

1-1-1986

Job Creation for Union Members through Pension Fund Investment

Paul J. Wessel

Follow this and additional works at: <https://digitalcommons.law.buffalo.edu/buffalolawreview>



Part of the [Labor and Employment Law Commons](#)

Recommended Citation

Paul J. Wessel, *Job Creation for Union Members through Pension Fund Investment*, 35 Buff. L. Rev. 323 (1986).

Available at: <https://digitalcommons.law.buffalo.edu/buffalolawreview/vol35/iss1/9>

This Comment is brought to you for free and open access by the Law Journals at Digital Commons @ University at Buffalo School of Law. It has been accepted for inclusion in Buffalo Law Review by an authorized editor of Digital Commons @ University at Buffalo School of Law. For more information, please contact lawscholar@buffalo.edu.

Job Creation for Union Members Through Pension Fund Investment

Table of Contents

| | | |
|------|---|-----|
| I. | INTRODUCTION | 324 |
| II. | PENSION FUND STRUCTURES AND THE REALITY OF CONTROL | 328 |
| | A. <i>Employer-Administered vs. Jointly Administered Plans</i> | 329 |
| | B. <i>Structure and Control in Construction Industry Plans</i> | 331 |
| III. | THE LAW OF PENSIONS AND PENSION INVESTING | 332 |
| | A. <i>Pre-ERISA</i> | 332 |
| | B. <i>ERISA</i> | 334 |
| | C. <i>ERISA Fiduciary Standards</i> | 335 |
| IV. | JOB-CREATING INVESTMENTS UNDER ERISA FIDUCIARY STANDARDS | 337 |
| | A. <i>Prohibited Transactions Rule</i> | 338 |
| | B. <i>Prudence Rule</i> | 339 |
| | C. <i>The Duty of Loyalty</i> | 341 |
| V. | <i>BROCK v. WALTON</i> —UNION INVESTMENT AFFIRMED .. | 347 |
| | A. <i>The District Court Decision</i> | 347 |
| | B. <i>The Decision Analyzed</i> | 351 |
| VI. | THE “UNION-LABOR” ISSUE | 353 |
| | A. <i>The Parties to the Issue and Their Positions</i> | 353 |
| | 1. Construction Unions | 354 |
| | 2. Participants and Beneficiaries | 354 |
| | 3. Employers | 355 |
| | 4. Department of Labor | 356 |
| | B. <i>Possible Legal Resolutions of the “Union-Labor” Issue</i> | 358 |
| VII. | CONCLUSION | 362 |

I. INTRODUCTION

American labor unions have begun to use their members' pension fund assets to make business investments that create union jobs. The legality of these investments is not completely certain. Questions concerning the fiduciary duty of union pension fund trustees are being raised when such investments, which often are not the most financially attractive available on the market, are made. A reinterpretation of pension trustee fiduciary responsibility is necessary to permit union pension fund trustees to continue making job-creating investments.

In the late 1970's, organized labor in the United States began to protest that the huge sums of money being held in retirement pension funds for union members were not being handled in a manner favorable to labor. Unions looked with disgust at the investment of their pension assets in foreign and domestic non-union competition in industry, at the abuse of pension assets by corporate managers for business and personal profit, and at the overall failure of pension fund trustees to keep fund growth at a rate comparable to the inflation rate. The way the unions saw it, their own pension funds were being used to finance the loss of their members' jobs and retirement income security.¹

Labor's appreciation of this situation led to a renewal of interest in efforts to gain a greater degree of control over the management of pension fund assets.² Prompted in part by the publication in 1978 of Rifkin and Barber's seminal work on union pensions and the potential for pension control in *The North Shall Rise Again*,³ unions became interested not only in correcting the abuses of pension funds, but also in utilizing them as an instrument to revitalize a struggling labor movement through pension asset investment to create union jobs. As AFL-CIO president Lane Kirkland stated in 1979:

Pension funds have been used by some banks and investment counselors to

1. See AMERICAN FED'N OF LAB.-CONG. OF INDUS. ORG., INVESTMENT OF UNION PENSION FUNDS 22-30 (1980) [hereinafter AFL-CIO].

2. Greater control of pension assets was originally supported by labor in the 1950's. See generally P. HARBRECHT, ECONOMIC POWER OF PENSION FUNDS (1959); R. TILOVE, PENSION FUNDS AND ECONOMIC POWER (1959) (both promoting ethical investing strategies and stock shareholder activism for union pension funds).

3. J. RIFKIN & R. BARBER, THE NORTH SHALL RISE AGAIN: PENSIONS, POLITICS AND POWER IN THE 1980S (1978).

finance runaway employers to the injury of the very unions and workers who negotiated and created those funds. That has to stop. We shall be pursuing every available means to insure that pension money is invested creatively and constructively to the benefit of workers and fair employers.⁴

In 1980, the AFL-CIO released its first-ever study on union strategies for pension investment control.⁵ It estimated that of the \$860 billion in total private and public sector pension funds in 1979, \$212 billion was held in trust for union members.⁶ Unions realized that if they could successfully manage these vast assets in financial markets themselves, it would have a significant impact on the economy in ways favorable to workers.⁷

The promise that increased control and use of pension funds held for labor in the late 1970's remains largely unfulfilled, however. Certain strategies that exploit the power of pension assets are being implemented by unions, but none on the scale originally hoped for by the captains of labor.⁸ One such strategy is the use of coordinated capital investment boycott campaigns against anti-union industries.⁹ Another is the exercise of shareholder voting rights held by pension funds to pass union supported resolutions at corporate shareholder meetings.¹⁰ Still another is the use of

4. H. GRAY, *NEW DIRECTIONS IN PENSION FUNDS* 42 (1983).

5. *Recommendations of the Committee on Investment of Union Pension Funds to AFL-CIO Executive Council on New Pension Fund Investment Initiatives*. PENS. REP. (BNA) No. 305, at R-16 - 17 (Aug. 25, 1980).

6. *Id.* Estimates of assets held in collectively bargained pension funds vary. The Department of Labor does not require that pension plans disclose whether or not they are established through collective bargaining, making statistics difficult to compile.

7. Senator Howard Metzenbaum (D-Ohio), who held congressional hearings on pension fund investment policies in 1979, stated: "Pension funds have . . . become one of the most important sources of capital in the nation's financial markets. Without question, those who manage pension funds are in a position to play a crucial role in determining the nature and direction of the nation's economic growth and development." *Pension Fund Investment Policies: Hearing Before the Subcomm. on Citizens and Shareholders Rights and Remedies, Comm. on the Judiciary*, 96th Cong., 1st Sess. 2 (1979).

8. In 1980, the AFL-CIO noted "four policy objectives of union participation in pension fund management." These were to increase employment through reindustrialization, to advance social proposals, to improve the ability of workers to exercise their rights as stock shareholders, and to exclude from pension plan investment portfolios companies hostile to workers rights. PENS. REP., *supra* note 5, at R-16. See generally Kaiser, *Labor's New Weapon: Pension Fund Leverage, Can Labor Legally Beat Its Plowshares Into Swords?* 34 RUTGERS L. REV. 409, 412-15 (1982) (describing labor's strategies for use of pension fund control).

9. See H. GRAY, *supra* note 4, at 96-99; Kaiser, *supra* note 8, at 412-15.

10. See H. GRAY, *supra* note 4, at 108-12; Kaiser, *supra* note 8, at 412-15. See, e.g., LABOR & INVESTMENTS, May 1982, at 5 (examples of occasions on which unions have con-

pension assets to finance home mortgages or other loans for fund members.¹¹ Each of these strategies has met with some success, but progress on the chief strategy of labor in pension asset use—the investment of assets in unionized businesses to create jobs—has been disappointing.

The main reason that unions have not been able to fully exploit the power of pension funds is that most unions lack any real control over the management of their fund. Control lies in the hands of the appointed trustees of the pension fund, and only a small percentage of unions have the power to appoint trustees or review the decisions that they make. Some form of control over the trustees is a prerequisite for pension asset use by a union.¹² Though cognizant of this, most unions have been either unwilling or unable to wrestle control from employers through the collective bargaining process.¹³ If the developments over the last ten years serve as example, it seems clear that unions will not soon take control over a significantly greater percentage of pension fund capital than they now control.¹⁴ Until they do, union pensions will not be revolutionized to advance organized labor's goals.

While labor has only begun the fight for wide-scale pension fund control, the battle over the legality of one method of exercising this control, job-creating investments, rages in the meantime. A small number of unions that already have some measure of discretionary authority over the operation of their fund have begun to make use of their power to promote the kinds of interests that labor advocated in the late 1970's. Most prominent among these unions are those in the building and construction trades, which have started to invest directly in capital real estate and building projects that create jobs for their members. The permissibility of union pension fund investments for job creation under the Em-

fronted employers at shareholder meetings).

11. See H. GRAY, *supra* note 4, at 80-92. See generally WORKING PAPERS, July-Aug. 1981, at 20 (critical of union pension fund investments as not being "terribly adventurous," because they have been somewhat limited to administratively simple, risk-free mortgage investments that displace other money already available on the market for mortgages). For an example of a union pension fund mortgage program, see 10 PENS. REP. (BNA) No. 437, at 552 (Mar. 28, 1983).

12. See *infra* notes 27-35 and accompanying text.

13. See *infra* note 29 and accompanying text.

14. *Id.*

ployee Retirement Income Security Act of 1974¹⁵ remains largely in question, however. This uncertainty has not stopped construction unions from going forward with their investment projects, even in the face of ERISA-based challenges from the Department of Labor.¹⁶ The resulting lawsuits have still not produced clear legal standards for the proper interpretation of ERISA.¹⁷ Clarification is critical. Unions, employers, and pension fund participants and beneficiaries have too much at stake to permit fund trustees to gamble on the legality of multi-million dollar investments. Organized labor anxiously awaits a clear set of standards, as these will play a large part in determining the future of this new strategy for all of organized labor.

This Comment addresses the current and possible future legal implications of union pension fund investments that benefit unions and their members. Specifically, it analyzes investments that are designed to create jobs for union members. Section II of this Comment will discuss the fundamental issue of control of pension fund administration. An appreciation of this issue is essential for putting the narrower issue of pension asset investment into its context as a strategy of organized labor. Section III will provide an overview of federal statutory law affecting private sector pension plans, with a focus on the rules regarding fiduciary responsibility for asset management and investment. Section IV deals specifically with the legal issues surrounding fiduciary requirements for investments designed to produce secondary or "collateral" benefits, such as the creation of union jobs. Section V offers a critical analysis of the recent Florida district court decision in *Brock v. Walton*.¹⁸ *Walton* is viewed by many as an important decision on the issue of union job-creating investments, but this Comment will argue that the weakness of the legal reasoning in this decision will limit its precedential value. Section VI addresses the specific issue of union pension fund investments strictly premised on the guarantee of union job creation. This issue, which I will refer to as the

15. The Employee Retirement Income Security Act of 1974, Pub. L. No. 93-406, 88 Stat. 829 (1974) (codified as amended at 29 U.S.C. §§ 1001-1461 (1982)).

16. The Secretary of Labor is empowered to bring actions for civil enforcement of ERISA. The Employee Retirement Income Security Act of 1974, § 502(a), 29 U.S.C. § 1132(a) (1982).

17. See *infra* notes 63-113 and accompanying text.

18. 609 F. Supp. 1221 (S.D. Fla. 1985).

"union-labor" investments issue, is examined closely because it lies at the heart of this strategy for unions and because it presents special problems of interpretation under ERISA. Case law under ERISA has only scratched the surface of this issue, leaving in doubt the legality of union labor investments. This Comment will conclude by discussing the possible legal resolutions of this issue and by suggesting the approach most consistent with the purposes of ERISA.

II. PENSION FUND STRUCTURES AND THE REALITY OF CONTROL

Labor unions can be identified as the organizations principally responsible for the rapid growth in pension plans for American workers in the private sector since World War II.¹⁹ In the late 1940's, the first national union agreements that provided for worker pensions funded by employer contributions were negotiated in the coal and auto industries.²⁰ Since that time, the number of private sector pension plans has risen dramatically, and pensions are now seen as an integral part of the average worker's compensation package. Today, approximately fifty million workers in private sector employment in the United States, more than half of the private sector labor force, are covered under pension or related retirement plans.²¹ Roughly 40% of all private sector plans are established through collective bargaining agreements.²² For all of the great strides in the creation of workers' pensions that unions have made, however, they have only minimal control over the vast assets held by these funds.

The ability to control a pension fund is defined by the amount of authority that the union has over decisions affecting the collection, management, investment, and dispersal of fund assets. Though vested participants have a recognized ownership in-

19. Pension plans covering employees in the public sector are not treated in this Comment. These plans are not regulated by ERISA, thus the investment of their assets into job-creating projects or for other "social" purposes raises different legal issues, mostly under state law.

20. A more detailed discussion of this history and of the development of pension funds in the United States in general can be found in H. GRAY, *supra* note 4, at 11-16.

21. *Public Employee Pension Benefit Plans: Joint Hearing Before the Subcomm. on Oversight of the Comm. on Ways and Means and Subcomm. on Labor-Management Relations of the Comm. on Education and Labor*, 98th Cong., 1st Sess. 63 (1983).

22. AFL-CIO, *supra* note 1, at 20.

terest in the assets held for their benefit,²³ there is no legal right to control which derives from this reality. The Supreme Court has made this clear by deciding that pension asset ownership and pension asset control are truly separate notions.²⁴ The existence of any real pension control, then, depends upon the structural type of pension fund that the collective bargaining agreement creates. The two principal types of administrative structures for pension plans are employer-administered plans and employer-union jointly administered plans.²⁵ The difference between these structures lies in the composition of the pension trust fund board of trustees, the group of individuals who have the authority and bear the ultimate responsibility for the handling of fund assets.²⁶

A. *Employer-Administered vs. Jointly Administered Pension Plans*

An employer-administered pension plan grants to the employer the authority to determine the members of the pension fund board of trustees. These plans represent approximately 60% of all private sector union plans.²⁷ The boards of trustees of these funds are usually composed of representatives of the employer and of independent financial institutions such as banks, trust companies, or insurance companies selected by the employer. The assets are often held by institutional investors in the form of pension trust funds or group annuity contracts. Trustees will contract with professional investment managers to make decisions regarding the investment of assets.

Under an employer-administered plan, the potential for union involvement in pension fund asset management is severely limited. As a result, some union's have experimented with forms

23. See *Nachman Corp. v. Pension Benefit Guaranty Corp.*, 446 U.S. 359 (1980).

24. In *Daniel v. Int'l Bhd. of Teamsters*, 439 U.S. 551 (1980), the Court held that federal securities law did not protect an employee from alleged fraud in the management of his retirement pension fund because he had no investment interest in the funds' assets cognizable under securities law.

25. Plans that were administered completely by union trustees were outlawed by the Taft-Hartley Act in 1947. Labor Management Relations (Taft-Hartley) Act, 1947, Pub. L. No. 80-101, § 302(c)(5), 61 Stat. 136, 157 (1947) (codified as amended at 29 U.S.C. § 186(c)(5) (1982)) (an employer cannot pay money to a union unless the payments are held in trust and subject to joint administration).

26. ERISA provides that all assets of employee benefit plans be held in trust by one or more trustees. The Employee Retirement Income Security Act of 1974, § 403, 29 U.S.C. § 1103 (1982).

27. AFL-CIO, *supra* note 1, at 20.

of "indirect control" of fund management. Indirect control exists where the collective bargaining agreement establishes the union in some sort of advisory capacity to the fund trustees.²⁸ Though these experiments have received a fair amount of attention from the labor movement, few would argue that these new structures, which do not establish ultimate authority over asset management decisions, will bring a large degree of pension control to organized labor. To some extent, these efforts show that the strategy that began in the late 1970's to obtain and use pension control has continued, but progress has been limited. Only a handful of unions have successfully bargained for any form of direct or indirect control in the last ten years.²⁹ Today, the matter has become low on the list of priorities for unions that see themselves as facing more critical issues in collective bargaining, such as job and wage protection.

Jointly administered pension plans, or "Taft-Hartley" funds, once established through collective bargaining, are required by law to have boards of trustees composed of an equal number of union and employer representatives.³⁰ Jointly trusteeed plans represent approximately 40% of all union plans.³¹ As with employer-administered plans, the trustees of these plans often engage the services of independent financial institutions, but here only as investment managers or actuaries, not as fund trustees. As with employer-administered plans, fund assets are most often held in pension trust funds or group annuity contracts through banks, trust companies, or insurance companies. The principle difference from employer funds lies in the fact that, with joint funds, the

28. The Industrial Union Department of the AFL-CIO has cited several ways in which unions can gain a voice in pension fund investments without establishing joint administration. These include securing a say in the appointment of fund trustees, participating in the selection of investment managers, and negotiating an agreement identifying particular investment goals. PENS. REP. (BNA) No. 294, at R-8 (June 9, 1980). See, e.g., LABOR & INVESTMENTS, Jan. 1981, at 6 (cases where unions have bargained for a voice in fund administration).

29. Major union bargaining achievements for greater pension fund control are chronicled in *Labor and Investments*, a publication of the Industrial Union Department of the AFL-CIO. Few have been reported over the last five years. See, e.g., LABOR & INVESTMENTS, Jan. 1981, at 6-7; *Id.*, Mar. 1981, at 1; *Id.*, Apr. 1981, at 5; *Id.*, Dec. 1983-Jan. 1984, at 1.

30. Jointly administered pension plans are regulated by section 302(c)(5) of the Taft-Hartley Act. Labor Management Relations (Taft-Hartley) Act, 1947, § 302(c)(5), 29 U.S.C. § 186(c)(5)(1982).

31. AFL-CIO, *supra* note 1, at 20.

ultimate authority for decisions about the management of assets rests with the union and the employer representatives who serve as trustees, not with institutional investor trustees.³²

The potential for using pension fund assets to promote the interests of unions is greatest with joint administration for the simple reason that the union controls one-half of the voting seats on the fund's board of trustees. The fact is, however, that many of these funds operate in a surprisingly similar fashion to employer-administered plans with regard to investment decisions.³³ Professional investment managers traditionally have made the investment decisions for these funds, with little supervision from employer and union trustees who may lack the financial sophistication to oversee them. Lack of union trustee sophistication has been a major obstacle to union pension control. The AFL-CIO has recognized this problem. In 1980, the federation promised its member unions that it would develop programs for information and training of union trustees interested in making job-creating investments.³⁴ No initiatives have been taken since 1980, and, indeed, it appears the AFL-CIO has lost some interest in taking a leadership role in the area of pension control.³⁵

B. *Structure and Control in Construction Industry Pension Plans*

The major exceptions to the trend of labor unions cooling on the idea of pension fund control and investment are unions in the building and construction trades. Though long considered to be among the most conservative labor unions, construction unions

32. Under Taft-Hartley, a jointly administered pension plan may have as its trustees only representatives of the employer and the union. Labor Management Relations (Taft-Hartley) Act, 1947, § 302(c)(5), 29 U.S.C. § 186(c)(5) (1982). No such requirement exists under ERISA. Thus, employer-administered funds are free to delegate the trusteeship to other individuals or institutions.

33. Telephone interview with Randy Barber, co-author of *The North Shall Rise Again: Pensions, Politics and Power in the 1980's*, and editor of *Labor and Investments*, a monthly publication of the Industrial Union Department of the AFL-CIO.

34. PENS. REP., *supra* note 5.

35. Mention of pension control is conspicuously absent from the AFL-CIO's recent policy statement on the strategies for organized labor's future. See AMERICAN FED'N OF LABOR-CONG. OF INDUS. ORGS., *THE CHANGING SITUATION OF WORKERS AND THEIR UNIONS* (1985). At the AFL-CIO national convention in November 1985, the federation merely approved resolutions relating to pension control and investments that were drawn almost entirely from the then five-year-old *Investment of Union Pension Funds* report. AFL-CIO, *supra* note 1. See AFL-CIO NEWS, Nov. 9, 1985, at 8.

have pushed to the forefront of this progressive strategy to promote unionism. They are doing it primarily by pooling the pension assets of different construction unions in the same regional areas into investment foundations that invest in real estate development projects which put their members to work. In 1984, construction union investment foundations financed \$240 million worth of real estate projects.³⁶

A major factor promoting this development among construction unions is the administrative structure of their pension plans, which are of the jointly administered, multiemployer variety.³⁷ These plans are administered by an equal number of representatives of the union and of the group of employers who contribute to the fund. This structure is used in the construction industry because it allows construction workers, who often move from employer to employer while remaining members of the same union, to maintain their pensions. Under this structure, unions enjoy the basic advantage for pension control that joint administration carries.³⁸ The multiemployer characteristic provides an additional advantage because it puts the union in the position of having more trustees on the board than any single employer, creating *de facto* control of the fund by the union. Construction unions have maintained these types of plans for years, and many union trustees have developed a certain amount of fund management expertise from their experience in control positions on the boards. This structure is well suited, then, to the strategy of union job-creating investments that some construction unions have begun to implement.

III. THE LAW OF PENSIONS AND PENSION INVESTING

A. *Pre-ERISA*

Prior to 1974, pension law in this country consisted mainly of the common law of trusts within individual states. Most of the common law was consistent with respect to fiduciary requirements

36. U.S. NEWS & WORLD REPORT, May 13, 1985, at 74.

37. Multiemployer plans are regulated by special provisions under ERISA. These provisions were added to ERISA by the Multiemployer Pension Plan Amendments Act of 1980, Pub. L. No. 96-364, 94 Stat. 1208 (1980) (codified at 29 U.S.C. §§ 1381-1453 (1982)).

38. See *supra* notes 30-32 and accompanying text.

for pension fund management.³⁹ The common law imposed on fiduciaries the time-honored "prudent man" standard of fund management, as well as the duty to act "solely in the interest" of plan participants and beneficiaries.⁴⁰ This duty included rules prohibiting fiduciaries from "self-dealing" with fund assets in order to protect against conflicts of interest.⁴¹ These fundamental common-law principles provided the framework for the fiduciary requirements of ERISA when it was enacted to preempt state common law for private plans.⁴²

Also predating ERISA are the requirements for pension plans under the Internal Revenue Code, which regulates pensions by virtue of its authorization of tax-exempt status for qualified plans.⁴³ For a fund to enjoy tax-exempt status, the Code requires that it be maintained by fiduciaries for the "exclusive benefit" of employees and beneficiaries,⁴⁴ a rule that has been carried over into the language of ERISA.⁴⁵ Since 1974, the Code has not been invoked by courts to impose fiduciary standards separate from ERISA, but its detailed requirements for qualification for tax exemption still apply.

The Taft-Hartley Act⁴⁶ regulates private pension plans established through collective bargaining. Section 302(c)(5) contains provisions aimed at protecting pension fund assets from union corruption and fraud.⁴⁷ Among them is an "exclusive benefit" provision similar to that contained in the Internal Revenue Code. In application, both prior to ERISA and especially since, Taft-Hartley has been treated as concerned primarily with fraudulent

39. See RESTATEMENT (SECOND) OF TRUSTS § 227 (1959). See also 2 A. SCOTT, THE LAW OF TRUSTS § 170 (3d. ed. 1967).

40. RESTATEMENT, (SECOND) OF TRUSTS, *supra* note 39; A. SCOTT, *supra* note 39.

41. RESTATEMENT (SECOND) OF TRUSTS, *supra* note 39; A. SCOTT, *supra* note 39.

42. See *infra* notes 49-62 and accompanying text.

43. The requirements for qualification for tax exemption are contained in section 401(a) of the Internal Revenue Code, 26 U.S.C. § 401(a) (1982).

44. *Id.*

45. The Employee Retirement Income Security Act of 1974, § 404(a)(1)(a); 29 U.S.C. § 1104(a)(1)(A) (1982); see *infra* note 61.

46. Labor Management Relations (Taft-Hartley) Act, 1947, §§ 1-303, 29 U.S.C. §§ 141-187 (1982).

47. Taft-Hartley attempted to limit the potential for union corruption in pension funds by completely outlawing union-administered plans. *Id.* at § 302(c)(5), 29 U.S.C. § 186(c) (5). The Act also requires that there be a written agreement detailing the basis on which payments are to be made. *Id.*

fund dealings by unions and not as applying general fiduciary standards for fund management.⁴⁸

B. ERISA

ERISA was signed into law on Labor Day, September 2, 1974 by President Gerald Ford. It is the only comprehensive employee benefits legislation ever passed in the United States, enacted to protect the interests of participants and beneficiaries of employee benefit plans by improving their equitable character and financial soundness.⁴⁹ The law affects all private employee benefit plans⁵⁰ such as pension, health, disability, and profit sharing plans. Its provisions apply to participants and beneficiaries⁵¹ of private pension and welfare plans, as well as to employers, labor organizations, insurance companies, banks, and other persons or organizations involved in employee benefit plans. ERISA preempts all state laws relating to private benefit plans,⁵² and although it does not preempt the Internal Revenue Code or the Taft-Hartley provisions for pension plans, it effectively takes from these statutes any independent regulation of pension fund fiduciary duty. Besides fi-

48. See Hutchison & Cole, *Legal Standards Governing Investment of Pension Assets for Social and Political Goals*, 128 U. PA. L. REV. 1340, 1348-49 (1980).

49. Concern over the inadequate regulation of employee benefits plans in Congress had been strong since the late 1950's. The Welfare and Pension Plans Disclosure Act, Pub. L. No. 85-836, 72 Stat. 997 (1958) (codified at 29 U.S.C. §§ 301-309 (1970 & Supp. 1972)), was passed in 1958, but by 1962 dissatisfaction with that Act led President Kennedy to appoint a cabinet-level committee to study the equitable character of pension plans in the United States and to recommend changes in federal legislation. The reports that they would produce, after long congressional consideration, eventually led to the passage of ERISA in 1974, which repealed the Welfare and Pension Plan Disclosure Act. See the Employee Retirement Income Security Act of 1974, § 111(a)(1), 29 U.S.C. § 1031(a)(1) (1982). See D. MCGILL, *FUNDAMENTALS OF PRIVATE PENSIONS* 32-35 (5th ed. 1984), for a more detailed description of these events.

50. ERISA does not regulate "governmental" plans—plans covering public employees. The Employee Retirement Income Security Act of 1974, § 4(b)(1), 29 U.S.C. § 1003(b)(1) (1982).

51. A "participant" is defined in ERISA as any employee or former employee "who is or may become eligible to receive a benefit of any type from an employee benefit plan." The Employee Retirement Income Security Act of 1974, § 3(7), 29 U.S.C. § 1002(7) (1982). A "beneficiary" is defined as "a person designated by a participant, or by terms of an employee benefit plan, who is or may become entitled to a benefit thereunder." *Id.* § 3(8), 29 U.S.C. § 1002(8).

52. Labor Management Relations (Taft-Hartley) Act, 1947, § 503(a), 29 U.S.C. § 144(a) (1982).

duciary standards,⁵³ ERISA provisions relating to pension plans include reporting and disclosure requirements,⁵⁴ participant eligibility and vesting requirements,⁵⁵ minimum funding standards,⁵⁶ and plan termination insurance through the creation of the Pension Benefit Guarantee Corporation.⁵⁷ Responsibility for enforcement of the Act belongs to the Secretary of Labor and the Secretary of the Treasury.⁵⁸ The federal district courts have exclusive jurisdiction for civil cases arising out of the enforcement of ERISA.⁵⁹

C. ERISA Fiduciary Standards

All regulation of private pension fund asset management is now accomplished under ERISA section 404(a)(1), its standards for fiduciaries. "Fiduciary" is defined broadly under the Act. It includes all those individuals who exercise control or discretion in the management of plan assets, who provide investment advice for the plan, and who have discretionary authority in administering the plan.⁶⁰

Section 404(a)(1) sets forth fiduciary duties in language borrowed heavily from common law, the Internal Revenue Code, and the Taft-Hartley Act. It states that fiduciaries shall discharge their duties "solely in the interest of participants and beneficiaries," and: (a) for the "exclusive purpose" of providing benefits and defraying administrative expenses; (b) as a "prudent man" would to conduct the enterprise under the circumstances; (c) by "diversify-

53. The Employee Retirement Income Security Act of 1974, §§ 401-414, 29 U.S.C. §§ 1101-1114 (1982). See *infra* notes 61-63 and accompanying text.

54. The Employee Retirement Income Security Act of 1974, §§ 101-111, 29 U.S.C. §§ 1021-1031 (1982).

55. *Id.* §§ 201-211, 29 U.S.C. §§ 1051-1061.

56. *Id.* §§ 301-306, 29 U.S.C. §§ 1081-1086.

57. *Id.* §§ 4001-4048, 29 U.S.C. §§ 1301-1348.

58. *Id.* §§ 501-515, 3001-3004, 29 U.S.C. §§ 1131-1204.

59. *Id.* § 502(e), 29 U.S.C. § 1132(e).

60. ERISA's definition of "fiduciary" reads:

[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 renders investment advice for a fee or other compensation, direct or indirect, with respect to any monies 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.

Id. § 3(21)(a), 29 U.S.C. § 1002(21)(a).

ing" plan investments; and (d) in conformity with "documents and instruments" governing the plan.⁶¹

In addition to the general duties imposed on fiduciaries, certain specific types of conduct are expressly prohibited under section 406(b). These "prohibited transactions" cover two major types of conflict of interest transactions—those between the plan and parties in interest, and those that amount to self-dealing on the part of a fiduciary.⁶²

61. ERISA requires that:

[A] fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and the beneficiaries and -

(A) for the exclusive purpose of:

- (i) providing benefits to participants and their beneficiaries and
- (ii) defraying reasonable expenses of administering the plan;

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

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

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

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

62. ERISA's prohibited transaction rule provides:

(a) Transactions between plan and party in interest.

Except as provided in section 1108 of this title:

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

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

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

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

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

(E) acquisition, on behalf of the plan, of any employer security or employer real property in violation of section 1107(a) of this title.

(2) No fiduciary who has authority or discretion to control or manage the assets of a plan shall permit the plan to hold any employer security or employer real property if he knows or should know that holding such security or real property violates section 1107(a) of this title.

(b) Transactions between plan and fiduciary.

A fiduciary with respect to a plan shall not—

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

IV. JOB-CREATING INVESTMENTS UNDER ERISA FIDUCIARY STANDARDS

ERISA's fiduciary requirements can be separated into three principal categories for analysis of their application to job-creating and other union-promoting investments: (1) prohibited transactions; (2) the prudence rule; and (3) the duty of loyalty.⁶³ These requirements, and the obstacles they present for these investments, are discussed in detail in this Section. In essence, the prohibited transactions rule involves fairly clear prohibitions and exemptions for specific types of investments. The prudence rule defines the type of expert profit-maximizing conduct that is expected of fiduciaries, but it limits not so much choices of vehicles for investment as it does regulate trustee expectations for return on investment. The duty of loyalty poses more difficult questions for fund fiduciaries considering job-creating investments than do the other standards because it imposes a nebulous set of rules restricting investments that attempt to serve purposes secondary to the purpose of maintaining the fund's financial health.

account,

(2) in his individual or in any other capacity act in any transaction involving the plan on behalf of a party (or represent a party) whose interests are adverse to the interest of the plan or the interests of its participants or beneficiaries, or

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

(c) Transfer of real or personal property to plan by party in interest.

A transfer of real or personal property by a party in interest to a plan shall be treated as a sale or exchange if the property is subject to a mortgage or similar lien which a party-in-interest placed on the property within the 10-year period ending on the date of the transfer.

Id. § 406, 29 U.S.C. § 1106.

63. These categories represent one currently accepted convention for categorizing the three different types of rules that ERISA imposes on fiduciaries. "Prohibited Transactions" are contained in section 406 of ERISA. The "Prudence Rule" is derived from the language in section 404(B). It is used here as also including the diversification requirement in section 404(c). The "Duty of Loyalty" describes the ERISA requirements contained in section 404 and section 404(A) that fiduciaries act "solely in the interest" and for the "exclusive purpose" of participants and beneficiaries. ERISA section 404(D) provides that fiduciaries operate the plan "in accordance with the documents and instruments governing the plan. . . ." This requirement, which is fairly straightforward, is not isolated for independent analysis here. See, e.g., Bredhoff, *Collective Bargaining for Socially Responsible Investment of Pension and Welfare Fund Assets: Another Look at ERISA*, LABOR & INVESTMENTS, July-Aug. 1982, at 3-8.

A. *Prohibited Transactions Rule*

The prohibited transactions rule identifies specific types of transactions that violate ERISA fiduciary standards.⁶⁴ Generally, it can be described as fleshing out the prudence and loyalty rules of ERISA, though it may also bar transactions not otherwise in violation of these rules. The prohibited transactions rule proscribes loans and sales between pension plan and "parties in interest,"⁶⁵ a term used to define individuals or organizations that benefit from fiduciary self-dealing.⁶⁶ Prohibited conduct also includes dealing with plan assets for a fiduciary's own interest or account, or engaging in transactions with any party whose interests are adverse to those of the plan.⁶⁷

The statute contains several statutory exemptions to the prohibited transactions rule for certain classes of transactions.⁶⁸ It also authorizes a procedure for exemptions made on a case-by-case basis by the Secretary of Labor.⁶⁹ These exemptions are based on the notion that some transactions involve technical violations of the rule but do not have the undesirable effects that it seeks to curb. The statute is strictly applied, however, to all non-exempt violations, including those that may lack an improper motivation or fail to result in any actual harm.⁷⁰

The prohibited transactions rule does not prohibit pension investing for union promotion or other social goals where the enterprise invested in is not related in some way to a fund or its trustees.⁷¹ Where a fund seeks to create jobs for its working participants by investing in the business of its plan sponsor/employer, a prohibited transaction problem naturally arises because the plan sponsor is a party in interest. Similarly, investments in enterprises that guarantee the creation of jobs for members of the

64. The Employee Retirement Income Security Act of 1974, § 502(e), 29 U.S.C. § 1132(e) (1982).

65. *Id.* § 406(a), 29 U.S.C. § 1106(a).

66. *Id.* § 3(14), 29 U.S.C. § 1002(14).

67. *Id.* § 406(b), 29 U.S.C. § 1106(b).

68. *Id.* § 408(b), 29 U.S.C. § 1108(b).

69. *Id.* § 408(a), 29 U.S.C. § 1108(a).

70. See *McDougall v. Donovan*, 552 F. Supp. 1206, 1215 (N.D. Ill. 1982); *Freund v. Marshall & Ilsley Bank*, 485 F. Supp. 629, 637 (W.D. Wis. 1979).

71. See generally M. LEIBIG, *SOCIAL INVESTMENTS AND THE LAW* 24-25 (1980) ("None of the prohibited transactions outlaw the consideration of non-self-serving, noneconomic criteria in pension investments.").

sponsor/union plan are potentially violative of the prohibited transactions rule because the union is also a party in interest. Limited exemptions for such investments, outlined here, can partially accommodate these investments under the prohibited transactions rule.

Pension plans may invest in the securities or real property of the sponsor/employer plan without violating the prohibited transactions rule where the investment does not exceed 10% of the fair market value of the plans' assets.⁷² For multiemployer plans, there is a more liberal provision relating to investments in real estate construction projects. Through a special class of exemptions promulgated by the Department of Labor and the Internal Revenue Service, these funds may make construction loans to fund sponsoring employers up to the value of 35% of the fund assets, so long as no more than 10% is loaned to a single employer and certain safeguards are met.⁷³ This favorable treatment under ERISA goes a long way in explaining why construction industry unions have an advantage over other unions making job-creating investments from their pension funds.

B. *The Prudence Rule*

ERISA section 404(a)(1)(B) provides that fiduciaries shall discharge their duties "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 with like aims."⁷⁴ The ERISA prudence rule imposes a stricter standard on fiduciaries than did the common law "prudent man" standard.⁷⁵ The ERISA rule has been characterized as imposing a "prudent expert" standard, having expanded the standard from the behavior of one managing one's own affairs to the behavior of one "famil-

72. The Employee Retirement Income Security Act of 1974, § 407, 29 U.S.C. § 1107 (1982).

73. 41 Fed. Reg. 12,740, 12,743 (1976) (Prohibited Transaction Exemption 76-1).

74. The Employee Retirement Income Security Act of 1974, § 404(a)(1)(B), 29 U.S.C. § 1104(a)(1)(B) (1982); see *supra* note 61.

75. The landmark decision that generated the American common law "prudent man" rule is *Harvard College v. Armory*, 26 Mass. (9 Pick.) 461 (1830). This rule represented a significant departure from English common law. See M. LEIBIG, *supra* note 71, at 1-3.

iar with such matters."⁷⁶

Department of Labor regulations interpreting ERISA's prudence rule detail the factors to be considered when assessing the prudence of investment decisions.⁷⁷ Considerations of risk of loss and opportunity for gain are of paramount importance. Other factors that must be considered include diversification, liquidity, and projected rate of return. The Department of Labor does not define these requirements by setting numerical standards that each investment must meet. Instead, it has adopted a "whole-portfolio" approach, which considers the prudence of individual investments taken in light of the entire investment portfolio.⁷⁸ Under this approach, fiduciaries must take into account specific circumstances of the plan—its size, financial health, extent of diversification, and so forth in assessing the role that each investment plays in the portfolio. In certain cases, then, higher risk or lower yield investments may satisfy prudence requirements where the fund is already well invested in blue-chip securities and is looking to test the market in other areas. This principle is bolstered by ERISA's diversification requirement in section 404(a)(1)(c), which encourages a blend of investments.⁷⁹ Under the whole-portfolio approach, the performance of fiduciaries is not judged by the success or failure of single investments, but by the performance of the entire portfolio.⁸⁰

Due in large part to the whole-portfolio approach, there is a certain amount of room for job-creating or other socially sensitive investments under the prudence rule. The Department of Labor regulations have created a rule for investments that, though stringent in terms of the degree of asset management expertise required, is not so inflexible as to prohibit investments made in part with noneconomic motivations (such as creating jobs or improving a local economic climate). Though commentators initially disagreed as to what obstacles the prudence rule put up for such investments,⁸¹ it is now fairly clear that the Department of Labor

76. M. LEIBIG, *supra* note 71, at 21-22. See also Bredhoff, *supra* note 63, at 5 n.35.

77. 29 C.F.R. § 2550.404a-1 (1985).

78. *Id.* See also 44 Fed. Reg. 37, 221-25 (1979).

79. The Employee Retirement Income Security Act of 1974, § 404(a)(1)(C), 29 U.S.C. § 1104(a)(1)(C) (1982).

80. See Hutchinson & Cole, *supra* note 48, at 1355-56.

81. Compare Hutchinson & Cole, *supra* note 48, at 1352-59 with Langbein & Posner, *Social Investing and the Law of Trusts*, 79 MICH. L. REV. 72, 96-107 (1980).

will not challenge them based exclusively on a prudence theory.⁸²

To summarize, if fiduciaries of union plans adopt an investment policy that is designed to meet the overall needs of the fund by giving proper attention to such factors as risk, diversification, and liquidity, it will satisfy the Department of Labor's interpretation of the ERISA prudence rule. Within the general exercise of prudence, single investments that serve additional purposes as well as the funds needs are permissible. Certainly, some union promoting investments may be challenged on the grounds that they have put the plan assets at too great a risk or have violated diversification or liquidity requirements. Such investments would violate the prudence rule regardless of the fact that they are motivated by union goals.⁸³ These are not the cases that generate debate over job-creating pension investments. The difficult legal questions are presented by those investments that are permissible under ERISA's prudence standard, that are also not prohibited under ERISA's prohibited transactions rule, but that push at the limits of another of ERISA's fiduciary requirements—the duty of loyalty.

C. *The Duty of Loyalty*

Beyond avoiding prohibited transactions and meeting the criteria for prudence, plan fiduciaries must meet ERISA requirements creating a duty of loyalty to plan participants and beneficiaries. Section 404(a)(1) stipulates that fiduciaries must act "solely in the interest of the participants and beneficiaries,"⁸⁴ as well as "for the exclusive purpose of: (i) providing benefits to participants

82. The Department of Labor has not taken the position in any case brought against a pension fund that a socially or union motivated investment presents a per se violation of the prudence requirement. Prudence challenges that have been made were factually based, concerning such issues as return or risk, and were usually coupled with claims for violation of ERISA's other fiduciary requirements. *See, e.g.*, *Donovan v. Mazzola*, 716 F.2d 1226 (9th Cir. 1983), *cert. denied*, 104 S. Ct. 704 (1984); *Brock v. Walton*, 609 F. Supp. 1221 (S.D. Fla. 1985); *Marshall v. Glass/Metal Assoc. & Glaziers & Glassworkers Pension Plan*, 507 F. Supp. 378 (D. Hawaii 1980).

83. *See, e.g.*, *Donovan v. Mazzola*, 716 F.2d 1226 (9th Cir. 1983) (construction loan imprudent because of inadequate security on the loan); *Marshall v. Glass/Metal Assoc. & Glaziers & Glassworkers Pension Plan*, 507 F. Supp. 378 (D. Hawaii 1980) (construction loan made without adequate consideration of risks, alternatives available, and need for diversification).

84. The Employee Retirement Income Security Act of 1974, § 404(a)(1), 29 U.S.C. § 1104(a)(1) (1982).

and their beneficiaries; and (ii) defraying reasonable expenses of administering the plan."⁸⁵ Together they form what is referred to as the "duty of loyalty" requirement for fiduciaries.⁸⁶

The duty of loyalty has been characterized by the Supreme Court as imposing on fiduciaries "an unwavering duty of complete loyalty to the beneficiar[ies] of the trust, to the exclusion of interests of all other parties."⁸⁷ Of course, this does not mean that it is unlawful for parties other than the fund to derive some benefit from the acts of fiduciaries; that business transactions such as investments are designed to be mutually beneficial is a truism. The critical inquiry is to what extent investments are permitted when they are motivated, in whole or in part, by expected benefit to parties other than the fund itself. In brief, judicial interpretation of the duty of loyalty has been to allow these investments only where their primary purpose is still to benefit the fund.⁸⁸ Recent case law makes clear that fiduciaries may consider "collateral benefits" to secondary parties when making investment decisions, so long as these considerations do not supplant the primary purpose of providing benefits to the fund.⁸⁹ An analysis of the important case law on the duty of loyalty will provide insight into how determinations are made as to when a collateral benefit becomes the primary purpose of an investment.

The leading pre-ERISA duty of loyalty case is *Blankenship v. Boyle*.⁹⁰ *Blankenship* involved, inter alia, investments by the United Mine Workers' pension fund made to coerce utility companies into purchasing coal supplies from UMW-organized suppliers. The district court held that the trustees had breached their fiduci-

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

86. Some commentators initially suggested that the "solely in the interest" and "exclusive benefit" language of ERISA § 404(a)(1) imposed separate requirements. See Hutchison & Cole, *supra* note 48, at 1359-71. The "duty of loyalty" terminology here refers to a combination of the two, interpreted as applying essentially one basic rule. See *supra* note 63. Courts applying § 404(a)(1) in recent years have treated them as one rule, though the terminology used varies. See, e.g., *Donovan v. Bierwith*, 680 F.2d 263 (2d Cir. 1982), *cert. denied*, 450 U.S. 1069 (1982) ("solely in the interest/exclusive purpose"); *Davidson v. Cook*, 567 F. Supp. 225 (E.D. Va. 1983) ("sole and exclusive interest"); *Donovan v. Daugherty*, 550 F. Supp. 390 (S.D. Ala. 1982) ("solely in the interest").

87. *NLRB v. Amax Coal Co.*, 453 U.S. 322, 329 (1981).

88. See *infra* notes 98-113 and accompanying text.

89. *Id.*

90. 329 F. Supp. 1089 (D.D.C. 1971), *stay denied per curiam*, 447 F.2d 1280 (D.C. Cir. 1971), *aff'd mem.*, 511 F.2d 447 (D.C. Cir. 1975).

ary duty, stating: "[T]he Fund was acting primarily for the *collateral benefit* of the Union and the signatory operators in making most of its utility stock acquisitions."⁹¹

Some commentators have cited *Blankenship* for the proposition that the duty of loyalty presents a barrier for pension funds investing to achieve collateral benefits.⁹² Case law since *Blankenship*, however, has interpreted it as meaning that investments motivated by collateral interests only violate the duty of loyalty where these interests, and not the best interests of the fund, are its primary purpose.⁹³ In *Blankenship*, the investment was detrimental to the participants and beneficiaries because it did not assure an adequate return. The investment was determined to be unlawful because the fund made financial sacrifices to achieve the collateral benefit, not merely because a collateral benefit was achieved. As the Washington Supreme Court stated in *Culinary Workers Health and Welfare Trust v. Gateway Cafe*: "The language in *Blankenship* referencing collateral benefits to the union was not intended to be descriptive of the general obligations of the trustees . . . as we noted in discussing the LMRA, some degree of collateral interest is permissible."⁹⁴

*Withers v. Teachers Retirement System of New York*⁹⁵ was the first case that ratified a pension investment challenged on the grounds that it served collateral interests. Though its precedential value is limited because it concerns a public employee plan which was regulated not by ERISA but by state law, it is valuable because it sheds light on the collateral benefit rule developed since *Blankenship*. In this case, participants of the pension plan challenged the trustees decision to purchase New York City municipal bonds at a time when the city was threatened with bankruptcy. The court approved the investment based on the unique circumstances of the case. It took cognizance of the fact that the city was the primary contributor to the fund and that, by investing to insure the city's financial health, the trustees also insured "the survival of

91. *Id.* at 1106 (emphasis added).

92. See, e.g., Langbein & Posner, *supra* note 81, at 97.

93. See, e.g., *Culinary Workers Health & Welfare Trust v. Gateway Cafe*, 91 Wash. 2d 353, 361-62, 588 P.2d 1344, 1340-41 (1979) (applies *Blankenship* as having weight for interpreting the ERISA duty of loyalty).

94. *Id.* at 361, 588 P.2d at 1340.

95. 447 F. Supp. 1248 (S.D.N.Y. 1978), *aff'd* 595 F.2d 1210 (2d Cir. 1979).

'the fund as an entity.'⁹⁶ The court distinguished the *Blankenship* ruling as one that involved a primary motivation to serve the collateral benefit.⁹⁷ Though, like *Blankenship*, this investment involved certain sacrifices (here in terms of increased risk), the court found that they were made primarily for the benefit of the fund itself, and not the city. In essence, the court took a broad view of the duty of loyalty, permitting an investment that posed obvious sacrifices in the short run but that could result in overriding benefits in the long run. *Withers* offers a bold interpretation of the duty of loyalty not yet taken by courts applying ERISA.

The federal courts applying ERISA have expressed acceptance of the basic collateral benefit rule that investment decisions will not be deemed to be violative of the duty simply because they serve a collateral purpose. Among the first statements of approval came in *Donovan v. Beirwith*.⁹⁸ *Beirwith* involved the use of pension assets to purchase additional stock of the plan sponsor/employer's company in order to avert an outside takeover attempt. The court held the investment to be unlawful, but stated: "Officers of corporations who are trustees of its pension plan do not violate their duties as trustees by taking action which, after careful and impartial investigation, they reasonably conclude best to promote the interests of participants and beneficiaries simply because it incidentally benefits the corporation or, indeed, themselves"⁹⁹ Soon thereafter, the *Beirwith* reasoning was applied in *Morse v. Stanley*,¹⁰⁰ which involved a different fact pattern,¹⁰¹ but articulated the same principle: "It is no violation of a trustee's fiduciary duties to take into account a course of action which reasonably

96. *Id.* at 1259.

97.

Blankenship was thus a case in which the trustees pursued policies which may incidentally have aided the beneficiaries of the fund but which were intended, primarily, to enhance the position of the union and the welfare of its members, presumably, through the creation and/or preservation of jobs in the coal industry. The decision is inapplicable here.

Id. at 1256.

98. 680 F.2d 263 (2d Cir. 1982), *cert. denied*, 459 U.S. 1069 (1982).

99. *Id.* at 271.

100. 566 F. Supp. 1455 (S.D.N.Y. 1983), *aff'd in part and rev'd on other grounds*, 732 F.2d 1139 (2d Cir. 1984).

101. In *Morse*, the trustees of a profit-sharing plan, who were also senior managers of the employer, refused to accelerate profit-sharing payments to a departing employee. 566 F. Supp. at 1456-57.

best promotes the interests of plan participants simply because it incidentally also benefits the corporation."¹⁰² The Department of Labor has consented with this view that investments do not violate the duty of loyalty solely for the reason that they also create a collateral benefit.¹⁰³ Indeed, it is arguable that this view is supported by ERISA's legislative history.¹⁰⁴

The current collateral benefit rule leaves to the courts the task of discovering the primary motives behind investment decisions on a case-by-case basis. The cases cited above establish that collateral benefits are permissible, but they fashion no guidelines for determining which benefits should be considered as merely incidental and which should be considered the primary purpose of the investment. The current approach is perhaps best articulated in *Davidson v. Cook*, a case involving an unlawful pension investment directly benefitting the union: "Proving purpose or intent is always difficult, and the court must rely on circumstantial evidence and reasonable inferences to reach its conclusion that the fiduciaries were attempting to also satisfy the desires and needs of the [union]."¹⁰⁵ Evidence that has weight in proving primary purpose includes the identity of the party benefitting,¹⁰⁶ the methodology used by the trustees in making the decision,¹⁰⁷ and the cost or

102. *Morse*, 732 F.2d at 1146 (citing with approval *Donovan v. Beirwith*, 680 F.2d 263 (2d Cir. 1982), cert. denied 459 U.S. 1069 (1982)).

103. Former Department of Labor Administrator of Pension and Welfare Benefit Programs Ian D. Lanoff expressed the Department's view to Congress in 1979: "If, after evaluating other factors, two investments appear to be equally desirable [in economic terms], then social judgments are permissible in determining which to select." *Pension Fund Investment Policy: Hearing Before the Subcomm. on Antitrust, Monopoly and Business Rights of the Senate Comm. on the Judiciary*, 96th Cong., 1st Sess. (Part II) 4 (1979).

104. See generally Bredhoff, *supra* note 63, at 6-7 (arguing that ERISA's legislative history provides "affirmative evidence" that Congress intended the duty of loyalty to be interpreted as applying a duty similar to that previously imposed under the Internal Revenue Code and the Taft-Hartley Act, which did not prohibit collateral benefit investments *per se*).

105. 567 F. Supp. 225, 236 (E.D. Va. 1983).

106. Collateral benefits that come to parties related to the pension fund are likely to raise the inference that fiduciary duties have been violated. See, e.g., *Leigh v. Engle*, 727 F.2d 113 (7th Cir. 1983) (trustees unlawfully benefit from use of pension assets to purchase stocks in trustees own investment portfolio); *Davidson v. Cook*, 567 F. Supp. 225 (E.D. Va. 1983) (pension plan co-sponsor local union unlawfully benefits when trustees make mortgage loan to a wholly owned real estate subsidiary of local union).

107. See, e.g., *Donovan v. Beirwith*, 680 F.2d 263 (2d Cir. 1982), cert. denied, 459 U.S. 1069 (1982) (court focuses on methodology followed by trustees in making investment decision, rather than on merits of investment itself).

benefit of the transaction to the fund.¹⁰⁸ Consistent with the flexibility of this approach, none of these factors alone or in any particular combination have been held to be necessarily dispositive of the issue.¹⁰⁹

One factor that the courts have refused to consider when searching for primary purpose is the potential that collateral benefit investments may have for long-term, indirect benefits to the fund itself. The argument is that trustees' decisions that ultimately serve the fund as the primary interest, though they initially seem to promote the collateral interest as primary, should satisfy the duty of loyalty. This argument was not considered under common law in *Blankenship*,¹¹⁰ and it was rejected under ERISA in *Beirwith*.¹¹¹ Though it found favor in *Withers*,¹¹² no federal court applying ERISA has accorded that case any weight, probably because it involved state law and could easily be distinguished on its facts.¹¹³

The above discussion summarizes the judicial understanding of the duty of loyalty under ERISA and its corollary collateral benefit rule at the time *Brock v. Walton* came to bar. The court in this case was faced with applying these nebulous rules to a difficult fact situation never before addressed by the courts—one where the primary and incidental purposes were so intertwined, and where the expected benefits to each were so great, that an equitable result would be nearly impossible to reach under these rules. Because it failed to explicitly recognize or sufficiently deal with this dilemma, this case does little more than add to the confusion surrounding ERISA's duty of loyalty.

108. See, e.g., *Morse v. Stanley*, 556 F. Supp. 1455 (S.D.N.Y. 1983) *aff'd in part and rev'd on other grounds*, 732 F.2d 1139 (2d Cir. 1984) (plan management decision that served collateral benefit as well as having a positive impact on the fund's financial reserve held lawful); *Brink v. DaLesio*, 496 F. Supp. 1350 (D. Md. 1980), *aff'd in part and rev'd on other grounds* 667 F.2d 420 (4th Cir. 1981) (investment creating collateral benefit at the possible or actual expense of the plan's participants and beneficiaries held unlawful). *But cf.* *Donovan v. Daugherty*, 550 F. Supp. 390, 410 n.21 (S.D. Ala. 1982) ("A violation of section 404(a) is not dependent on a finding of monetary loss.")

109. See *supra* notes 105-08 and accompanying text. In none of the cases cited has a court held any single factor to be determinative.

110. See *supra* notes 90-93 and accompanying text.

111. See *supra* notes 98-99 and accompanying text.

112. See *supra* notes 95-97 and accompanying text.

113. See *supra* text accompanying notes 95-96.

V. *BROCK v. WALTON*—UNION INVESTMENT AFFIRMEDA. *The District Court Decision*

*Brock v. Walton*¹¹⁴ has been hailed by organized labor and other observers as the decision that sets a firm and favorable precedent for union pension investments that create jobs.¹¹⁵ The court in this case approved investments by the jointly administered, multiemployer pension fund of Local 675 of the Operating Engineers International Union in a southern Florida real estate project which was developed exclusively through the use of Local 675 laborers. The Department of Labor challenged the investments in federal court on the grounds that the trustees of the fund breached their fiduciary duties in making the investments.¹¹⁶ In a lengthy opinion tailored closely to the facts of the case, Florida District Court Judge Gonzalez granted defendant trustees' motion for summary judgment, stating: "The Department's charges are indeed serious, but its bark is worse than its bite . . . the [Department of Labor] was simply unable to prove its case by a preponderance of the evidence."¹¹⁷

Brock v. Walton can be seen as a test case brought by the Department of Labor to resolve the issue of union pension investments that create union jobs.¹¹⁸ Nevertheless, the court's decision

114. 609 F. Supp. 1221 (S.D. Fla. 1985).

115. See, e.g., *Court Issues Strong Statement Supporting Prudence of Pension Fund Investment*, LABOR & INVESTMENTS, June 1985, at 1, 6; *Donovan v. Walton Opinion Provides Guidelines for Fiduciaries*, PENSION WORLD, Oct. 1985, at 58-60; *Union Investment Affirmed*, PENSIONS & INVESTMENT AGE, Mar. 18, 1985, at 2-3.

116. Originally, the Department of Labor [hereinafter "DOL" in notes] had also challenged the fund's sponsorship of a home mortgage loan program for plan participants and its administrative service payments to union employees for "in kind" services performed as violations of fiduciary duty. Earlier rulings by the Florida district court disposed of these issues in the trustee's favor. *Walton*, 609 F. Supp. at 1225 & nn. 2 & 3; 10 PENS. REP. (BNA) No. 438, at 606 (Apr. 4, 1983). The DOL appealed the ruling on the mortgage loan program to the court of appeals, but the district court view was upheld. The issue on appeal was the DOL's contention that ERISA required the trustees to charge participants offered mortgage loans a prevailing or market rate of interest. The court of appeals held that section 406(a)(1)(B) of ERISA, requiring that a "reasonable rate of interest" be charged participants for mortgage loans, should not be construed as requiring a prevailing or market rate. The court noted that section 406(a)(1)(B) takes into account factors other than the interest rate in determining whether such a loan is a prohibited transaction and found that in cases where certain other safeguards are met that a "reasonable rate" could be below the market rate. *Brock v. Walton*, No. 85-5641, slip op. (11th Cir. July 21, 1986).

117. *Walton*, 609 F. Supp. at 1238.

118. *But cf.* note 162 (positing several alternative reasons why the DOL might chal-

neither ratifies nor strikes down this type of pension investing. It is based mostly on a narrow analysis of the particular investment made here under ERISA prudence standards. The impact of ERISA's duty of loyalty on job-creating investments is largely ignored. While this case is important because it permitted a union job-creating investment, what may be more important is that the court declined an opportunity in this case to decide this issue under the duty of loyalty standards, where this analysis properly belongs.¹¹⁹

The facts of the case are as follows.¹²⁰ In 1979, the Operating Engineers Pension Trust Fund decided to purchase and develop ninety-five acres of land in Broward County, Florida as part of the fund's overall investment policy of seeking to increase the fund's capital returns through real estate. The fund also planned to finance the construction of several buildings on the site, with the intention of landing Local 675 as the principal tenant of a new office building. Even if this could not be accomplished, the fund would proceed with the construction of the building, as independent studies had shown that the rental market and projected capital return were very promising. The fund financed the project completely with its own funds rather than by acquiring construction loans. Land development and construction of the buildings were the result of competitive bidding that was limited to companies whose workers were represented by Local 675. Under threat of legal challenge from the Department of Labor, the project commenced in 1981.

The Department of Labor filed suit against the trustees, challenging the real estate investment project on several grounds under ERISA's fiduciary standards. They charged that the trustees violated section 404(a)(1)(B)'s prudence rule by paying too

lenge job-creating investments by union pension fund trustees).

119. The court's use of the prudence rule over the duty of loyalty may be attributable in part to the DOL's posture at trial. The DOL had focused on the duty of loyalty in its unsuccessful challenge of the pension fund's home mortgage loan program. *See supra* note 116. Its focus on the prudence rule at trial concerning the real estate development project may simply have been a change in strategy, and one which affected the court's written opinion. Interview with Jayne E. Zanglein, Attorney-at-Law, Operating Engineers Local 675, Fringe Benefit Funds, in Buffalo, New York (Oct. 22, 1985). The court's failure to deal sufficiently with the duty of loyalty may also explain why the DOL did not appeal the ruling on the real estate project. *Id.*

120. *Walton*, 609 F. Supp. at 1226-27.

much in construction costs, by not negotiating a high enough rent from the union, by financing the project with equity capital rather than debt, and by inaccurately projecting the rate of return on the project.¹²¹ The Department also charged that the investment violated section 404(a)(1)(A)'s exclusive benefit rule by constructing and leasing a building to the union for their benefit on terms not beneficial to the participants.¹²² Finally, the Department alleged that the fund's construction of the office building specifically for the union violated section 406(b)'s prohibited transactions rule.¹²³ The court rejected each of the Department's claims. It based its decision primarily on a strict prudence analysis of the investment. Having decided that the prudence rule's requirements were met, the court had little difficulty dismissing the allegations on other grounds.

In finding that a prudent investment was made, Judge Gonzalez emphasized that the prudence rule requires analysis of the methods used in making investment decisions, not the results achieved.¹²⁴ In so concentrating on the decision to invest, the court found indicative of a course of prudent behavior such actions taken by the trustees as enlisting independent consultants to research and advise on the viability of the investment, conducting competitive bidding on the design and construction of the buildings, and retaining an independent real estate manager to negotiate the union's lease with the fund.¹²⁵ In truth, the entire project was meticulously conceived and executed by the trustees and independent experts. All signs indicated nothing less than a "smashing success."¹²⁶ The Department of Labor's charges of imprudence based on individual aspects of the project which they claimed raised its costs to the fund simply were not proven and could not hold up against the court's broad view of what constitutes prudent decision making.¹²⁷

121. *Id.* at 1231-37.

122. *Id.* at 1244-45.

123. *Id.* at 1246.

124. "[O]ne must resist the knee jerk reflex to pronounce an investment prudent or imprudent based on the success of the venture, for ERISA is concerned with the soundness of the decision to invest." *Id.* at 1242.

125. *Id.* at 1240.

126. *Id.* at 1244.

127. "The DOL's difficulty stems from its perception of this case as much as its lack of persuasive evidence . . ." *Id.* at 1238.

The opinion gave less play to ERISA duty of loyalty requirements than it did the prudence rule.¹²⁸ Adopting the collateral benefit rule as it had been developed by the federal courts in recent years, the court dismissed the Department's charge that the union benefit from the investment caused a breach of fiduciary duty. It ruled that: "ERISA section 404(a)(1)(A) simply does not prohibit a party other than a plan's participants and beneficiaries from benefiting in some measure from a prudent transaction with the plan."¹²⁹ It cited a plethora of case law in support of this view.¹³⁰

The court acknowledged that the union did derive a benefit from the lease of the office building and the increase in job opportunities for its members. Consistent with the collateral benefit rule, it noted that secondary benefits are not precluded by ERISA where they are incidental to the primary benefit to the fund.¹³¹ Though it noted the rule, the court failed to make the crucial analysis of trustee motivation that the collateral benefit rule requires. It did not address what constitutes primary versus incidental benefit, nor did it attempt to make a finding of either on the facts before it.

Finally, the court made short work of the claim that the investment violated ERISA's prohibited transactions rule because it involved a party in interest. The Department of Labor did not contend that the construction loans to the independent contractors organized by the union were prohibited transactions because the contractors or the union were parties in interest. These transactions were exempted from the rule because they were qualified

128. The opinion does not use the phrase "duty of loyalty," but its analysis of ERISA § 404(a)(1) applies the statutory language and case law from which this phrase is derived. Cf. note 82 (DOL has not taken position that socially or union motivated investments present per se violation of prudence rule).

129. *Walton*, 609 F. Supp. at 1245.

130. This being a case of first impression in the 11th Circuit, the court drew for support from case law from other circuits. The opinion discussed *Leigh v. Engle*, 727 F.2d 113 (7th Cir. 1983); *Donovan v. Bierwith*, 680 F.2d 263 (2d Cir. 1982), cert. denied 459 U.S. 1069 (1982); *Morse v. Stanley*, 566 F. Supp. 1455 (S.D.N.Y. 1983), *aff'd in part rev'd on other grounds* 732 F.2d 1139 (2d Cir. 1984). *Donovan v. Dougherty*, 550 F. Supp. 390 (S.D. Ala. 1982); *Brink v. DaLesio*, 496 F. Supp. 1350 (D. Md. 1980), *aff'd in part rev'd on other grounds* 667 F.2d 420 (4th Cir. 1981). *Walton*, 609 F. Supp. at 1245-46.

131. "[A] trustee may make management decisions that incidentally benefit the plan or the trustees provided the judgment is prudent and primarily promotes the interest of plan participants and beneficiaries." *Walton*, 609 F. Supp. at 1245.

construction loans.¹³² The Department contended, rather, that the fund violated the prohibited transactions rule by constructing an office building for use by the union, a transaction with a party in interest.¹³³ The issue was resolved by the court simply by giving a broad construction to two other exemptions to the rule which permit multiemployer plans to lease office space to the sponsoring employee organization when certain conditions are met.¹³⁴

B. *The Decision Analyzed*

Brock v. Walton stands for the proposition that union pension investments that create jobs for the members of the union may be made so long as they satisfy ERISA prudence requirements and are exempted from the prohibited transactions rule. In other words, this case could be taken to mean that, as a matter of law, union job-creating investments do not constitute a per se violation of the ERISA duty of loyalty. Such a holding would represent a bold step in the interpretation of ERISA fiduciary standards, were it expressly taken. Because it was not, the Florida district court has missed an excellent opportunity to set significant precedent by giving definition to the collateral benefit rule of the duty of loyalty in cases involving union job-creating pension investments.

The district court relied on its own watered-down version of the collateral benefit rule to find that this investment satisfied the trustees' duty of loyalty. Employment of the rule to approve of secondary benefits from investments is typically premised on a finding that those benefits are incidental to the primary benefit to the fund.¹³⁵ Though it acknowledged this, the court applied a much different test under the auspices of the collateral benefit rule. It held that benefits derived by the union do not violate the duty of loyalty where they are "parallel and inseparable from the

132. The loans qualified for exemption from the prohibited transactions rule under 41 Fed. Reg. 12,740, 12,744-45 (1976) (Prohibited Transaction Exemption 76-1).

133. *Walton*, 609 F. Supp. at 1246.

134. 41 Fed. Reg. 12,740, 12,744-45 (1976) (Prohibited Transaction Exemption 76-1); 42 Fed. Reg. 33,918 (1977) (Prohibited Transaction Exemption 77-10). The main conditions these provisions require for exemption are that the plan receive reasonable compensation for the lease, that the plan be able to terminate the relationship on reasonably short notice, and that the plan maintain the necessary records so that the DOL can verify compliance. See *Walton*, 609 F. Supp. at 1247.

135. See *supra* notes 98-113 and accompanying text.

benefits derived for the fund and its participants."¹³⁶ Such a test blatantly ignores the issue of the trustees' motivation in making the investment decision—the investment's "primary purpose." This issue is the foundational element upon which the collateral benefit rule relies.¹³⁷ Because this was a case of first impression in the eleventh circuit, the court was of course not bound by any set interpretation of the duty of loyalty. By applying a new set of rules without clearly enunciating or supporting them, however, the court limited its decision's importance and left itself open for reversal.

Perhaps the court ignored the issue of motivation because it presented such a difficult problem in this case. If a motivation-based test were used, and an improper primary motivation found, the court would be forced to strike down, based on a strict legalism, what it otherwise had found to be a perfectly prudent and profitable investment.

The question in this case of what was the primary purpose of the investment was a vexing one. Because of the prudence of this investment, it was clear to the court that the trustees were motivated, at least in part, by a desire to serve the financial interests of the fund. It was also clear, though, that the trustees gave a great deal of consideration to the benefits that the union and its members would receive. In such a case, how should a court determine primary purpose? The courts have stated that they will look at all of the circumstantial evidence and attempt to draw reasonable inferences.¹³⁸ One factor that leads to a finding that the collateral benefit was the primary purpose is intentional financial sacrifice.¹³⁹ A financial sacrifice was made by the trustees of Local 675's pension fund when they decided that the main building of the development project would be constructed by a building contractor who employed Local 675 members. The court recognized that this decision raised the cost of the project over what it would have been had the trustees decided to use nonunion labor¹⁴⁰ and, yet, it overlooked its impact on the duty of loyalty rule. This is not to suggest that the court should have held that the trustees vio-

136. *Walton*, 609 F. Supp. at 1245.

137. *See supra* notes 98-113 and accompanying text.

138. *See supra* notes 105-09 and accompanying text.

139. *See supra* note 108 and accompanying text.

140. *Walton*, 609 F. Supp. at 1234.

lated their duty simply because they chose to use union rather than nonunion labor. Union labor may not result in extra expense in every case. Indeed, some would argue that the use of higher-cost union labor does not pose a sacrifice for the value of the investment to the fund, but adds to its value because the higher wage costs are outweighed by the additional quality that union labor brings to the finished product.¹⁴¹ This does suggest that the proper analysis of investments predicated on the guaranteed use of union labor raises more serious questions under the collateral benefit rule than are dealt with in *Walton*.

A clearer statement of ERISA fiduciary requirements for union job-creating investments must be made. Interpretation of both the prudence and duty of loyalty rules over the past several years has evolved to allow collateral benefit investments that are primarily motivated by a desire to serve the financial interest of the fund.¹⁴² Investments that create union jobs push at the limits of this interpretation because they impose costs on the pension fund that call into question their primary motivation. A discussion of the genesis of the issue of job-creating investments in the building and construction trades unions will point out its importance, and highlight the arguments for and against sanctioning these investments under ERISA.

VI. THE "UNION-LABOR" ISSUE

A. *The Parties to the Issue and Their Positions*

Building and construction trades unions have seized the initiative on the union strategy of using pension fund assets to finance increased job opportunities for members. Investments in real estate development projects are being made on the guarantee that only union members will perform the work created by the investment. Though most of these investments have proceeded without challenge, a serious question as to their legality remains. Put simply, is a union labor guarantee permissible under ERISA? The eventual resolution of the "union-labor" issue is critical to the fu-

141. Interview with Jayne E. Zanglein, *supra* note 119.

142. See *supra* notes 74-113 and accompanying text. *But cf.* Lynn, *Investing Pension Funds for Social Goals Requires Changing the Law*, 53 U. COLO. L. REV. 101 (1981) (arguing that current ERISA fiduciary rules are not sufficient to accommodate "social" benefit investments).

ture of pension investing as a strategy to promote unionism. For the parties currently embroiled in this controversy, the stakes are very high.

1. *The Construction Unions.* Predicating union pension investments on the guaranteed use of union labor is a strategy for survival among building and construction trades unions. The percentage of union-built commercial construction has declined from about 80% in the 1960's to as low as 40% in recent years, causing membership in these unions to decline.¹⁴³ By using their pension funds to create jobs for union members, construction unions have begun to fully exploit the degree of control that they have over their pension plans. This is due to the fact that most construction union pension plans are of the jointly administered, multiemployer variety.¹⁴⁴ Union trustees have given new direction to the investment policy of these pension funds by playing a more active role in investment decision making. The movement of pension assets of construction union funds into job-creating projects has been significant,¹⁴⁵ and though estimates are not available, it is clear that these projects have created an equally significant number of union jobs. This fact alone has increased the attractiveness of union membership among workers in the construction industry. The future viability of construction unions may indeed depend on the continued legality of job-creating pension investments.

2. *Participants and Beneficiaries.* Participants and beneficiaries of pension plans, those whose sole interest and exclusive benefit is protected by ERISA, actually have the least to say about pension investment decisions. The Supreme Court has made clear in *Daniel v. International Brotherhood of Teamsters* that workers do not have a remedy under federal law for complaints about the management of their pension funds assets.¹⁴⁶ Where workers are organized in a union, however, it can hardly be said that they lack the means to control pension asset management. The distinction is that they cannot do so individually, but they can do so collectively by ratifying union contracts that create and regulate pension funds, as well as by electing the union officers who sit on the

143. H. GRAY, *supra* note 4, at 41.

144. See *supra* notes 37-38 and accompanying text.

145. See *supra* note 36 and accompanying text.

146. 439 U.S. 551 (1980).

board of trustees of jointly administered funds.¹⁴⁷ In this respect, labor unions can be seen as the agents for connecting participant ownership of fund assets with participant control. Resolution of the union-labor issue is necessary to define the extent to which this control can be used to promote the participant interests of increased employment opportunities and retirement security.

Participant members of construction unions have strongly supported the efforts of their leadership to use their pension assets to finance job opportunities; more work means not only a steadier living wage, it also means a greater likelihood for workers of vesting and eventually receiving a pension.¹⁴⁸ Retired members and other beneficiaries collecting union pensions have also been supportive; more work for current participants also helps ensure the stability of the fund by increasing employer contributions to it.¹⁴⁹ Moreover, equity real estate investments have proved to be profitable, low risk investments in recent years,¹⁵⁰ which also ensures the health of the fund.

3. *Employers.* Initially, the corporate community was un-receptive to the idea of union job creation and other "social investments."¹⁵¹ Pension trustees had learned from institutional investors to think only in terms of conventional asset management, which permits investing for no other reason than to maximize returns. The diminished resistance among employers can be attributed to two main developments. First, the courts have interpreted ERISA fiduciary requirements to be flexible enough to permit at least some consideration of collateral benefits from investment.¹⁵² The potential personal liability of fiduciaries for the large sums of money that may be lost by bad investments¹⁵³ is a strong deterrent for taking chances on ERISA. Second, like the unions, many employers have realized the benefits that job-creating investments in

147. See *supra* notes 30-32 and accompanying text.

148. See *infra* note 174 and accompanying text.

149. See *infra* note 175 and accompanying text.

150. See generally D. Walton, ERISA, Solely In Whose Interest? 21-24 (unpublished paper presented at Florida International University, Mar. 1983). Pension fund investments in real estate continue to increase. In 1985, pension funds in the United States invested \$6 billion in real estate, bringing their total collective holdings to over \$40 billion. Wall St. J., Apr. 1, 1986, at 1, col. 6.

151. See H. GRAY, *supra* note 4, at 47-51.

152. See *supra* notes 63-113 and accompanying text.

153. See H. GRAY, *supra* note 4, at 51.

their business can bring.¹⁵⁴ They, too, have been the victim of traditional investment policy that ignores the positive collateral impact that pension investments can have on business.

Some of the stiffest opposition to guaranteed union labor investments in the construction industry has come from a different group of employers, however. These are the nonunion construction contractors who lose business when real estate projects are developed with union-labor guarantees. Because these contractors do not have standing to bring a civil action for breach of fiduciary duty under ERISA,¹⁵⁵ opposition has come in the form of claims against union funds under section 1 of the Sherman Anti-Trust Act¹⁵⁶ for restraint of trade. This form of opposition has not been successful. The Department of Justice concluded in June, 1984 that it would not consider a Cincinnati area building trades investment foundation to be in restraint of trade because it loaned money only to union developers and contractors.¹⁵⁷ Similarly, a district court in California in January, 1985 dismissed an anti-trust suit brought by a nonunion contractor against a union pension fund making "union only" construction loans.¹⁵⁸ Opposition among nonunion employers is not organized. They do have a strong ally, though, in the Department of Labor.

4. *Department of Labor.* The Department of Labor's concern about union job-creating investments is not apparent. Even its position on the permissibility of such investments under ERISA fiduciary requirements is not clear, though its actions in recent years would seem to indicate that it is negative.¹⁵⁹

Equally unclear is the Department of Labor's position on the union-labor issue. With the exception of the *Walton* case, where the labor costs challenge was merely one among many,¹⁶⁰ the Department of Labor has not raised this union-labor issue in lawsuits

154. *Id.*

155. The Employee Retirement Income Security Act of 1974, § 432(a), 29 U.S.C. § 1132(a) (1982).

156. The Sherman Act, 15 U.S.C. § 1 (1982).

157. See LABOR & INVESTMENTS, Sept. 1984, at 1.

158. *Beutler Sheetmetal v. McMorgan & Co.*, 616 F. Supp. 453 (N.D. Cal. 1985).

159. Aside from bringing union pension fund trustees to court over job-creating investments, the DOL has used the threat of legal action to cause union trustees to back away from planned investment projects. See, e.g., 12 PENS. REP. (BNA) No. 2, at 86 (Jan. 14, 1985). Meanwhile, however, certain other projects have proceeded unchallenged. See, e.g., LABOR & INVESTMENTS, Nov. 1983, at 3.

160. See *supra* text accompanying notes 121-23.

brought against union funds making job-creating investments.¹⁶¹ It is possible that the Department of Labor raised the issue in *Walton* simply as one of a host of alternative challenges to the investment to see which, if any, the court would recognize. It is also possible that the Department of Labor has realized the pivotal role that the union-labor issue plays in determining the legality of job-creating investments. If so, we are likely to see more direct challenges from the Department of Labor of these investments where increased labor costs is a result. Given the unsettled nature of the ERISA duty of loyalty and its collateral benefit rule after *Walton*, such a legal argument remains plausible. Regardless, it is still hard to imagine why the Department of Labor should continue to challenge investments such as were made in *Walton*. One can only speculate about the reasons why it would challenge prudent, profitable, low risk, job-creating investments based on an arguably weak duty of loyalty theory.¹⁶²

161. See, e.g., *Marshall v. Glass/Metal Assoc. & Glaziers & Glassworkers Pension Plan*, 507 F. Supp. 378 (D. Hawaii 1980); *Donovan v. Retirement Fund Trust of the Plumbing, Heating and Piping Industry of S. California* (Civil Action No. 84-9967 AHS (Bx), Jan. 4, 1985) (reported in 12 PENS. REP. (BNA) No. 2, at 86 (Jan. 14, 1985)); 12 PENS. REP. (BNA) No. 4, at 152 (Jan. 28, 1985)).

162. There are several possibilities. One is that the DOL has no particular disagreement with job-creating investments, so long as they are prudent, and that the *Walton* case should be viewed as an aberration, brought by the DOL for reasons not so enforcement-minded. Observers of that case claim that it may have been brought because of certain animosities that officials at the DOL held for the outspoken Dennis Walton, president and pension fund trustee of Local 675. Interview with Jayne E. Zanglein, *supra* note 119.

It is also possible that the DOL is sensitive to what they may feel is the increased risk involved when a pension fund breaks from traditional investing in favor of a program for job-creating investments, an area of still largely uncharted territory. As the enforcement agent of ERISA fiduciary standards, the DOL is responsible for seeing that pension plans do not invest imprudently and raise the risk of plan termination, which is against the financial interest of participants and beneficiaries, employers, and the Pension Benefit Guaranty Corporation, which insures pension plan termination. See generally *The Employee Retirement Income Security Act of 1974*, §§ 4061-4068, 29 U.S.C. §§ 1361-1368 (1982) (single-employer liability); *Multiemployer Pension Plan Amendments Act of 1980*, §§ 1-24, 29 U.S.C. §§ 1381-1405 (1982) (multiemployer liability); *The Employee Retirement Income Security Act of 1974*, §§ 4001-4009, 29 U.S.C. §§ 1301-1309 (1982) (Pension Benefit Guaranty Corporation).

Still another possibility is the DOL's alleged anti-union bias under President Reagan. In 1982, the DOL contracted with the anti-union National Right to Work Committee for a study of pension fund investments that create jobs for participants. Not surprisingly, the study condemned all plan investments in job-creating projects as inherently imprudent and contrary to the interests of the participants. Under pressure from the AFL-CIO, the DOL decided not to release the study. See *LABOR & INVESTMENTS*, June 1983, at 3-5. Commentators have also noted that the DOL under Reagan has shown extreme anti-union animus in

B. Possible Legal Resolutions of the "Union-Labor" Issue

The legal resolution of the union-labor issue must come from the federal courts. The Department of Labor has taken the position that it will not exercise its power to issue agency regulations to govern "social investment" questions and instead will leave the fate of these investments to the courts.¹⁶³ There are also no indications that ERISA fiduciary requirements will be amended by Congress to make a clearer accommodation for job-creating investments.¹⁶⁴

Brock v. Walton can be seen as a missed opportunity to reach a resolution of the union-labor issue. It is especially unfortunate that the decision did not focus on this issue because the facts of the case were such a perfect invitation to do so.¹⁶⁵ The union-labor issue can be expected to arise again, and when it does, a trier of fact may make one of several possible determinations.

One possibility is to continue along the lines of *Walton*. That is, to disregard the importance of the union-labor issue. This rationale would permit job-creating investments so long as they are prudent, ignoring the implications of ERISA's duty of loyalty. While this alternative may be acceptable to organized labor because it achieves its ends, it should not be argued by union litigators because it is destined to be short-lived. As the above analysis suggests, the *Walton* result is a misapplication of ERISA fiduciary requirements.¹⁶⁶ This decision is as likely to be ignored as it is to be accorded any weight by future courts looking at this issue.

Another possibility is to outlaw union job-creating investments based on a strict interpretation of the duty of loyalty rule. This is the position apparently taken by the Department of Labor¹⁶⁷ and other opponents of this type of investing.¹⁶⁸ They argue that an investment predicated on union job creation will nec-

areas of enforcement other than for pension plans. See D. ELBAOR & L. GOLD, DOES UNCLE SAM LOOK OR AIM FOR THE UNION LABEL? (1985).

163. 11 PENS. REP. (BNA) No. 19, at 613 (May 7, 1984).

164. Lynn, *supra* note 142, makes the argument that such an amendment is necessary to accommodate these investments.

165. See *supra* note 120 and accompanying text.

166. See *supra* notes 135-42 and accompanying text.

167. See *supra* notes 159-62 and accompanying text.

168. See Langbein & Posner, *supra* note 81, at 96-104.

essarily violate the duty of loyalty because it puts the interests of the union ahead of those of the fund. This, they argue, is beyond the scope of acceptable investments under the collateral benefit rule to the duty of loyalty.¹⁶⁹ The fact that the fund has made financial sacrifices to accommodate the collateral union benefit, by way of the higher costs of investing in union as opposed to non-union construction, for example, is evidence that the union benefit is the primary purpose of the investment. Such an argument, while admittedly consistent with the current interpretation of the collateral benefit rule,¹⁷⁰ should no longer be seriously entertained because it actually contravenes the central purpose of ERISA which is, as the name of the Act itself suggests, to promote "employee retirement income security."¹⁷¹ This purpose is not served by a rule that discourages pension fund trustees from financing the employment of its own participants and encourages them to finance the employment of other workers, sometimes even those who compete against participants for work in the same industries. This interpretation of the duty of loyalty has been criticized as being premised on "myopic legalisms"¹⁷² and evidencing "tunnel vision"¹⁷³ on the part of the Department of Labor. Indeed, such an analysis ignores the fact that every pension investment has potential secondary impacts on a fund beyond simply the profits or losses that it returns.

The final possibility is that the federal courts will ratify union job-creating investments by expanding the present interpretation of the ERISA duty of loyalty. Under an expanded interpretation, the collateral benefit rule would come to mean that investments which are designed to confer benefits on a collateral interest, so long as they can pass muster under ERISA's prohibited transactions and prudence rules, do not violate the duty of loyalty simply because they earn less direct return than non-collateral benefit investments. The foundational element of the collateral benefit rule, the primary purpose analysis, would open up to accept proof

169. *Id.*

170. *See supra* notes 98-113 and accompanying text.

171. *See* The Employee Retirement Income Security Act of 1974, §2, 29 U.S.C. § 1001 (1982) (congressional findings and declaration of policy).

172. Defendants' Memorandum in Support of Second Motion For Partial Summary Judgment at 33, *Brock v. Walton*, 609 F. Supp. 1221 (S.D. Fla. 1985).

173. S. FLA. Bus. J., Apr. 1-7, 1985, at 33 (quote of Dennis Walton).

of a purpose to benefit the retirement security interest of participants and beneficiaries in ways other than through investment return, such as through job creation. Job creation promotes this interest by raising the likelihood of participant vesting¹⁷⁴ and by adding to the amount of contributions to the fund.¹⁷⁵

This interpretation of the duty of loyalty would involve broadening the definitions of "solely in the interest" and "exclusive benefit" in the statute to include all significant interests and benefits that heed ERISA's mandate to protect retirement income security. This construction of the duty of loyalty takes the collateral benefit rule a step further, beyond where it was left after ERISA cases such as *Beirwith*,¹⁷⁶ and closer to an analysis such as was suggested under state law in *Withers*.¹⁷⁷ Essentially, this new interpretation would reject the notion that the duty of loyalty should create a per se rule against higher cost union job-creating investments. Nor would it create a per se rule in the opposite direction—that all job-creating investments satisfy the duty because of the mere possibility that they indirectly benefit the retirement interests of participants and beneficiaries. Furthermore, it would not permit taking into account, for the purpose of satisfying the duty of loyalty, those collateral benefits that, though they may be laudable, cannot be directly related to improving retirement income security.

174. ERISA authorizes three types of vesting formulas for pension plans: 10 year "cliff" vesting, 5 to 15 year "graduated" vesting, and vesting under "the rule of 45." See D. MCGILL, *supra* note 49, at 140-43 for an explanation of these formulas. Under each, the years of service of the participant is determinative of nonforfeitability. For the latter two, the years of service will also affect the amount of the benefit received.

175. The financial strength of a pension fund derives from the amount of contributions to it as well as it does from the return on its investments. There are two main types of pension funding arrangements. In a "defined contribution" plan, employee and/or employer contributions to the fund are based on time worked and are paid into individual employee accounts. In a "defined benefit" plan, employer contributions are based on actuarial projections that determine the current funding necessary to meet the future liability of the fund to pay benefit levels which are fixed for vested participants. See D. MCGILL, *supra* note 49, at 89-111 for a discussion of defined benefit and defined contribution plans.

Increased work for participants raises the level of contributions to the fund, directly for a defined contribution plan, and indirectly for defined benefit plans through the effect of increased expectation of participant vesting on actuarial projections. Increasing the asset pool of a pension fund may raise the quality of the investments that the fund can make, thus strengthening the fund for the benefit of participants and beneficiaries.

176. See *supra* text accompanying notes 98-99.

177. See *supra* text accompanying notes 95-97.

Analysis of the primary purpose of collateral benefit investments would remain fact oriented, with fulfillment of the fiduciary requirement for loyalty determined on a case-by-case basis. In other words, a trier of fact would need to determine in each case whether or not the projected sacrifice to the fund (through increased labor costs, for example) is outweighed by the potential for benefits returned to the fund from the collateral interest promoted. The benefits accruing from an investment would be measured by adding to the projected direct financial return such other factors related to retirement security as the greater likelihood of participant vesting and the increase of employer contributions to the fund.¹⁷⁸ This balancing of the dual purposes of an investment would more accurately discern its "primary purpose" and, thus, determine whether the duty of loyalty is satisfied.

Perhaps the courts are reluctant to expand the duty of loyalty in this manner because they see a difficulty in limiting it. If the trustees are permitted to satisfy their fiduciary obligations by making investments that benefit the fund through the indirect impacts of a collateral interest, how broad a view of indirect impacts should be taken? Are investments in other areas of the regional economy permissible because they may eventually result in increased business to the employer and thus more jobs? These types of questions will, admittedly, be difficult ones to answer under this new approach, but not ones which the courts cannot resolve by making "reasonable inferences" from "circumstantial evidence."¹⁷⁹ These are questions of fact for the court to resolve in deciding whether or not the trustees have made the interests of the fund their primary concern. As has always been the case under the collateral benefit rule, the courts will analyze the beneficial impact of an investment by measuring its financial return. This new approach simply redefines the way in which financial return is measured by looking for indirect as well as direct return.

Perhaps the courts are also reluctant to adopt this broader view of the duty of loyalty because they fear that it will disturb the current interpretation of the prudence rule. Because it would now be permissible for return from collateral benefits to enter into the

178. See *supra* notes 174-75 and accompanying text.

179. *Davidson v. Cook*, 567 F. Supp. 225, 236 (E.D. Va. 1983); See *supra* note 105 and accompanying text.

equation for trustees assessing investment alternatives, would a failure to take it into account be a violation of the prudence rule? Though an affirmative answer would seem to turn the prudence rule on its head, the plain language of the statute does seem to lead to this conclusion. ERISA requires that a fiduciary act as a "prudent man acting in a like capacity and familiar with such matters."¹⁸⁰ Under the current interpretation of the rule, many investments have been permitted that served to the detriment of fund participants. For union pension funds, examples are investments in the securities of corporations that produce overseas or that are in direct competition with the enterprise employing the participant.¹⁸¹ Moreover, the current prudence rule gives no favorable consideration to investments that promote the retirement income security of participants through creating job opportunities for them; the rule has only been stretched so far as to tolerate such investments in some cases.¹⁸² To be true to the prudence rule, the courts must recognize that a prudent man in a union pension fund trustee "capacity" and "familiar with such matters" as pertain to union workers would, and must, act to avoid those investments that may take jobs away from participants and promote instead those investments that will create jobs.

VII. CONCLUSION

Within union pension funds lies a largely untapped resource which unions would like to use to restore strength to their movement. Directed union investment of pension funds can create jobs for union members, help sustain local and regional economies where unions are strong, and discourage employers from engaging in anti-union activities. The battle that needs to be fought before this occurs is over the control of pension fund assets through union negotiation of jointly administered plans.

Unions in the building and construction trades industries, most of which already manage jointly administered pension plans, have charted a course in job-creating pension investment for other unions to follow. The legality of these investments under

180. The Employee Retirement Income Security Act of 1974, § 404(a)(1)(B), 29 U.S.C. § 1104(a)(1)(B) (1982).

181. See *supra* text accompanying note 1.

182. See *supra* notes 81-83 and accompanying text.

ERISA fiduciary requirements is not yet clear. By predicating their investments on the guaranteed use of union labor in the work that the investment generates, union funds are in danger of violating the duty of loyalty requirement for fiduciaries. The recent federal district court decision in *Brock v. Walton*, though it has been celebrated by labor for the fact that it permitted a construction union job-creating investment, serves more to confuse the debate over the duty of loyalty than it does to focus it.

A clearer resolution by the federal courts of the "union-labor" issue is necessary, for there is much at stake for the parties to this controversy. Several resolutions are possible, but only one is consistent with the central purpose of ERISA to promote the retirement income security of pension participants and beneficiaries. Judicial interpretation of the duty of loyalty should be broadened to take into account the indirect benefits to retirement security that union job-creating investments bring. ERISA fiduciary standards must be interpreted to require pension plan trustees to take into account the actual impacts that pension fund investments have on employers, unions, workers, and retirees.

PAUL J. WESSEL

