) (statement of Dennis Cook).

115. *HEREIU REPORT*, *supra* note 3, at 103 n.334.

116. *Id.* at 103-04. If a PBP is legitimately run, there usually will be a “maximum cap” on the profits that service providers can make. Profits exceeding the “cap” have to be returned to the trust fund. *Id.* at 104.

117. *Id.* at 105-07.

118. See *HEREIU Hearings*, 98th Cong., 1st Sess., pt. 4, at 8 (1983) (statement of Dennis Cook).

119. See *HEREIU REPORT*, *supra* note 3, at 17-20.

120. See *HEREIU Hearings*, 97th Cong., 2d Sess., pt. 1, at 27 (1982) (statement of James Maher, Federal Bureau of Investigation) (“They will burn your business, blow up your car, blow up your home, threaten your family. They will kill you, and that gives them quite a competitive edge.”).

121. *HEREIU REPORT*, *supra* note 3, at 105-07.

the trust administrator. In order to insure that it can meet this commitment, and still guarantee itself a healthy profit, it will take as its fee an unusually high percentage of the total employer contributions for the PBP.¹²² The trust administrator will also charge a high percentage, but as its reward for "overseeing" the plan's PBPs in a way that allows organized crime to reap its profits, it usually will not have to make any kickbacks.¹²³ Moreover, since trust administrators have fiduciary obligations, their actions will be subject to greater scrutiny than plan administrators.

In order to conceal its kickbacks to organized crime, the plan administrator's payments will often be made through "support suppliers," companies controlled by organized crime which supposedly provide the plan administrator with secretarial services, computer assistance, office space and equipment, marketing and consulting assistance, complaint resolution services, etc. These companies are often nothing more than conduits to organized crime, and provide little in the way of actual services.¹²⁴

The pilfering does not end there, however. The service provider, who normally is not as closely associated with organized crime as the administrators, will find that in order to secure the PBP contract it must hire certain support suppliers.¹²⁵ Not coincidentally, they are often the same ones that work for the plan administrator.¹²⁶ The service provider is willing to hire them when it discovers that this is the only way it can be selected and that it will receive a high per capita fee that more than compensates it for any unnecessary expenses.¹²⁷

In PBPs that are legitimately run, the total administrative costs, which include the administrators' fees and the amounts paid to service providers and support suppliers, are limited to

122. *HEREIU Hearings*, 98th Cong., 1st Sess., pt. 4, at 8-10 (1983) (statement of Dennis Cook).

123. *See* *HEREIU REPORT*, *supra* note 3, at 107-08.

124. *HEREIU REPORT*, *supra* note 3, at 107-08. It should be emphasized that even corrupt PBPs hire many legitimate support suppliers as well. *See* *HEREIU Hearings*, 98th Cong., 1st Sess., pt. 4, at 7, 13 (1983) (statement of Dennis Cook).

125. *See, e.g.*, *HEREIU REPORT*, *supra* note 3, at 118-19.

126. *See, e.g., id.* at 112-21.

127. *See, e.g., id.* at 119.

ten to fifteen percent of the employer contributions.¹²⁸ The administrative costs for corrupt PBPs are considerably higher. For example, in one nine-month period, the administrative costs for HEREIU Local 54's Dental Plan in Atlantic City, New Jersey, were approximately forty percent of the \$1.15 million contributed by the employers that period for the dental plan.¹²⁹

B. Problems in Establishing Non-Fiduciary Liability

The primary reason that no federal court has addressed this problem is that corrupt schemes involving non-fiduciaries are very complex, and therefore, difficult to identify. "You need very special kinds of investigators for this kind of crime. You need people who understand the actuarial tables, audit procedures, [and] have [a] background in criminal law. The average investigator is going to look at these records all day long and not perceive what is going on."¹³⁰ This is not surprising given the considerable skills possessed by organized crime figures, and the lawyers, accountants and other consultants that they hire to assist them.¹³¹

Organized crime figures will attempt to make their schemes appear respectable, so as not to attract the attention of state or federal authorities. One way to do this is to provide union members with quality services. The problem is that the union members are paying Rolls-Royce prices for Cadillac services.¹³² It was stated above that kickbacks would be channelled through support suppliers to organized crime. The money will usually take a more circuitous route, travelling through several entities, and often ending up not in the hands of organized crime figures, but in the hands of their relatives,

128. *Id.* at 104.

129. *Id.* at 112, 114, 120.

130. *HEREIU Hearings*, 98th Cong., 1st Sess., pt. 4, at 14 (1983) (Statement of Senator Warren Rudman).

131. *HEREIU Hearings*, 98th Cong., 1st Sess., pt. 4, at 8 (1983) (statement of Dennis Cook) ("These people are extremely imaginative, innovative, intelligent; they hire extremely qualified people in the field to use their brain[s], . . . experience . . . [and] . . . knowledge to find new and exciting ways to take money out of these plans.").

132. See *HEREIU REPORT*, *supra* note 3, at 105-10; *HEREIU Hearings*, 98th Cong., 1st Sess., pt. 4, at 12 (1983) (statement of Dennis Cook). While management actually pays for the PBP, if it is overpriced due to the influence of organized crime, there is less money available for wages and other fringe benefit programs.

friends or companies that they secretly control. In order to legitimize the transfers from one entity to the next, the plan assets may be called dividends, donations, or salaries, and at the same time, they may be commingled with other funds so they become harder to trace.¹³³

While the most difficult problem is simply identifying which PBPs have been corrupted, once this is accomplished, it should be relatively easy to establish that the trustees and the trust administrator failed to satisfy their fiduciary obligations when they permitted enormous sums of money to be raked off the top in the form of administrative costs.¹³⁴ If these fiduciaries breached their statutory duties, it should also be possible to find the non-fiduciaries, namely the plan administrator, the service provider and the support suppliers, liable under ERISA for their knowing participation in these breaches of trust.

The paper record will probably contain little more than a few contracts, some facially innocuous communications, cancelled checks, and the service provider's files on the individual union members. There will not be written evidence establishing actual knowledge of the breaches of trust, nor should one expect organized crime figures to admit to any wrongdoing during depositions or at trial, and many are apt to assert their fifth amendment rights. Non-fiduciaries, such as service providers who are not members of criminal syndicates, will not be likely to make any admissions either, since it usually is not in one's best interests to "tattle" on organized crime.¹³⁵ As discussed above, however, courts should require only that plaintiffs establish that non-fiduciaries had constructive knowledge of the breaches of fiduciary duties.

In most cases, there will be a marked difference between the rates charged by corrupt non-fiduciaries, and those charged by legitimate non-fiduciaries in the average PBP. Courts should charge plan administrators with the knowledge that the *total* administrative costs of the average PBPs is fifteen percent or less. If the plan administrator helped itself to

133. See, e.g., *HEREIU Hearings*, 98th Cong., 1st Sess., pt. 4, at 169-70 (1983) (statement of Paul Jackson, Fellow, Society of Actuaries, The Wyatt Co.).

134. See *supra* note 8 for a discussion of fiduciary obligations.

135. See, e.g., *HEREIU Hearings*, 97th Cong., 2d Sess., pt. 2, at 2 (1982) (statement of Chairman William Roth).

twenty-five percent of the employer contributions, it "should have known" (and probably did know) that there was a breach of fiduciary duties.¹³⁶ Similarly, a support supplier "should have known" (and probably did know) that there was a breach of fiduciary duties when it received over \$200,000 in one year for very little work.¹³⁷

However unlikely, organized crime figures might temper their greed if they realized this might increase both the possibility that they would escape notice, and the difficulty in proving constructive knowledge. The plan administrator in the example above might lower its cut to ten percent, or the support supplier might be content with \$20,000. At first glance, this makes it harder to say that organized crime figures "should have known" of the breach. But these numbers should not be judged in a vacuum. Not only should courts consider the fee, but also the amount of services provided. These fees may still be too high once the level of services, if any, is factored in. When a support provider is doing next to nothing, it is no more entitled to \$20,000 than \$200,000.

While corrupt non-fiduciaries could falsify their records in an attempt to justify their high fees, this does not occur as often as one would expect. Some support suppliers maintain that their fees are simply "retainers."¹³⁸ A service provider could falsify its records to show that union members made above-average use of its services in a particular period, thereby justifying its high per capita rate.¹³⁹ However, the service provider's records could be verified by contacting individual patients about the actual treatment they received.

Depending on the type of service provided, when support suppliers exaggerate what they did for a plan administrator or service provider, there may not be any union members with whom to cross-check the records. But it still should be possible to establish the actual level of services provided by contacting other individuals or corporations with whom the support suppliers did business. If the support supplier says

136. See, e.g., *HEREIU REPORT*, *supra* note 3, at 112.

137. See, e.g., *id.* at 113.

138. See, e.g., *HEREIU Hearings*, 98th Cong., 1st Sess., pt. 4, at 10 (1983) (statement of Dennis Cook).

139. See *HEREIU Hearings*, 98th Cong., 1st Sess., pt. 4, at 170 (1983) (statement of Paul Jackson).

that it provided secretarial services, plaintiffs can contact the secretaries who supposedly worked, and the companies that supposedly provided things like paper and typewriters.

It is more difficult when support suppliers claim to have provided something amorphous like marketing assistance or consulting services. The recipients of these services should be required to demonstrate why these services were needed and how the advice supposedly rendered was utilized. The supplier of these "services" should be required to produce records which document when its "services" were provided and what advice was given. It should not be enough that there were a few telephone conversations or informal meetings.

In the face of substantial evidence that they made large profits from PBPs for doing very little, some non-fiduciaries may argue that they are simply honest business people without fiduciary obligations, and therefore, should not be held accountable if their services are over-priced relative to the competition.¹⁴⁰ The argument is appealing since legitimate non-fiduciaries are entitled to maximize their profits. But it is fatally flawed when these companies do not honestly compete for PBP contracts, and are organized solely to siphon off plan assets. Plaintiffs should be able to establish either that no potential competitors were contacted to submit bids or that those that submitted superior bids were inexplicably rejected.

This is just a sampling of the issues that courts will face in actions brought to halt the abuse of PBPs. Other issues discussed in Sections II and III will also arise. For example, it

140. Consider the following hypothetical situation used by a support supplier in the only case that deals with PBP abuse:

Local Labor Union has a health and welfare plan on behalf of its members. Local's [trust] administrator . . . selects bids for dental services on behalf of local's employees. After examination of all relevant factors, plan trustees [select] Dental, Inc., which then proceeds to contract with Computer, Inc. and Secretarial, Inc. to provide administrative and other services to Dental, Inc.

Computer, Inc. and Secretarial, Inc. will only provide their services to Dental, Inc. at a set fee which may be higher than similar services offered by other companies. Do Computer, Inc. and Secretarial, Inc. have a duty to lower their fee to Dental, Inc.? . . . If Dental, Inc. had a duty . . . to secure the services of Cheap-Computer, Inc. and Cheaper, Inc. and Cheaper-Secretarial, Inc. . . . have Computer, Inc. and Secretarial, Inc. incurred liability under ERISA by reason of their fees charged to and paid by Dental, Inc.?

Defendant's Notice of Motion to Dismiss at 8-9, *Gerace*, No. 85-3669 (D.N.J. filed July 25, 1985).

will be difficult to argue that service providers or support suppliers participate in breaches of trust in the sense that they help cause them to occur. They usually will not have any dealings with fiduciaries, and may only become involved *after* the trustees and the trust administrator abdicate their fiduciary responsibilities. While it might be relatively easy to establish that they are "recipients with knowledge," it may be increasingly difficult to prove that entities that funnel plan assets, or the organized crime figures that eventually receive them, are as well. In addition, there may be problems imputing knowledge to corporations. There may be withdrawal and late joiner issues for courts partial to applying the conspiracy doctrine. There is the possibility that a court will hold a non-fiduciary jointly and severally liable for schemes in which he did not participate if his associates were involved in more than one PBP.

Despite these problems, courts should be able to see through the maze of corporations, contracts and arguments to determine how non-fiduciaries profited from breaches of trust, and the "knowing participation" rationale provides an easily understood construct in which to hold them liable under ERISA. In difficult cases, it may boil down to a question of "how bad the fish smell."¹⁴¹ While this may be an inelegant way for courts to proceed, ERISA's legislative history makes clear that Congress intended courts to err on the side of benefit plan participants and their beneficiaries, not non-fiduciaries.

V. SUGGESTED CONGRESSIONAL ACTION

When ERISA cases are brought, courts should be able to remedy breaches of trust by the continued use of the broad powers granted to them by Congress. But the cases are few in number and take years to be resolved. It took seven years for the district court in *Schmoutey* to issue its opinion. The Secretary filed his complaint in *Thornton* in 1979, and that case is now back in the district court. These delays are understandable when one recognizes the complexity of schemes to bilk benefit plans and the financial and legal skills of those who perpetrate them. For the same reasons, it is very difficult to

141. *Blankenship v. Boyle*, 329 F. Supp. 1089, 1104 (D.D.C. 1971).

even identify these schemes, an even more troublesome concern that probably accounts for the small number of cases discussing non-fiduciary liability. Congress should act, therefore, to reduce the possibility that breaches of trust will occur and to make them easier to spot when they do. The suggestions below range from the obvious to the extreme, and would raise the administrative costs of benefit plans. But if benefit plans are to be adequately protected, they are costs worth bearing.

A. *Increased Resources, Education and Coordination*

In an era of record-breaking deficits, increased investigative and enforcement resources might be hard to find. But if the President and Congress understand that benefit plans probably represent the largest sum of money in the country outside of the United States Treasury,¹⁴² they might be inclined to step up vigilance in this area. If just one percent of the approximately \$1 trillion in benefit plans is being skimmed off, that amounts to a loss of \$10 billion. Even in a nation of our great size, that represents a significant amount of foregone wages, investment, and research and development.¹⁴³

If no one is capable of identifying, let alone unraveling these schemes, however, any increase in resources will go to waste. Since many branches of the federal government have jurisdiction over benefit plans,¹⁴⁴ an interagency task force should be formed to coordinate investigative and enforcement strategies, and to hold training sessions for government officials who deal with benefit plans.¹⁴⁵ In order to supplement the government's investigations, efforts should also be made to

142. See *Select Comm. Hearings*, *supra* note 39, at 3 (statement of Rep. Matthew Rinaldo).

143. See *Select Comm. Hearings*, *supra* note 39, at 2 (statement of Chairman Claude Pepper).

144. The Departments of Justice, Labor and the Treasury have jurisdiction over benefit plans, and investigations have been held by Senate and House Committees, and the General Accounting Office. The Department of Labor is responsible for enforcing ERISA's fiduciary provisions. See Reorg. Plan No. 4 of 1978, 43 Fed. Reg. 47,713, 47,714 (1978). Unfortunately, "there is abundant evidence that the Department of Labor has been grossly derelict in its responsibility to enforce this and other provisions of ERISA." *Select Comm. Hearings*, *supra* note 39, at 2 (statement of Chairman Claude Pepper).

145. Since states generally license and monitor unions and have documentation of benefit plan activities not readily accessible to federal investigators, state officials should be invited to these training sessions. See *HEREIU Hearings*, 97th Cong., 2d Sess., pt. 1,

educate participants and beneficiaries about fiduciary duties and the possible avenues of abuse. Their ability to identify the most intricate schemes should not be underestimated. Moreover, some may *know* of the schemes, but do not know who to tell, or are afraid to come forward with information.

Management is another resource that has largely gone untapped. In most cases, employers lose interest in benefit plans once collective bargaining agreements are signed and costs become fixed.¹⁴⁶ Employers should recognize that this hands-off policy is costing them money. If benefit plans were properly managed, they would be less expensive to maintain, and as discussed above, more money would be available for other, more productive uses.

B. Expand the List of Prohibited Transactions

The list of prohibited transactions currently contained in ERISA¹⁴⁷ should also include any transaction between a benefit plan and a non-fiduciary that involves a significant percentage of the plan's current asset value. Prohibiting these transactions will help insure that honest fiduciaries do not risk the financial safety of a plan by placing large amounts of plan assets in the hands of unscrupulous non-fiduciaries. When fiduciaries are dishonest, the percentage limitation will act as a deterrent since large transactions should attract the attention of government authorities, participants, employers and others who are aware of the percentage limitation. To insure that good investment opportunities are not passed up, however, the Secretary should establish an expedited exemption procedure similar to that currently in place.¹⁴⁸

What amount is "significant?" Benefit plans are now required to include in their annual reports a description of their "reportable transactions," which are transactions involving more than three percent of the plan's current asset value.¹⁴⁹ There is, however, a difference between reporting and prohibiting a transaction. A complete loss of three percent, while

at 49-58 (1982) (statement of Lt. Col. Justin Dintino, Executive Officer, New Jersey State Police).

146. See HEREIU REPORT, *supra* note 3, at 104-05.

147. See 29 U.S.C.A. § 1106 (West 1985). See *supra* note 36.

148. See 29 U.S.C.A. § 1108 (1982).

149. 29 U.S.C.A. § 1023(b) (3) (H) (West 1985).

something to be avoided, would probably not beget extensive financial problems. However, caution should be the guide when dealing with these plans; therefore, the percentage figure should probably lie between three and ten percent. The Secretary should insure that non-fiduciaries do not circumvent this rule by breaking up transactions that exceed the limit into smaller ones that do not.

C. *More Frequent Reporting*

ERISA requires a benefit plan to file an annual report with the Secretary that includes, among other things, an independent and qualified public accountant's financial analysis of the plan.¹⁵⁰ While the information contained in these reports is useful in spotting breaches of trust, the reports are issued too infrequently. Benefit plans should be required to issue reports with the same frequency as public corporations regulated by the securities laws, which file annual reports, quarterly reports, and special reports whenever there is any material change in their financial positions.¹⁵¹ One justification for this frequent disclosure is that persons who might purchase the securities of these corporations need accurate and current information in order to make an intelligent investment decision.¹⁵² Protecting benefit plan participants and beneficiaries provides an equally, if not more compelling justification for increasing the frequency of plan reports. Independent accountants, actuaries, participants and beneficiaries, employers and a host of government officials will necessarily have more timely opportunities to spot evidence of malfeasance.

D. *More Extensive Disclosure*

In addition to more frequent reporting, there should be an increase in the information contained in the reports. ERISA's disclosure provisions currently "omit significant information [about benefit plan] vendors and subcontractors."¹⁵³ These

150. 29 U.S.C.A. § 1023(a) (3) (A) (West 1985). A pension plan must also include an actuary's report containing its opinion on the plan's ability to satisfy its long-term obligations. *Id.*

151. See 17 C.F.R. §§ 240.13a, 240.15d (1985).

152. See, e.g., 15 U.S.C. § 78(b) (1982).

153. HEREIU REPORT, *supra* note 3, at 8.

omissions are especially glaring in the area of PBPs, where the Secretary may only know the names of administrators and service providers until investigations are commenced. Benefit plans should be required, at a minimum, to disclose the compensation arrangements of these parties. Since most support suppliers will be legitimate, even in corrupt PBPs, it may be too much to ask that plans disclose how every support supplier is paid. The problem, however, is that *any* support supplier could be a conduit to organized crime. Benefit plans should be required, therefore, to report the compensation arrangements for support suppliers whenever it amounts to three percent or more of the plan's current asset value.

The Secretary should keep accurate records of PBP payment arrangements, and other financial data currently disclosed.¹⁵⁴ When the sample sizes are large enough, the Secretary will be able to determine, for example, the average payment arrangements for PBPs, the average salaries for trustees, and the average security received in a lending transaction, thus making it easier to determine which benefit plans should be subject to closer scrutiny.

E. Licensing

While non-fiduciaries have been the focus of the article, their ability to steal from benefit plans is largely dependent on fiduciaries who breach their positions of trust. The Secretary should be required to license fiduciaries before they can work for benefit plans. Given that most states require barbers and grocers to be licensed, this suggestion should not be considered too extreme. Non-fiduciaries such as plan administrators and service providers, and outside the context of PBPs, non-fiduciaries that engage in plan-related work that exceeds three percent of a plan's current asset value, should be licensed as well. Applicants for these licenses should be required to describe their financial backgrounds, their experience with trust work, the services they expect to provide, the remuneration they expect to receive, the method by which they were selected, and state whether they have ever been convicted of, or faced civil liability for, anything relating to benefit plans, trust

154. As of 1984, information disclosed by the plans to the Department of Labor had not been "uniformly reviewed [or] catalogued." *Id.*

work, or unions. The Secretary should be required to follow objective standards in considering license applications, and provisions should be made to insure that processing is expedited and there are adequate appeals and exemption procedures.¹⁵⁵

Some might consider these suggestions unduly paternalistic. However, if the private and voluntary benefit plan system now in place is not protected from corrupt and incompetent individuals, the workers of this country may have to turn to a government-run benefit plan system, a result far more radical than what is advocated above.

155. Since non-fiduciaries are not required to exhibit the same level of prudence as fiduciaries, the Secretary should impose less restrictive standards on non-fiduciaries than on fiduciaries.