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See No Evil - The Role of the Directed Trustee under ERISA

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SEE NO EVIL? THE ROLE OF THE DIRECTED TRUSTEE UNDER ERISA

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I. INTRODUCTION

"Other people's money," just lying around in pension plans, continues to tempt everyone from the President[1] to Congress[2] to employers sponsoring 401(k) plans.[3] Too often those with access to these funds regard them as "a convenient source of ready cash"[4] or as their "personal piggy banks."[5]

The temptation to use others' employee benefit funds is not new. A central mission of the Employee Retirement Income Security Act of 1974 ("ERISA")[6] was to stop fiduciaries' misuse of plan assets.[7] A principal

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1. The Clinton administration has eyed both private and public pension funds. For example, a 1994 Department of Labor ("DOL") Interpretive Bulletin encouraged private pension plans' investment in "economically targeted investments" (defined as "investments selected for the economic benefits they create apart from their investment return to the employee benefit plan") in certain circumstances. 29 C.F.R. § 2509.94-1 (1995). In 1995, Treasury Secretary Robert Rubin shifted billions of dollars in securities held in federal workers' retirement funds into cash to prevent the government from defaulting on the national debt. *E.g.*, David Wessel, *Rubin Moves to Avoid Default by U.S., Shifting $61.3 Billion in Funds to Cash*, WALL ST. J., Nov. 16, 1995, at B5.

2. *See* H.R. 2491, 104th Cong., 1st Sess. § 11307 (1995). The bill would have allowed companies to withdraw surpluses in their defined-benefit pension funds—thereby incurring a tax, suggesting the legislation's motivation—if used for other employee benefits, including health care.

3. The DOL recently investigated misuse of contributory employee benefit plans, particularly plans commonly known as "401(k) plans" in reference to the Internal Revenue Code ("IRC") section authorizing them. 26 U.S.C. § 401(k) (1994). The DOL found "numerous violations" (in 34% of the cases closed thus far) by employers delaying or failing to transmit to plans the contributions withheld from participants' wages. 60 Fed. Reg. 66036 (1995) (to be codified at 29 C.F.R. § 2510.3-102) (proposed Dec. 20, 1995). The DOL has proposed revisions to existing regulations that would shorten the time period during which participant contributions may be treated as other than "plan assets," which must be held in trust. 60 Fed. Reg. 66036 (1995).

4. Labor Secretary Robert Reich, *quoted in* Steven Pearlstein, *Many Companies Tapping 401(k) Funds For Their Own Use, U.S. Investigators Say*, MINNEAPOLIS-ST. PAUL STAR TRIB., Nov. 23, 1995, at 7B.

5. Norman Stein, *ERISA and the Limits of Equity*, 56 LAW & CONTEMP. PROBS. 71, 103 (1993).

6. Pub. L. No. 93-406, 88 Stat. 829, (codified as amended primarily at 29 U.S.C. §§ 1001-1461 (1994) and in various provisions of the IRC).

7. *E.g.*, II SENATE SUBCOMM. ON LABOR OF THE COMM. ON LABOR AND PUBLIC WELFARE, EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974 [hereinafter SEN. SUBCOMM.], S. 4, 93d Cong., 1st Sess. (1973), *reprinted in* II LEGISLATIVE HISTORY OF THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974 [hereinafter II LEGIS. HIST.], at 1693 (1976) (remarks of Senator Roth) ("We must always be cognizant of the temptation to misuse others' money"); *see* Lockheed Corp. v. Spink, 116 S. Ct. 1783, 1788 (1996); Massachusetts Mut. Life Ins. Co. v. Russell, 473 U.S. 134, 141 n.8 (1985) (misuse of plan assets by fiduciaries was "crucible of congressional concern").

means to that end was to require that plan assets "be held in trust."[8] ERISA then vests the "trustee" with "exclusive authority and discretion to manage and control" the plan's assets.[9]

But just before ERISA's passage, Congress added a provision allowing a sponsoring employer to use a "named fiduciary"[10]—usually one or more of the employer's officers[11]—to direct the trustee.[12] In that case, the trustee is to "be subject to proper directions of such fiduciary which are made in accordance with the terms of the plan and which are not contrary to this Act."[13] Such a trustee is commonly called a "directed trustee."[14]

After ERISA became law, commentators immediately observed that section 403(a)(1) generated more questions than answers.[15] For instance,

8. ERISA § 403(a), 29 U.S.C. § 1103(a) (1994). Pre-ERISA law had also required the trust form in more limited circumstances. *See* discussion *infra* part IV.A. There are some exceptions to the trust requirement, including plan assets consisting of insurance contracts and plans consisting of individual retirement accounts held in custodial accounts. ERISA § 403(b), 29 U.S.C. § 1103(b) (1994).

9. ERISA § 403(a), 29 U.S.C. § 1103(a) (1994). Congress reasoned that by expressly requiring the trust mechanism, the new legislation would invoke the common law of fiduciary responsibility applicable to trustees. *E.g.*, S. REP. NO. 1150, 92d Cong., 2d Sess. 39 (1972).

10. A "named fiduciary" is a plan fiduciary, "named in the plan instrument" and generally responsible for plan operation. ERISA § 402(a), 29 U.S.C. § 1102(a) (1994). *See infra* part III.B.

11. *See* Pension Benefit Guar. Corp. v. Ross, 733 F. Supp. 1005, 1006 (M.D.N.C. 1990). ERISA expressly allows a plan to name fiduciaries who might be subject to conflicts of interest. ERISA § 408(c)(3), 29 U.S.C. § 1108(c)(3) (1994). ERISA's authorization of non-neutral fiduciaries has been called "an unorthodox departure from the common law rule against dual loyalties. . . ." Donovan v. Bierwirth, 538 F. Supp. 463, 468 (E.D.N.Y. 1981), *aff'd as modified*, 680 F.2d 263 (2d Cir.), *cert. denied*, 459 U.S. 1069 (1982).

12. ERISA § 403(a)(1), 29 U.S.C. § 1103(a)(1) (1994).

13. *Id.*

14. *See Ross*, 733 F. Supp. at 1006. There are also two other means by which another entity can control an ERISA trustee in the management and control of plan assets. First, investment responsibility may be delegated to a qualified "investment manager." ERISA §§ 403(a)(2), 3(38), 29 U.S.C. §§ 1103(a)(2), 1002(38) (1994) (defining "investment manager"). Second, participants may exercise control over the assets in certain individual accounts. ERISA § 404(c), 29 U.S.C. § 1104(c) (1994). While there is some discrepancy in terminology, the most common use of the term "directed trustee" refers to a trustee directed by a named fiduciary under ERISA § 403(a)(1). *E.g.*, *Ershick*, 948 F.2d at 665. This article will focus on the latter directed trustee, but will contrast directions by investment managers and participants. *See infra* parts III.C-E, VI.C.

15. *See generally* COMMITTEE ON FIDUCIARY RESPONSIBILITY (EMPLOYEE BENEFITS GROUP), *Directed Trusts Under ERISA*, 12 REAL PROP. PROB. & TR. J. 535, 546-50 (1977)[hereinafter COMM. ON FIDUCIARY RESPONSIBILITY]; H. Stennis Little, Jr. & Larry T. Thrailkill, *Fiduciaries Under ERISA: A Narrow Path To Tread*, 30 VAND. L. REV. 1, 35 (1977) [hereinafter Little & Thrailkill] ("Extreme concern has been expressed by corporate

is a directed trustee a "fiduciary" at all?[16] Does the directed trustee have a duty to investigate the named fiduciary's direction to ascertain that it is "proper," "made in accordance with the terms of the plan," and "not contrary to" ERISA?[17] If so, how intensive must the investigation be? Can a named fiduciary contractually bind the trust to make an investment without the directed trustee's prior knowledge or approval?

Over the past two decades, federal courts' answers[18] to these questions have usually been dead wrong or hopelessly unclear.[19] Congress intended generally for ERISA to strengthen the fiduciary standards of the common law of trusts.[20] Ironically, the courts have interpreted ERISA—usually unwittingly—to weaken those standards when applied to directed trustees.[21] For example, spurred on by a widespread judicial misconception that ERISA requires a "fiduciary" to possess "discretion,"[22] several courts have held[23] that a directed trustee is not an ERISA "fiduciary" subject to ERISA's normal fiduciary duties.[24] These "non-fiduciary trustee" cases,[25] com-

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trustees in this area."); ABA NATIONAL INSTITUTE, *Fiduciary Responsibilities Under The Pension Reform Act: Special Problems of Banks*, 31 BUS. LAW. 241, 241-45 (1975)[hereinafter *Special Problems of Banks*].

16. *Special Problems of Banks*, *supra* note 15, at 241-42. "Fiduciary" is defined in ERISA § 3(21)(A), 29 U.S.C. § 1002(21)(A) (1994). Only a "fiduciary" is subject to ERISA's fiduciary duties. ERISA § 404(a)(1), 29 U.S.C. § 1104(a)(1) (1994). *See infra* note 26 and accompanying text. A "fiduciary" bears potential liability for a co-fiduciary's breach of duty. ERISA § 405(a), 29 U.S.C. § 1105(a) (1994). Only a "fiduciary" must avoid entering into "prohibited transactions." ERISA §§ 406(a)-(b), 29 U.S.C. §§ 1106(a)-(b) (1994); Lockheed Corp. v. Spink, 116 S. Ct. 1783, 1788-90 (1996). Only a "fiduciary" may be sued for money damages arising from losses caused to a plan by breaching a fiduciary duty. ERISA § 409(a), 29 U.S.C. § 1109(a) (1994); *see* Mertens v. Hewitt Assocs., 508 U.S. 248, 251, 253-55 (1993). A "fiduciary" may bring suit under ERISA's civil enforcement provisions. ERISA § 502(a), 29 U.S.C. § 1132(a) (1994). *See, e.g.*, Hibernia Bank v. International Bhd. of Teamsters, 411 F. Supp. 478, 490 (N.D. Cal. 1976) (denying a custodial bank standing to sue under ERISA on ground that the bank was not a "fiduciary").

17. *See, e.g.*, ERISA § 403(a)(1), 29 U.S.C. § 1103 (a)(1) (1994); *Ershick*, 948 F.2d at 665 n.3.

18. Much of the law now governing employee benefit plans subject to ERISA is federal common law. *See generally* Jay Conison, *Foundations of the Common Law of Plans*, 41 DEPAUL L. REV. 575, 576-79 (1992)[hereinafter Conison].

19. *See* discussion *infra* part VII.

20. *E.g.*, SENATE SUBCOMM., S. 4, 93d Cong., 1st Sess. (1973), *reprinted in* I LEGISLATIVE HISTORY OF THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974 [hereinafter I LEGIS. HIST.], at 203 (1976) (remarks of Senator Javits) ("[e]xisting law is strengthened to provide safeguards against corruption and conflicts of interest").

21. *See infra* part VI.B.

22. *See infra* note 269 and accompanying text.

23. *See infra* part VII.A.

24. An ERISA "fiduciary" must "discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries." ERISA § 404(a)(1), 29 U.S.C.

bined with the Supreme Court's recent decision in *Mertens v. Hewitt Associates*,[26] produce the curious result that a participant could not sue an ERISA directed trustee for damages even if the trustee knowingly participated in the named fiduciary's breach of fiduciary duty.[27]

Other courts have invented out of whole cloth the concept of a "second-tier" fiduciary status for ERISA directed trustees.[28] Courts have also ignored directed trustees' obvious conflicts of interest and confused trustees with asset custodians.[29] Still other courts have indicated that the directed trustee has little, if any, duty to investigate the named fiduciary's direction before following it.[30] A recent case even held that the named fiduciary could obligate the trust to purchase property without the directed trustee's knowledge or consent.[31]

The burgeoning law of ERISA directed trustees thus contains many departures from the common law of trusts.[32] These cases exemplify what has been called the courts' "ahistorical" approach to ERISA common law.[33] Moreover, these cases form part of a broader landscape in which federal courts

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§ 1104(a)(1) (1994). Specifically, there are four somewhat overlapping fiduciary duties delineated in § 404(a)(1): the duty to act for the "exclusive purpose of providing benefits to participants and their beneficiaries" (known as the "exclusive benefit rule"); the duty to use the care and diligence "that a prudent man acting in a like capacity" would use (the "prudence rule"); the duty to diversify plan investments (the "diversification rule"); and the duty to act "in accordance with the documents . . . governing the plan." *Id.* ERISA then explicitly prohibits fiduciaries from entering into certain transactions ("prohibited transactions"). ERISA § 406, 29 U.S.C. § 1106 (1994). *See generally* James D. Hutchison, *The Federal Prudent Man Rule Under ERISA*, 22 VILL. L. REV. 15 (1976-77); Morton Klevan, *The Fiduciary's Duty of Loyalty Under ERISA Section 406(b)(1)*, 23 REAL PROP. PROB. & TR. J. 561 (1988); Arthur H. Kroll & Yale D. Tauber, *Fiduciary Responsibility and Prohibited Transactions Under ERISA*, 14 REAL PROP. PROB. & TR. J. 657 (1979) [hereinafter Kroll & Tauber]; Little & Thrailkill, *supra* note 15, at 35.

25. *See infra* notes 269, 275.

26. 508 U.S. 248, 253-54 (1993) (holding that ERISA provides no cause of action for compensatory damages against a non-fiduciary participating in a fiduciary's breach of duty). *Mertens* left open the possibility that a non-fiduciary participating in a fiduciary's breach of duty might be liable for "equitable relief" (such as restitution or the imposition of a constructive trust). *Id.* at 252-63.

27. *See infra* notes 269, 275; *Id.* at 253-54.

28. *See infra* part VII.B.

29. *See infra* part VII.A-B.

30. *See infra* part VII.C.

31. Queen's Harbour Yacht & Country Club, Ltd. v. Singer Co. Master Trust, No. 92-254-Civ-J-10, slip op. at 5 (M.D. Fla. Aug. 19, 1993) (order denying defendants' Motion For Summary Judgment). *See infra* part VII.E.

32. *See infra* part VI.B.

33. Conison, *supra* note 18, at 580 (the courts' "prevailing approach" to ERISA common law is "ahistorical, . . . treat[ing] both ERISA's guiding principles and the post-ERISA common law of plans as created largely out of a vacuum").

interpret ERISA to cut off, rather than protect, participants' rights to employee benefits.[34]

This article will argue that the directed trustee is always an ERISA fiduciary subject to the obligations—and rights—that term implies. ERISA's language, structure,[35] expressed public policy,[36] and legislative history,[37] confirmed by Department of Labor ("DOL") interpretations,[38] strongly support this result. In addition, I will argue that the directed trustee necessarily has some duty to investigate the named fiduciary's directions if the trustee is to fulfill section 403(a)(1)'s requirements[39] and avoid co-fiduciary liability. How broad and intensive this investigation should be depends on the specific direction, its relative impact on the plan, and whether the directed trustee itself has a conflict of interest with respect to the direction.

Part II briefly suggests the empirical importance of directed trustee liability. Part III examines ERISA's trust requirement, the three ways in which the trustee can be relieved of its exclusive authority over plan assets (via an investment manager, a named fiduciary's directions, or participant control), and the consequences of each of these three means for trustee liability. Part IV analyzes ERISA's legislative history pertaining to directed trustees. Part V collects DOL pronouncements relating to directed trustees. Part VI compares ERISA's treatment of directed trustees to the view prevailing under the state common law of trusts. Part VII critiques the federal common law of directed trustees as developed in the past two decades under ERISA. Finally, Part VIII offers suggestions for improving the federal common law to better protect plan assets.

II. FINANCIAL IMPORTANCE OF THE ISSUE

There are over 700,000 private pension plans in the United States, more than double the number when ERISA was enacted.[40] Over 43 million American

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34. *E.g.*, *id.* at 634-37; William K. Carr & Robert L. Liebross, *Wrongs Without Rights: The Need For A Strong Federal Common Law of ERISA*, 4 STAN. L. & POL'Y REV. 221 (1992-93); Catherine L. Fisk, *Lochner Redux: The Renaissance of Laissez-Faire Contract In The Federal Common Law of Employee Benefits*, 56 OHIO ST. L.J. 153 (1995); Keith A. Rabenberg, Note, *Punitive Damages and ERISA: An Anomalous Effect of ERISA's Preemption of Common Law Actions*, 65 WASH. U. L.Q. 589, 590 (1987).

35. *See infra* part III.

36. *See, e.g.*, ERISA § 2(b), 29 U.S.C. § 1001(b) (1994) ("It is hereby declared to be the policy of this chapter to protect . . . the interests of participants in employee benefit plans and their beneficiaries . . . by establishing standards of conduct, responsibility, and obligation for fiduciaries of employee benefit plans . . . . "). *See also infra* note 151.

37. *See infra* part IV.

38. *See infra* part V. The DOL enforces Title I of ERISA, which contains the fiduciary standards. The Internal Revenue Service ("IRS") enforces Title II, ERISA's tax provisions.

39. ERISA § 403(a)(1), 29 U.S.C. § 1103(a)(1) (1994).

40. *Questions and Answers on Employee Benefits Issues*, *in* ISSUE BRIEF 11 (Employee Benefit Research Institute ("EBRI"), 1994) [hereinafter *Questions and Answers*].

workers are vested in such plans.[41] The dollar amount of private trusteed pension plan assets has grown from approximately $152 billion in 1973[42] to at least $2.5 trillion in 1994.[43] Thus, the growth in pension fund assets has far outstripped Congress' initial observation that pension assets were growing by $10 billion annually.[44]

Private trusteed funds account for approximately 55% of total pension assets in the United States, including public pensions.[45] Much of this vast capital pool is held by directed trustees.[46]

About "900,000 benefit plans file annual reports with the [DOL]." Central States, Southeast & Southwest Areas Pension Fund v. Central Transp., Inc., 472 U.S. 559, 578 (1985). The DOL estimated that 5.4 million employee benefit plans were subject to ERISA enforcement in 1989. STAFF OF SENATE SUBCOMM. ON LABOR OF THE SENATE COMM. ON LABOR AND HUMAN RESOURCES, 101st Cong., 2d Sess., REPORT ON ERISA ENFORCEMENT 35 (Comm. Print 1990).

41. *Questions and Answers*, *supra* note 40, at 12.

42. *See, e.g.*, SEN. SUBCOMM., S. 4, 93d Cong., 1st Sess. (1973), *reprinted in* 1 LEGIS. HIST., *supra* note 20, at 91 (remarks of Senator Williams) (referring to the size of the industry in 1973).

43. Paul Fronstin, *Pension Assets Grow 2.3 Percent Between Second and Third Quarter 1994*, *in* 16 EMPLOYEE BENEFIT NOTES 3 (Employee Benefit Research Institute, 1995). EBRI has more broadly estimated that "[a]dvance funded pension and retirement savings programs have accumulated over $5 trillion in savings." Dallas L. Salisbury, *The Changing Employer Role in Retirement Security*, *in* 16 EMPLOYEE BENEFITS NOTES 1 (Employee Benefit Research Institute, 1995).

44. *See, e.g.*, SEN. SUBCOMM., S. 4, 93d Cong., 1st Sess. § 2(a) (1973), *reprinted in* I LEGIS. HIST., *supra* note 20, at 95.

45. *Questions and Answers*, *supra* note 40, at 15. This percentage figure has not changed too much in the past twenty years. During congressional hearings on S. 3598 (a forerunner of ERISA), the president of the American Bankers' Association stated that approximately 3,500 banks nationwide exercised trustee powers, and held as trustee approximately $100 billion (out of a total estimated $175 billion) of plan assets in connection with 120,000 employee benefit plans. RETIREMENT INCOME SECURITY FOR EMPLOYEES ACT, 1972: *Hearings on S. 3598 Before the Subcomm. on Labor of the Senate Comm. on Labor and Public Welfare*, 92d Cong., 2d Sess. 250 (1972) [hereinafter *S. 3598 Hearings*] (statement of John M. Cookenbach). In Illinois alone, in 1973, the ten largest corporate trust departments acted as trustee or agent for approximately 4,000 employee benefit plans having assets in excess of $15 billion. RETIREMENT INCOME SECURITY FOR EMPLOYEES ACT, 1972: *Hearings on S. 4 Before the Subcomm. on Labor of the Senate Comm. on Labor and Public Welfare*, 93d Cong., 1st Sess. 619 (1973) [hereinafter *S. 4 Hearings*] (statement of Corporate Fiduciaries Assoc. of Ill.).

46. The funds in private pension plans are typically managed by either an insurance company or a trustee (often directed by a named fiduciary or investment manager). *See Questions and Answers*, *supra* note 40, at 15. While I have found no figures estimating the percentage of private plan assets held by a directed trustee, the practice is very common, as evidenced by the numerous cases involving directed trustees. *See, e.g.*, *In re* American Continental Corp., 794 F. Supp. 1424, 1458 (D. Ariz. 1992); *see also* MICHAEL J. CANAN, QUALIFIED RETIREMENT AND OTHER EMPLOYEE BENEFIT PLANS 1323-25 (1993) (sample

III. ERISA'S LANGUAGE AND STRUCTURE

ERISA's language and structure indicate all but conclusively that a directed trustee is always a fiduciary, is subject to ERISA's fiduciary duties in carrying out his responsibilities, and may bear co-fiduciary liability for the breach of another plan fiduciary. The scope of the directed trustee's liability, however, depends on the type of entity directing the trustee: named fiduciary, investment manager, or participant.

A. Trustees and Fiduciaries

1. Trustee's Role: To Hold, Manage, and Control Plan Assets

The confusion over the role of a directed trustee may stem from ERISA's failure to spell out the role of *any* trustee.[47] Although ERISA requires that "all assets of an employee benefit plan shall be held in trust by one or more trustees,"[48] ERISA formally defines neither "trustee"[49] nor what it means to hold plan assets "in trust."[50] The most that can be

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form for Defined Benefit Pension Plan and Trust includes provisions allowing an Administrative Committee to direct trustee as to investment of plan assets and other matters).

47. *See Welfare and Pension Plan Legis.: Hearings on H.R. 2 and H.R. 462 Before the General Subcomm. on Labor of the House Comm. on Educ. and Labor*, Part 2, 93d Cong., 1st Sess. 676 (1973) [hereinafter *H.R. 2 Hearings*] (statement of Michael Antin) ("[the bills do not] define trustee. . . This is of great importance to me, because of the directed and nondirected trustee function").

48. ERISA § 403(a), 29 U.S.C. § 1103(a) (1994).

49. *See* ERISA § 3, 29 U.S.C. § 1002 (1994) (definitional section). One of ERISA's predecessor bills, in the context of the provision allowing trust responsibilities to be allocated between two or more trustees, defined "trustee" as "a person who has accepted an appointment pursuant to the terms of the plan or trust wherein he is given authority, discretion or control respecting the assets or administration of the trust, to act on behalf of the participants in the plan." H.R. 9824, 93d Cong., 1st Sess. 47 (1973), *reprinted in* I LEGIS. HIST., *supra* note 20, at 686, 732. ERISA as passed did not contain this provision. *See supra* note 6.

To be sure, the Restatement (Second) of Trusts is no more explicit. "Trustee" is defined as "[t]he person holding property in trust." RESTATEMENT (SECOND) OF TRUSTS § 3(3) (1959). The Restatement also implies that the legal title to the interest in the trust property is in the trustee's name. *Id.* at § 2 cmts. d, f. *See also* Alaska State Employees Ass'n v. Alaska Pub. Employees Ass'n, 825 P.2d 451, 458 (Alaska 1991); DAN M. MCGILL & DONALD S. GRUBBS, JR., FUNDAMENTALS OF PRIVATE PENSIONS 566 (1989) [hereinafter MCGILL & GRUBBS].

50. Rather, the regulations merely attempt to define "plan assets." 29 C.F.R. § 2510.3-101 (1995). *Cf.* John Hancock Mut. Life Ins. Co. v. Harris Trust & Sav. Bank, 510 U.S. 86, 89 (1993) (stating that ERISA does not comprehensively define "plan assets"); Howard Pianko, *The Plan Asset Saga*, *reprinted in* HOWARD PIANKO & A. RICHARD SUSKO, PENSION PLAN INVESTMENTS 1995: NUTS, BOLTS AND CURRENT DEVELOPMENTS 71-99

gleaned is a definition by grant of authority. The trustee "holds" and, with certain exceptions, has "exclusive authority and discretion to manage and control" the plan assets.[51]

2. Trustee's Fiduciary Status

Pre-ERISA trust law held axiomatically that a trustee was always a fiduciary.[52] Congress' goal in ERISA was to extend the reach of fiduciary responsibility beyond the trustee[53] by defining "fiduciary" functionally rather than categorically:

> [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 moneys or other property of such plan, or has any authority or responsibility to do so, or (iii) he has any discretionary authority or discretionary responsibility in the administration of such plan. . . .[54]

Consistent with this approach, ERISA never states explicitly that a trustee is a fiduciary.[55] However, the similarity in wording between the descriptions of "trustee" (having "authority and discretion to manage and control" plan assets)[56] and "fiduciary" (having "authority or control respecting management or disposition of [plan] assets")[57] indicates an identity of function and hence of duty. Simply by holding the legal interest in plan assets, a trustee "exercises . . . authority or control respecting management or disposition of [plan] assets,"[58]

(P.L.I. 1995) [hereinafter PIANKO & SUSKO].

51. ERISA § 403(a), 29 U.S.C. § 1103(a) (1994); *see also* ERISA § 405(c)(3), 29 U.S.C. § 1105(c)(3) (1994) (defining "trustee responsibility" for purposes of that section). For a practical overview of pension trusts and trustees, see MCGILL & GRUBBS, *supra* note 49, at 565-68.

52. Indeed, this is the *sine qua non* of the trust form. RESTATEMENT (SECOND) OF TRUSTS § 2 (1959) ("A trust . . . is a fiduciary relationship with respect to property, subjecting the person by whom the title to the property is held to equitable duties to deal with the property for the benefit of another person . . . ."). *See also* UNIF. FIDUCIARIES ACT § 1, 7A U.L.A. 391, 395 (1985) ("'Fiduciary' includes a trustee under any trust"); ZECHARIAH CHAFEE, JR., SOME PROBLEMS OF EQUITY 122-23, 162, 232 (U. Mich. 1950).

53. *E.g.*, SEN. SUBCOMM., S. REP. 93-127, 93d Cong., 1st Sess. 30 (1973), *reprinted in* I LEGIS. HIST., *supra* note 20, at 587, 616.

54. ERISA § 3(21)(A), 29 U.S.C. § 1002(21)(A) (1994).

55. *See supra* note 47.

56. *See supra* note 51 and accompanying text.

57. ERISA § 3(21)(A), 29 U.S.C. § 1002(21)(A) (1994).

58. *Id.*

thus meeting the definition of "fiduciary" in every case. Indeed, ERISA thrice uses "trustee" as an example of a "fiduciary."[59]

It is well established under ERISA that a traditional, non-directed trustee is a fiduciary.[60] The doctrinal uncertainty arises when a trustee is "directed" by ERISA's new creature, the "named fiduciary."[61]

3. Why Retain The Trustee With Proliferation of Other Fiduciaries?

One might profitably ask why, with ERISA's elaborate system of functional plan fiduciaries and concomitant fiduciary duties, Congress felt the need to retain the trust structure at all. If, as the common law provided, a "trust" is merely a means to create "a fiduciary relationship with respect to property,"[62] and if ERISA mandates such fiduciary relationships with respect to plans,[63] then superimposing an additional trust/trustee requirement seems redundant.

No evidence exists in the legislative history that Congress directly considered this puzzle, but several explanations can be readily inferred. First, ERISA built on its forerunners' trust requirement. Both the Labor-Management Relations Act of 1947 ("LMRA")[64] and the Internal Revenue Code ("IRC")[65] had mandated the trust form for certain plans, and many plans had already been set up that way. Second, Congress generally intended the courts to apply the common law of trusts to employee benefit plans under ERISA.[66] If the trust concept were superseded, the courts may not have followed this directive as readily.

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59. First, "party in interest" (an important concept for determining the existence of a "prohibited transaction," ERISA § 406, 29 U.S.C. § 1106 (1994)), is defined to mean "any fiduciary (including, but not limited to, any administrator, officer, *trustee*, or custodian) . . ." ERISA § 3(14)(A), 29 U.S.C. § 1002(14)(A) (1994) (emphasis added). Second, "investment manager" is defined as "any fiduciary (other than a *trustee* or named fiduciary . . .)" who meets certain criteria. ERISA § 3(38), 29 U.S.C. § 1002(38) (1994) (emphasis added). Third, a plan may allow any person to "serve in more than one fiduciary capacity with respect to the plan (including service both as *trustee* and administrator). . ." ERISA § 402(c)(1), 29 U.S.C. § 1102(c)(1) (1994) (emphasis added).

60. *E.g.*, 29 C.F.R. § 2509.75-8 (D-3) (1995); Jay Conison, *The Federal Common Law of ERISA Plan Attorneys*, 41 SYRACUSE L. REV. 1049, 1071 (1990); Kroll & Tauber, *supra* note 24, at 660; *Special Problems of Banks, supra* note 15, at 241.

61. *See infra* part III.B.

62. RESTATEMENT (SECOND) OF TRUSTS § 2 (1959).

63. *See* ERISA § 403(a), 29 U.S.C. § 1103(a) (1994).

64. LMRA § 302 (c)(5), 29 U.S.C. § 186(c)(5) (1994).

65. I.R.C. § 401(a) (1970).

66. *E.g.*, S. REP. NO. 1150, 92d Cong., 2d Sess. 39 (1972); Central States, Southeast & Southwest Areas Pension Fund v. Central Transp., Inc., 472 U.S. 559, 568, 570 (1985). *See also* Daniel Fischel & John H. Langbein, *ERISA's Fundamental Contradiction: The Exclusive Benefit Rule*, 55 U. CHI. L. REV. 1105, 1114 (1988) [hereinafter Fischel & Langbein] ("A main reason for using the trust form is that it invokes a developed set of fiduciary rules that regulate the behavior of trustees.").

Finally, ERISA's overriding goal was to preserve plan assets so participants and beneficiaries would receive their expected benefits.[67] Although many persons might act in some fiduciary capacity in the plan's administration, the fiduciary duty owed by the person who actually held and controlled the disposition of plan assets was paramount.[68] The ready-made paradigm for that role was the trustee.

4. Exceptions To Trustee's Exclusive Authority To Control Plan Assets

Management functions of the modern pension trust are more specialized than the "unitary trusteeship" of the traditional private trust.[69] According to a 1972 Senate study, 61% of all employee benefit plans were administered by the employer, not the trustee.[70] Plan sponsors frequently gave responsibility for the investment of plan assets to a company insider, an investment professional, or the participant himself rather than the institutional trustee.[71] A Securities and Exchange Commission study found that "[i]nternal management [of plans] was often chosen because of a belief that this might be less costly than external management."[72] Accordingly, within the confines of the trust/trustee requirement, ERISA gives sponsoring employers several structural choices in the investment and preservation of plan assets. The employer can choose to: (1) employ a traditional trustee with full investment discretion;[73] (2) allow a "named fiduciary" to direct the trustee;[74] (3) employ an "investment manager" to manage plan assets;[75] or (4) authorize a participant herself to exercise control over the assets in her individual account.[76] This type of "fractionation of traditional

67. *E.g.*, 1974 U.S.C.C.A.N. 5186 (remarks of Senator Williams) (ERISA was designed to "establish uniform fiduciary standards to prevent transactions which [would] dissipate or endanger plan assets; and to provide effective remedies for breaches of trust").

68. *See Central Transp.*, 472 U.S. at 572 (trustee's duty is to preserve and maintain trust assets); *see also* Brock v. Robbins, 830 F.2d 640, 647 (7th Cir. 1987) ("imprudent trustees undermine the purpose of ERISA, which is to insure that the assets of a fund will be there when the beneficiaries need them").

69. JOHN H. LANGBEIN & BRUCE A. WOLK, PENSION AND EMPLOYEE BENEFIT LAW 626 (2d ed. 1995) [hereinafter LANGBEIN & WOLK].

70. S. REP. NO. 1150, 92d Cong., 2d Sess. 109 (1972).

71. Committee on Investments by Fiduciaries, *Responsibility of Trustee Where Investment Power is Shared or Exercised By Others*, 9 REAL PROP. PROB. & TR. J. 517, 517-18 (1974)[hereinafter Comm. on Investments]; Note, *Trust Advisers*, 78 HARV. L. REV. 1230, 1230 (1965).

72. S. REP. NO. 1150, 92d Cong., 2d Sess. 65 (1972).

73. ERISA § 403(a), 29 U.S.C. § 1103(a) (1994).

74. ERISA § 403(a)(1), 29 U.S.C. § 1103(a)(1) (1994).

75. ERISA § 402(c)(3), 29 U.S.C. § 1102(c)(3) (1994). "Investment manager" is defined at ERISA § 3(38), 29 U.S.C. § 1002(38) (1994).

76. ERISA § 404(c), 29 U.S.C. § 1104(c) (1994).

trusteeship"[77] has caused doctrinal uncertainties in the law of ERISA directed trustees.

B. *The "Named Fiduciary"*

The "named fiduciary" did not exist under that name in the common law of trusts,[78] and was a concept that only appeared in the final bills before ERISA's passage.[79] ERISA requires the written plan document to list "one or more named fiduciaries who jointly or severally shall have authority to control and manage the operation and administration of the plan."[80] Congress, seeking to enhance fiduciary accountability, thereby intended that "the employees may know who is responsible for operating the plan."[81]

In addition to assuming other plan administration responsibilities, a named fiduciary may direct the trustee in the management and control of plan assets:

> [T]he trustee or trustees shall have exclusive authority and discretion to manage and control the assets of the plan, except to the extent that—
>
> (1) the plan expressly provides that the trustee or trustees are subject to the direction of a named fiduciary who is not a trustee, in which case the trustees shall be subject to proper directions of such fiduciary which are made in accordance with the terms of the plan and which are not contrary to this Act . . . .[82]

Two points are noteworthy. First, the named fiduciary "is not a trustee,"[83] suggesting a separation of function which emphasizes the trustee's continued ultimate control over plan assets. Second, the trustee is

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77. LANGBEIN & WOLK, *supra* note 69, at 627.

78. The closest pre-ERISA analogue was what the Restatement calls a person with a "power to control the action of the trustee in certain respects." RESTATEMENT (SECOND) OF TRUSTS § 185 (1959). *See infra* notes 247, 252-55 and accompanying text.

79. *See infra* note 193 and accompanying text.

80. ERISA § 402(a)(1), 29 U.S.C. § 1102(a)(1) (1994). Somewhat tautologically, "named fiduciary" means "a fiduciary who is named in the plan instrument, or who, pursuant to a procedure specified in the plan, is identified as a fiduciary . . . ." ERISA § 402(a)(2), 29 U.S.C. § 1102(a)(2) (1994).

81. SEN. SUBCOMM., H.R. CONF. REP. NO. 1280, 93d Cong., 2d Sess. 297 (1974), *reprinted in* III LEGISLATIVE HISTORY OF THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974 [hereinafter III LEGIS. HIST.], at 4277, 4564 (1976). Because the trustee must also be named in either the plan or the trust instrument, or be appointed by the named fiduciary, and must accept such appointment, the concept of accountability also extends to the trustee. *See* ERISA § 403(a), 29 U.S.C. § 1103(a) (1994).

82. ERISA § 403(a)(1), 29 U.S.C. § 1103(a)(1) (1994) (noting that the Code replaces the word "Act" with the word "chapter").

83. ERISA § 403(a)(1), 29 U.S.C. § 1103(a)(1) (1994).

not given carte blanche to follow the named fiduciary's direction.[84] That direction must be "proper," "made in accordance with the terms of the plan," and "not contrary to" ERISA.[85]

It is not clear what the requirement that the direction be "proper" (an undefined term) adds to the requirements that the direction conform to the plan and to ERISA. Nor is it apparent from the statute how much monitoring and investigation the trustee must perform to ascertain that any given direction meets all the requirements. However, as a fiduciary, the directed trustee is subject to ERISA's fiduciary duties[86]—such as prudence—in evaluating the named fiduciary's direction.[87]

C. The "Investment Manager"

The relationship between a named fiduciary and a directed trustee under section 403(a)(1) is to be contrasted with the relationship between an investment manager and trustee under section 403(a)(2):

> [T]he trustee or trustees shall have exclusive authority and discretion to manage and control the assets of the plan, except to the extent that—
>
> . . .
>
> > (2) authority to manage, acquire, or dispose of assets of the plan is delegated to one or more investment managers pursuant to section 402(c)(3).[88]

Section 402(c)(3), if the plan so provides, allows a named fiduciary to "appoint an investment manager or managers to manage (including the power to acquire and dispose of) any assets of a plan."[89] An "investment manager" must be a registered investment adviser, a bank, or a qualified insurance company.[90] Thus, an investment manager must meet more stringent qualifications than a named fiduciary (indeed, there are no qualifications required to serve as a named fiduciary).[91]

There is also a significant difference between the statutory authority of the investment manager and that of the named fiduciary to control plan

84. *See id.*

85. *See, e.g., id.*

86. *See supra* note 24.

87. ERISA § 404(a)(1), 29 U.S.C. § 1104(a)(1) (1994). *Cf.* Susan J. Stabile, *Fiduciary Standards*, *reprinted in* PIANKO & SUSKO, *supra* note 50, at 58-59 ("The duty of prudence also arises in the context of the performance of fiduciary functions other than plan investment decisions.").

88. ERISA § 403(a)(2), 29 U.S.C. § 1103(a)(2) (1994).

89. ERISA § 402(c)(3), 29 U.S.C. § 1102(c)(3) (1994).

90. ERISA § 3(38)(B), 29 U.S.C. § 1002(38)(B) (1994).

91. *See* ERISA § 402(a)(2), 29 U.S.C. § 1102(a)(2) (1994) (explaining that a "named fiduciary" is merely a "fiduciary who is named in the plan" or who by a specified procedure is "identified as a fiduciary".).

assets. An investment manager can be given authority directly to "acquire or dispose of" plan assets.[92] A named fiduciary can only direct the trustee to acquire or dispose of plan assets.[93] Thus, the trustee retains ultimate authority—and greater potential for liability—when a named fiduciary, rather than an investment manager, is in place.

D. Participant Control of An Individual Account

One of ERISA's apparent statutory glitches is that section 403(a) provides only two exceptions to the trustee's exclusive authority to manage and control plan assets—for a named fiduciary or an investment manager, as described above—yet section 404(c) also contemplates an unstated third exception. That is, a plan may provide for a participant to exercise control over the assets in his individual account.[94]

The DOL has tried to smooth over the statutory confusion by taking the position that a participant exercising control over plan assets is really a "named fiduciary" under section 403(a)(1).[95] This position, while defensible, is not immediately apparent from the statute, and it is doubtful that Congress thought of a participant as a "named fiduciary" under section 403(a)(1). Sections 403(a) and 404(c) do not cross-reference each other. Moreover, the impulse in section 404(c)(2) is toward exculpating the trustee for following a participant's direction, while section 403(a)(1) suggests no such impulse with respect to a named fiduciary's direction.[96]

In any event, defined contribution plans (including individual accounts), as a percentage of total private pension plans, have been steadily increasing

92. *See supra* note 88 and accompanying text; ERISA § 402(c)(3), 29 U.S.C. § 1102(c)(3) (1994).

93. *See* ERISA § 402(c)(3), 29 U.S.C. § 1102(c)(3) (1994).

94. ERISA § 404(c), 29 U.S.C. § 1104(c) (1994). An "individual account" is essentially a defined contribution pension plan "which provides for an individual account for each participant and for benefits based solely upon the amount contributed to the participant's account, and any income, expenses, gains and losses . . . ." ERISA § 3(34), 29 U.S.C. § 1002(34) (1994).

95. Fiduciary Responsibility in Connection with Attempted Corporate Takeovers, Op. Ltr. Dep't of Labor (Apr. 30, 1984) [hereinafter *Carter Hawley Hale letter*], *reprinted in* 11 Pens. Rep. (BNA) 633; *see also* Reich v. NationsBank of Ga., N.A., 19 Employee Benefits Cas. (BNA) 1345 (N.D. Ga. March 29, 1995); Tender Offers, (Feb. 23, 1989) [hereinafter *Polaroid letter*], *reprinted in* 16 Pens. Rep. (BNA) 390; Letter from Bette J. Briggs, Chief, Div. of Fiduciary Interpretations, Office of Regs. and Interpretations, to Paul S. Altman, Attorney, Pedersen & Houpt, P.C., Op. Ltr. Dep't of Labor (Aug. 19, 1994), *available in* 1994 WL 707769 (E.R.I.S.A.).

96. *See* discussion *infra* part III.E.

since 1975.[97] Accordingly, the law relating to participant-directed trusts is assuming even greater importance.

E. Consequences of Different Sources of Direction

The different grants of authority to the named fiduciary, the investment manager, and the participant result in different paths to potential liability for the directed trustee. It is helpful to conceptualize this potential liability as twofold: (1) direct liability for breach of the directed trustee's own fiduciary obligations under section 409,[98] and (2) co-fiduciary liability for another fiduciary's breach under section 405.[99]

As discussed above, the ERISA trustee's basic duties are to hold all assets in trust and to exercise exclusive authority and discretion to manage and control plan assets, unless one of the mechanisms for overriding this "exclusive authority" is in place.[100] Thus, the directed trustee must still comply with ERISA's general fiduciary duties[101] in performing whatever tasks are left to the trustee after permissibly carving out an area of control for the named fiduciary, investment manager, or participant.

As to co-fiduciary liability, section 405 begins, but does not exhaust, an inquiry into the parameters of directed trustee liability.[102] Section 405 does not comprehensibly address the trustee's potential liability for following the directions of a named fiduciary, nor does it even mention participant directions.[103] Other than section 405(a),[104] which sets forth

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97. *Questions and Answers*, supra note 40, at 11 ("Defined contribution plans have increased as a percentage of all private pension plans from 66.8 percent in 1975 to 84.1 percent in 1990.").

98. ERISA § 409, 29 U.S.C. § 1109 (1994).

99. ERISA § 405, 29 U.S.C. § 1105 (1994). Of course, technically a violation of § 405 would also be a breach of a fiduciary obligation under § 409, but for clarity of analysis it is still helpful to separate the directed trustee's direct and co-fiduciary liability.

For general discussions of fiduciary and co-fiduciary liability, see, Daniel C. Knickerbocker, Jr., *Trust Law With A Difference: An Overview of ERISA Fiduciary Responsibility*, 23 REAL PROP. PROB. & TR. J. 633 (1988); Allen H. Merrill, *Liabilities for Breaches by Co-Fiduciaries*, 31 BUS. LAW. 115 (1975).

100. ERISA § 403(a), 29 U.S.C. § 1103(a) (1994).

101. *See supra* note 24.

102. ERISA § 405, 29 U.S.C. § 1105 (1994).

103. *See id.*

104. ERISA § 405(a), 29 U.S.C. § 1105(a) (1994), reads in full:

> In addition to any liability which he may have under any other provisions of this part [Part 4—Fiduciary Responsibility, ERISA §§ 401-414, 29 U.S.C. §§ 1101-1114], a fiduciary with respect to a plan shall be liable for a breach of fiduciary responsibility of another fiduciary with respect to the same plan in the following circumstances:
>
> (1) if he participates knowingly in, or knowingly undertakes to conceal, an act or omission of such other fiduciary, knowing such act or omission is a breach;

the three general rules of when one fiduciary can be held liable for the breach of another,[105] section 405 is nearly impenetrable in its awkward structure and phrasing.

1. Investment Manager Control

Section 405 is relatively clear about the trustee's liability for the acts of an investment manager. Here, the trustee faces the least potential for co-fiduciary liability. If an investment manager is properly appointed, then the trustee—unless he knowingly participates in or conceals the investment manager's breach of duty[106]—is entirely off the hook for the investment manager's acts.[107] The trustee need not worry about two of the three general rules of co-fiduciary liability: (1) if the trustee's breach enables the investment manager to breach[108] or (2) if the trustee knows of the investment manager's breach, yet fails to try to correct it.[109] This result probably followed from existing practice.[110]

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(2) if, by his failure to comply with section 404(a)(1) [Fiduciary Duties, 29 U.S.C. §1104] in the administration of his specific responsibilities which give rise to his status as a fiduciary, he has enabled such other fiduciary to commit a breach; or

(3) if he has knowledge of a breach by such other fiduciary, unless he makes reasonable efforts under the circumstances to remedy the breach.

105. The three general rules of co-fiduciary responsibility closely follow the rules for "Liability for Breach of Trust of Co-Trustee" in the Restatement (Second) of Trusts, § 224 (1957). *See* Knickerbocker, *supra* note 99, at 669.

106. For a discussion of a trustee's "knowledge" of an investment manager's breach, see David L. Heald & Joseph P. Mulhern III, *Directed Trustee Liability Under ERISA*, 9 LOY. U. CHI. L.J. 617, 628-34 (1978) [hereinafter Heald & Mulhern].

107. ERISA § 405(d)(1) provides: "If an investment manager or managers have been appointed under section 1102(c)(3) of this title, then, notwithstanding subsections (a)(2) and (3) and subsection (b) of this section, no trustees shall be liable for the acts or omissions of such investment manager or managers, or be under an obligation to invest or otherwise manage any asset of the plan which is subject to the management of such investment manager." 29 U.S.C. § 1105(d)(1) (1994). However, even where there is an investment manager, the trustee is still liable for any breach he may commit in the performance of his own duties. ERISA § 405(d)(2), 29 U.S.C. § 1105(d)(2) (1994). For an analysis of § 405(d)(2), see Heald & Mulhern, *supra* note 106, at 634-35.

108. ERISA § 405(a)(2), 29 U.S.C. § 1105(a)(2) (1994).

109. ERISA § 405(a)(3), 29 U.S.C. § 1105(a)(3) (1994). Section 405(a)(1) contains the third general rule of co-fiduciary liability: namely, if the trustee's actions cause him—alone—to breach.

110. For example, in the hearings on an ERISA forerunner, a representative of the Investment Counsel Association of America, explained:

> Typically, in a so-called split power trust a bank is appointed as trustee but the entire investment responsibility is given to an adviser retained at the direction of the employer company. In such a case, the trust agreement relieves the bank of [investment] responsibility and in turn the adviser is not responsible for the actions taken by the bank.

2. Participant Control

Thanks to the DOL, participant control under ERISA is at present a rather murky area of the law. Through changing interpretations and new regulations, the DOL has fogged up one of ERISA's clearer provisions. Section 404(c), which allows participant control of individual accounts, used to be interpreted on its face as a straightforward exculpation of the trustee for losses directly resulting from a participant's exercise of control over the assets in her individual account.[111] The legislative history[112] and the DOL itself (in an early advisory opinion)[113] confirmed this interpretation. Moreover, because section 404(c)(1) provided that a participant did not become a "fiduciary" by exercising control over plan assets,[114] the trustee could not be liable under section 405, which governs co-fiduciary liability.

This position made intrinsic sense—the funds in an individual account are, by definition, the participant's own to do with what she wishes[115]—and followed a long tradition in the common law of trusts.[116] Generally, a trustee was not liable for following the direction of the trust beneficiary when no one else's interests were involved—in other words, when the beneficiary herself did not act in a fiduciary capacity toward others.[117]

However, since at least 1984, the DOL's position has been that a participant acts as a limited "named fiduciary" under section 403(a)(1), at least when she

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In recognizing this reduced responsibility, the bank can afford to charge less than its full trustee's commission.

S. 3598 Hearings, *supra* note 45, at 1078.

111. *E.g.*, McGILL & GRUBBS, *supra* note 49, at 436 ("Under an individual account plan which permits individual participants and their beneficiaries to exercise control over their own accounts, no fiduciary is liable for the actions of the participants or beneficiaries"); JOHN H. LANGBEIN & BRUCE A. WOLK, PENSION AND EMPLOYEE BENEFIT LAW 501 (1st ed. 1990).

112. For example, the Conference Report stated that "if the participant instructs the plan trustee to invest the full balance of his account in, *e.g.*, a single stock, the trustee is not to be liable for any loss because of a failure to diversify or because the investment does not meet the prudent man standards." H.R. CONF. REP. NO. 1280, 93d Cong., 2d Sess. 305 (1974), *reprinted in* III LEGIS. HIST., *supra* note 81, at 4572.

113. A 1979 advisory opinion stated: "ERISA section 404(c)(2) exempts the directed trustee of an individual account plan from liability for losses arising out of participant and beneficiary directions. No similar protection is available with respect to investments directed by others." Letter from Alan D. Lebowitz, Acting Assistant Administrator, Office of Fiduciary Standards, to Lawrence J. Hass, Attorney, Groom and Nordberg, Op. Ltr. Dep't of Labor (Feb. 12, 1979), *available in* 1979 WL 6948 (E.R.I.S.A.) at *5 n.1.

114. *See* ERISA § 404(c)(1), 29 U.S.C. § 1104(c)(1) (1994).

115. *See supra* note 94 and accompanying text.

116. *See infra* part VI.B.

117. RESTATEMENT (SECOND) OF TRUSTS § 185 cmt. c (1959). *See infra* notes 248-51 and accompanying text.

directs the trustee with respect to stock allocated to her individual accounts.[118] Accordingly, the DOL now asserts that the trustee which is directed by participants in voting or tendering shares must determine "whether following participant directions would result in a violation of" ERISA's fiduciary obligations.[119]

More generally, in 1992, following the authorization of section 404(c),[120] the DOL finally promulgated regulations to clarify when "a plan provides a participant or beneficiary an opportunity to exercise control over assets in his account."[121] Those regulations cut back considerably on section 404(c)(2)[122] by setting forth numerous detailed conditions that must be met before the trustee may enjoy relief from liability for following the participant's instructions.[123]

Despite this added layer of complexity, the upshot of the DOL regulations is the same as the statute's. If the regulations' requirements are met, the trustee is not liable for any loss resulting from the participant's exercise of control.[124]

3. Named Fiduciary Control

Although ERISA broadly releases the trustee for acts of the investment manager,[125] and at least attempts to do so when a participant exercises control over her individual account,[126] it contains no comparable exculpation of the trustee for following the directions of a named fiduciary.[127]

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118. *See supra* note 95.

119. *Carter Hawley Hale letter*, *supra* note 95, at 633.

120. ERISA § 404(c), 29 U.S.C. § 1104(c) (1994).

121. 29 C.F.R. § 2550.404c-1(b)(2)(i) (1995). For an overview of Section 404(c) and the DOL regulations promulgated thereunder, see Nell Hennessy & Frank Daniele, *Participant-Directed Retirement Plans Under Section 404(c)*, *reprinted in* SUSAN P. SEROTA, ERISA FIDUCIARY LAW 175-86 (1995). For a thoughtful discussion of how the regulations affect the law of participant-directed trusts, see *Now That the 404(c) Regulations Are Final, Who Cares?*, 1 No. 11 ERISA LITIG. REP. 15 (1992) [hereinafter *404(c) Regulations*].

122. Although the DOL's regulations arguably go beyond the statutory language of ERISA § 404(c), I will assume the regulations' validity in the remainder of the article.

123. For example, the regulations now require a plan to offer the participant a choice between at least three diversified funds; most Employee Stock Ownership Plans ("ESOPs") are therefore not subject to the protection. *See* Ronald S. Rizzo & James F. Carey, *Reich v. NationsBank of Georgia: Pass-Through Tender Decisions Under ERISA*, 4 No. 4 ERISA LITIG. REP. 14, 17 (1995) [hereinafter Rizzo & Carey]. The trustee in the example given in the Conference Report, *supra* note 112, would probably not be relased from liability for loss under the new DOL regulations.

124. 29 C.F.R. § 2550.404c-1(d)(2) (1995).

125. *See supra* note 107 and accompanying text.

126. *See supra* part III.E.2.

127. *E.g.*, Rizzo & Carey, *supra* note 123, at 19.

I maintain this position despite the presence of the oddly-placed section 405(b)(3)(B), which provides that "[n]o trustee shall be liable under this subsection for following instructions referred to in section 403(a)(1)."[128] Section 403(a)(1) is, of course, the directed trustee section that is the focus of this article. Read in isolation, section 405(b)(3)(B) might suggest a kind of safe harbor from liability for the directed trustee following the directions of a named fiduciary.[129] But after striving to follow the canon of statutory construction that attempts to give meaning to each statutory provision,[130] I have concluded that not only does subsection 405(b)(3)(B) not provide that safe harbor, it is a nullity.

Initially, what does "this subsection"[131] refer to: all of subsection 405(b), which covers both multiple trustee and multiple trust situations, or only subsection 405(b)(3), which is limited to the situation where plan assets are held in multiple trusts? Either way, section 405(b)(3)(B)—addressing a single trustee's liability for following a named fiduciary's direction—seems misplaced. Perhaps the drafters meant to say that a trustee of one trust is not liable when the trustee of a second trust follows a named fiduciary's direction. That would make sense, given the provision's placement; but that is not what section 405(b)(3)(B) says.

The reference to a named fiduciary's direction of the trustee in a section that seems to address only co-trustees may be a throwback to the Restatement (Second) of Trusts' approach that a trustee's liability for the acts of a person with a power to direct the trustee—like ERISA's named fiduciary—was analogous to liability for a co-trustee's acts.[132] However, if Congress meant to release the trustee from any duty of care to prevent a breach by the named fiduciary, as one commentator has suggested,[133] it was silently—and very unclearly—effecting a major change from the Restatement position.[134] Further, equating a named fiduciary with a co-trustee for purposes of this one subsection violates the canon of statutory construction that identical terms within a statute should consistently bear the same meaning.[135]

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128. ERISA § 405(b)(3)(B), 29 U.S.C. § 1105(b)(3)(B) (1994).

129. *Cf.* JAY CONISON, EMPLOYEE BENEFIT PLANS IN A NUTSHELL 260 (1993) ("When a plan provides that a trustee is subject to the *proper directions* of a named fiduciary, ERISA relieves the directed trustee from liability for following such directions.").

130. *E.g.*, United States v. Smith, 499 U.S. 160, 174 (1991).

131. ERISA § 405(b)(3)(B), 29 U.S.C. § 1105(b)(3)(B) (1994).

132. RESTATEMENT (SECOND) OF TRUSTS § 185 cmt. e (1959). *See infra* part VI.B.

133. COMM. ON FIDUCIARY RESPONSIBILITY, *supra* note 15, at 539.

134. *See* discussion *infra* notes 250-51 and accompanying text; *see also* RESTATEMENT (SECOND) OF TRUSTS § 185 (1959).

135. *See* Varity Corp. v. Howe, 116 S. Ct. 1065, 1083 (1996) (dissenting opinion) (citation omitted).

Moreover, section 405(b)(2) undercuts an interpretation of section 405(b)(3)(B) that might grant amnesty to a trustee following a named fiduciary's direction. Section 405(b)(2) states: "Nothing in this subsection [*i.e.*, subsection 405(b)] shall limit any liability that a fiduciary may have under subsection (a) or any other provision of this part."[136] Subsection 405(b)(3)(B) is part of "this subsection [405(b)],"[137] and therefore whatever it means, it cannot limit the three general rules of co-fiduciary liability of section 405(a) or the primary fiduciary duties of section 404(a).

Finally, the "instructions referred to in section 403(a)(1)"[138] are "proper"[139] instructions that "are made in accordance with"[140] the plan and ERISA.[141] To say that a trustee is not liable for following such an instruction is to beg the question of when an instruction is improper enough for the trustee to ignore. That is, if subsection 405(b)(3)(B) refers generally to the directed trustee's liability for following a named fiduciary's direction, it is redundant.

The absence of a co-fiduciary subsection clearly addressed to a trustee directed by a named fiduciary is significant. If a trustee were free from liability for following a named fiduciary's directions, one would expect to see that stated unambiguously in section 405. Moreover, even if Congress had meant non-liability to be the general rule, one would expect to see an exception for the trustee's knowing participation in or concealment of the named fiduciary's breach—exactly as it exists in the case of an investment manager.[142]

Instead, the statutory structure suggests the following duties. The trustee must determine that the named fiduciary's direction is "proper" and conforms to the terms of the plan and ERISA.[143] In making this determination itself, the trustee must comply with the fiduciary duties of prudence, diligence,[144] and acting for the participants' exclusive benefit.[145] If the trustee knows the named fiduciary's direction is improper, yet follows it, the trustee has breached not only his own fiduciary duty but may be liable under the first and third general co-fiduciary liability rules.[146] If the trustee

136. ERISA § 405(b)(2), 29 U.S.C. § 1105(b)(2) (1994). "This subsection" in section 405(b)(2) must mean section 405(b), because there is nothing else in subsection 405(b)(2).

137. ERISA § 405(b)(3), 29 U.S.C. § 1105(b)(3) (1994).

138. ERISA § 405(b)(3)(B), 29 U.S.C. § 1105(b)(3)(B) (1994).

139. ERISA § 403(a)(1), 29 U.S.C. § 1103(a)(1) (1994).

140. *Id.*

141. *See* Queen's Harbour Yacht & Country Club, Ltd. v. Singer Co. Master Trust, No. 92-254-Civ-J-10, slip op. at 6 n.2 (M.D. Fla. Aug. 19, 1993).

142. *See* ERISA § 405(a)(1), 29 U.S.C. § 1105(a)(1) (1994); *see also supra* notes 106-07.

143. *See* ERISA § 403(a)(1), 29 U.S.C. § 1103(a)(1) (1994).

144. *See* ERISA § 404(a)(1)(B), 29 U.S.C. § 1104(a)(1)(B) (1994).

145. *See* ERISA § 404(a)(1)(A)(i), 29 U.S.C. § 1104(a)(1)(A)(i) (1994).

146. ERISA §§ 405(a)(1),(3), 29 U.S.C. § 1105(a)(1),(3) (1994).

breaches his fiduciary duty—say, of diligence—in determining the propriety of a named fiduciary's direction, thereby implementing an improper direction, the trustee again has breached not only his own fiduciary duty but may be liable under the second general co-fiduciary liability rule.[147]

IV. LEGISLATIVE HISTORY

ERISA's thousands of pages of legislative history shed little light on the tough questions that arise when a named fiduciary directs a trustee. Rather than evolving through successive versions of the bill, section 403(a)(1), in its present form, appeared to spring fully formed shortly before passage.[148] Two things, however, are clear. First, Congress intended ERISA to strengthen, not weaken, fiduciary standards developed under the common law of trusts.[149] Second, there is no evidence in the legislative history that it ever occurred to Congress that an entity could be a trustee without being a fiduciary.[150]

A. *The Absence of Fiduciary Standards In Earlier Federal Legislation*

A principal impetus towards ERISA's enactment was the desire to provide uniform fiduciary standards, which were missing from existing legislation.[151] The IRC already governed employee benefit plans, conditioning employers' receipt of tax benefits upon the requirement that the plan serve the exclusive benefit of employees and their beneficiaries.[152] Though this standard was a fiduciary one in concept, and persisted in ERISA, there was a perception that the IRS was not enforcing it.[153] The

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147. ERISA § 405(a)(2), 29 U.S.C. § 1105(a)(2) (1994).

148. *See infra* notes 187-94 and accompanying text.

149. *See supra* note 20 and accompanying text.

150. *See infra* part IV.C.

151. *E.g.*, SEN. SUBCOMM., S. 4, 93d Cong., 1st Sess. (1973), *reprinted in* I LEGIS. HIST., *supra* note 20, at 91 (remarks of Senator Williams) ("improved and more stringent fiduciary standards" would be a key reform); SEN. SUBCOMM., S. 4, 93d Cong., 1st Sess. (1973), *reprinted in* I LEGIS. HIST., *supra* note 20, at 204, 207-08 (remarks of Senator Ribicoff) (One of the "major problems which gives rise to pension horror stories" was the "ineffective fiduciary requirements which threaten the safety and preservation of fund assets."). The final bill's "declaration of policy" included "establishing standards of conduct, responsibility, and obligation for fiduciaries of employee benefit plans." ERISA § 2(b), 29 U.S.C. § 1001(b) (1994).

152. 26 U.S.C. § 401(a) (1970).

153. *E.g.*, S. REP. NO. 1440, 85th Cong., 2d Sess. (1958), *reprinted in* 1958 U.S.C.C.A.N. 4137, 4151; *H.R. 2 Hearings*, *supra* note 47, at 338-39 (statement of William H. Bret, Jr.) ("[Ninety] percent of lawyers believe that the exclusive benefit provision of the IRC and the 503(c) prohibited transaction rules, if rigidly enforced, would stop most abuse."); Hutchison, *supra* note 24, at 18. *But see* S. REP. NO. 1440, 85th Cong., 2d Sess. (1958),

LMRA governed plans established pursuant to a collective bargaining agreement,[154] but its similar lack of express fiduciary standards was widely believed to have contributed to pension abuse.[155] Moreover, the lack of express fiduciary standards was perceived as problematic even though both the IRC and the LMRA required the trust form, with its implied imposition of fiduciary obligations.[156]

Thus, as early as 1954, President Eisenhower recommended a congressional investigation of pension plans.[157] In 1958, Congress passed the first federal statute directly regulating employee benefit plans, the Welfare and Pension Plan Disclosure Act ("WPPDA").[158] But even after amendments in 1962,[159] the WPPDA contained no fiduciary standards, only disclosure and bonding requirements.[160] The continued lack of fiduciary standards fed the momentum for a comprehensive pension statute.[161]

ERISA had numerous precursors in the House and Senate.[162] All the

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reprinted in 1958 U.S.C.C.A.N. 4137, 4179 (stating position of minority leaders that Welfare and Pension Plans Disclosure Act was unnecessary because IRC already regulated pension plans).

154. LMRA § 302(c)(5), 29 U.S.C. § 186(c)(5) (1970).

155. *See, e.g.*, Blankenship v. Boyle, 329 F. Supp. 1089 (D.D.C. 1971) (providing an example of union trustees' misuse of pension funds). Although the received wisdom was that uniform federal fiduciary standards would cure union pension abuse, Judge Gesell did quite well with existing common law trust principles in fashioning relief for the trustees' breach of fiduciary duties in that case. Indeed, after *Mertens v. Hewitt Associates*, 508 U.S. 248 (1993), Judge Gesell today might have found himself without any remedial tools against the non-fiduciary bank defendant, which knowingly participated in the trustees' breach of duty. *Blankenship*, 329 F. Supp. at 1101-03.

156. I.R.C. §§ 401(a), 503(b) (1970); Rev. Rul. 69-231, 1969-1 C.B. 118; LMRA § 302(c)(5), 29 U.S.C. § 186(c)(5) (1970).

157. H.R. REP. NO. 998, 87th Cong., 2d Sess. (1961), *reprinted in* 1962 U.S.C.C.A.N. 1532, 1533.

158. Pub. L. No. 85-836, 72 Stat. 997 (1958), *reprinted in* 1958 U.S.C.C.A.N. 1172.

159. Welfare and Pension Plans Disclosure Act Amendments of 1962 ("WPPDAA"), Pub. L. No. 87-420, 76 Stat. 35 (1962), *reprinted in* 1962 U.S.C.C.A.N. 43. The amendments added criminal penalties for embezzlement of pension funds. Why embezzlement of pension funds might not have been a criminal act before the amendments is unclear. Indeed, the legislative history of both the WPPDA and the WPPDAA indicated that state criminal laws would cover outright embezzlement by trustees. S. REP. NO. 1440, 85th Cong., 2d Sess. (1958), *reprinted in* 1958 U.S.C.C.A.N. 4137, 4145; H.R. REP. NO. 998, 87th Cong., 2d Sess. (1961), *reprinted in* 1962 U.S.C.C.A.N. 1532, 1551.

160. Pub. L. No. 87-420, 76 Stat. 35 (1962), *reprinted in* 1962 U.S.C.C.A.N. 43.

161. *E.g.*, SEN. SUBCOMM., S. 4, 93d Cong., 1st Sess. (1973), *reprinted in* I LEGIS. HIST., *supra* note 20, at 207; SEN. SUBCOMM., H.R. REP. NO. 93-533, 93d Cong., 1st Sess. 4 (1973), *reprinted in* II LEGIS. HIST., *supra* note 7, at 2351. ERISA repealed and entirely replaced the WPPDA.

162. More comprehensive overviews of ERISA's legislative history have been provided elsewhere. *E.g.*, Conison, *supra* note 18, at 619-29; SEN. SUBCOMM., *Comparison of Senate-*

bills shared one provision, though—the requirement that employee benefit plans be established pursuant to a trust agreement or (presumably anticipating that some still would not be) should be "deemed to be a trust."[163] Because a fiduciary relationship is the essence of the trust structure, the trust requirement was a first step in the eventual adoption of broad-based fiduciary standards. Further common ground in the early bills, foreshadowing the development of fiduciary standards, was the provision that trust funds not be used for any purpose other than paying retirement benefits and defraying reasonable administration expenses.[164]

B. Tracing the History of Section 403(a)

1. Existing IRC Provisions Regarding Directed Trustees

The concept of a directed trustee was already part of the pre-ERISA IRC landscape regulating pension plans. The pension plans of self-employed individuals were required (with certain exceptions) to use a bank as trustee, "but a person (including the employer) other than a bank may be granted, under the trust instrument, the power to control the investment of the trust funds either by directing investments . . . or by disapproving proposed investments . . . ."[165] Notably, Congress did not require ERISA directed trustees to be banks, despite considerable lobbying by the corporate trust industry in favor of institutional fiduciaries.[166]

Passed and House-Passed Versions of H.R. 2, 94th Cong., 2d Sess. (1974), *reprinted in* III LEGIS. HIST., *supra* note 81, at 4251. Some legislators thought pension reform should come through amendments to the IRC and be enforced by the IRS. Others, who eventually prevailed, believed pension reform was labor legislation and the DOL should bear primary enforcement responsibility for fiduciary standards. Express fiduciary standards were present in even the earliest labor bills, but missing from the early tax bills.

163. *E.g.*, S. 3598, 92d Cong., 2d Sess. § 15(a) (1972); SEN. SUBCOMM., H.R. 2, 93d Cong., 1st Sess. § 111(a)(1) (1973), *reprinted in* I LEGIS. HIST., *supra* note 20, at 3, 41; SEN. SUBCOMM., S. 4, 93d Cong., 1st Sess. § 510 (1973), *reprinted in* I LEGIS. HIST., *supra* note 20, at 93, 170; SEN. SUBCOMM., S. 1557, 93d Cong., 1st Sess. § 11 (1973), *reprinted in* I LEGIS. HIST., *supra* note 20, at 307; SEN. SUBCOMM., S. 1179, 93d Cong., 1st Sess. § 501(a)(3) (1973), *reprinted in* I LEGIS. HIST., *supra* note 20, at 946; SEN. SUBCOMM., H.R. 4200, 93d Cong., 1st Sess. (1973), *reprinted in* II LEGIS. HIST., *supra* note 7, at 2055.

164. SEN. SUBCOMM., H.R. 2, 93d Cong., 1st Sess. § 111(a)(2) (1973), *reprinted in* I LEGIS. HIST., *supra* note 20, at 41; SEN. SUBCOMM., S. 4, 93d Cong., 1st Sess. § 510 (1973), *reprinted in* I LEGIS. HIST., *supra* note 20, at 170; SEN. SUBCOMM., S. 1557, 93d Cong., 1st Sess. § 11 (1973), *reprinted in* I LEGIS. HIST., *supra* note 20, at 307.

165. 26 U.S.C. § 401(d)(1) (1970); 26 C.F.R. §§ 1.401-12(c)(1)(i), (c)(3) (1972).

166. The American Bankers' Association and others believed that most pension abuses were committed by non-institutional, non-bank fiduciaries who were "not qualified to act as fiduciaries" and lacked the funds to pay a liability judgment. *S. 3598 Hearings*, *supra* note 45, at 251. *See also H.R. 2 Hearings*, *supra* note 47, at 337, 678-681; *S. 4 Hearings*, *supra*

2. Early Bills' Recognition of Directed Trustees' Fiduciary Duties

The earliest bills forerunning ERISA did not overtly refer to directed trustees. But many early bills covered trusts that provided for a directed trustee.[167] These bills expressly subjected the trustee to all fiduciary duties in carrying out the directions.

Section 510 of Senate Bill 4 ("S. 4"), proposing a new section 15(c) to the WPPDA, is a representative example.[168] It described eight actions a fiduciary *could* take, notwithstanding the fiduciary's prescribed duties[169] and prohibitions on its conduct.[170] The last two permitted actions alluded to directed trustees.

Section 15(c)(7) would have permitted a fiduciary to follow an instruction in the trust or other plan document, so long as the instruction did

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note 45, at 619-20; S. REP. NO. 1440, 85th Cong., 2d Sess. (1958), *reprinted in* 1958 U.S.C.C.A.N. at 4151. These concerns, while obviously somewhat economically motivated, were rationally based on past cases. *E.g.*, Blankenship v. Boyle, 329 F. Supp. 1089 (D.D.C. 1971). *See also* SEN. SUBCOMM., Senate Consideration of Conference Report to Accompany H.R. 2, 93d Cong., 2d Sess. (1974), *reprinted in* III LEGIS. HIST., *supra* note 81, at 4795-96 (remarks of Senator Bentsen). Congress, however, perhaps fearing that overregulation would choke off employers' voluntary formation of employee benefit plans, *e.g.*, SEN. SUBCOMM., S. REP. NO. 127, 93d Cong., 1st Sess. 14, *reprinted in* I LEGIS. HIST., *supra* note 20, at 587, 600, did not follow the trust industry's advice. ERISA allows both insider and individual trustees. ERISA § 408(c)(3), 29 U.S.C. § 1108(c)(3) (1994).

167. S. 3598, 92d Cong., 2d Sess. (1972); SEN. SUBCOMM., S. 4, 93d Cong., 1st Sess. (1973), *reprinted in* I LEGIS. HIST., *supra* note 20, at 93; SEN. SUBCOMM., S. 1557, 93d Cong., 1st Sess. (1973), *reprinted in* I LEGIS. HIST., *supra* note 20, at 280; SEN. SUBCOMM., H.R. 4200, 93d Cong., 1st Sess. (1973), *reprinted in* II LEGIS. HIST., *supra* note 7, at 1883.

168. SEN. SUBCOMM., S. 4, 93d Cong., 1st Sess. § 15 (1973), *reprinted in* I LEGIS. HIST., *supra* note 20, at 172-76. The section in S. 4 was the equivalent of section 15(c) of S. 3598 and of section 11 of S. 1557, *reprinted in* I LEGIS. HIST., *supra* note 20, at 308-13. These provisions were unchanged when the bill was reported out of committee. SEN. SUBCOMM., S. 4, 93d Cong., 1st Sess. 184 (1973), *reprinted in* I LEGIS. HIST., *supra* note 20, at 572. Subsections 15(c)(7) and (c)(8) were renumbered, otherwise unchanged, in one amendment to S. 4 and then were renumbered, substantially unchanged, in a new version of H.R. 4200. SEN. SUBCOMM., H.R. 4200, 93d Cong., 1st Sess. 179-80 (1973), *reprinted in* II LEGIS. HIST., *supra* note 7, at 2061-62. They reappeared in section 511(a), which proposed new Sections 15(c)(5) and (6) to the WPPDA, in the version of H.R. 2 passed by the Senate before the bill went to conference. SEN. SUBCOMM., H.R. 2, 93d Cong., 2d Sess. § 15 (1974), *reprinted in* III LEGIS. HIST., *supra* note 81, at 3777.

169. Proposed section 15(b)(1) listed the now-familiar fiduciary duties—the exclusive benefit rule, the prudent man rule, and the duty to follow the trust documents. SEN. SUBCOMM., S. 4, 93d Cong., 1st Sess. 78 (1973), *reprinted in* I LEGIS. HIST., *supra* note 20, at 170.

170. Section 15(b)(2) listed many of the prohibitions on a fiduciary's conduct now known as the "prohibited transaction" rules of ERISA section 406. SEN. SUBCOMM., S. 4, 93d Cong., 1st Sess. 79 (1973), *reprinted in* I LEGIS. HIST., *supra* note 20, at 171-72.

not involve a prohibited transaction.[171] Section 15(c)(8) would have permitted a fiduciary to "tak[e] action" authorized in the trust or other plan document, so long as the action was consistent with *all* the listed fiduciary duties and prohibitions, not just the prohibited transactions.[172] Thus, if a fiduciary followed an "instruction"[173] in the trust instrument, the fiduciary would not be subject to the prudence[174] or exclusive benefit[175] rules, but if the fiduciary took "action" authorized by the trust instrument, the fiduciary would be subject to the latter rules.

The operative difference between subsections (c)(7) and (c)(8) is not transparent; subsection (c)(8), in particular, appears to subsume subsection (c)(7).[176] However, it could be plausibly argued that subsection (c)(7) applies where, for example, the trust agreement itself directs the trustee to invest assets in a particular type of investment,[177] while subsection (c)(8) includes the more fluid situation where the plan authorizes someone to instruct the trustee to make investments or take other acts.

If this is a plausible reading, then the distinction between subsections (c)(7) and (c)(8) indicates a congressional intent that directed trustees would not be released from any fiduciary duties in following someone else's directions. Under subsection (c)(7), where the fiduciary is merely following what the trust document says, the fiduciary has only to avoid the specific prohibited transactions—not to follow the more general fiduciary duties.[178] But under subsection (c)(8), which includes the directed trustee situation, the fiduciary continues to be

171. SEN. SUBCOMM., S. 4, 93d Cong., 1st Sess. 84 (1973), *reprinted in* I LEGIS. HIST., *supra* note 20, at 176 (fiduciary could "follow[] the specific instructions in the trust instrument or other document governing the fund insofar as consistent with the specific prohibitions listed in subsection (b)(2)").

172. SEN. SUBCOMM., S. 4, 93d Cong., 1st Sess. 84 (1973), *reprinted in* I LEGIS. HIST., *supra* note 20, at 176 (fiduciary could "tak[e] action pursuant to an authorization in the trust instrument or other document governing the fund, provided such action is consistent with the provisions of subsection (b)[setting forth the fiduciary principles]").

173. *See supra* note 171.

174. *See* ERISA § 404(a)(1)(B), 29 U.S.C. § 1104(a)(1)(B) (1994).

175. *See* ERISA § 404(a)(1)(A)(i), 29 U.S.C. § 1104(a)(1)(A)(i) (1994).

176. S. 4 at 84, *reprinted in* I LEGIS. HIST., *supra* note 20, at 176.

177. *See, e.g.*, Moench v. Robertson, 62 F.3d 553, 557-58 (3d Cir. 1995) (ESOP terms directed trustee to invest plan funds in company stock), *cert. denied*, 116 S. Ct. 917 (1996); Rinard v. Eastern Co., 978 F.2d 265, 267 (6th Cir. 1992) (trust agreement directed trustee to return surplus plan assets to employer upon plan termination), *cert. denied*, 507 U.S. 1029 (1993); Kuper v. Quantum Chems. Corp., 852 F. Supp. 1389, 1392 (S.D. Ohio 1994) (ESOP provided assets that were to be invested primarily in company securities), *aff'd sub nom.* Kuper v. Iovenko, 66 F.3d 1447 (6th Cir. 1995); Arakelian v. National W. Life Ins. Co., 680 F. Supp. 400, 402 (D.D.C. 1987) (trust document directed that plan assets be invested in annuity contracts of the sponsor).

178. ERISA as passed, however, provides that a fiduciary may follow only those provisions in the trust document that comply with ERISA. § 404(a)(1)(D), 29 U.S.C. § 1104(a)(1)(D) (1994).

subject to both the general fiduciary duties and the specific prohibited transactions.[179]

Several representatives of the corporate trust industry, testifying during the congressional hearings on ERISA forerunners, commented on proposed sections 15(c)(7) and (c)(8). Many such witnesses recognized the pre-ERISA existence of directed trustees.[180] The industry generally favored federal fiduciary standards,[181] but recommended—to no avail—that Congress adopt provisions exculpating directed trustees.

For example, the American Bankers' Association advocated an amendment stating that directed trustees would not be liable for acts taken in good faith.[182] Congress ignored this suggestion, although it accepted other recommendations from the American Bankers' Association.[183] The Investment Counsel Association of America argued that subsection 15(c)(7) should be "clarified" to provide expressly that a trustee would not be subject to the prudence rule if it followed a specific provision in the trust instrument.[184] Instead, Congress amended the fiduciary rules to provide that ERISA's provisions always trump the trust document.[185] Nor did Congress provide an exception for directed trustees from ERISA's general prohibition against exculpatory clauses.[186]

3. More Explicit Acknowledgement of Directed Investments and Investment Managers

House Bill 12906 contained the first recognizable forerunner of what became section 403(a)(1).[187] There was still no mention of a "named fiduciary"; the

179. The DOL, commenting on S. 1557's version of subsections (c)(7) and (c)(8), stated that "the practice of including in trust instruments various authorizations governing the handling of the fund" was "generally recognized as appropriate" and would be among the "listed transactions in which fiduciaries are expressly allowed to engage. . . . *It is emphasized, however, that even with respect to the transactions expressly allowed, the fiduciary's conduct must be consistent with the prudent man standard.*" Explanatory Statement of Amendments to the Welfare & Pension Plans Disclosure Act Made by the Employee Benefits Protection Act, *reprinted in* I LEGIS. HIST., *supra* note 20, at 274, 276 (emphasis added).

180. *E.g.*, *S. 4 Hearings*, *supra* note 45, at 629.

181. *S. 3598 Hearings*, *supra* note 45, at 1077 (statement of Henry B. Thielbar, Member of the Board of Governors of the Investment Counsel Association of America); *S. 4 Hearings*, *supra* note 45, at 620 (statement of the Corporate Fiduciaries Association of Illinois).

182. *S. 3598 Hearings*, *supra* note 45, at 38 (statement of the American Bankers' Assoc.).

183. For example, the American Bankers' Association's suggestion that a plan funded by insurance contracts should be exempted from the trust requirement appears in ERISA § 403(b). *S. 3598 Hearings*, *supra* note 45, at 30-31.

184. *S. 3598 Hearings*, *supra* note 45, at 1080.

185. ERISA § 404(a)(1)(D); 29 U.S.C. § 1104(a)(1)(D) (1994).

186. ERISA § 410(a), 29 U.S.C. § 1110(a) (1994).

187. H.R. 12906, 93d Cong., 2d Sess. § 111(e) (1974), *reprinted in* II LEGIS. HIST.,

equivalent concept was an "administrator."[188] After the usual requirement that plan assets be held in trust, proposed section 111(e) stated that the trustee:

> shall have exclusive authority and discretion to manage, and exclusive control of, the assets of the plan (subject to proper directions of the administrator which are made under the terms of the plan and which are not contrary to this title and except to the extent that authority to manage, acquire, or dispose of assets of the plan is delegated to one or more investment managers).[189]

Thus, House Bill 12906 also contained the first direct mention in the bills of an investment manager.

The report accompanying House Bill 12906 contained no explanation of section 111(e).[190] However, the section began to lay the groundwork for the different consequences in which (1) a named fiduciary (here, "administrator") and (2) an investment manager presented for the trustee's liability. While the trustee's otherwise "exclusive authority" to manage plan assets could only be "subject to" an administrator's directions that were "proper" and "not contrary to this title," the task of managing plan assets could be entirely delegated to an investment manager. This section was incorporated unchanged into the version of House Bill 2 that the House passed before conference.[191]

4. The Emergence of the "Named Fiduciary" and Section 403(a)(1)

Meanwhile, the version of House Bill 2 that passed the Senate before going to conference still contained proposed sections 15(c)(7) and (c)(8) (now renumbered (c)(5) and (c)(6)).[192] The conference bill that emerged

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supra note 7, at 2761.

188. *Id.* at § 111(a)(1), *reprinted in* II LEGIS. HIST., *supra* note 7, at 2810 ("a written plan . . . shall identify and appoint . . . an administrator [who] . . . shall be deemed to have full authority and responsibility for the operation of [the] plan . . . .").

189. SEN. SUBCOMM., H.R. 12906, 93d Cong., 2d Sess., § 111(e) (1974), *reprinted in* II LEGIS. HIST., *supra* note 7, at 2817.

190. *Employee Benefit Security Act of 1974: Material Explaining H.R. 12906 Together With Supplemental Views (To accompany H.R. 2)*, *reprinted in* II LEGIS. HIST., *supra* note 7, at 3293-3350.

191. *Compare* SEN. SUBCOMM., H.R. 12906, 93d Cong., 2d Sess. 50-52 (1974), *reprinted in* II LEGIS. HIST., *supra* note 7, at 2810-12 *with* SEN. SUBCOMM., H.R. 2, 93d Cong., 2d Sess. 50-52 (1974), *reprinted in* III LEGIS. HIST., *supra* note 81, at 3947-49 *and* SEN. SUBCOMM., H.R. 12906, 93d Cong., 2d Sess. 57-58 (1974), *reprinted in* II LEGIS. HIST., *supra* note 7, at 2817-18 *with* SEN. SUBCOMM., H.R. 2, 93d Cong., 2d Sess. 57 (1974), *reprinted in* III LEGIS. HIST., *supra* note 81, at 3954.

192. SEN. SUBCOMM., H.R. 2, 93d Cong., 2d Sess. § 15 (1974), *reprinted in* III

replaced the concept of an administrator with that of a "named fiduciary" and added what was essentially the current version of section 403(a).[193] Not once does the report accompanying the conference bill mention that the concept of a "named fiduciary" is unprecedented in the numerous predecessor bills or in the common law. No detailed discussion of the duty of a trustee directed by a "named fiduciary" appears. Nothing in the Conference Report even mentions, let alone explains, the interaction of the odd new section 405(b)(3)(B), seeming to absolve trustees of liability for following named fiduciary's directions, with section 403(a)(1)'s requirement that the directed trustee follow only "proper" directions that are not otherwise contrary to ERISA.[194] The entire explanation of new section 403, "Establishment of Trust," reads:

> If the plan provides that the trustees are subject to the direction of named fiduciaries, then the trustees are not to have the exclusive management and control over the plan assets, but generally are to follow the directions of the named fiduciary. Therefore, if the plan sponsor wants an investment committee to direct plan investments, he may provide for such an arrangement in the plan. In addition, since investment decisions are basic to plan operations, members of such an investment committee are to be named fiduciaries. (For example, the plan could provide that the investment committee is to consist of the persons who serve as the president, vice-president for finance, and comptroller of the employer.) If the plan so provides, the trustee who is directed by an investment committee is to follow that committee's directions unless it is clear on their face that the actions to be taken under those directions would be prohibited by the fiduciary responsibility rules of the bill or would be contrary to the terms of the plan or trust.
>
> In addition (as discussed below), to the extent that the management of plan assets is delegated to a special category of persons called "investment managers," the trustee is not to have exclusive discretion to manage and control the plan assets, nor would the trustee be liable for any act of such investment manager.[195]

But the standard that a trustee must follow the named fiduciary's directions "unless it is clear on their face" that they are prohibited by ERISA or the plan documents is so inherently imprecise as to be almost useless.[196] Moreover, the standard is inconsistent with section 403(a)(1)'s

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LEGIS. HIST., *supra* note 81, at 3778.

193. SEN. SUBCOMM., H.R. REP. NO. 1280, 93d Cong., 2d Sess. 58 (1974), *reprinted in* III LEGIS. HIST., *supra* note 81, at 4277, 4333.

194. *See, e.g.*, SEN. SUBCOMM., H.R. REP. NO. 1280, 93d Cong., 2d Sess. 1 (1974), *reprinted in* III LEGIS. HIST., *supra* note 81, at 4566.

195. SEN. SUBCOMM., H.R. REP. NO. 1280, 93d Cong., 2d Sess. 298 (1974), *reprinted in* III LEGIS. HIST., *supra* note 81, at 4565.

196. *See, e.g.*, *supra* note 195. Of course, it is possible to imagine directions so absurd

requirements that the direction be "proper" and consistent with the plan and ERISA.[197]

To take a bright-line example, ERISA generally prohibits investing more than ten percent of plan assets in the employer's common stock.[198] Suppose a plan has $10 million in assets, including $500,000 already invested in company stock. The named fiduciary directs the trustee to take $600,000 of plan cash and purchase company stock. Nothing about the direction "on its face"[199] violates ERISA. The trustee can only know that this direction violates the 10% limitation[200] by reference to the total amount of plan assets and the existing investment portfolio. Yet surely Congress did not intend that the trustee could neglect even this minimal level of plan monitoring, which could be determined by a glance at the latest plan report.[201]

The Conference Report tried once more to clarify section 403(a)(1), but again succeeded only in confusing matters. Once again, the legislative comment seems easier on directed trustees than the actual statutory language:

> As described above (*Establishment of trust*) the plan may also provide that the trustee is to be subject to the direction of named fiduciaries with respect to investment decisions. In this case, if the trustee properly follows the instructions of the named fiduciaries, the trustee generally is not to be liable for losses which arise out of following these instructions. (The named fiduciaries, however, would be subject to the usual fiduciary responsibility rules and would be subject to liability on breach of these rules.)[202]

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that violations of ERISA would be "clear on their face," *id.*, such as a direction to invest all plan assets in lottery tickets. But none of the reported directions to trustees approach that level of foolishness. *See* ERISA §§ 403-05, 29 U.S.C §§ 1103-05 (1994).

197. Rizzo & Carey, *supra* note 123, at 18-19; COMM. ON FIDUCIARY RESPONSIBILITY, *supra* note 15, at 546. *But see 404(c) Regulations, supra* note 121, at 18 (asserting that these excerpts from the legislative history cannot "be reconciled with a general duty [on the trustee's party] to investigate").

198. ERISA § 407(a)(2), 29 U.S.C. § 1107(a)(2) (1994). The 10% limitation does not apply to "eligible individual account plan[s]," including ESOPs. ERISA §§ 407(b)(1), (d)(3)(A), 29 U.S.C. §§ 1107(b)(1), (d)(3)(A) (1994).

199. *See, e.g., supra* note 195.

200. *See, e.g., supra* note 198 and accompanying text.

201. The plan's annual report must contain a schedule of all investments of the fund. ERISA § 103(b), 29 U.S.C. § 1023(b) (1994). *See* IRS Form 5500 & Schedule G (1995); *Cf.* 12 C.F.R. § 9.7(a)(2) (1995) (requiring that a federal bank with "investment responsibilities" as a fiduciary to review the assets when the account is opened, and to conduct a review of the assets held each year "to determine the advisability of retaining or disposing of such assets."). The question of when a direction is "facially valid" is closely related to the question of whether a directed trustee has any duty to investigate the named fiduciary's direction. *See* discussion *infra* part VIII.B.

202. H.R. REP. NO. 1280 at 301-02, *reprinted in* III LEGIS. HIST., *supra* note 81, at 4568-69.

Assuming that the qualifier "properly" incorporates section 403(a)(1)'s requirements that the direction be consistent with ERISA and the plan documents, this statement verges on tautology. Early industry commentators were quick to point out that section 403(a)(1) gave directed trustees no comfort in mechanically following a named fiduciary's directions.[203] The statutory structure does not accomplish the trustee's asserted non-liability for following the named fiduciary's instructions. With the Conference Report thus appearing to contradict the statute, it is no wonder that the law in this area is in shambles.

C. Did Congress Consider a Directed Trustee a Fiduciary?

Perhaps anticipating the spate of definitional litigation to follow, employee benefits professionals were uncomfortable with Congress' functional rather than categorical definition of "fiduciary." At the hearings on House Bill 2, one such witness expressed what scores of judges and litigants must have echoed since:

> The . . . thing that has bothered me about the bill [is] . . . [a]s I read the bill, [I] keep asking [myself,] "Who is . . . a fiduciary?" . . . I think the bill ought to sharply define . . . "fiduciary."
> . . . May I suggest that a fiduciary is the retirement plan committee, a designated corporate officer, a trustee, a custodian, an agent, an investment counselor, an insurance company who has discretion to invest fund moneys.
> This act may well be unworkable because of its failure to distinguish these as clearly needed . . . .[204]

Congress did not adopt the suggestion that "fiduciary" be defined by listing specific entities, including "trustee." But Congress would probably have been astonished to learn that federal judges would one day reach the conclusion that a directed trustee was not an ERISA "fiduciary."

The two terms were often used synonymously.[205] A "trustee" was

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203. COMM. ON FIDUCIARY RESPONSIBILITY, *supra* note 15, at 546-48; *Special Problems of Banks*, *supra* note 15, at 243.

204. *H.R. 2 Hearings*, *supra* note 47, at 338. *See also S. 4 Hearings*, *supra* note 45, at 629 (suggesting definition of "fiduciary" include investment counselors).

205. For example, in debate on the proposed limit on the percent of plan assets to be invested in employer securities, Senator Taft stated, "I think that the Finance Committee position [0%] is an unnecessary restriction on the powers of a trustee. They are already under fiduciary restrictions contained in S. 4." SEN. SUBCOMM., Senate Consideration of S. 4, 93d Cong., 2d Sess. (1974), *reprinted in* II LEGIS. HIST., *supra* note 7, at 1848. *See also* SEN. SUBCOMM., Senate Consideration of Conf. Report to accompany H.R. 2, 93d Cong., 2d Sess. (1974), *reprinted in* III LEGIS. HIST., *supra* note 81, at 4825 (remarks of Senator Beall) (H.R. 2 mandates "tighter fiduciary or trustee standards to protect against mismanagement or misuse of pension funds"); SEN. SUBCOMM., Outline of Major Provisions of S. 4—Williams-Javits Pension Reform Bill, *reprinted in* I LEGIS. HIST., *supra* note 20, at 190 (S. 4 "[p]rescribes new rules of conduct for trustees and fiduciaries controlling employee benefit funds"); SEN. SUBCOMM., S. REP. NO. 127, 93d Cong., 1st Sess. 11 (1974), *reprinted in* I

given as an example of a "fiduciary."[206] Moreover, the early sections imposing the trust requirement were entitled "Fiduciary Responsibility,"[207] with the explanation that "[t]he fiduciary must adhere to trust principles established by the Act . . . ."[208] There cannot be a trust without a trustee. As the American Bankers' Association categorically stated, "a 'trustee' is a 'fiduciary.'"[209]

V. DOL INTERPRETATIONS

The DOL has repeatedly recognized that directed trustees are ERISA fiduciaries.[210] An early regulation states that a trustee, by "the very nature of

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LEGIS. HIST., *supra* note 20, at 597 ("The only current federal requirement is that the Secretary of Labor require fiduciaries, trustees, etc., to make disclosure.").

206. *E.g.*, SEN. SUBCOMM., S. 1557, 93d Cong., 1st Sess. (1973), *reprinted in* I LEGIS. HIST., *supra* note 20, at 276 (Introductory Statement of Mr. Javits) ("an employer will often . . . function as a trustee or in some other fiduciary capacity"); SEN. SUBCOMM., H.R. REP. NO. 533, 93d Cong., 1st Sess. 17 (1973), *reprinted in* II LEGIS. HIST., *supra* note 7, at at 2364 (purpose of bill is "to establish minimum standards of fiduciary conduct for Trustees, Administrators and others dealing with retirement plans"); SEN. SUBCOMM., House of Representatives Consideration of H.R. 2, 93d Cong., 1st Sess. (1973), *reprinted in* II LEGIS. HIST., *supra* note 7, at 3370 (remarks of Rep. Perkins) ("[S]ince trustees and managers of plans have not always been above manipulating or investing funds for their own gain rather than in the interest of the beneficiary, fiduciary standards are established which will provide additional safeguards against mismanagement."); SEN. SUBCOMM., *Summary of Differences between the Senate Version and the House Version of H.R. 2 To Provide for Pension Reform, Part Three: Fiduciary and Enforcement* 14 (1974), *reprinted in* III LEGIS. HIST., *supra* note 81, at 5264 (making staff recommendation that "[a] fiduciary (including a trustee) is to be liable for a breach of fiduciary responsibility committed by a co-fiduciary"); SEN. SUBCOMM., Senate Consideration of Conf. Report to Accompany H.R. 2, 93d Cong., 2d Sess. (1974), *reprinted in* III LEGIS. HIST., *supra* note 81, at 4771 (remarks of Sen. Javits) ("The conferees decided to include a provision permitting either the employer, the union, the plan or the trustee himself to purchase insurance covering the personal liability of a trustee in the event of a trustee's breach of fiduciary responsibility"). *But see* ERISA § 411(a)(1), 29 U.S.C. § 1111(a)(1) (1994) (prohibiting any person convicted of certain crimes from serving "as an administrator, fiduciary, officer, trustee, custodian, counsel, agent, employee, or representative in any capacity of any employee benefit plan").

207. *See, e.g.*, SEN. SUBCOMM., H.R. REP. NO. 9824, 93d Cong., 1st Sess. § 111, at 39 (1973), *reprinted in* I LEGIS. HIST., *supra* note 20, at 724.

208. SEN. SUBCOMM., Summary of Major Provisions of S. 4-Williams-Javits, *reprinted in* I LEGIS. HIST., *supra* note 20, at 200.

209. *S. 3598 Hearings*, *supra* note 45, at 279-80.

210. Banks acting as directed trustees have asked for advisory opinions on whether certain financial arrangements directed by the named fiduciaries would constitute prohibited transactions under ERISA § 406. *See e.g.*, Letter from Robert J. Doyle, Director of Regulations and Interpretations, to John B. Brescher, Jr., Attorney, McCarter & English, Op. Ltr. Dep't of Labor (Oct. 27,1992), *available in* 1992 WL 314117 (E.R.I.S.A.) at *2 [hereinafter Brescher Letter]; Letter from Robert J. Doyle, Director of Regulations and

his position, [must] have 'discretionary authority or discretionary responsibility in the administration' of [a] plan," thus satisfying the definition of "fiduciary."[211] The DOL later opined that even though a certain bank did not have investment discretion over plan assets, the bank "would be a fiduciary under Section 3(21) of ERISA upon its appointment as [directed] trustee."[212]

In one case, the DOL charged that Chemical Bank, as a directed trustee, had breached its fiduciary duty by investing half the plan's assets in the sponsor's treasury stock; Chemical Bank agreed to pay $225,000 in a consent decree.[213] Obviously, the DOL believed Chemical Bank was a fiduciary.[214]

Less clear than the DOL's confirmation of the directed trustee's fiduciary status has been its pronouncements on just what that status implies about the directed trustee's duty to investigate the propriety of the direction. The DOL does not subscribe to anything like the "facially valid" standard for directions espoused in the Conference Report;[215] it clearly believes the directed trustee has some duty of inquiry:

> [U]nder section 403(a)(1) of ERISA, a trustee that is subject to proper directions from the plan's named fiduciary remains responsible for determining whether following a given direction would result in a violation of ERISA. The directed trustee also *has responsibility to exercise discretion* where the directed trustee has reason to believe that the named fiduciary's directions are not made in accordance with the terms of the plan or are contrary to ERISA. Furthermore, as with other fiduciary duties, the trustee must ascertain whether existing or potential conflicts of interest may interfere with the proper exercise of this responsibility.[216]

However, the DOL's actions have indicated that it is more willing to infer a duty to investigate thoroughly when the trustee is directed by a participant on

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Interpretations, to Charlotte D. Roederer, Vice President and Associate General Counsel, Manufacturers and Traders Trust Co., Op. Ltr. Dep't of Labor (Feb. 2, 1988), *available in* 1988 WL 192821 (E.R.I.S.A.). Since § 406 applies only to fiduciaries, the DOL necessarily assumes that these banks are fiduciaries when it responds to these requests for opinion letters by analyzing whether the transactions themselves are prohibited transactions.

211. 29 C.F.R. § 2509.75-8(D-3) (1995) (promulgated in 1975). The DOL was not specifically addressing here whether a "directed" trustee was a fiduciary, although one court has cited this release for the proposition that "a trustee is by definition a fiduciary." NARDA, Inc. v. Rhode Island Hosp. Trust Nat'l Bank, 744 F. Supp. 685, 690 (D. Md. 1990).

212. Op. Ltr. Dep't of Labor (Dec. 8, 1982), *available in* 1982 WL 21245 (E.R.I.S.A.) at *2.

213. Donovan v. Ashplant, No. 83 Civ. 1455 (S.D.N.Y. July 30, 1984); *Chemical Bank Agrees To Pay Total $225,000 To Settle U.S. Claims*, WALL. ST. J., Aug. 10, 1984 at 31 [hereinafter *Chemical Bank*].

214. *See Chemical Bank*, *supra* note 213, at 31.

215. *See* discussion *supra* part IV.B.4.

216. Brescher Letter, *supra* note 210, at *3 (emphasis added).

voting or tendering plan stock than when the trustee is directed by company officers. Judging from the reported cases, the DOL seems more willing to pursue breach-of-fiduciary-duty cases against the former type of trustee than the latter.[217] The DOL's opinions with respect to participant-directed trustees have also been far more explicit in mandating a thorough investigation, even in the absence of notice of any problem.[218] Finally, the DOL has recently taken the position, with respect to participant voting, that the trustee has a duty in the absence of any direction to exercise full discretionary powers to determine the best course of action.[219] It is doubtful that the DOL means to apply this position uncritically to all directions and lack of directions made by a non-participant named fiduciary.

A 1994 Interpretive Bulletin that did not address participant directions ducked the hard issues relating to directed trustees' voting of proxies on securities held in plan investment portfolios.[220] The DOL reiterated its view that "[t]he fiduciary act of managing plan assets that are shares of corporate stock includes the voting of proxies appurtenant to those shares of stock."[221] Accordingly, the trustee is exclusively responsible for voting proxies "except to the extent that either . . . the trustee is subject to the directions of a named fiduciary" or an investment manager has been appointed.[222]

217. *Compare* Reich v. NationsBank of Ga., N.A., 19 Employee Benefits Cas. (BNA) 1345 (N.D. Ga. March 29, 1995) (DOL sued bank trustee directed by participants in tendering Polaroid stock during competing tender offers) *and Carter Hawley Hale letter, supra* note 95, at 633 (DOL investigated actions of trustee Bank of America's handling of participant directions in The Limited's tender offer for Carter Hawley Hale stock) *with* Donovan v. Cunningham, 716 F.2d 1455, 1475 (5th Cir. 1983), *cert. denied,* 467 U.S. 1251 (1984) (directed trustee was third-party defendant, not named as defendant by DOL); Wells Fargo Bank v. Bourns, Inc., 860 F. Supp. 709, 711-12 (N.D. Cal. 1994) (DOL conducted investigation of employee benefit plan; employer later sued directed trustee); Pension Benefit Guar. Corp. v. Ross, 733 F. Supp. 1005 (M.D.N.C. 1990) (directed trustee not named as defendant). In *Cunningham* and *Ross,* the DOL and the Pension Benefit Guaranty Corporation ("PBGC") brought breach-of-fiduciary-duty cases against other plan fiduciaries but did not join the directed trustee as a defendant. *See* Donovan v. Cunningham, 716 F.2d 1455 (5th Cir. 1983, *cert. denied,* 467 U.S. 1251 (1984); Pension Benefit Guar. Corp. v. Ross, 733 F. Supp. 1005 (M.D.N.C. 1990). Of course, the DOL's failure in these cases to name the directed trustee may have resulted from considerations of strategy, proof, and/or fault.

218. *See* discussion *infra* part VII.C.3.

219. *Reich,* 19 Employee Benefits Cas. (BNA) at 1351.

220. 29 C.F.R. § 2509.94-2(1) (1995).

221. *Id.*

222. *Id.*

The directed trustee is still responsible for actually voting the proxies, and nothing in the Interpretive Bulletin indicates that this is less than a "fiduciary act,"[223] even if directed.[224]

The difficulty comes in determining how much independent duty of investigation may fall on the trustee directed by a non-participant named fiduciary in voting the proxies or deciding whether to vote them at all. Here, the DOL obscures matters by using the phrase "responsible fiduciary."[225] The regulations state that the "responsible fiduciary" must "vote proxies on issues that may affect the value of the plan's investment," must "consider those factors that may affect the value of the plan's investment," and must "not subordinate the interests of the participants and beneficiaries in their retirement income to unrelated objectives."[226] Moreover, the "responsible fiduciary" may conclude that monitoring or influencing the management of corporations in which the plan owns stock[227] will enhance the value of the plan's investment.

But one is never quite certain if the "responsible fiduciary" is meant to include the directed trustee. On the one hand, it probably does, since the directed trustee is the entity that will vote the shares.[228] However, one sentence indicates the DOL may have meant to let directed trustees off the hook, as contrasted with an investment manager. The regulations state:

> Although a trustee may be subject to the directions of a named fiduciary pursuant to ERISA §403(a)(1), an investment manager who has authority to make investment decisions, including proxy voting decisions, would never be relieved of its fiduciary responsibility if it followed directions as to specific investment decisions from the named fiduciary or any other person.[229]

But since section 403(a)(1) requires that a direction be "proper" and conform to the plan documents and ERISA before the trustee is "relieved of its fiduciary responsibility,"[230] the sentence ultimately begs the question.

VI. THE COMMON LAW OF TRUSTS

A. ERISA Heightened the Common-Law Standard of Fiduciary Responsibility

The extent to which ERISA was intended to incorporate the common law of trusts is unsettled. It is often stated that ERISA was generally meant to codify

223. *Id.*
224. *Id.*
225. *See id.*
226. *Id.*
227. *Id.*
228. *Id.*
229. 29 C.F.R. § 2509.94-2(2).
230. *Id.*

the common law of trusts.[231] But ERISA's few fiduciary provisions do no more than provide a framework of general principles, and Congress openly "intended that a body of Federal substantive law [would] be developed by the courts to deal with issues involving rights and obligations under private welfare and pension plans."[232] Thus, courts have sometimes used the common law to fill gaps in ERISA.[233] Nonetheless, courts have on occasion taken as intentional the absence in ERISA of a principle thought to be well-settled in the common law.[234] Of course, if the common law of trusts had adequately rectified the perceived problems leading to ERISA's passage, there would have been no need to federalize the law.[235] In

231. For example, the explanatory statement of S. 1557 prepared by the DOL stated, "The fiduciary responsibility section, in essence, codifies and makes applicable to these fiduciaries certain principles developed in the evolution of the law of trusts." SEN. SUBCOMM., DOL Statement explaining S. 1557 [hereinafter DOL Statement], *reprinted in* I LEGIS. HIST., *supra* note 20, at 275. *See also, e.g.*, Morse v. Stanley, 732 F.2d 1139, 1145 (2d Cir. 1984); Schoenholtz v. Doniger, 628 F. Supp. 1420, 1428 (S.D.N.Y. 1986); *cf.* Firestone Tire & Rubber Co. v. Bruch, 489 U.S. 101, 110 (1989) ("ERISA abounds with the language and terminology of trust law").

232. SEN. SUBCOMM., Senate Consideration of Conf. Report to Accompany H.R. 2, 93d Cong., 2d Sess. (1974), *reprinted in* III LEGIS. HIST., *supra* note 81, at 4771; Knickerbocker, *supra* note 99, at 634.

233. *E.g.*, Central States, Southeast & Southwest Areas Pension Fund v. Central Transp., Inc., 472 U.S. 559, 570 (1985) (ERISA trustee's duties are based on the common law of trusts, which supplies all powers and duties of trustees and other fiduciaries not enumerated).

234. *E.g.*, Mertens v. Hewitt Assocs., 508 U.S. 248, 254 (1993) (refusing to find nonfiduciary liability for knowing participation in breach of trust despite corresponding common law principle); *Bruch*, 489 U.S. at 111 (1989) (declining to adopt common law's "deferential standard of review . . . when a trustee exercises discretionary powers" as standard of review for ERISA trustee's denial of benefits, unless the trust instrument grants discretion); NARDA, Inc. v. Rhode Island Hosp. Trust Nat'l Bank, 744 F. Supp. 685, 696 (D. Md. 1990) (finding no right of fiduciary indemnification in ERISA because the Restatement (Second) of Trusts has an indemnification provision and ERISA does not).

235. The DOL gave several reasons why the common law of trusts was inadequate for employee benefit plans. First, "[A] number of plans are structured in such a way that it is unclear whether the traditional law of trusts is applicable. Predominantly, these are plans which, although maintaining a fund of assets to finance benefit payments, are not established as trusts." S. Rep. No. 127, 93d Cong., 1st Sess. 29 (1973), *reprinted in* I LEGIS. HIST., *supra* note 20, at 615. Thus, the new federal legislation would require or deem all plan assets to be held in trust. *Id.* Second, "a measure of uniformity" was needed in the area of fiduciary obligation. *Id.* Finally, the sheer size of the assets at stake appeared to be reason to the DOL sufficient to justify federal involvement. *Id.* Some of these concerns were echoed almost verbatim in the Senate Report that was issued when the bill was first reported from committee. *Id.* The Senate Report added the concerns that "without standards by which a participant can measure the fiduciary's conduct . . . he is not equipped to safeguard either his own rights or the plan assets" and that as plans were now "increasingly interstate,"

particular, the legislative history emphasized that trust law had "developed in the context of testamentary and inter vivos trusts (usually designed to pass designated property to an individual or small group of persons) with an attendant emphasis on the carrying out of the instructions of the settlor."[236] The rationales behind some of the rules thus developed did not apply to employee benefit trusts, "covering hundreds or even thousands of participants."[237] In addition, qualified employee benefit trusts—unlike private trusts—had special tax advantages.[238] Thus, Congress "expected that courts [would] interpret the prudent man rule and other fiduciary standards bearing in mind the special nature and purposes of employee benefit plans intended to be effectuated by [ERISA]."[239] Thus, it appears that Congress expected the courts to be more solicitous of the interests of plan participants than they had been of private trust beneficiaries.

Several principles of trust law in particular had not transplanted well to employee benefit plans. First, the common law allowed the settlor of a private trust to exculpate the trustee, absent fraud or gross negligence.[240] Second and similarly, the settlor could authorize the trustee to make investments the law otherwise disallowed.[241] Third, the common law allowed self-dealing by a trustee with the beneficiary's knowledge and consent, so long as the beneficiary did not act in a fiduciary capacity.[242]

ERISA overturned these principles in the context of employee benefit plans. With the advent of ERISA, clauses purporting to exculpate

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administrators, fiduciaries and participants could evaluate the legality of proposed actions without referring to differing state laws. *Id.*

236. DOL Statement, *supra* note 231, *reprinted in* I LEGIS. HIST., *supra* note 20, at 275.

237. *Id.*

238. Knickerbocker, *supra* note 99, at 634.

239. SEN. SUBCOMM., S. 1557, 93d Cong., 1st Sess. (1973) (statement by Mr. Javits), *reprinted in* I LEGIS. HIST., *supra* note 20, at 275; SEN. SUBCOMM., S. REP. NO. 127, 93d Cong., 1st Sess. 29 (1973), *reprinted in* I LEGIS. HIST., *supra* note 20, at 615; SEN. SUBCOMM., H.R. REP. NO. 533, 93d Cong., 1st Sess. 12 (1973), *reprinted in* II LEGIS. HIST., *supra* note 7, at 2359.

240. *E.g.*, Hopkins v. Comm'r, 144 F.2d 683, 689 (6th Cir. 1944); MAJS Inv., Inc. v. Albany Bank & Trust Co., 529 N.E.2d 1035, 1037 (Ill. App. Ct. 1988) (citing Axelrod v. Giambalvo, 472 N.E.2d 840, 844 (Ill. App. Ct. 1984)); Bartlett v. Dumaine, 523 A.2d 1, 9 (N.H. 1986); *In re* Liquidation of Canal Bank & Trust Co., 159 So. 325, 326 (La. 1935); *In re* Langdon's Will, 277 N.Y.S. 581, 584 (N.Y. Sur. Ct. 1935); RESTATEMENT (SECOND) OF TRUSTS § 222 (1959).

241. *E.g.*, Commercial Trust Co. of New Jersey v. Barnard, 142 A.2d 865, 868 (N.J. 1958).

242. *E.g.*, Ames v. Bank of Nutley, 178 A. 363, 365 (N.J. Ch. 1935), *aff'd per curiam*, 183 A. 172 (N.J. 1936); *see* Reeve v. Chase Nat'l Bank of New York, 287 N.Y.S. 937 (N.Y. App. Div. 1936).

fiduciaries are now void.[243] Plan documents cannot excuse fiduciaries from ERISA's fiduciary duties.[244] And to engage in self-dealing, an ERISA trustee must find an exception to the prohibited transaction rules.[245]

B. The Common Law of Directed Trustees

ERISA did not create directed trustees. The common law of trusts had long allowed the settlor to grant a person other than the trustee (even the settlor himself) the power to control the trustee's actions.[246] Never was it suggested in such a case that the trustee was therefore no longer a fiduciary at all.[247]

Instead, the trustee's duty to obey the direction depended on the fiduciary status of the person holding the power of direction.[248] If the person holding that power was not a fiduciary but acted only in a beneficial capacity, the trustee had no duty except to ascertain that the direction complied with the trust terms.[249] But when the person holding the power

243. ERISA § 410(a), 29 U.S.C. § 1110(a) (1994); *e.g.*, Martin v. NationsBank of Ga., N.A., 16 Employee Benefits Cas. (BNA) 2138, 2140-42 (N.D. Ga. 1993); *see also* SEN. SUBCOMM., S. REP. NO. 127, 93d Cong., 1st Sess. 34 (1973), *reprinted in* I LEGIS. HIST., *supra* note 20, at 620 ("[w]hatever the validity such provisions might have with respect to testamentary trust[s], they are inappropriate in the case of employee benefit plans").

244. ERISA § 404(a)(1)(D), 29 U.S.C. § 1104(a)(1)(D) (fiduciary has duty to act "in accordance with the documents and instruments governing the plan *insofar as such documents and instruments are consistent with the provisions of this subchapter* and subchapter III of this chapter") (emphasis added); Central States, Southeast & Southwest Areas Pension Fund v. Central Trans., Inc., 472 U.S. 559, 568 (1985).

245. ERISA §§ 406, 408, 29 U.S.C. §§ 1106, 1108 (1994).

246. *E.g.*, Hopkins v. Comm'r, 144 F.2d 683, 688-90 (6th Cir. 1944) (settlor retained such power over trust that income was taxable to him); Ames v. Bank of Nutley, 178 A. 363, 364 (N.J. Ch. 1935) (settlor retained power to direct trustee's investments), *aff'd per curiam*, 183 A. 172 (N.J. 1936); In re Langdon's Will, 277 N.Y.S. 581, 582 (N.Y. Sur. Ct. 1935) (will gave individual trustee the power to direct corporate co-trustee); Rice v. Halsey, 142 N.Y.S. 58 (N.Y. App. Div. 1913), *aff'd*, 109 N.E. 1091 (N.Y. 1915); RESTATEMENT (SECOND) OF TRUSTS, § 185 (1959); GEORGE G. BOGERT & GEORGE T. BOGERT, THE LAW OF TRUSTS AND TRUSTEES § 551 at 6 (1980) [hereinafter BOGERT & BOGERT]; IIA AUSTIN W. SCOTT & WILLIAM F. FRATCHER, THE LAW OF TRUSTS § 185 (4th ed. 1987) [hereinafter IIA SCOTT & FRATCHER].

247. *But see* Reeve v. Chase Nat'l Bank of New York, 287 N.Y.S. 937, 939 (N.Y. App. Div. 1936) (trustee was "mere custodian").

248. *See generally 404(c) Regulations*, *supra* note 121, at 16-17; Comm. on Investments, *supra* note 71, at 518-19; *Trust Advisers*, *supra* note 71, at 1230-31.

249. *E.g.*, Harrington v. Bishop Trust Co., 43 Haw. 277 (1959) (trustee liable for following settlor's direction when it violated trust terms).

to direct the trustee was herself a fiduciary,[250] the trustee also had a duty to refuse the direction if it violated the other's fiduciary duty.

> If under the terms of the trust a person has power to control the action of the trustee in certain respects, the trustee is under a duty to act in accordance with the exercise of such power, unless the attempted exercise of the power violates the terms of the trust or is a violation of a fiduciary duty to which such person is subject in the exercise of the power.[251]

ERISA continued the concept of a directed trustee, but changed the common law's terminology in a significant way. The common law's person with a "power to control" the trustee became an ERISA "named fiduciary" in section 403(a)(1). The "named fiduciary" is, of course, always a fiduciary,[252] whereas under the common law, the person with the power to direct the trustee might not be a fiduciary.[253] The implication for directed trustee liability under ERISA is clear. As under the common law, the ERISA directed trustee may be subject to liability if he follows directions that would breach the named fiduciary's duty.[254]

That raises the more difficult question of how the trustee, under the common law, was supposed to know that the other person's attempted exercise of power violated the latter's fiduciary duty. Obviously, the trustee's actual knowledge of a fiduciary violation would be sufficient cause to disobey the instruction,[255] else the rule would be a nullity.[256] But

250. *E.g.*, Allen v. Nunnally, 180 F.2d 318, 320 (5th Cir. 1950).

251. RESTATEMENT (SECOND) OF TRUSTS § 185 (1959). This section is substantially unchanged from the First Restatement of Trusts, and was not revised in the Third. *See also* BOGERT & BOGERT, *supra* note 246, § 555 at 122 n.36.

252. ERISA § 402(a)(2), 29 U.S.C. § 1102(a)(2) (1994) ("the term 'named fiduciary' means a fiduciary who is named in the plan instrument, or who, pursuant to a procedure specified in the plan, is identified as a fiduciary . . .").

253. *See, e.g.*, RESTATEMENT (SECOND) OF TRUSTS § 185 cmt. d, e (1959).

254. *See supra* part III.E.3.

255. *E.g.*, Chase Nat'l Bank of New York v. Reinicke, 10 N.Y.S.2d 420, 431-32 (N.Y. App. Div. 1938) (directed trustee refused settlor's direction during World War II to "loan" him 80% of trust corpus, knowing that the German government prohibited repayment of foreign loans).

256. In the non-trust context, even a depository bank, which was not deemed a fiduciary, was liable for transferring funds to a fiduciary if the transfer was not in "good faith," defined as actual knowledge of wrongdoing or knowledge of enough facts to impute knowledge of a breach of fiduciary duty. *E.g.*, Kaufman v. First Nat'l Bank, 493 F.2d 1070, 1074 (5th Cir. 1974) (bank improperly set off funds in accounts it knew were being held for the benefit of persons other than its debtor/depositor); Goldstein v. Riggs Nat'l Bank, 459 F.2d 1161, 1163 (D.C. Cir. 1972) (bank had "actual knowledge" when adverse claimant notifies bank that depositor is a trustee about to misappropriate the funds); Anacostia Bank v. United States Fidelity & Guar. Co., 119 F.2d 455, 456 (D.C. Cir. 1941) (bank that levied on ward's funds to satisfy guardian's personal liability was liable because it knew that the

most commentators agreed that the trustee's responsibility to disobey instructions was not limited to cases where the trustee had actual knowledge of a breach:

> If the trustee has *reason to suspect* that the holder of a power is attempting to exercise it in violation of a fiduciary duty to which the holder is subject in the exercise of the power, the trustee is under a duty not to comply and may be liable if he does comply. If the holder of the power insists upon compliance notwithstanding the objection of the trustee, it is the duty of the trustee to apply to the court for instructions.
>
> Even though the person holding the power holds it as a fiduciary and in fact violates his duty as fiduciary in the exercise of the power, the trustee is not liable for acting in accordance with the exercise of the power if he has *no notice* that the holder of the power is violating his duty as fiduciary.[257]

Professor Scott has a similar formulation:

> [W]here the holder of the power [to direct the trustee] holds it as a fiduciary, the trustee is not justified in complying with his directions if the trustee *knows or ought to know* that the holder of the power is violating his duty to the beneficiaries as fiduciary in giving the directions.[258]

The range between "knows," "ought to know," "reason to suspect," and "no notice" of a violation is uncertain; these are points along a continuum and perhaps can be no better defined. But since a trustee had a duty not to comply with the directions even when he had "reason to suspect" a violation—short of actual knowledge—the directed trustee necessarily had some duty of inquiry or due diligence.[259]

That inference is strengthened by the Restatement's explicit analogy between the directed trustee's duty with respect to the person with power to direct and co-trustees' duties toward each other.[260] Several cases had compared a "trust advisor" to a "co-trustee."[261] Co-trustees had the duty

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loan was personal and knowingly participated in a breach of trust); UNIF. FIDUCIARIES ACT § 1, 7A U.L.A. 395, 396 (1985).

257. RESTATEMENT (SECOND) OF TRUSTS § 185 cmt. e (1959) (emphasis added).

258. IIA SCOTT & FRATCHER, *supra* note 246, § 185, at 574 (emphasis added).

259. Comm. on Investments, *supra* note 71, at 521; *Trust Advisers, supra* note 71, at 1233 ("[T]he most careful trustees will examine [adviser's instructions] as if the trustee had the sole investment responsibility."). *But see* Calvin Grigsby, Comment, *Separable Liabilities of Trustees in Directory Trusts*, 60 CAL. L. REV. 1151 (1972) (arguing that an investigation by only one fiduciary is enough).

260. RESTATEMENT (SECOND) OF TRUSTS § 185 cmt. e (1959).

261. Lewis v. Hanson, 128 A.2d 819, 828 (Del. 1957), *aff'd in relevant part sub nom.* Hanson v. Denckla, 357 U.S. 235 (1958); Gathright's Trustee v. Gaut, 124 S.W.2d 782, 783 (Ky. 1939); United States Nat'l Bank v. First Nat'l Bank, 142 P.2d 785, 790 (Or.), *clarified*, 143 P.2d 909 (Or. 1943).

to use reasonable care to prevent each other from committing a breach of trust.[262] Thus, it may be inferred that the drafters of the Restatement (Third) contemplated that a directed trustee should "use reasonable care to prevent a [person with power of direction] from committing a breach of trust."[263]

Many cases decided under ERISA hold that a directed trustee is not a fiduciary,[264] suggest that the directed trustee has no duty to investigate a named fiduciary's direction,[265] or would allow a named fiduciary to make an investment without the directed trustee's consent.[266] As discussed above, these cases are not consistent with the common law of trusts.

VII. FEDERAL COMMON LAW UNDER ERISA

A. The Non-Fiduciary Directed Trustee?

The courts that have held a directed trustee is not an ERISA "fiduciary"[267] have ignored or misread the statutory language, legislative history, DOL interpretations, and common law background discussed above. The courts' typical mistake is in misreading the definition of "fiduciary" to require that the trustee have some element of "discretion," and then concluding that because the directed trustee must follow directions, it has no

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262. The Restatement (Third) of Trusts provides: "If there are several trustees, each is under a duty to the beneficiaries to participate in the administration of the trust and to use reasonable care to prevent a co-trustee from committing a breach of trust, and if necessary to compel a co-trustee to redress a breach of trust." RESTATEMENT (THIRD) OF TRUSTS § 184 (1992).

263. *Id.* Taking the analogy further, the Restatement (Second) compared the liability of a directed trustee for the acts of the person holding the power of direction "to the liability of a trustee for the actions of a co-trustee." RESTATEMENT (SECOND) OF TRUSTS § 185 cmt. e (citing *id.* § 224, "Liability For Breach of Trust of Co-Trustee"). ERISA section 405, "Liability For Breach by Co-Fiduciary," was modeled after Restatement section 224. Knickerbocker, *supra* note 99, at 669; *see* NARDA, Inc. v. Rhode Island Hosp. Trust Nat'l Bank, 744 F. Supp. 685, 697 (D. Md. 1990). This implies that both sections apply to directed trustees.

264. *See infra* note 267.

265. *See infra* note 378.

266. *See infra* note 524.

267. Maniace v. Commerce Bank, 40 F.3d 264, 267 (8th Cir. 1994), *cert. denied*, 115 S. Ct. 1964 (1995); Pension Fund—Mid Jersey Trucking Indus.—Local 701 v. Omni Funding Group, 731 F. Supp. 161, 173-75 (D.N.J. 1990); Richardson v. U.S. News & World Report, 623 F. Supp. 350, 352 (D.D.C. 1985); Bradshaw v. Jenkins, 5 Employee Benefits Cas. (BNA) 2754 (W.D. Wash. 1984); *see also* Arakelian v. National W. Life Ins. Co., 755 F. Supp. 1080, 1083-85 (D.D.C. 1990) (holding trustees had no "discretion" and were not fiduciaries because plan mandated investment of plan assets in annuity contracts); Bourns, Inc. v. Wells Fargo Bank, No. C-93-3961 MHP, 1994 WL 36998, at *5 (N.D. Cal. Feb. 2, 1994) (declining to decide question of fiduciary status of directed trustee).

"discretion."[268] Moreover, even assuming incorrectly that some "discretion" is a necessary element of fiduciary status, a directed trustee necessarily has "discretion" to decide whether any particular direction is "proper," "not contrary to ERISA," and conforms with plan documents.[269] Indeed, the hallmark of a trustee traditionally is discretion, "unless the instrument or some particular doctrine of trust law denies discretion."[270] Under ERISA, even if the trust purports to require the trustee to follow the named fiduciary's direction, the trustee must still refuse the direction if it violates ERISA.[271] Considering how little "discretion" has been found to satisfy the definition in other contexts,[272] the "discretion" to decide if a named fiduciary's direction is "proper" seems weighty.

Moreover, Congress intended that all trustees, directed or not, act as fiduciaries; merely by holding plan assets, any trustee "exercises . . . authority or discretionary control respecting management . . . or disposition of [those] assets."[273] Nevertheless, some courts still refuse to acknowledge that anyone who actually transfers, wires, or withdraws plan funds "exercises control" over plan assets.[274]

Although it did not involve a directed trustee, the most frequently cited of these cases is *Robbins v. First American Bank.*[275] There, the trustees

268. Many courts determining ERISA fiduciary status make this fundamental error. *E.g.*, Kerns v. Benefit Trust Life Ins. Co., 992 F.2d 214, 215-17 (8th Cir. 1993); Pohl v. National Benefits Consultants, Inc., 956 F.2d 126, 129 (7th Cir. 1992); American Fed'n of Unions Local 102 Health and Welfare Fund v. Equitable Life Assurance Soc'y, 841 F.2d 658, 662 (5th Cir. 1988); O'Toole v. Arlington Trust Co., 681 F.2d 94, 95-96 (1st Cir. 1982); NARDA, Inc. v. Rhode Island Hosp. Trust Nat'l Bank, 744 F. Supp. 685, 693 (D. Md. 1990); Hibernia Bank v. International Bhd. of Teamsters, 411 F. Supp. 478, 490 (N.D. Cal. 1976).

269. DOL Op., No. 92-23A, 1992 WL 314117, at *3 (Oct. 27, 1992) ("directed trustee also has responsibility to exercise discretion"); *see also* Knickerbocker, *supra* note 99, at 662.

270. John H. Langbein, *The Supreme Court Flunks Trusts*, 1990 SUP. CT. REV. 207, 219 (1991). Indeed, it has been said that the element of discretion is one distinction between a fiduciary and a contractual relationship. *See* Railway & Express Co. v. United States, 56 F.2d 687, 703 (Ct. Cl. 1932).

271. *See* ERISA § 404(a)(1)(A), 29 U.S.C. § 1104(a)(1)(A) (1994).

272. *E.g.*, *NARDA*, 744 F. Supp. at 694 (insurance company might have exercised discretion in "provid[ing] guidelines for claims administration and collection[]").

273. ERISA § 3(21)(A)(i), 29 U.S.C. § 1102(21)(A)(i) (1994).

274. *E.g.*, Useden v. Acker, 947 F.2d 1563, 1568, 1575-76 (11th Cir. 1991) (bank holding plan stock as collateral not a fiduciary when it sold stock to reduce outstanding loan balance), *cert. denied sub nom.* Useden v. Greenberg, Traurig, Hoffman, Lipoff, Rosen & Quentel, 508 U.S. 959 (1993); O'Toole v. Arlington Trust Co., 681 F.2d 94, 95-96 (1st Cir. 1982) (bank which set off trust funds to repay debt owed by plan sponsor not a fiduciary); Pension Benefit Guar. Corp. v. Ross, 733 F. Supp. 1005, 1006-08 (M.D.N.C. 1990) (firm that held pension funds in a clearing account and wired funds to sponsor's corporate account not a fiduciary); Robbins v. First Am. Bank, 514 F. Supp. 1183, 1189-91 (N.D. Ill. 1981).

275. 514 F. Supp. 1183 (N.D. Ill. 1981).

of a pension fund bought 90% of a land-development loan under a loan participation agreement which required that the lending bank ensure the borrower's proper use of loan proceeds.[276] The bank allegedly violated ERISA by allowing the borrower to draw down more money than was legitimately needed for land development.[277] The court granted the bank's motion to dismiss the ERISA claim on the ground that the bank was not an ERISA fiduciary because its acts were merely "ministerial," not "discretionary."[278] The court failed to recognize that the bank exercised significant control and authority over a plan asset, namely the loan.

Building on *Robbins'* error, *Bradshaw v. Jenkins*[279] was the first reported case to hold that a directed trustee was not a fiduciary. The case is also striking for its failure to recognize the trustee's obvious conflict of interest in its dual roles of sponsor and trustee.

The complaint alleged that Seafirst Corporation ("Seafirst") established a profit-sharing plan to provide retirement benefits for its employees and those of its subsidiaries, including Seattle-First National Bank ("Bank").[280] The Bank was also the plan trustee.[281] The plan required 50% of employer contributions to be allocated to "Fund A," which the Bank or Seafirst's Employee Benefits Committee invested in Seafirst common stock.[282] The Bank then began to purchase energy-related loans, without creating sufficient loan loss reserves, thus artificially inflating the price of Seafirst stock.[283] However, the Bank continued to invest Fund A in Seafirst stock.[284] When loan defaults were made public, the stock price, and consequently the value of plan assets, sharply declined.[285]

The court dismissed the count alleging that the Bank breached ERISA's fiduciary duties.[286] The court reasoned as follows:

> Bradshaw alleges that the Bank is a fiduciary because as trustee of the Plan it invested all employer contributions allocated to Fund A . . . in Seafirst common stock. These allegations are insufficient to support Bradshaw's claim that the Bank is a fiduciary.

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276. *Id.* at 1186.
277. *Id.*
278. *Id.* at 1190-91.
279. 5 Employee Benefits Cas. (BNA) 2754 (W.D. Wash. 1984).
280. *Id.* at 2757.
281. *Id.*
282. *Id.*
283. *Id.*
284. *Id.*
285. *Id.*
286. To be sure, the court granted plaintiff leave to amend, *id.* at 2760, but it appears in subsequent opinions in the case that plaintiff abandoned her ERISA claim against the Bank. *See* Bradshaw v. Jenkins, Fed. Sec. L. Rep. (CCH) ¶ 91,645 (W.D. Wash. Aug. 27, 1984); Bradshaw v. Jenkins, Fed. Sec. L. Rep. (CCH) ¶ 91,646 (W.D. Wash. Aug. 27, 1984); Bradshaw v. Jenkins, Fed. Sec. L. Rep. (CCH) ¶ 99,719 (W.D. Wash. Mar. 9, 1984).

> . . . [N]ot all trustees are fiduciaries. To be a fiduciary a trustee must possess discretionary authority and control in performing its functions. Here, Bradshaw has alleged no facts which indicate that the Bank exercised any discretionary control over the investment . . . of Fund A assets . . . . The pleadings do not set forth whether the Bank had full investment discretion with respect to Fund A or whether the Bank was instead a "directed trustee," that is, a mere custodian of plan assets who follows the instructions of another fiduciary.[287]

This reasoning is faulty. There are two parts to section 3(21)(A)(i): a person is an ERISA fiduciary to the extent that he either (1) "exercises any discretionary authority or discretionary control respecting management of [the] plan" *or* (2) "*exercises any authority or control respecting management or disposition of [the plan's] assets*."[288] Thus, the second clause of section 3(21)(A)(i) of ERISA requires no element of discretion, just authority or control over plan assets: the definition of a trustee. Therefore, in *Bradshaw*, the Bank's ability to "control" the "disposition" of plan assets by investing them in Seafirst stock was enough to make the Bank an ERISA "fiduciary" under the second clause of section 3(21)(A)(i).[289]

Further, the opinion creates confusion between a "directed trustee" and an "asset custodian." Whether a non-trustee custodian of plan assets is an ERISA fiduciary is itself a vexing question.[290] But the role of custodian is distinct

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287. *Bradshaw*, 5 Employee Benefits Cas. (BNA) at 2759-60 (citing Robbins v. First Am. Bank, 514 F. Supp. 1183 (N.D. Ill. 1981)).

288. 29 U.S.C. § 1002(21)(A)(i) (1994) (emphasis added). Knickerbocker, *supra* note 99, at 639 ("The word 'discretionary' is pointedly absent from authority in respect of plan assets. The exercise of any power at all over the disposition of assets imports fiduciary status."). *See also* LANGBEIN & WOLK, *supra* note 69, at 497 ("Power over plan assets is intrinsicially discretionary.").

289. *But see* Richardson v. U.S. News & World Report, 623 F. Supp. 350, 351-52 (D.D.C. 1985) (dismissing complaint against plan trustee, alleging distribution of plan assets in violation of fiduciary duties, in part on ground that trustee was not a fiduciary because it exercised no discretionary authority or control over plan assets).

290. The legislative history as well as ERISA indicate that Congress may have intended that an asset custodian would be an ERISA fiduciary to the extent it actually exercised control over plan assets. *See, e.g.*, ERISA § 3(14), 29 U.S.C. § 1002(14) (1994) (defining "party in interest" to include "any fiduciary (including . . . any administrator, officer, trustee, or custodian)"); SEN. SUBCOMM., S. REP. NO. 127, 93d Cong., 1st Sess. 46 (1973), *reprinted in* I LEGIS. HIST. 632 (giving, as a parenthetical definition of "fiduciary," "a person who is responsible for handling plan funds"); *S. 3598 Hearings*, *supra* note 45, at 251 (indicating that the ABA believed the term "fiduciary" should include "anyone who handles . . . employee benefit funds"). As one commentator has stated, "'custody' might be argued, by its very inherent nature, to include 'control.'" *Special Problems of Banks*, *supra* note 15, at 242. An IRS form, "Annual Return of Fiduciary of Employee Benefit Trust," assumes a custodian is a fiduciary; item 1a on the form asks for the "[n]ame of trustee or custodian." IRS Form 5500, Schedule P (1995). However, most courts have found that an

from that of trustee.[291] The trust form is mandatory; section 403(a) sketches the trustee's duties.[292] No comparable provisions exist for custodians.

Both of these errors—requiring a "fiduciary" to have discretion and confusing a directed trustee with an asset custodian—are repeated in *Pension Fund—Mid Jersey Trucking Industry—Local 701 v. Omni Funding Group.*[293] The directed trustee (Southeast Bank), a mortgage broker (Omni Funding),[294] and the pension fund entered into a "trust indenture" pursuant to which $20 million in pension funds was deposited with the Bank.[295] Upon submission of appropriate documentation[296] and compliance with certain conditions, the Bank was required to invest these funds in mortgage loans originated by Omni.[297] After two years and $13 million in losses from mortgage loan defaults, the pension fund alleged that Omni and former fund officials had conspired to defraud it.[298]

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asset custodian is not an ERISA fiduciary. Hibernia Bank v. International Bhd. of Teamsters, 411 F. Supp. 478 (N.D. Cal. 1976); *see* Brandt v. Grounds, 687 F.2d 895 (7th Cir. 1982); O'Toole v. Arlington Trust Co., 681 F.2d 94 (1st Cir. 1982); *see also* ERISA § 412(a), 29 U.S.C. § 1112(a) (1994) (appearing to distinguish between a "fiduciary of an employee benefit plan" and a "person who handles funds or other property of such a plan" and requiring both types of plan officials to be bonded).

291. *E.g.*, ERISA § 3(14)(A), 29 U.S.C. § 1002(14)(A) (1994); ERISA § 411(a)(1), 29 U.S.C. § 1111(a)(1) (1994). *See Private Pension Plan Reform: Hearings Before the Subcomitteeon Private Pension Plans of the Senate Comm. on Finance*, 93d Cong., 1st Sess. 1274 (1973) (statement of Investment Company Institute) ("[A] large bank might manage the assets of an employee benefit fund and thus be a fiduciary. If the employee benefit plan includes mutual fund shares in its assets, this section [regarding prohibited transactions] might prevent the bank from providing normal banking services, e.g., as depositary, custodian, or transfer agent, for the mutual fund, since the bank is a fiduciary and the mutual fund might be a party in interest.").

292. *See supra* notes 48-51 and accompanying text. Moreover, the trustee (but not a custodian) must be identified in the plan's summary plan description. ERISA § 102(b), 29 U.S.C. § 1022(b) (1994); 29 C.F.R. § 2520.102-3(h) (1995).

293. 731 F. Supp. 161 (D.N.J. 1990).

294. The opinion does not clarify whether Omni Funding qualified as an "investment manager" under ERISA section 3(38), 29 U.S.C. § 1002(38) (1994). It seems, however, that the relationship contemplated by the "trust indenture" was essentially that of trustee (Bank) and named fiduciary (Omni Funding), given the Bank's duty of reviewing documentation for compliance with necessary conditions. The court also explicitly refers to the Bank as a "directed trustee." *Omni Funding*, 731 F. Supp. at 173.

295. *Id.* at 164, 171-73.

296. Under the trust indenture, Omni was required to deposit with the bank: the note, mortgage, assignment, title insurance, evidence of hazard and private mortgage insurance, and evidence that the appropriate documents had been recorded in the land records. *Id.* at 172.

297. *Id.* The Bank was also authorized to invest in short-term investments the money not used in the Acquisition Fund; the Bank admitted it was a fiduciary with respect to these funds. *Id.*

298. *Id.*

The fund alleged that the Bank had breached its fiduciary and co-fiduciary duties under ERISA in numerous ways. First, instead of ensuring that there was mortgage insurance equal to 15% of the property's appraised value, the Bank held back 15% of the mortgage loan amount from Omni, and then allowed Omni to use the "holdbacks" to Omni's own profit.[299] Second, the Bank accepted photocopies rather than original documents at closings.[300] Third, the Bank purchased commercial loans in excess of certain limits set by the trust indenture.[301] Fourth, the Bank purchased some mortgage loans which, contrary to the trust indenture, were not secured by a first or second lien.[302]

The Bank moved for partial summary judgment, alleging that it was not an ERISA fiduciary with respect to the mortgage loans.[303] The court first made the same statutory misinterpretation of the definition of "fiduciary" as the *Bradshaw* court: "[a] party becomes a fiduciary with regard to pension fund assets when it is vested with or exercises *discretionary* authority."[304] The facts of *Omni Funding* make it particularly unfortunate that the court ignored the second clause of ERISA section 3(21)(A)(i), which makes any "person . . . a fiduciary . . . to the extent he exercises any discretionary authority or discretionary control respecting management . . . or disposition of [plan] assets."[305] The Bank held $20 million of pension funds—plan assets—as indenture trustee.[306] It was charged under the trust indenture not to release the funds for purchasing mortgage loans unless specified conditions were met, and it allegedly violated those explicit provisions of the trust.[307] If the Bank did not exercise control respecting disposition of plan assets, the second clause of section 3(21)(A)(i) is meaningless.

Further, the court's holding that the Bank was neither vested with nor exercised any discretion with respect to the mortgage loans[308] defies logic. First, the court reasoned circularly, "[the] Bank followed strict guidelines

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299. *Id.* at 173.

300. *Id.*

301. *Id.* Among many other conditions, the trust indenture required that the mortgage could only be a first or second lien on the premises; on commercial loans, there was to be mortgage insurance in the amount of "15% of the appraised value of the property"; and no single commercial loan could "exceed 10% of the $20 million portfolio," or approximately $2 million. *Id.* at 172.

302. *Id.* at 173.

303. *Id.* at 164, 173.

304. *Id.* at 173 (emphasis added).

305. 29 U.S.C. § 1002(21)(A)(i) (1994).

306. *Omni Funding*, 731 F. Supp. at 171-72. An indenture trustee typically is an institution "named in a trust indenture and charged with holding legal title to the trust property and with carrying out the terms of the indenture." BLACK'S LAW DICTIONARY 770 (6th ed. 1990).

307. *Omni Funding*, 731 F. Supp. at 171.

308. *Id.* at 175.

regarding the payout of monies. It . . . had no authority to prevent disbursement of funds if all the conditions were met and Omni so ordered."[309] But the "guidelines" were not followed and the "conditions" were not met.[310] Nevertheless, asserting that the Bank's status was "sufficiently analogous" to that of an asset custodian (which several courts have found to be a non-fiduciary role),[311] the court continued:

> Whereas a breach of duty may reflect an independent decision not to follow instructions, this decision itself does not equate with an exercise of discretion. The Pension Fund has not demonstrated that [the] Bank actually exercised discretion, but instead has shown only that [the] Bank failed to follow instructions. Assuming arguendo that [the] Bank failed to abide by the Trust Indenture, its failure to do so amounted to no more an exercise of discretion than had it complied with its terms.[312]

Thus, the court contends that a trustee is not a fiduciary whether it follows the instructions or not, because either way, it is not exercising discretion. It takes an unnaturally stingy reading of "discretion" to draw these conclusions. The Bank was not an automaton; it was vested with discretion to decide whether the submitted documentation complied with the trust indenture's requirements. Moreover, the Bank had exercised discretion by disbursing funds despite deviations from those requirements.

The court's treatment of the co-fiduciary liability claim was no more skillful. It could not summarily dispose of this claim on the ground that the Bank was not a fiduciary, because the Bank had admitted it was a fiduciary with respect to the monies it invested in short-terms funds (not mortgage loans).[313] Instead, the court decided that all three subsections of section 405(a) required a "causal connection" between the Bank's fiduciary role in handling the short-term funds and Omni's breaches of fiduciary duty with respect to the mortgage loans.[314] Although subsection 405(a)(2) clearly contains language requiring a "causal connection"—one fiduciary's breach must have enabled another's[315]—neither subsection 405(a)(1) nor (a)(3) is so limited.[316] In fact, the court judicially overturned subsection (a)(3):

309. *Id.*

310. *Id.*

311. *See id.*

312. *Id.* (citations omitted).

313. *Id.*

314. *Id.* at 175-76.

315. *E.g.*, Brandt v. Grounds, 687 F.2d 895, 898 (7th Cir. 1982).

316. Moreover, fiduciary liability under section 405(a)(2) can occur regardless of actual knowledge of the co-fiduciary's breach, Sandoval v. Simmons, 622 F. Supp. 1174, 1216 (C.D. Ill. 1985); Freund v. Marshall & Ilsley Bank, 485 F. Supp. 629, 641 (W.D. Wis. 1979), unlike liability under subsections (a)(1) and (a)(3), both of which require knowledge.

> To further broaden the fiduciary's liability would result in manifest unfairness. For instance, a party with a limited and discrete fiduciary duty could be held liable under §1105(a)(3) if it knew of another fiduciary's breach and did not make reasonable efforts to remedy it, even if the first fiduciary has insufficient knowledge or experience to remedy the breach.[317]

This "manifest unfairness" is, of course, precisely what section 405(a)(3) provides. The first fiduciary's lack of experience would be considered in analyzing whether his efforts to remedy the second fiduciary's breach were reasonable "under the circumstances."

The *Omni Funding* court had the luxury of engaging in a narrow interpretation of ERISA fiduciary liability because it thought it had two fallbacks against the Bank: ERISA non-fiduciary liability and a state law negligence claim.[318] If they ever existed, these fallbacks are now illusory. *Mertens v. Hewitt Associates*[319] has eliminated the first,[320] while ERISA preemption doctrine should eliminate the second.[321]

The "non-fiduciary trustee" cases culminated in the Eighth Circuit's decision in *Maniace v. Commerce Bank*.[322] The Juvenile Shoe Company ("JSC") established an ESOP.[323] The plan designated, as named fiduciary for plan management, an Administrative Committee ("Committee"), to be appointed by JSC's board of directors.[324] The trustee, Commerce Bank of Kansas City ("Commerce"), was authorized to invest plan assets in a variety of investment vehicles, including the company's own stock.[325] However, with respect to any purchase or sale of JSC stock, the trust

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317. *Omni Funding*, 731 F. Supp. at 176.

318. *Id.* at 172.

319. 508 U.S. 248 (1993).

320. *Id.* at 249-51, 263.

321. ERISA § 514(a), 29 U.S.C. § 1144(a) (1994). *See, e.g.*, Metropolitan Life Ins. Co. v. Taylor, 481 U.S. 58, 61-62 (1987) (ERISA preempted state law breach of contract claim); Pilot Life Ins. Co. v. Dedeaux, 481 U.S. 41, 43-44 (1987) (ERISA preempted state law contract and tort claims).

322. 40 F.3d 264 (8th Cir. 1994), *cert. denied*, 115 S. Ct. 1964 (1995). Criticism of *Maniace* has been unanimous. Roger C. Siske et al., *What's New in Employee Benefits-A Summary of Current Cases and Other Developments, reprinted in* 1 PENSION, PROFIT-SHARING, WELFARE, AND OTHER COMPENSATION PLANS 64 (A.L.I.-A.B.A. 1995); Maniace v. Commerce Bank of Kansas City, N.A.: *8th Circuit Holds That Directed Trustee Did Not Breach Fiduciary Duties*, 4 No. 2 ERISA LITIG. REP. 15 (1995); Rizzo & Carey, *supra* note 123, at 18.

323. *Maniace*, 40 F.3d at 265. As an ESOP, the plan expressly contemplated that its primary invesment would be in JSC stock. *Id.* For a look at the special issues confronting ESOP fiduciaries, see Arthur H. Kroll, *Dilemmas Facing ESOP Fiduciaries, reprinted in* SUSAN P. SEROTA, ERISA FIDUCIARY LAW 201-212 (1995).

324. *Maniace*, 40 F.3d at 265.

325. *Id.*

purported to require Commerce to follow whatever the Committee directed it to do.[326] Further, the trust expressly purported to relieve the trustee from fiduciary responsibility with respect to the JSC stock.[327]

JSC's financial fortunes declined over the next decade, culminating in bankruptcy in 1989.[328] As the court delicately described the trustee's role, "Commerce took an essentially hands-off approach to the business problems encountered by JSC," although it did review JSC's annual financial statements "[a]s part of its trustee responsibilities."[329] When JSC's 1987 financial statements revealed a $3 million loss, Commerce resigned as trustee.[330] Ultimately, the trust assets were insufficient to pay out the participants' benefits and the JSC stock became "worthless."[331]

ESOP participants sued the trustee for (1) "fail[ing] to fulfill its fiduciary [duty] . . . to prudently manage and protect [p]lan assets," and (2) enabling and failing to remedy the Committee's breaches of fiduciary duty.[332] The participants' "primary accusations" apparently "involve[d] Commerce's retention of large amounts of JSC stock as Plan Trustee despite the stock's declining value, as well as Commerce's overall lack of participation in company finances and management feuds."[333] The district court granted Commerce's motion for summary judgment, and the Eighth Circuit affirmed.[334]

Heralding the wooden analysis to follow, the Eighth Circuit began with an unabashed proclamation that "Labels are important . . . ."[335] Citing 29 U.S.C. section 1002(21)(A), the court concluded that Commerce was not a fiduciary with respect to the JSC stock.[336]

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326. *Id.* at 266.

327. *Id.*

328. *Id.*

329. *Id.* The district court elaborated: "During JSC's difficulties, Commerce Bank neither sold the company stock nor participated in the ongoing management feud." Maniace v. Commerce Bank, No. 90-5021-CV-SW-8, 1993 WL 761987, at *1 (W.D. Mo. Apr. 14, 1993).

330. *Maniace,* 40 F.3d at 266. However, it appears that there was trouble before 1987. The district court opinion reports that JSC had suffered "decreasing profits and net worth by the mid-1980s," *Maniace,* 1993 WL 761987, at *1, which the trustee should have noticed if it was, in fact, annually reviewing JSC financial statements. Moreover, the district court opinion reports that "[b]eginning in 1986, the company began to experience a series of management, labor and quality problems." *Maniace,* 1993 WL 761987, at *1.

331. *Maniace,* 40 F.3d at 266.

332. *Id.*

333. *Id.*

334. *Id.* at 266, 269.

335. *Id.* It was never clear, however, what "label" led the court to conclude that the trustee was not a fiduciary.

336. *Id* at 267.

Like its predecessors in *Bradshaw*[337] and *Omni Funding*,[338] the court misread the definition of "fiduciary," believing that "discretion is the benchmark for fiduciary status under ERISA."[339] The court reasoned, *ipse dixit*: "[The trust] explicitly limits Commerce's discretion vis a vis JSC stock. Commerce had no discretion and could only act at the direction of the Committee. As such, Commerce could not be a fiduciary (nor breach fiduciary duties) with respect to the JSC stock."[340]

The court also separated an inseparable question into two parts. Having already concluded that the trustee was not a fiduciary with respect to the JSC stock, the court then went on to consider, separately, whether the trustee, even so, "followed [the] statutory mandate" to act upon directions that "[are] not contrary to ERISA."[341] Thus, the court appeared to conclude that a directed trustee, while not a fiduciary, does have two *non-fiduciary* duties under section 403(a)(1). One is to determine if the direction is "in accordance with the terms of the plan" and the other is to determine if the direction is "contrary to ERISA."[342]

But if a directed trustee is not a fiduciary in carrying out these two duties, by what standard is its compliance with these duties to be judged?[343] ERISA's enforcement provisions literally do not provide a remedy to a participant or beneficiary for the directed trustee's "breach" of "non-fiduciary duties."[344] Taken to its logical conclusion, the court's holding that Commerce was not a fiduciary could mean that the participants

337. 5 Employee Benefits Cas. (BNA) 2754.

338. 731 F. Supp. 161.

339. *Maniace*, 40 F.3d at 267.

340. *Id.*

341. *Id.* at 267-68.

342. *Id.* at 268. The court apparently assumed that the further requirement that the named fiduciary's direction be "proper" was redundant. *Id.*

343. The court suggested that "[t]he obligations of a directed trustee are something less than that owed by typical fiduciaries. Commerce was not required to weigh the merits of an investment in JSC stock against all other investment options every time it was directed to purchase said stock by the Committee." *Id.* But even a trustee with full investment discretion is not obliged to weigh every potential investment "against all other investment options." The court equates the lack of an obligation to weigh all other investment options with the lack of fiduciary duty altogether. But the two are not mutually exclusive. Particularly in the context of an ESOP, a plan's investment policy can favor one type of investment (the company's own stock), while retaining the trustee's fiduciary duties of prudence and exclusive benefit.

344. ERISA § 502(a), 29 U.S.C. § 1132(a) (1994). Because of ERISA's expansive and explicit preemption of state law, an argument that ERISA preempts a state-law claim for breach of contract against the directed trustee is not far-fetched, even if it meant a participant would be left without a remedy. *See, e.g.*, Mertens v. Hewitt Associates, 508 U.S. 248, 251, 263 (1993) (ERISA excludes liability of nonfiduciaries for aiding and abetting a breach of fiduciary duty); Metropolitan Life Ins. Co. v. Taylor, 481 U.S. 58, 62-63 (1987) (ERISA can preempt a cause of action even if it means no remedy remains for the plaintiff).

had no standing under ERISA to sue Commerce, even if it was conceded that any given direction was "contrary to" ERISA.

More strained yet was the court's purported distinction of *FirsTier Bank v. Zeller*,[345] a directed trustee case from the same circuit the year before. The *FirsTier* court had correctly concluded that where a trustee was subject to the plan sponsor's direction to make loans to participants out of plan assets, the trustee could still violate ERISA's fiduciary duties by following such direction.[346] The *Maniace* court tried to distinguish *FirsTier* by noting that the *FirsTier* trustee's general authority "to hold, manage, invest, and account for all plan assets,"[347] was limited only by the sponsor's ability to direct the trustee to make loans to participants.[348] But the *FirsTier* situation was perfectly analogous to the *Maniace* trustee's "general responsibilities, powers, and authority" to invest plan assets,[349] limited only by the Committee's ability to direct the trustee to buy and sell JSC stock.[350] The *Maniace* court apparently thought that the *FirsTier* trustee, despite being subject to direction, somehow retained some discretion in its ability to grant or refuse a loan to participants upon direction. The court never explained why the *Maniace* trustee did not have the very same discretion to decide whether to buy or sell JSC stock upon direction.[351]

The court tangled its logic still further in discussing the participants' second claim: that Commerce enabled and failed to remedy the Committee's breaches of fiduciary duty.[352] Here, the court's holding that Commerce

345. 16 F.3d 907 (8th Cir.), *cert. denied sub nom.* Vercoe v. FirsTier Bank, N.A., 115 S. Ct. 194 (1994).

346. 16 F.3d at 911 ("an ERISA trustee who deals with plan assets in accordance with proper directions of another fiduciary is not relieved of its fiduciary duties to conform to the prudent man standard of care; to attempt to remedy known breaches of duty by other fiduciaries; and to avoid prohibited transactions" (citations omitted)). However, *FirsTier* then held that the directed trustee there had not violated its duty. *Id.* at 913; *see* discussion *infra* part VII.C.2.

347. *Maniace*, 40 F.3d at 268.

348. *Id.*

349. *Id.* at 265.

350. *Id.* at 266.

351. *Id.* at 266-69.

352. *Id.* at 268. Although the court does not cite to an ERISA section thereby allegedly violated, presumably the participants were referring to section 405, 29 U.S.C. § 1105 (1994), "Liability for Breach of Co-Fiduciary." *See id.* The court cited Presley v. Blue Cross-Blue Shield of Alabama, 744 F. Supp. 1051 (N.D. Ala. 1990), and recognized that that case cited section 1105(a) and (c). *Id.* However, the *Maniace* court failed to realize that by holding that the directed trustee was not a fiduciary, it foreclosed the applicability of sections 1105(a) and (c). Section 1105(a) only imposes, in certain circumstances, liability on a "fiduciary" for breach of "another fiduciary." 29 U.S.C. § 1105(a) (1994). Having concluded that Commerce was not a "fiduciary," the court's own reasoning ends the inquiry into section 1105. *Maniace*, 40 F.3d at 267.

was not a fiduciary with respect to the JSC stock[353] presented even greater problems of internal consistency. The court may have dimly realized that if Commerce was not a fiduciary, then it could not be liable under section 405 for a breach of fiduciary duty by the Committee, an undisputed fiduciary, even if Commerce had known about, and closed its eyes to, that breach. Probably not wanting to reach that result, the court rested on the alternative that the participants had presented no facts warranting a finding that the Committee itself had breached any fiduciary duty;[354] therefore there was nothing for the trustee to have known about or corrected.

This is not to suggest that the end result in *Maniace* was necessarily wrong. The primary alleged fiduciary breach in *Maniace* was the trustee's failure to sell stock the ESOP already owned as the company's fortunes declined, despite the lack of direction to sell by the named fiduciary.[355] The standards for directed trustee behavior in a "no-direction" case[356] are even foggier than in a "bad-direction" case, particularly where the plan is an ESOP and there are rules prescribing minimum time periods for holding the stock.[357] Analyzed properly, it is not at all clear that Commerce breached its fiduciary duties under the circumstances.

B. A Second-Tier Fiduciary?

Several cases have not gone as far as *Maniace* and other cases holding that a directed trustee is not even a fiduciary.[358] Instead, a kind of judicial halfway house has been born: something less than a "full fiduciary," but more than a non-fiduciary. This position is statutorily untenable.

For example, in *Donovan v. Cunningham*,[359] the DOL sued the plan sponsor's administrative committee for directing the ESOP to purchase sponsor-company stock from Cunningham, the sponsor's president, "for more than adequate consideration."[360] Defendants Carter and Perrin, not

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353. *Id.*

354. *Id.* at 267-68. The court only concludes, but never analyzes why, the Committee's directions to Commerce were proper. *Id.*

355. *Id.* at 266. Maniace also alleged that Commerce failed to vote the stock proxies to improve company management, but the opinions do not describe what the issues were on which the proxies could have been voted. *Id.*; Maniace v. Commerce Bank, No. 90-5021-CV-SW-8, 1993 WL 761987, at *1-*4 (April 14, 1993).

356. *See* discussion *infra* part VII.D.

357. *See* John S. Welch, *Fiduciary Aspects of Employee Stock Ownership Plan Investments in Employer Securities*, 23 REAL PROP. PROB. & TR. J. 575, 579-81 (1988).

358. *See infra* notes 359, 375-77.

359. 541 F. Supp. 276 (S.D. Tex. 1982), *aff'd in part, rev'd in part and vacated in part*, 716 F.2d 1455 (5th Cir. 1983), *cert. denied*, 467 U.S. 1251 (1984).

360. *Id.* at 280-81. An ESOP's purchase of stock from a party in interest, such as Cunningham, is exempted from ERISA's prohibited transaction provisions if the ESOP pays no more than "adequate consideration." ERISA § 408(e), 29 U.S.C. § 1108(e) (1994). If

the DOL, filed a third-party complaint against the directed trustee, Allied Bank, for contribution and indemnity as a co-fiduciary.[361]

The district court found that the "primary fiduciaries" (the committee members) did not breach any fiduciary duties, and thus it was not necessary for the court to address the merits of the third-party complaint against the directed trustee.[362] The court of appeals reversed as to the committee members but affirmed as to the directed trustee.[363]

The Fifth Circuit held that the committee members' reliance on an independent appraisal of the stock was not a prudent investigation of the stock price, and that the committee members had therefore breached their fiduciary duties to the ESOP under ERISA sections 404(a) and 406.[364] The committee members' reliance on the appraisal, which was written more than a year before the stock purchases, was held unreasonable because the committee members knew the company's actual revenues and growth rate since then had been significantly less than the revenues and growth rate the appraisal had assumed.[365]

This analysis was straightforward enough, but the Fifth Circuit never rethought the directed trustee's possible liability in light of the committee members' newfound breach. It is reasonable to assume Allied Bank had access to the same financial data, since Allied had just completed a $1 million loan to the company's ESOP and the company was obligated to make payments to the ESOP to repay the loan.[366] Nevertheless, the Fifth Circuit merely affirmed the district court's holding[367] that "[t]he statutory construction of ERISA makes clear that the responsibility of Allied as directed trustee is not equal to that of primary fiduciaries."[368] Although recognizing that Allied could only follow "proper directions" consistent with the plan and ERISA, the district court postulated different "standards of care implied by section [403]": "Notwithstanding the limited role prescribed by section [403], the trustees [sic] actual exercise of authority or control could

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there is no "generally recognized market" for the stock, "adequate consideration" is defined as "the fair market value of the asset as determined in good faith by the trustee or named fiduciary pursuant to the terms of the plan and in accordance with regulations promulgated by the Secretary." ERISA § 3(18), 29 U.S.C. § 1002(18) (1994).

361. *Cunningham,* 541 F. Supp. at 279.

362. *Id.* at 288. It is not clear from either reported opinion exactly what Allied, as directed trustee, did, but one can assume that Allied simply followed the direction to purchase Cunningham's stock for the ESOP, at the price dictated by the administrative committee. *Id.*; Donovan v. Cunningham, 716 F.2d 1455(5th Cir. 1983), *cert. denied,* 467 U.S. 1251 (1984).

363. *Cunningham,* 716 F.2d at 1473-75.

364. *Id.* at 1474.

365. *Id.* at 1469-71.

366. *Id.* at 1460.

367. *Id.* at 1473.

368. *Cunningham,* 541 F. Supp. at 290.

raise the fiduciary responsibility required of such trustee. However, . . . Allied at all times remained within the limited role of directed trustee."[369]

This is a phantom two-tier standard. The court actually made the same mistake that the courts in *Maniace*[370] and *Omni Funding*[371] made: reasoning that because the directed trustee is directed, it is not exercising authority or control over plan assets.[372] This is an unnatural reading of the role of the entity that holds legal title to the plan assets and has the ability to disburse them.

Other judicial formulations of the "less than a fiduciary" standard have emerged.[373] After an exhaustive and scholarly canvas of the role of ESOP fiduciaries, the Third Circuit conclusorily tossed off the dictum that a directed trustee is "essentially" "immune from judicial inquiry."[374] At least one district court within the Ninth Circuit has asserted that directed trustees have "very limited 'independent judgment' to exercise."[375] Another found that directed trustees "are primarily recordkeepers and transaction handlers, rather than decision makers."[376]

These offhand dicta encourage faulty analysis that could exonerate, with little or no judicial scrutiny, the actions of a directed trustee even when it has a direct conflict of interest. Neither the language nor the protective policy of ERISA supports these judicial inventions. Under section 403(a), the district court must always determine whether the named fiduciary's direction is "proper" and consistent with the terms of the plan and ERISA itself.[377]

But how much, if any, investigation must an ERISA directed trustee perform to ascertain if the named fiduciary's direction in fact complies with these requirements? I now examine how the courts have (usually implicitly) answered that question.

C. *Don't Ask, Don't Tell?*

Although no court has actually stated this as a rule of settled doctrine, the cases decided thus far stand for the proposition that an ERISA directed trustee has no duty of inquiry into the propriety of a named fiduciary's

369. *Id.* (citations omitted).

370. 40 F.3d 264.

371. 731 F. Supp. 161.

372. *Maniace*, 40 F.3d at 267; *Omni Funding*, 731 F. Supp. at 173-75.

373. *Maniace* also suggested this notion with its comment that directed trustees can be "something less than . . . typical fiduciaries." *Maniace*, 40 F.3d at 268.

374. Moench v. Robertson, 62 F.3d 553, 571 (3d Cir. 1995), *cert. denied*, 116 S. Ct. 917 (1996).

375. Wells Fargo Bank v. Bourns, Inc., 860 F. Supp. 709, 716 (N.D. Cal. 1994).

376. *In re* American Continental Corp., 794 F. Supp. 1424, 1458 (D. Ariz. 1992).

377. ERISA § 403(a), 29 U.S.C. § 1103(a) (1994).

direction absent actual knowledge of the named fiduciary's breach of fiduciary duty.[378] I have found no case in which a directed trustee was held liable for following a named fiduciary's direction in the absence of such actual knowledge.[379] Moreover, participants who sue a directed trustee alleging a duty of inquiry may have the directed trustee's attorneys' fees awarded against them.[380]

Thus, the courts have unwittingly lowered the level of the ERISA directed trustee's fiduciary responsibility from that applied by the common law of trusts.[381] More disturbingly, many courts have even overlooked the directed trustee's conflict of interest,[382] ignoring the common law's settled principle that such a conflict must be considered in deciding the prudence of a trustee's action.[383]

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378. *See* FirsTier Bank v. Zeller, 16 F.3d 907, 912 (8th Cir.), *cert. denied sub nom.* Vercoe v. FirsTier Bank, 115 S. Ct. 194 (1994); Ershick v. United Missouri Bank, 948 F.2d 660 (10th Cir. 1991); Newton v. Van Otterloo, 756 F. Supp. 1121, 1133 (N.D. Ind. 1991).

379. For cases in which the directed trustee had actual knowledge the direction was improper, see Fisher v. MacKenzie, No. C-84-868-JLQ (E.D. Wash. Oct. 8, 1985) (LEXIS, Genfed library, Dist file) (directed trustee had actually brought the investment, which turned out to be a prohibited transaction, to the Investment Committee's attention); Donovan v. Ashplant, No. 83 Civ. 1455 (S.D.N.Y. July 30, 1984) (directed trustee's internal files showed it questioned prudence of similar earlier proposed investment); *see also Chemical Bank Agrees To Pay Total $225,000 To Settle U.S. Claims*, WALL ST. J., Aug. 10, 1984 at 30 (directed trustee should have been aware of illegality of its investment due to the documentation of the trustee's predecessor).

380. *FirsTier Bank*, 16 F.3d at 913-14; *Ershick*, 948 F.2d at 672.

381. *See* discussion *supra* part VI.B.

382. A common conflict of interest in the directed trustee situation occurs where the financial institution acts simultaneously as directed trustee to a plan, often an ESOP, and as lender to the company or to the ESOP itself. *E.g.*, *FirsTier Bank*, 16 F.3d 909 (directed trustee was creditor of plan sponsor); *Ershick*, 948 F.2d at 663 (directed trustee was creditor of plan sponsor); *Cunningham*, 716 F.2d at 1459-60 (directed trustee was creditor of ESOP).

383. Under the common law, a trustee's actions will be more closely scrutinized if the trustee is in a potential conflict of interest. *E.g.*, Cashman v. Pontiac Trust Co. (*In re* Culhane's Estate), 256 N.W. 807, 810 (1934) (trustee held liable for loss when it deposited trust funds in affiliated bank that failed); Strauss v. United States Fidelity & Guar. Co., 63 F.2d 174, 177 (4th Cir. 1933) (trustee held liable for loss when it deposited trust funds in affiliated bank); UNIF. TRUSTEES' POWERS ACT § 5(b), 7B U.L.A. 741, 755-56 ("If the duty of the trustee and his individual interest . . . conflict in the exercise of a trust power, the power may be exercised only by court authorization . . . upon petition of the trustee."). Leading ERISA cases involving non-directed trustees have also appplied a similar principle. Donovan v. Bierwirth, 680 F.2d 263, 271-72 (2d Cir.), *cert. denied*, 459 U.S. 1069 (1982) (where a conflict of interest arises, trustee should seek the advice of an independent counsel); Leigh v. Engle, 727 F.2d 113, 132 (7th Cir. 1984), *cert. denied sub nom.* Estate of Johnson v. Engle, 489 U.S. 1078 (1989) (trustees violated fiduciary duty by not seeking independent advice when trustees "had divided loyalties").

1. Duty of Inquiry: No Conflict of Interest

Newton v. Van Otterloo[384] involved a directed trustee with no conflict of interest and no actual knowledge of the named fiduciary's breach.[385] Plaintiffs, employees of South Bend Lathe ("SBL"), were participants in an ESOP that owned 81% of SBL stock.[386] Van Otterloo, SBL's president, owned 18% of the stock.[387] The ESOP had borrowed about $5 million to purchase the stock, and SBL had "agreed to make annual cash contributions to the ESOP" to make loan payments.[388] When a loan payment was made, shares serving as collateral were redeemed and allocated to individual employees' accounts.[389] The "ESOP Committee"[390] held the stock in trust, and directed the 1st Source Bank—the "voting trustee"—in voting the stock.[391]

Plaintiffs alleged that in the 1989 shareholder election, the three pro-management members of the five-member ESOP Committee breached their fiduciary duties by directing the voting trustee to abstain from voting the "unallocated" stock (approximately 70% of the ESOP-held shares), allowing retention of current management.[392] As to 1st Source, the directed voting trustee, plaintiffs claimed it breached its fiduciary duty by voting (or abstaining) as directed, and was liable as a co-fiduciary for the Committee members' breaches.[393] No one appeared to question the fiduciary status of 1st Source, and the court, citing section 403(a)(1), correctly noted that "[a] custodial trustee ordinarily is bound to carry out instructions from a plan's named fiduciaries, but only if the instructions are proper and are not contrary to ERISA."[394]

The court, holding the three Committee members to a "heightened standard of care" due to their "divided loyalties" as members of incumbent management,[395] found that they had breached their fiduciary duties by failing to conduct "'an intensive and scrupulous independent investigation

384. 756 F. Supp. 1121 (N.D. Ind. 1991).

385. *Id.* at 1133.

386. *Id.* at 1124.

387. *Id.*

388. *Id.*

389. *Id.*

390. At the relevant times, the ESOP Committee had five members, two from labor and three from incumbent management. *Newton*, 756 F. Supp. at 1124.

391. *Id.* at 1124-25.

392. *Id.* at 1125. The voting ESOP participants (the "allocated" shares) voted 5,100 to 1,900 against incumbent management. *Id.* If the 15,500 unallocated shares had been voted in the same proportion, incumbent management would have been defeated. *See id.*

393. *Id.* at 1132.

394. *Id.*

395. *Id.* at 1129 (citing Teamsters Local No. 145 v. Kuba, 631 F. Supp. 1063, 1071 (D. Conn. 1986)).

of their options'" in directing the voting of the unallocated shares.[396] However, while the Committee's "instruction [to abstain] was sufficiently irregular that 1st Source questioned it," the court held that "[n]othing in the record . . . would charge 1st Source with knowledge of the Committee members' failure to engage in [the independent] investigation" of their options.[397]

The court's statement in *Newton* that 1st Source "could not have known of the Committee members' breaches of fiduciary duty" in failing to investigate other options[398] is unpersuasive. One imagines it would not have been difficult for 1st Source to have simply asked the Committee if it had explored options other than abstaining the unallocated stock; a direction so unusual that 1st Source had, in fact, questioned it.[399]

A better rationale for the case would have been that no further duty of inquiry was required when there was an independent directed trustee with no conflict of interest and with no other knowledge of a problem than (probably) the knowledge that the Committee was weighted 3-2 toward management.[400] While I hesitate to draw inferences from the DOL's failure to join a directed trustee as a defendant, it appears that the DOL uses something like this standard. For example, *Bourns v. Wells Fargo Bank*[401] reports that the DOL found that Bourns, Inc. and its investment committee had breached their fiduciary duties by directing the investment of plan assets in a speculative real estate development.[402] However, the DOL did not sue the directed trustee, Wells Fargo Bank.[403] It does not appear that Wells either had a conflict of interest or knew enough about the transaction to raise any red flags.[404]

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396. *Id.* (quoting Leigh v. Engle, 727 F.2d 113 (7th Cir. 1984), *cert. denied sub nom.* Estate of Johnson v. Engle, 489 U.S. 1078 (1989)).

397. *Id.* at 1132-33. The court also held that the plan documents authorized the abstention, so the instruction was not contrary to the plan. *Id.* at 1132.

398. *Id.* at 1133.

399. *Id.* at 1132.

400. Moreover, even if 1st Source had fully investigated the Committee's direction to abstain from voting the stock, 1st Source would have found that there was no other management slate presented. *Newton*, 756 F. Supp. at 1129. Failing to vote the stock would thereby have plunged the company into "corporate chaos," hardly a prudent course of action. *Id.*

401. No. C-93-3961 MHP, 1994 WL 36998 (N.D. Cal. Feb. 2, 1994).

402. *Id.* at *1.

403. *Id.*

404. *Id.* Bourns, not the DOL, attempted to hold Wells liable for following Bourns' own investment directions. *Id.* The court held that the suit was barred by the statute of limitations. *Id.* at *4. Wells was later awarded its attorneys' fees under an indemnity trust agreement with Bourns, subject to a further finding of fact that there was not "negligence or misconduct on part of Wells." Wells Fargo Bank v. Bourns, Inc., 860 F. Supp. 709, 715-17 (N.D. Cal. 1994).

2. Duty of Inquiry: Existing Conflict of Interest

With respect to an institutional directed trustee, the most common conflict of interest occurs when the institution's trust department acts as directed trustee for a plan, often an ESOP, at the same time the institution's lending department has made a loan to the sponsoring company. Courts have correctly held that ERISA does not prohibit this dual role *per se*.[405] However, in a specific situation, the two roles may well present a conflict of interest.[406] For example, an ESOP's purchase of company stock may generate operating cash for the company, thereby improving the company's ability to repay its loan, but not necessarily improving the company's overall financial condition or its stock value. Thus, when presented with a direction by the ESOP's "named fiduciary," typically a company officer, to purchase more company shares, the directed trustee has a potential conflict of interest.[407]

Although no court has so held, ERISA sections 406(b)(1) and (2) arguably prohibit this institution from continuing to serve in both capacities.[408] Even if the situation does not rise to the level of a prohibited transaction, the fiduciary must still comply with the general fiduciary duties to act with prudence and for the participants' exclusive benefit.[409] At the very least, it is well-settled that a conflicted fiduciary should be even more scrupulously careful, and will be more intensely scrutinized *ex post*, than an impartial fiduciary.[410] Yet courts have failed to subject the actions of these ESOP lender-trustees to any scrutiny at all.

In *Ershick v. United Missouri Bank*[411] the United Missouri Bank

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405. *See, e.g.*, *Ershick*, 948 F.2d at 670-71 (citing ERISA §§ 406(a), (b)(2), 29 U.S.C. §§ 1106(a), (b)(2) (1994)); Friend v. Sanwa Bank California, 35 F.3d 466, 469 (9th Cir. 1994).

406. Professor Scott notes, but does not resolve, the persistence of this problem. IIA SCOTT & FRATCHER, *supra* note 246, at § 170.23A. *See generally* Leo Herzel & Dale E. Colling, *The Chinese Wall and Conflict of Interest in Banks*, 34 BUS. LAW. 73 (1978) (discussing the legal problems arising when commercial banks also engage in fiduciary activities).

407. *See* Dixon v. Northwestern Nat'l Bank, 297 F. Supp. 485, 487 (D. Minn. 1969).

408. Sections 406(b)(1) and (2) provide:

> A fiduciary with respect to a plan shall not—
> (1) deal with the assets of the plan in his own interest or for his own account,
> (2) in his individual or in any other capacity act in any transaction involving the plan on behalf of a party (or represent a party) whose interests are adverse to the interests of the plan or the interests of its participants or beneficiaries . . . .

29 U.S.C. § 1106(b)(1), (2) (1994).

409. ERISA § 404(a)(1), 29 U.S.C. § 1104(a)(1) (1994).

410. *See supra* note 383.

411. 948 F.2d 660 (10th Cir. 1991). Like many of the directed trustee cases, *Ershick* engendered numerous opinions, reported initially under the name Ershick v. Greb X-Ray Co.,

("UMB") wore three hats: directed trustee for the Greb X-Ray ESOP, "major secured creditor" of the Greb X-Ray company, and executor of the estate of Mr. Greb, the company's deceased founder.[412] The facts presented the classic ESOP quandary: what to do when the named fiduciary, the company president (Curtright), directs the ESOP directed trustee (UMB) to purchase more company stock although the company's fortunes are in decline?[413]

President Curtright directed the challenged stock purchases in 1983, 1984, and early 1985.[414] The value of plaintiff participants' individual accounts had declined by 75% when they left the company in 1985 and 1986.[415] Plaintiffs claimed UMB should not have followed Curtright's directions to purchase stock, asserting that UMB "should have known" at the time of the purchases of the company's deteriorating condition and Curtright's mismanagement.[416]

In opinions virtually devoid of reasoning on the point, both the trial court and the Tenth Circuit concluded that UMB did not violate ERISA by purchasing the stock.[417] In large part, the courts rested merely on UMB's status as a directed trustee,[418] without analyzing whether the directions themselves violated the named fiduciary's fiduciary duty, and if so, why

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No. CIV.A.87-2362-S, 1987 WL 208887 (D. Kan. Dec. 17, 1987); 705 F. Supp. 1482 (D. Kan. 1989); No. CIV.A.87-2362-S, 1989 WL 94901 (D. Kan. June 30, 1989); and No. CIV.A.87-2362-S, 1989 U.S. Dist. LEXIS 15001 (D. Kan. Nov. 30, 1989); and then under the name Ershick v. United Missouri Bank, 12 Employee Benefits Cas. (BNA) 2323 (D. Kan. 1990), *aff'd*, 948 F.2d 660 (10th Cir. 1991).

412. *Ershick*, 948 F.2d at 663.

413. *Id.* at 663-64.

414. *Ershick*, 12 Employee Benefits Cas. (BNA) at 2325; *Ershick*, 948 F.2d at 663. In five reported opinions on this case, the courts never say which employees the ESOP purchased the shares from nor whether the ESOP was contractually obligated to purchase the shares under a stock purchase agreement. *See, e.g.*, *Ershick*, 948 F.2d at 663. My analysis of the case assumes that the employee-sellers were not the plaintiffs, and that the ESOP was not contractually obligated to purchase these shares.

415. *Ershick*, 948 F.2d at 664.

416. *Id.* at 667. Plaintiffs also objected to UMB's "routine" granting of the ESOP-held stock proxies to Curtright to perpetuate his management control in the face of employee challenges. *Id.* at 665; *Ershick*, 12 Employee Benefits Cas. (BNA) at 2326. This theory was apparently not pled in the complaint, *see Ershick*, 705 F. Supp. at 1487-88, but the court disposed of it anyway on the theory that UMB had no actual knowledge of the challenge to Curtright's position. *Ershick*, 948 F.2d at 667-68. In hindsight, this may have been plaintiffs' strongest theory. *See infra* part VII.C.3.

417. *Ershick*, 948 F.2d at 667-68.

418. *Ershick*, 948 F.2d at 669; *Ershick*, 12 Employee Benefits Cas. (BNA) at 2327. The equities of UMB's position were undoubtedly helped by plaintiffs' pretrial settlement with all other defendants, including Curtright; plaintiffs went to trial only against UMB, presumably the deep pocket. *Ershick*, 948 F.2d at 664; *Ershick*, 12 Employee Benefits Cas. (BNA) at 2323-24.

UMB did not also violate ERISA by following the directions. In response to plaintiffs' claim that UMB should have known about the company's decline, the Tenth Circuit stated without elaboration that plaintiffs "failed to present any credible evidence establishing that UMB was aware of Curtright's mismanagement."[419] UMB did not know of Curtright's more egregious practices, such as manipulating inventory and bonuses and making improper loans.[420]

Therefore, both courts implied that UMB should not be held liable unless it actually knew that Curtright's directions breached his fiduciary duties[421]—perhaps if some evidence of mismanagement hit UMB on the head. Neither court considered whether the facts that UMB *did* know were enough to trigger a duty to further investigate Curtright's directions—particularly in light of UMB's conflict of interest.[422]

Both opinions mention evidence that might have supported an inference that UMB knew, or knew enough to inquire further, of the company's decline when it purchased the stock in 1983, 1984, and 1985.[423] First, as early as 1981, UMB—through its role as executor of the estate of Mr. Greb, the company's deceased founder—knew that Greb X-Ray was contractually obligated to purchase "a large amount" of Mr. Greb's stock.[424] Second, in its role as trustee, UMB reviewed the company's annual financial statements, which revealed a large loss in 1983 and a razor-thin profit in 1984, compared to large profits for earlier years.[425] Third, by mid-1983 UMB, in its role as the company's "major secured creditor," had lowered

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419. *Ershick*, 948 F.2d at 667-68. One senses that the result in *Ershick* in favor of defendant UMB is attributable at least in part to counsel's less than adequate presentation of plaintiffs' case. *E.g.*, *id.* at 669 (plaintiffs failed to raise a strong argument before the district court, so it could not be raised on appeal); Ershick v. Greb X-Ray Co., No. CIV.A.87-2362-S, 1989 WL 151960, at *1 (Nov. 30, 1989) (plaintiffs' motion to reconsider grant of summary judgment untimely); *Ershick*, 705 F. Supp. at 1487 (opposing defendants' motion for summary judgment, plaintiffs failed to attach evidence in the form required by Fed. R. Civ. P. 56); *Ershick*, No. CIV.A.87-2362-S, 1987 WL 208887, at *1 (plaintiffs failed to respond to defense motions until after motions were granted).

420. *Ershick*, 12 Employee Benefits Cas. (BNA) at 2326.

421. *Ershick*, 948 F.2d at 667-68; *Ershick*, 12 Employee Benefits Cas. (BNA) at 2326.

422. *Ershick*, 12 Employee Benefits Cas. (BNA) at 2324 (UMB was the Plan Trustee and "major secured creditor" of the plan's sponsor).

423. *Ershick*, 948 F.2d at 663-64; *Ershick*, 12 Employee Benefits Cas. (BNA) at 2325-26.

424. *Ershick*, 12 Employee Benefits Cas. (BNA) at 2325. The court does not say exactly how "large" this amount was, but it can be assumed that the purchases adversely affected Greb X-Ray's financial statements. *Id.*

425. *Id.* However, the really alarming losses did not occur until 1985 and 1986, after the last stock purchase. *Id.* Thus, plaintiffs also claimed UMB breached its fiduciary duty by failing to sell the stock in those years (even though it was not directed to do so). *Ershick*, 948 F.2d at 667.

the company's credit line, making it more difficult for the company to finance its operations.[426]

The Tenth Circuit did not address any of these three facts as a basis for charging UMB with knowledge that Greb X-Ray was in decline.[427] The district court addressed only the third as a possible basis for finding UMB's trust department should have known of the same adverse financial conditions that led to the lending department's contraction of credit.[428] Rejecting this argument, the district court relied upon banking regulations supposedly requiring a "Chinese Wall" between a bank's trust department and commercial lending department to prevent the flow of information.[429] But the cited regulations, designed to comply with insider trading laws, apply only to bank customers whose stock is publicly traded. Greb X-Ray was privately held.[430]

Moreover, the DOL apparently rejects the "Chinese Wall" theory as protection for the directed trustee in the analogous non-ESOP situation.[431] Recently the DOL sued Bank of America ("BOA"), which was both the directed trustee for the Norcal Pension Plan and a senior lender to Norcal.[432] BOA, at the direction of Plan fiduciaries, invested $3 million of Plan assets in the stock of Techno-Therm, which later went bankrupt.[433] The DOL charges that BOA, through its position as senior lender, had enough information to determine that the transaction violated ERISA because Techno-Therm's president would use proceeds from the stock sale to repay a loan from a Norcal subsidiary.[434] Moreover, the DOL charges that BOA had enough information to determine that Techno-Therm was financially shaky.[435]

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426. *Ershick*, 12 Employee Benefits Cas. (BNA) at 2325.

427. *Ershick*, 948 F.2d at 667.

428. *Ershick*, 12 Employee Benefits Cas. (BNA) at 2327-28.

429. *Id.* at 2327 (citing 12 C.F.R. § 9.7(d) and 43 Fed. Reg. 12,755 (1978)).

430. *Ershick*, 12 Employee Benefits Cas. (BNA) at 2324.

431. *See* Labor Department Sues Bank of America for Losses to Pension Plans, DOL News Release, 1996 WL 66305, at *1 (D.O.L.), Feb. 15, 1996 [hereinafter Labor Department Sues]; Bill Wallace, *U.S. Sues Bank Over S.F. Trash Firm Pensions*, S.F. CHRON., Feb. 22, 1996, at A15.

432. Labor Department Sues, *supra* note 431, at *1.

433. Labor Department Sues, *supra* note 431, at *1; Wallace, *supra* note 431, at A15.

434. Labor Department Sues, *supra* note 431, at *1.

435. *Id.* Whether the DOL's position in the BOA case is typical is hard to tell. The DOL has not appeared eager to include directed trustees as defendants in prior DOL-initiated litigation regarding fiduciary investments. *See, e.g.*, *Cunningham*, 716 F.2d 1455; *Wells Fargo*, 860 F. Supp. 709. Some might speculate that the DOL has been gunning for BOA ever since the value of participants' interests in the Carter Hawley Hale retirement plan, of which BOA was also directed trustee, declined following a corporate control battle. *See Carter Hawley Hale letter*, *supra* note 95, at 633; Maggie Mahar, *Cracked Nest Egg: A Double Whammy for Employees of Carter Hawley Hale*, BARRON'S, Apr. 8, 1991 at 14.

In any event, the *Ershick* district court's misplaced reliance on the "Chinese Wall" regulations[436] did not go far enough. Even assuming it would have been improper for UMB's trust department to ask its lending department for information on Greb X-Ray, the trust department, alerted by the negative facts it already knew,[437] could still have asked Greb X-Ray itself for additional financial and managerial information to evaluate the prudence of the directions to purchase more stock.

Of course, the courts in *Ershick* were comforted that "an independent appraiser not affiliated with Greb X-Ray" valued the stock the ESOP purchased.[438] The district court, in fact, held that UMB "fully discharged its responsibility" by relying on the independent appraisal to ensure that the ESOP paid no more than "adequate consideration" for the stock.[439] While the appraisal may have provided a reasonable basis for the price paid at the time, appraisals do not normally address whether buying the stock at all is prudent and for the exclusive benefit of the participants; the purchase itself was what plaintiffs were challenging.[440]

FirsTier Bank v. Zeller,[441] better reasoned than *Ershick*, nonetheless also concluded the directed trustee had no duty to inquire about the propriety of the directions in question,[442] which it characterized as having come from participants themselves rather than from a named fiduciary.[443]

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436. *Ershick*, 948 F.2d at 665.

437. *Id.* at 664.

438. *Id.* One longs to know more about the "independent" appraisal; we are not told who hired the appraiser or the appraisal's date. *Id.*

439. *Ershick*, 12 Employee Benefits Cas. (BNA) at 2326.

440. *Id.* at 2324. One commentator has argued that the stock price carries within it an implicit judgment about the wisdom of purchasing the stock, and thus that the "adequate consideration" factor collapses into the "prudence" factor. Welch, *supra* note 357, at 582-83 (arguing that ESOP fiduciaries should never have to inquire into the prudence of the stock purchase itself). However, taking this position to its logical extreme, that means stock that it would not be prudent to purchase should have a price of $0. At least for closely-held stock, it seems possible to arrive at a fair price for the stock if you have decided you are going to purchase it, while simultaneously concluding that the more prudent course is not to purchase it at all. *See* Moench v. Robertson, 62 F.3d 553, 571-72 (3d Cir. 1995), *cert. denied*, 116 S. Ct. 917 (1996); Eaves v. Penn, 587 F.2d 453, 459 (10th Cir. 1978) ("[T]he structure of [ERISA] itself requires that in making an investment decision of whether or not a plan's assets should be invested in employers [sic] securities, an ESOP fiduciary . . . is governed by the 'solely in the interest' and 'prudence' tests of §§ 404(a)(1)(A) and (B).").

441. 16 F.3d 907 (8th Cir.), *cert. denied sub nom.* Vercoe v. FirsTier Bank, N.A., 115 S. Ct. 194 (1994).

442. *Id.* at 912-13.

443. *Id.* at 912. Generally, if a participant exercises control over the assets in her individual account, she will not be deemed to be a "fiduciary" and the directed trustee will not be liable for any losses resulting from the participant's exercise of control. *See* discussion *supra* parts II.D-E.

Yet this was not an entirely satisfactory solution given the highly suspicious circumstances confronting a conflicted directed trustee.

FirsTier was both directed trustee of Land Paving Company's ("LPC") profit-sharing plan and a lender to LPC.[444] Four days before FirsTier was due to receive a $600,000 loan payment, the company president and named fiduciary, Dombrowski, proposed substituting himself for FirsTier as trustee, so he could "free up cash by funding the existing Plan accounts with annuities."[445] A FirsTier trust officer "advised [him] that the annuity proposal was impermissible," and "refused to accept FirsTier's removal as . . . trustee because he knew of LPC's heavy indebtedness and feared misuse of Plan assets."[446]

Yet just five days later, and two days after the $600,000 loan payment was due, Dombrowski wrote to the very same trust officer who "feared misuse of Plan assets,"[447] directing FirsTier to loan plan funds totalling almost $100,000 to four participants.[448] Without asking how the participants intended to use the loan proceeds, FirsTier complied.[449] Pursuant to a prearranged agreement with Dombrowski, the participants then reloaned the proceeds to LPC, and Dombrowski made part of FirsTier's loan payment with those funds.[450]

After LPC went bankrupt, without sufficient assets to repay the participants' loans, FirsTier commenced an action seeking a declaration of its status and the participants asserted counterclaims and third party claims against FirsTier.[451] After a bench trial, the district court found that "FirsTier had not violated its fiduciary duties under ERISA"; the Eighth Circuit affirmed.[452]

Plaintiffs conceded that the requests for participant loans facially complied with the applicable ERISA requirements.[453] Plaintiffs also

444. *FirsTier*, 16 F.3d at 909.

445. *Id.*

446. *Id.*

447. *Id.*

448. *Id.* at 910.

449. *Id.*

450. *Id.*

451. *Id.*

452. *Id.* Both courts rejected FirsTier's *Maniace*-like argument that it was not a fiduciary at all. *Id.* at 911.

453. *Id.* at 912 (citing 29 U.S.C. § 1108(b)(1) (1994)). DOL regulations on participant loans were not in effect at the time. 29 C.F.R. § 2550.408b-1 (1995). These regulations neither address the directed trustee situation nor, obviously, a directed trustee's duty of inquiry. *Id.* While the court in *FirsTier* did not rely on these regulations, it did support the propositions that a fiduciary generally has no duty to inquire about the participant's ultimate use of the loan proceeds, and that absent actual knowledge of an intended prohibited transaction, the fiduciary will not be liable. *E.g.*, 29 C.F.R. at § 2550.408b-1(a)(4), *Examples* 3, 4, and 6. However, the regulations do not postulate an example like *FirsTier* where the

conceded that FirsTier did not actually know the participants would lend the loan proceeds to LPC, which would then pay FirsTier.[454] However, plaintiffs urged that FirsTier breached its duty of prudence by failing to investigate the loans' purpose in light of the troubling facts FirsTier already knew.[455]

The court agreed that under the common law, a directed trustee ordinarily had some duty to investigate the propriety of a direction, but held that no such duty existed "on the specific facts of this case."[456] Because the direction to make the loans had come from the participants as well as the named fiduciary, the case fell within the common law rule that "[w]hen acting at the direction of the ultimate beneficiary of a trust, the trustee's fiduciary duty is satisfied if it simply complies with a direction that does not violate the terms of the trust."[457]

While one can sympathize with the result (as the participants were demanding that FirsTier redress their own gullibility, even dishonesty),[458] the court made several leaps over the statute. First, the direction to make the loans did technically come from the named fiduciary, and the court admitted that such directions had to comply with section 403(a)(1)'s requirements in order to be upheld.[459] Dombrowski's direction was clearly not "proper" and violated section 406(a)(1)(B) because he knew, having organized the scheme, that the transaction was indirectly a loan from the plan to LPC.[460]

Second, even assuming the participants themselves directed the loans, ERISA only releases the trustee from liability under the conditions set forth in section 404(c), which is ERISA's rough codification of the common-law rule that the directed trustee is generally not liable with respect to a beneficiary's directions.[461] Oddly, the court never cited section 404(c) or the corresponding DOL regulations.[462]

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fiduciary had a conflict of interest and knew of suspicious circumstances before the transaction. 29 C.F.R. § 2550.408b-1(a)(4) (1995).

454. *FirsTier*, 16 F.3d at 912.

455. *Id.*

456. *Id.* at 912-13 (quoting IIA SCOTT & FRATCHER, *supra* note 246, at § 185).

457. *Id.* at 912 (citing IIA SCOTT & FRATCHER, *supra* note 246, at 574).

458. *Id.*

459. *Id.*

460. However, the court found that Dombrowski himself had not breached any fiduciary duty because he did not "coerce the Participants into lending . . . the loan proceeds to LPC." *Id.* at 913. Even if that was true, it does not erase the prohibited transaction under § 406(a)(1)(B).

461. ERISA § 404(c), 29 U.S.C. § 1104(c) (1994); *see* discussion *supra* parts II.D-E, V.B.

462. *FirsTier*, 16 F.3d 907. The relevant DOL regulations, 29 C.F.R. § 2550.404c-1 (1995), had been promulgated but were not in effect at the time of the events in *FirsTier*. The transaction in *FirsTier* probably would have fallen within 29 C.F.R. § 2550.404c-

Third, if section 404(c) did apply here, it bumped up against section 406(a)(1)(B), which prohibited FirsTier from causing the transaction if it "should [have] know[n] that [the] transaction constitute[d] a direct or indirect . . . lending of money between the plan" and LPC, "a party in interest."[463] While a directed trustee should have no duty to investigate if it knows nothing to raise suspicion, the circumstances here did not fall into that bland category.[464] Moreover, the court quoted Professor Scott's treatise for the proposition that FirsTier's conflict of interest as trustee-lender did not automatically void the transaction.[465] However, the court neglected to quote or apply the next sentence in the same treatise, which reads, "[t]he conflict of interest is a factor to be considered in determining whether the bank acted for the best interest of the beneficiaries."[466] FirsTier's conflict of interest carried no weight in the court's conclusion that FirsTier had no duty to inquire about the purpose of the loans.[467]

3. The Duty To Investigate Participant Directions

FirsTier involved quasi-participant directions to make loans to participants.[468] Without referring to either section 404(c) or the DOL regulations promulgated thereunder, the result in *FirsTier* implies that a directed trustee has no duty of inquiry even in the presence of some relatively suspicious circumstances.[469]

In contrast, most cases involving participants' directions to vote or tender plan stock point to the opposite result.[470] Courts generally require the directed trustee to ascertain, through diligent investigation, that following the participants' directions in voting or tendering stock would not violate

1(d)(2)(ii)(E)(2) (an "instruction which . . . [w]ould result in a direct or indirect . . . [l]oan to a plan sponsor," thereby denying FirsTier any protection for having followed the direction).

463. ERISA § 406(a)(1)(B), 29 U.S.C. § 1106(a)(1)(B) (1994).

464. *See FirsTier*, 16 F.3d at 909-10.

465. *Id.* at 913 n.6 (quoting IIA SCOTT & FRATCHER, *supra* note 246, § 170.23A at 429).

466. IIA SCOTT & FRATCHER, *supra* note 246, § 170.23A at 429.

467. *FirsTier*, 16 F.3d at 913 n.16. For more critical commentary on *FirsTier*, see Alson R. Martin, *Recent Tax, Employee Benefit, and Business Law Developments Affecting PCs and Other Closely-Held Businesses*, C980 A.L.I.-A.B.A. 1419, 1453 (1995).

468. *FirsTier*, 16 F.3d at 909-10.

469. *Id.*

470. *See, e.g.*, Reich v. NationsBank of Georgia, 19 Employee Benefits Cas. (BNA) 1345, 1351 (N.D. Ga. March 29, 1995); Central Trust Co. v. American Avents Corp., 771 F. Supp. 871, 876 (S.D. Ohio 1989); Danaher Corp. v. Chicago Pneumatic Tool Co., 635 F. Supp. 246, 250 (S.D.N.Y. 1986).

ERISA—and to disregard the directions if they would not be prudent and for the exclusive benefit of all participants and beneficiaries.[471]

Section 404(c) seems to immunize trustees from liability for following participant directions,[472] while section 403(a)(1)[473] provides no such comfort for following "named fiduciary" directions.[474] Thus, it is ironic that courts have required trustee investigation of participant directions[475] but not of named fiduciary directions.[476]

The DOL avoids section 404(c)'s apparent insulation of the trustee by calling the participant in this situation a "named fiduciary" under section 403(a)(1).[477] However, the DOL has not been as clear about the trustee's affirmative duty of investigation of directions by non-participant named fiduciaries. Nor have cases brought by private plaintiffs postulated such a duty.

For example, in *Ershick v. United Missouri Bank*,[478] even after the ESOP became the majority shareholder, the directed trustee, UMB, routinely gave the proxies to the named fiduciary (the company president) to vote the ESOP shares.[479] UMB continued to follow this routine procedure even in the face of a challenge to management, of which UMB was "not informed."[480] Plaintiffs argued that UMB thereby violated its fiduciary

471. *See Reich*, 19 Employee Benefits Cas. (BNA) at 1351; *Central Trust*, 771 F. Supp. at 876; *Danaher*, 635 F. Supp. at 250; *see also Carter Hawley Hale letter*, *supra* note 95, at 633; Edward A. Landry, *Fiduciary Responsibility Under ERISA in a Takeover Situation*, 12 PROB. NOTES 148, 151 (1986) (describing a similar result for directed trustee in Martin Marietta tender offer for Bendix shares).

472. *See* ERISA § 404(c), 29 U.S.C. § 1104(c) (1994). While a surface reading of 29 U.S.C. § 1104(c) might indicate exculpation of the trustee, the later DOL regulations only exculpate the trustee where there is an "ERISA section 404(c) plan," a newly defined term. 29 C.F.R. § 2550.404c-1(b)(1)(i) (1995). Unless the plan has a range of at least three diversified investments (in addition to employer stock) for the participant to choose from, an ESOP will not be considered an "ERISA section 404(c) Plan." 29 C.F.R. § 2550.404c-1(b)(3)(i)(B) (1995). "Consequently, as the regulations are currently drafted, pass-through voting and tender directions in the typical ESOP are not exercised by a participant or beneficiary in a nonfiduciary capacity, and a trustee is therefore not insulated from liability for following such directions." Rizzo & Carey, *supra* note 123, at 17.

473. *See* ERISA § 403(a)(1), 29 U.S.C. § 1103(a)(1) (1994).

474. *See supra* part III.E.2.

475. *See, e.g., Carter Hawley Hale letter, supra* note 95, at 633.

476. *See* cases cited *supra* note 378.

477. *See supra* part III.D.

478. 12 Employee Benefits Cas. (BNA) 2323.

479. *Id.* The plan apparently did not provide for pass-through voting by participants. *Id.* at 2324-26. "Pass-through voting" refers to participants' directing the voting of shares held in their individual accounts. *Central Trust*, 771 F. Supp. at 873; LANGBEIN & WOLK, *supra* note 69, at 770.

480. *Ershick*, 12 Employee Benefits Cas. (BNA) at 2326.

duties by perpetuating the company's mismanagement.[481] The Tenth Circuit rejected this argument primarily because it had not been raised in the trial court, but also asserted that under state law, a majority shareholder was not a fiduciary for the other shareholders.[482] That response, of course, misses the point that as trustee, UMB already owed a fiduciary duty to the ESOP shareholders.

As to participant directions involving actions other than voting or tendering stock, the DOL does not appear to require the same level of trustee scrutiny. The unstated reason for treating plan participants as "named fiduciaries"—acting in a fiduciary capacity—when voting or tendering shares is that the actions of the majority can potentially affect the minority. In contrast, a participant choice of, say, one of three diversified investment funds in which her individual account should be invested has no discernible effect on other participants' investments. That kind of direction is what was referred to under the common law of trusts as a "beneficial direction," affecting no one's interests other than the beneficiary's, and as to which the trustee had only the duty to assure compliance with the trust's terms.[483]

Pass-through voting, however, enables majority control of the vote. In addition, the majority probably will vote in their own interest, not for the exclusive benefit of all participants and beneficiaries. For example, in *Central Trust Co. v. American Avents Corp.*,[484] the management-controlling shareholders owned 51% of the total common stock (and about 43% of the ESOP-held common stock).[485] The plan allowed pass-through voting.[486] There was an offer, opposed by management, to purchase company shares for $12 per share.[487] The court upheld the trustee's determination that if the shares were not tendered, participants would receive $5 or less—and possibly nothing.[488] Thus, the court allowed the trustee to tender the shares because "the allowance of pass-through voting in this instance would halt the sale of shares to [the tender offeror] and not be in the best economic interest of the plan participants and their beneficiaries."[489]

481. *Ershick*, 948 F.2d at 669.

482. *Id.*

483. *See supra* note 249 and accompanying text. Indeed, a trustee may be held liable for losses resulting from the trustee's failure to follow the participant's instruction. *See* Schoonmaker v. Employee Sav. Plan of Amoco Corp., 987 F.2d 410, 414-15 (7th Cir. 1993).

484. 771 F. Supp. 871.

485. *Id.* at 873.

486. *Id.*

487. *Id.* at 874.

488. *Id.* at 875.

489. *Id.*

Not surprisingly, however, ESOP participants other than controlling shareholders also tend to vote with current management.[490] Most likely, they fear they will lose their jobs under new ownership or management. If participants make fully informed decisions free of pressure from their employer, it is hard to justify overriding their directions to the trustee,[491] and even the DOL seems reluctant to force the trustee to do so.[492] It may be difficult, however, to discern genuine participant desire to vote with current management from employer-pressured desire.[493] Thus, the DOL continues to insist that trustees scrutinize all participants' voting instructions to assure ERISA compliance.[494]

Most recently, in *Reich v. NationsBank*[495] the directed trustee of the Polaroid ESOP faced competing tender offers for Polaroid stock. The DOL's position in the case had its genesis in what is generally known as the "Polaroid letter."[496] At the time of the letter, there were two competing tender offers: one by Shamrock Acquisitions at $45 for all Polaroid shares, and the other by Polaroid itself at $50 for a maximum of 16 million shares.[497]

Polaroid's ESOP instrument required the trustee:

(1) to follow each participant's direction to sell the Polaroid stock allocated to his or her individual account;
(2) to treat a lack of direction as a direction not to sell the participant's allocated shares; and
(3) to sell the same proportion of unallocated shares as the trustee received participant directions to sell allocated shares (known as a "mirror provision").[498]

The DOL appraised these provisions' validity in its "Polaroid letter" as follows:

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490. *See, e.g.*, *Reich*, 19 Employee Benefits Cas. (BNA) at 1346; Martin Marietta Corp. v. Bendix Corp., No. 82 CIV. 6135, 1982 WL 1379, at *1 (S.D.N.Y. Sept. 22, 1982) (about 94% of participants withdrew directed trustee's tender of their shares to hostile tender offeror).

491. Indeed, the Internal Revenue Code actually requires pass-through voting both on all decisions regarding ESOP publicly-traded stock and on major corporate decisions regarding ESOP closely-held stock. 26 U.S.C. §§ 409(e)(2), (3) (1994).

492. *See Reich*, 19 Employee Benefits Cas. (BNA) at 1351.

493. *See Carter Hawley Hale letter, supra* note 95.

494. *See Reich*, 19 Employee Benefits Cas. (BNA) at 1351.

495. 19 Employee Benefits Cas. (BNA) 1345; *see also* Martin v. NationsBank, 16 Employee Benefits Cas. (BNA) 2138 (N.D. Ga. 1993) (holding the trustee's indemnification agreement invalid).

496. *Polaroid letter, supra* note 95. These principles apply to fiduciary conduct in the face of participant directions for either tender offers or proxy voting. *Id.*

497. *Reich*, 19 Employee Benefits Cas. (BNA) at 1346.

498. *Id.*

(1) The plan may authorize participants to direct the trustee with respect to allocated shares. However, the participant is considered a named fiduciary for that limited purpose, and the directed trustee must make sure, following section 403(a)(1), that the direction is proper and not contrary to ERISA.[499]

(2),(3) The trustee has "exclusive responsibility" for making the tender decision as to non-voted allocated shares and unallocated shares. The trustee may follow the plan provisions only to the extent consistent with ERISA's fiduciary rules.[500]

The DOL seemed to allow greater trustee deference to affirmative participant direction of allocated shares—borne out by a decreased willingness to prosecute the trustee for following these directions.[501] However, under the DOL's formulation, there does not seem to be much theoretical or practical difference in the trustee's duty of investigation for any of the three categories.

For whatever reason, the directed trustee did not entirely follow the DOL's advice.[502] The actual results were:

(1) Of the allocated shares, the trustee received participant directions to tender about 55% to Polaroid, to tender about 0.4% to Shamrock, and not to tender about 6% to either offeror.[503] The trustee followed all these directions except the directions to tender to Shamrock, determining that the Shamrock offer could not be consummated on its terms.[504]

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499. *Polaroid letter, supra* note 95, at 390. The DOL also warned that the trustee was "responsible for assuring that the participants receive necessary and accurate information in order to allow them to be fully informed as they consider how to vote or whether to tender." *Id. n.2.* Moreover, the trustee was "required" to ignore participant directions if the "participants were subjected to undue pressure." *Id.* In the ensuing litigation, NationsBank did not dispute DOL's characterization of participants as named fiduciaries. *Reich,* 19 Employee Benefits Cas. (BNA) at 1348.

500. *Polaroid letter, supra* note 496, at 390.

501. The DOL did not challenge NationsBank's following participants' affirmative directions not to tender. *Reich,* 19 Employee Benefits Cas. (BNA) at 1348. However, its lack of challenge was due to what it termed "prosecutorial discretion," Rizzo & Carey, *supra* note 123, at 15, rather than any notion that section 404(c) excused NationsBank if it followed participant directions.

502. *Reich,* 19 Employee Benefits Cas. (BNA) at 1346-47.

503. Rizzo & Carey, *supra* note 123, at 15 (citing DOL Memorandum in Support of Motion For Summary Judgment). Approximately 90% of the shares held by the ESOP were unallocated. *Reich,* 19 Employee Benefits Cas. (BNA) at 1346.

504. Rizzo & Carey, *supra* note 123, at 15. The Shamrock offer was conditioned on tender of 90% of Polaroid stock. *Id.* The trustee determined this could not be accomplished since the ESOP owned 14% of all outstanding stock and less than 1% was tendered to Shamrock. *Id.*

(2) As to the remaining 38% of the allocated shares, the trustee received no participant directions.[505] Following the plan's provision that such silence should be deemed a direction not to tender, the trustee did not tender these shares.[506]

(3) As to the unallocated shares, the trustee followed the "mirror" provision, thus tendering about 55% of the unallocated shares to Polaroid, and not tendering the other 45%.[507]

The DOL did not say in its 1989 letter[508] what it later asserted in its 1992 lawsuit—that tendering to Polaroid at $50 was "the only prudent choice."[509] Therefore, the DOL claimed that NationsBank violated its fiduciary duties by not tendering to Polaroid all the unallocated shares and the allocated shares for which it had received no participant directions.[510]

As to the plan's "mirror provision," NationsBank moved for summary judgment,[511] arguing that it acted as a directed trustee and its fiduciary obligations were met when it followed the participants' directions and the plan terms.[512] The district court, denying this motion, decided that as to the unallocated shares, current plan participants simply could not act as named fiduciaries due to their inherent conflict of interest with future participants.[513]

Disqualifying plan participants from acting as named fiduciaries for unallocated shares seems unnecessary. ERISA expressly allows a "representative of a party in interest" to serve as a fiduciary.[514] Thus, there is no structural reason the plan cannot authorize each participant to act as a named fiduciary for his or her proportion of the unallocated shares. However, knowing the present participant may have a conflict of interest, the directed trustee should scrutinize those directions more carefully than it scrutinizes directions that affect only the participant's allocated shares.

D. *Silence Instead of a Direction*

What is the trustee's responsibility if the plan allows the trustee to be directed, but no direction is forthcoming? Here also, courts have only

505. Rizzo & Carey, *supra* note 123, at 15.

506. *Id.*

507. *Id.*

508. *Polaroid letter, supra* note 496, at 390-91.

509. *Reich,* 19 Employee Benefits Cas. (BNA) at 1347.

510. *See id.* The DOL asserted that by following the plan's "mirror provision" and "no-direction-no-tender provision," NationsBank "failed to adequately investigate . . . the merits of the [competing] tender offers." *Id.* at 1347-48.

511. *Id.* at 1345.

512. *Id.* at 1348.

513. *Id.* at 1350-51.

514. ERISA § 408(c)(3), 29 U.S.C. § 1108(c)(3) (1994).

required the trustee to act, using its own best judgment, in the context of voting or tendering plan stock.[515] Courts have assumed without discussion that the trustee has no duty to act in the non-participant named fiduciary situation, at least where the trustee receives no direction to sell stock held in an ESOP.[516]

In *Reich v. NationsBank*,[517] the court, urged on by DOL, held that "when a trustee receives no affirmative direction regarding allocated shares, the trustee must take exclusive responsibility for decisions regarding these shares," and may not infer from the participant's silence that she did not want to tender the shares.[518] One commentator agreed that silence can never count as a "direction."[519]

It seems reasonable to require a trustee to decide and act, in the absence of a direction, when there is something immediately pressing to decide and act upon, like a tender offer. However, the responsibility to act without a direction cannot be practically extended too far beyond that.[520] If the trustee has a duty to constantly ascertain whether to act, the very idea of

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515. *See infra* notes 517-19 and accompanying text.

516. *See, e.g.*, *Maniace*, 40 F.3d at 267-68 (holding the directed trustee not liable for failing to sell stock held in ESOP when no direction to sell was given); *Ershick*, 948 F.2d at 667-69 (holding the directed trustee not liable for failing to sell stock held in ESOP when no direction to sell was given).

517. 19 Employee Benefits Cas. (BNA) 1345.

518. *Id.* at 1351.

519. Rizzo & Carey, *supra* note 123, at 16. ("Given the lack of expertise of the average plan participant and the fact that participants are often asked to furnish instructions with respect to complicated corporate transactions or other investment decisions without the benefit of independent financial or legal counsel, it is certainly not unreasonable to assume that many participants will fail to act out of bewilderment or confusion."). The author cites RESTATEMENT (SECOND) OF TRUSTS § 185 cmt. f, and Steiner v. Hawaiian Trust Co., 393 P.2d 96 (Haw. 1964). The latter case does not truly involve a trustee waiting for the affirmative direction of an advisor. *Steiner*, 393 P.2d at 96. Rather, it involves a trustee with full investment powers subject to the consent of an advisor. *Id.* at 99. Thus, the onus was on the trustee in that case to initiate diversification of the trust assets, by consulting with the advisor, rather than to wait for a direction to diversify that was not forthcoming. *Id.* at 107-10.

520. For example, in a pre-ERISA case, the trust agreement for a profit sharing plan of which Manufacturers Hanover was trustee provided that a Profit Sharing Committee had complete authority to determine employees' interests in the fund, and the trustee could only disburse funds to an employee on written direction from the Committee. Golden v. Kentile Floors, Inc., 475 F.2d 288, 291 (5th Cir. 1973). When an employee claimed a right to funds in the trust and sued the Committee and Manufacturers Hanover, the court held "that Manufacturers Hanover did not breach a fiduciary duty in refusing to disburse funds without specific authorization from the Committee." *Id.* *Cf.* In re Westfield Trust Co., 176 A. 101, 103 (N.J. 1935) (trustee not liable for not seeking court instruction when co-trustee responsible for directing investments did not direct sale of securities during the Depression).

allowing employers to control plan investments through named fiduciaries will be lost.

E. Impotent To Stop Malfeasance of a Named Fiduciary?

If a directed trustee is not even a fiduciary, or has no duty to inquire about the propriety of a direction, does the directed trustee still have the final say on the disposition of the trust assets it holds? If so, it seems odd indeed to rid the trustee of the protective mantle of fiduciary duty. If not, then the named fiduciary alone must have the authority to commit trust assets, even without the trustee's knowledge or consent. Such a rule, however, would nullify the trust requirement and could lead to disastrous results.

Suppose the sponsoring company hires as its named fiduciary for investment a close personal friend of a company director. The new named fiduciary, who has no prior investment experience, soon signs a contract, supposedly on the trust's behalf, to purchase raw land in Florida for approximately $44 million. The putative seller is a friend of the company's largest stockholder. After signing the contract, the named fiduciary directs the trustee to wire the purchase price, from plan assets, to Florida to close the deal. The directed trustee, a trust company with no prior notice of the deal, refuses to send the funds without further investigation. After performing its due diligence, the trustee concludes that the land is worth only $12 million and refuses to follow the named fiduciary's direction to wire the trust funds for a closing. The putative seller sues the trust for breach of contract and the trustee for tortious interference with contract.

This is essentially what happened in *Queen's Harbour Yacht & Country Club, Ltd. v. Singer Co. Master Trust.*[521] There, the trust document authorized the Singer Company's directors to appoint a "named fiduciary for asset investment" to direct investments of plan assets by the trustee, The Northern Trust Company.[522] After Paul Bilzerian, a corporate raider, took control of the Singer Company (and renamed it Bicoastal Corporation), the trust agreement was amended, purportedly to allow the named fiduciary not

521. No. 92-254-CIV-J-10, slip op. (M.D. Fla. Aug. 19, 1993). For additional background on the case, see Bullard v. Northern Trust Co., No. 91-994-CIV-T-17A, 1992 U.S. Dist. LEXIS 4873 (M.D. Fla. Apr. 7, 1992); Bullard v. Northern Trust Co., No. 91-994-CIV-T-17A, 1992 WL 153594 (M.D. Fla. June 19, 1992). The author was one of the attorneys for The Northern Trust Company in the *Queen's Harbour* case. The case settled in late 1993 prior to trial. *See also In re* Bicoastal Corp., 191 B.R. 238 (Bankr. M.D. Fla. 1995) (in later related fees litigation, in which the author was not involved, bankruptcy court denied the successor-in-interest to the Singer Company pension plan reimbursement of fees and expenses from the debtor, Bicoastal Corporation, incurred in defending the *Queen's Harbour* case).

522. *Queen's Harbour*, No. 92-254-CIV-J-10, slip op. at 2-3.

only to direct the trustee as to investments of plan assets, but to direct the trustee to actually transfer assets to a "separate account" over which the named fiduciary could "assume investment responsibility."[523] The amended trust agreement purported to prohibit the trustee from "mak[ing] any investment review of, or consider[ing] the propriety of holding or selling, . . . any assets over which the [named fiduciary] has assumed investment responsibility."[524]

The court found: "On 8 January 1991 Bicoastal's board appointed Victoria Clear as the named fiduciary for asset management, with an annual salary of $250,000 even though she had limited investment experience."[525] Reading this bland exposition, one would never suspect the following facts, which Northern Trust fairly characterized as undisputed, contained in the briefs before the court:

— "Bicoastal's board" consisted solely of Bilzerian's father-in-law and Bilzerian's business associate.[526] Bilzerian himself was not on the Bicoastal board at this time because of his felony conviction for securities fraud in an unrelated matter.[527] Bicoastal itself was in bankruptcy.[528]

— In the week before this board's appointment of Clear as named fiduciary, Bilzerian's conviction was affirmed by the United States Court of Appeals for the Second Circuit.[529]

— Clear had been an employee of and personal accountant for Bilzerian and Bilzerian's father-in-law.[530] Clear was a close personal friend of Bicoastal's other director.[531]

— Bilzerian had borrowed heavily from Mesa Holdings to purchase Bicoastal.[532] In the days before Clear's appointment as named fiduciary, Bicoastal failed to satisfy a financial commitment owed

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523. *Id.*

524. *Id.* at 3.

525. *Id.*

526. Memorandum in Support of Defendant's Motion for Summary Judgment, at 1, *Queen's Harbour Yacht & Country Club, Ltd. v. Singer Co. Master Trust*, No. 92-254-CIV-J-10, slip op. (M.D. Fla. Aug. 19, 1993) [hereinafter Defendant's Memorandum]; *see also In re* Bicoastal Corp., 600 A.2d 343, 348 (Del. 1991).

527. United States v. Bilzerian, 926 F.2d 1285, 1289 (2d Cir.), *cert. denied*, 502 U.S. 813 (1991). ERISA prohibits a person with a felony conviction from serving in a fiduciary capacity. ERISA § 411(a), 29 U.S.C. § 1111(a) (1994). Because Bicoastal's board of directors had the power to appoint the pension plan's named fiduciary for asset investment, the board members were fiduciaries to that extent. 29 C.F.R. § 2509.75-8 (D-4) (1995).

528. *In re* Bicoastal Corp., 149 B.R. 216, 217 (Bankr. M.D. Fla. 1993).

529. *Bilzerian*, 926 F.2d at 1301.

530. Defendant's Memorandum, *supra* note 526, at 1.

531. Deposition of David Tallant, Queen's Harbour Yacht & Country Club, Ltd. v. Singer Co. Master Trust, No. 92-254-CIV-J-10, slip op. (M.D. Fla. Aug. 19, 1993).

532. *Bicoastal*, 600 A.2d at 346.

> Mesa, and under the terms of the loan documents Mesa was about to take control of Bicoastal's board of directors.[533]

Thus, at the time of Clear's appointment, Bilzerian and Mesa were locked in a Delaware court battle for control of Bicoastal.[534] Clear remained named fiduciary until the final resolution in Mesa's favor, three months later.[535] Before she was ousted by new management,[536] however, Clear allegedly executed a contract[537] *on behalf of the trust* to purchase, for $38,500,000, the undeveloped portion of a residential and country club project in Jacksonville, Florida.[538] The contract also purported to include a $5,000,000 loan from the trust to be used for further project development.[539] The project at the time was primarily owned by Queen's Harbour Yacht & Country Club, Ltd. ("Queen's Harbour"), a limited partnership, the general partner of which was Fred B. Bullard, Jr.[540] Bullard was a self-described friend of Bilzerian who had testified as a character witness in Bilzerian's criminal trial.[541]

Without informing Northern Trust that she had already signed a contract purporting to obligate the trust to invest $43.5 million in raw land in Florida, Clear scheduled a closing for one week after she allegedly signed the contract.[542] We pick up the narrative from the court's slip opinion:

> Clear directed Northern to send $44 million to a newly created account that she opened in order to fund the closing of the agreement. Northern notified Clear, by letter dated 20 March 1991, that it required further review of the agreement before it would release any funds in support of the agreement. By letter dated 31 March 1991, Northern notified Bullard and Queen's Harbour that it would not proceed with the agreement.[543]

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533. *Id.* at 347-48.

534. Mesa Holding Ltd. Partnership v. Bicoastal Corp., No. CIV.A.11210, 1991 WL 17172 (Del. Ch. Feb. 11, 1991), *aff'd sub nom. In re* Bicoastal Corp., 600 A.2d 343 (Del. 1991).

535. *Bicoastal*, 149 B.R. at 217.

536. *Id.*

537. There was some evidence that Clear had not, in fact, executed the final version of the contract at all, or at least did not do so until after Northern Trust had told her it would not transfer the funds without performing due diligence. For purposes of its summary judgment motion, however, Northern Trust assumed that Clear executed the contract on its purported date, March 13, 1991. Defendant's Memorandum, *supra* note 526, at 2.

538. *Queen's Harbour*, No. 92-254-CIV-J-10, slip op. at 3.

539. *Id.* at 3-4.

540. Defendant's Memorandum, *supra* note 526, at 1.

541. *Id.* at 1-2; Deposition of Fred B. Bullard, Jr., Bullard v. Northern Trust Co., No. 91-994-CIV-T-17A, 1992 U.S. Dist. LEXIS 4873 (M.D. Fla. June 19, 1992).

542. Defendant's Memorandum, *supra* note 526, at 2.

543. *Queen's Harbour*, No. 92-254-CIV-J-10, slip op. at 4 (citations to record omitted). The court's paraphrase of Northern Trust's March 20, 1991 letter was in error in attributing any knowledge to Northern Trust of any "agreement" on that date. Defendant's

Queen's Harbour sued the Singer trust for specific performance or damages for breach of contract and sued Northern, the trustee, for tortious interference with contract, all under Florida law.[544] The trust and the trustee moved for summary judgment, arguing first that ERISA preempted Queen's Harbour's state-law contract and tort claims.[545] In denying the motion, the court made short shrift of this argument with virtually no analysis: "Queen's Harbour's claims are 'run-of-the-mill state-law claims' by a party which is not a principle [sic] ERISA entity and are not preempted by ERISA."[546]

The court disregarded the preemption analysis mandated by ERISA section 514 and numerous Supreme Court preemption decisions, under which ERISA preempts all claims under state law (including decisional law) "relating to" a plan.[547] More to the point, the court missed the gist of the trustee's preemption argument.

Memorandum, *supra* note 526, at 2. As of March 20, Northern had received only an oral request to transfer the funds, followed by a written draft of a new trust agreement transferring the assets to a "separate account" of which Clear would be trustee. *Id.* Northern Trust maintained that it did not discover that Clear had actually purported to execute a contract until at least one month later. *Id.* Moreover, Northern's March 31, 1991 letter, on its face, did not refuse to proceed with the agreement, as the court reports, *Queen's Harbour,* No. 92-254-CIV-J-10, slip op. at 4, but merely stated that Northern required further time for due diligence.

Although one could wish for greater factual accuracy on the court's part, the inaccuracies are not material to the analysis herein. Even if Northern Trust had known of the contract's existence at this point in time, it was undisputed that Northern Trust never approved or ratified that contract. *See Queen's Harbour,* No. 92-254-CIV-J-10, slip op. at 4. Therefore, the question remains whether ERISA permits a named fiduciary to bind the trust over the trustee's refusal.

Another undisputed fact the court curiously omitted in its opinion was that, as part of Northern Trust's subsequent due diligence, its appraiser valued the property "as is" at approximately $12 million, Defendant's Memorandum, *supra* note 526, at 2, far below the $38.5 million called for in the contract. Although Queen's Harbour obviously disputed that valuation, it did not dispute the fact that Northern's appraiser had arrived at that valuation.

544. *Queen's Harbour,* No. 92-254-CIV-J-10, slip op. at 4. Bullard individually sued the trustee first. *See Bullard,* No. 91-994-CIV-T-17A, 1992 U.S. Dist. LEXIS 4873, at *3. When Queen's Harbour's suit followed, both cases were transferred under 28 U.S.C. § 1404(a) from Tampa to Jacksonville and consolidated. *Bullard,* No. 91-994-CIV-T-17A, 1992 WL 153594. Bullard's suit was later dismissed pursuant to a settlement.

545. *Queen's Harbour,* No. 92-254-CIV-J-10, slip op. at 4.

546. *Id.* at 4-5 (citing Mackey v. Lanier Collection Agency & Serv., 486 U.S. 825, 833 (1988); Memorial Hosp. Sys. v. Northbrook Life Ins. Co., 904 F.2d 236, 248-50 (5th Cir. 1990)).

547. ERISA § 514, 29 U.S.C. § 1144(a) (1994); *e.g.*, Ingersoll-Rand Co. v. McClendon, 498 U.S. 132, 140 (1990); Fort Halifax Packing Co. v. Coyne, 482 U.S. 1, 23 (1987); Metropolitan Life Ins. Co. v. Taylor, 481 U.S. 58, 66-67 (1987); Pilot Life Ins. Co. v. Dedeaux, 481 U.S. 41, 54 (1987); *see also* Jay Conison, *ERISA and the Language of Preemption*, 72 WASH. U. L.Q. 619 (1994).

The trustee argued that although ERISA allows a named fiduciary to direct the trustee's investment of plan assets, it does not allow the named fiduciary to bypass the trustee altogether in investing those assets.[548] The trustee maintained that it was still subject to fiduciary duties, even though directed by a named fiduciary, and even though the trust agreement purported to relieve the trustee of those duties.[549] Moreover, ERISA, in requiring the directed trustee to ascertain whether a named fiduciary's direction is "proper" and "not contrary to ERISA," plainly contemplates that a trustee would operate as a check on the untrammeled power of a named fiduciary.[550]

Therefore, ERISA necessarily preempts any state law, such as the doctrine of "apparent authority," that allows the named fiduciary to bind the pension trust to third parties without the trustee's knowledge and consent. Allowing state law to continue to operate in this field could subject the trust and *plan assets* to damages or even specific performance for breach of a contract that the trustee itself determined to be imprudent under ERISA.

The *Queen's Harbour* court ignored this analysis.[551] After the court made a conclusory statement that ERISA preempted neither the contract claim against the trust nor the tortious interference claim against the trustee, it continued: "Nevertheless, ERISA plays a considerable role in determining the outcome of the case. The [trust and trustee] argue that Clear did not have the authority to sign the agreement and thereby bind Singer. However, the trust plan gave her that authority and ERISA is not to the contrary."[552]

A holding that ERISA does not preempt state law, yet "plays a considerable role in determining the outcome of the case,"[553] appears to be both illogical and unprecedented. ERISA either preempts state law or plays no role at all.

Further, while noting the trustee's argument "that Clear did not have the authority to sign the agreement and thereby bind Singer,"[554] the court failed to understand that this was not a separate thought but was an integral part of the preemption argument. It is *ERISA* that denies the named fiduciary the authority to bind the trust to a contract; therefore, ERISA preempts any state law that allows the named fiduciary to do so.

But the court's flawed preemption analysis turns out not to matter. Although the court said that ERISA did not preempt the state law claims, what the court really concluded was that ERISA itself allows the named

548. Defendant's Memorandum, *supra* note 526, at 4-8.

549. *Id.*

550. *Id.*

551. *Queen's Harbour,* No. 92-254-CIV-J-10, slip op. at 4-7.

552. *Id.* at 5.

553. *Id.*

554. *Id.*

fiduciary to bind the trust without the trustee's knowledge and consent.[555] Thus, the court ultimately did not need its preemption holding to reach its result.

Earlier, the court had noted that the plan documents gave the named fiduciary the authority to direct the trustee to enter into investment agreements, in some circumstances, without any review by the trustee of their propriety.[556] However, ERISA plainly does not allow private trust agreements and other plan documents to contravene ERISA.[557] Thus, if the trust agreement purported to give the named fiduciary this authority, that provision would be irrelevant if such authority were contrary to ERISA.

The court does not satisfactorily explain why it concluded that ERISA gave the named fiduciary the authority to enter into contracts without the trustee.[558] The court simply quotes ERISA section 402(a), which allows the plan sponsor "to appoint 'one or more named fiduciaries who jointly or severally shall have authority to control or manage the operation and administration of the plan.'"[559] While this provision certainly allows for broad powers of named fiduciaries, it is far from explicit in granting the named fiduciary the power to contractually bind the trust without the trustee—particularly when read in conjunction with the more specific enumerated powers of a trustee in section 403.[560] Indeed, when Congress wanted to state that someone had the power to "dispose of [plan] assets," it knew how to do so.[561]

The court then noted that ERISA allows a named fiduciary to "'appoint an investment manager . . . to manage (including the power to acquire and dispose of) any assets of the plan.'"[562] However, this observation was

555. *Id.* at 6. As a preliminary matter, it is hard to see how the court could construe the language of the trust plan that "*the Trustee*, acting only as directed by the [named fiduciary], *shall enter into such agreements* as are necessary to facilitate any investment," *id.* at 2 (emphasis added), to mean that the named fiduciary itself, *without* the trustee, could enter into such an agreement. However, I will assume *arguendo* that the trust agreement did, in fact, allow the named fiduciary to enter into binding contracts on behalf of the trust.

556. *Id.* at 2-3.

557. ERISA § 404(a)(1)(D), 29 U.S.C. § 1104(a)(1)(D) (1994); *e.g,* Central States, Southeast & Southwest Areas Pension Fund v. Central Transp., Inc., 472 U.S. 559, 568 (1985) (holding that "trust documents cannot excuse trustees from their duties under ERISA").

558. *Queen's Harbour,* No. 92-254-CIV-J-10, slip op. at 5-6. Indeed, under the common law of trusts, one co-trustee could not sell a trust asset without all of the co-trustees' consent. *E.g.*, Learned v. Welton, 40 Cal. 349, 394 (1870); Fritz v. City Trust Co., 76 N.Y.S. 625, 626 (N.Y. App. Div. 1902).

559. *Queen's Harbour,* No. 92-254-CIV-J-10, slip op. at 5, (quoting 29 U.S.C. § 1102(a) (1994)).

560. ERISA § § 402(a), 403, 29 U.S.C. § § 1102(a), 1103 (1994).

561. *See supra* notes 88-89 and accompanying text.

562. *Queen's Harbour,* No. 92-254-CIV-J-10, slip op. at 5, (quoting 29 U.S.C.

irrelevant, since it is undisputed that Clear was purporting to act as a named fiduciary, not as an investment manager.[563]

Finally, the court quoted ERISA section 403(a)(1), the directed trustee provision.[564] Unable to reconcile section 403(a)(1) with the Singer trust agreement's absolution of trustee responsibility for investment review (because the court failed to recognize that ERISA trumps trust agreements when trust agreements contravene ERISA), the court thrashed:

> Although the trust plan denies Northern the authority to question a named fiduciary's investment directions, under Section 1103(a)(1), Northern retained the *residual* power not to follow such directions if it found them to be improper, not in accordance with the trust plan, or contrary to ERISA. However, the exercise of this residual power could subject Singer to breach of contract claims.[565]

This conclusion can only be characterized as absurd. If an ERISA trustee is under a fiduciary duty to act as a prudent person for the exclusive benefit of the plan participants, a duty no one disputed in the *Queen's Harbour* case,[566] Congress could not have rationally meant to put the trustee to the Hobson's choice of either allowing plan assets to be used in an improper, imprudent investment or subjecting itself and the plan to a judgment for breach of an improper contract.

Having thus erroneously concluded that ERISA permitted the named fiduciary and the trustee to work at cross-purposes, thereby exposing the pension plan's assets to loss, the court could not explain how the trustee could be expected to fulfill its fiduciary duties in these circumstances: "Conversely, Northern not only had the authority, but also the duty to deny improper instructions. 29 U.S.C. § 1104. Failure to fulfill this duty would make Northern liable to Singer. 29 U.S.C. § 1109. In any case, Clear had the authority to bind Singer."[567]

The last sentence conveys a distinct judicial throwing-up-of-the-hands. All parties agreed in *Queen's Harbour* (unlike in *Maniace*) that Northern Trust was an ERISA "fiduciary" despite the named fiduciary's ability to direct investments.[568] However, the court was unable to reconcile the trustee's fiduciary duties with the court's holding that a named fiduciary could force the trust to make an imprudent investment over the trustee's

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§ 1102(c)(3) (1994)).

563. *Id.* at 5-6; *see* ERISA § 3(38), 29 U.S.C. § 1002(38) (1994).

564. *Queen's Harbour,* No. 92-254-CIV-J-10, slip op. at 5, (quoting 29 U.S.C. § 1103(a)(1) (1994)).

565. *Id.* at 6.

566. *See id.* at 4-7.

567. *Id.* at 6.

568. *See id.* at 2.

dissent.[569] Thus, the court downplayed the directed trustee's fiduciary status.

The court should have held that ERISA required Northern, the directed trustee, to do exactly what it did: to investigate the transaction further in light of the magnitude of the proposed investment and the suspicious circumstances in which it was proposed.[570] Surely when the trustee's appraisal of the property weighed in at less than one-third of the directed purchase price,[571] the trustee had a duty to disregard the named fiduciary's direction. ERISA clearly should have preempted the claims that the trust and trustee had "breached" and "tortiously interfered" with this contract.[572] Furthermore, if ERISA bars any remedy for the would-be seller, federal courts have nonetheless held that ERISA preempts the state-law claims of more deserving plaintiffs.[573]

VIII. SUGGESTIONS FOR IMPROVING FEDERAL COMMON LAW UNDER ERISA

ERISA itself, properly understood and with some reference to the common law, provides the means to accomplish correct results in these cases.

A. Fiduciary Status and Trustee's General Duties

The fact that a directed trustee is an ERISA fiduciary should not be controversial. Astonishingly, many courts have held to the contrary.[574] Every indication is that ERISA meant to retain the fiduciary status of a directed trustee "to the extent" it performs the normal functions of a trustee: exercising authority and control over the plan assets.[575]

A directed trustee remains a trustee, and as such, must be familiar with plan documents, safeguard the trust, and routinely monitor plan assets.[576] "A trustee has the power to perform . . . every act which a prudent [person] would perform for the purposes of the trust."[577] Upholding these general

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569. *See id.* at 6.

570. *Id.* at 4; Defendant's Memorandum, *supra* note 526, at 2.

571. Defendant's Memorandum, *supra* note 526, Exhibit 4, at 2.

572. *Queen's Harbour*, No. 92-254-CIV-J-10, slip op. at 4.

573. *E.g.*, Cannon v. Group Health Serv., Inc., 77 F.3d 1270, 1274 (10th Cir. 1996); Morstein v. National Ins. Serv., Inc., 74 F.3d 1135, 1138 n.3 (11th Cir. 1996); Carlo v. Reed Rolled Thread Die Co., 49 F.3d 790, 794 (1st Cir. 1995) ("ERISA preemption in these benefit misrepresentation suits often leaves plaintiffs remediless").

574. *See* cases cited *supra* note 267.

575. ERISA § 3(21)(A)(i), 29 U.S.C. § 1002(21)(A)(i) (1994).

576. *E.g.*, ERISA §§ 103(a)(1), (b)(3)(G), 29 U.S.C. §§ 1023(a)(1), (b)(3)(G) (1994); IRS Form 5500, Schedule C (1995); *Trust Advisers*, *supra* note 71, at 1233.

577. UNIF. TRUSTEES' POWERS ACT § 3(a), 7B U.L.A. 741, 746 (1985); *see also Central States*, 472 U.S. at 570-71 & n.11.

duties, the directed trustee will usually be in a position to determine whether the named fiduciary's directions (or lack thereof) violate the plan documents or ERISA. The extent of the directed trustee's duty to investigate those directions is discussed below.

B. The Duty To Investigate The Named Fiduciary's Directions

The notion that ignorance is no excuse if one "could have taken the trouble to ascertain the facts" dates back at least to Aristotle.[578] But this notion must be balanced against Learned Hand's admonition not to "make trusteeship so hazardous" or burdensome that good people will be unwilling to serve.[579]

Most pre-ERISA commentary supported the notion that a directed trustee had some duty to investigate the propriety of a direction by another fiduciary, without putting much flesh on the bones of the general rule.[580] Post-ERISA commentators have largely continued to assume that an ERISA trustee has some duty of inquiry.[581]

Although post-ERISA cases have not explicitly discussed the question in detail, the cases' results indicate an implicit rejection of a directed trustee's duty of inquiry.[582] But a flat rule that there is no duty of inquiry is untenable in light of section 403(a)(1)'s authorization only of "proper directions" that conform to ERISA and the plan.[583] Moreover, under ERISA's co-fiduciary liability rules, the directed trustee need not have actual knowledge of the named fiduciary's breach to be held liable. Under section 405(a)(2), the directed trustee will be liable under the co-fiduciary rules if

578. III v. 8-9 ARISTOTLE, THE NICOMACHEAN ETHICS 147 (H. Rackham trans., Harvard Univ. Press 1934) ("[M]en are punished for offences committed through ignorance of some provision of the law which they ought to have known, and might have known without difficulty; and so in other cases where ignorance is held to be due to negligence, on the ground that the offender need not have been ignorant, as he could have taken the trouble to ascertain the facts.").

579. Dabney v. Chase Nat'l Bank, 196 F.2d 668, 675 (2d Cir. 1952).

580. *See supra* notes 257-59 and accompanying text.

581. Lawrence K. Cagney, *Fiduciary Obligation of the Plan Trustee*, *reprinted in* DAN M. MCGILL, PROXY VOTING OF PENSION PLAN EQUITY SECURITIES 74, 81-82 (1989); Knickerbocker, *supra* note 99, at 546-48; Merrill, *supra* note 99, at 120 ("[T]he [directed] trustee must independently investigate every investment which the named fiduciary tells him to make, in order to determine whether the investment would be prudent . . . ."); Richard S. Wheeler, *Implications of Substituting Officers of Employee Benefit Plan Sponsor for Bank as Plan Trustee Under the Pension Reform Act*, 114 TR. & EST. 132, 191 (1975) ("These co-fiduciary responsibility rules clearly imply that each plan fiduciary has an affirmative and continuing duty to inquire as to the manner in which each of his co-fiduciaries is discharging his particular responsibility."). *But see 404(c) Regulations*, *supra* note 121, at 18-19.

582. *See* cases cited *supra* note 378.

583. ERISA § 403(a)(1), 29 U.S.C. § 1103(a)(1) (1994).

it breaches its own fiduciary duties, thereby enabling the named fiduciary to breach hers.[584] Thus, if the directed trustee knows some fact into which "prudence" and "diligence" dictate a further inquiry that never occurs, the directed trustee can be held liable.

In addition, it is perhaps helpful to place the possibilities along a spectrum under pre-ERISA law, roughly running from what is required of a non-directed trustee with full investment powers, to what is required of a non-fiduciary dealing with a known fiduciary:

Person Receiving Direction	Person Giving Direction	Duty of Inquiry
Trustee with full investment powers (fiduciary)	[None]	Full investigation and continued monitoring
Directed trustee (fiduciary)	Fiduciary	Direction must comply with trust terms and not violate the director's fiduciary duties
Directed trustee (fiduciary)	Non-fiduciary	Direction must comply with trust terms
Depository/ custodian (non-fiduciary)	Fiduciary	None, but will be liable if actual knowledge or bad faith

At one end of the spectrum, a trustee with full investment powers necessarily has the duty (in order to fulfill her general fiduciary duties)[585] to investigate potential investments,[586] to monitor existing investments,[587] and to obtain necessary information about taking other actions on behalf of the trust.[588] At the other end of the spectrum, a non-fiduciary depository

584. ERISA § 405(a)(2), 29 U.S.C. § 1105(a)(2) (1994).

585. *E.g.*, RESTATEMENT (THIRD) OF TRUSTS §§ 170 (Duty of Loyalty), 183 (Duty to Deal Impartially with Beneficiaries), 227 (General Standard of Prudent Investment) (1992); *see* ERISA §§ 404(a), 406, 29 U.S.C. §§ 1104(a), 1106 (1994).

586. *See generally* 29 C.F.R. § 2550.404a-1 (1995) (investment duties under ERISA).

587. RESTATEMENT (THIRD) OF TRUSTS § 227 cmt. d (1992); *see* Buccino v. Continental Assurance Co., 578 F. Supp. 1518, 1521 (S.D.N.Y. 1983) ("Under the 'prudent investor' rule, a fiduciary has the duty 'from time to time to examine the state of the investments to see whether any of them have become such that it is no longer proper to retain them.'") (citing III SCOTT ON TRUSTS § 231 (3d ed. 1967)); *see also* Morrissey v. Curran, 567 F.2d 546, 549 n.9 (2d Cir. 1977) ("The trustee's obligation to dispose of improper investments within a reasonable time is well established at common law.") (citing III SCOTT ON TRUSTS § 209 (3d ed. 1967)).

588. For example, the trustee "'must keep informed of the bundle of rights and

bank may transfer trust assets to a known fiduciary so long as the bank makes the transfer in "good faith," usually defined as the absence of actual knowledge of the fiduciary's breach.[589] However, a non-fiduciary dealing with a fiduciary has no independent obligation to investigate the fiduciary's actions, even in suspicious circumstances.[590]

While a non-fiduciary depository bank has no duty to inquire into a fiduciary's use of trust funds,[591] the ERISA directed trustee bears a fiduciary duty toward the participants and beneficiaries and is in a much better position than they are to monitor the named fiduciary's directions.[592] If there was no duty to inquire, the trustee would have an incentive to remain ignorant.

There may be business pressures on directed trustees not to pry unnecessarily into the named fiduciary's instructions.[593] But as a co-fiduciary, a named fiduciary has a duty to inform the directed trustee of pertinent circumstances[594] and, therefore, is obligated to answer questions. The protective, even paternalistic, policy of ERISA demands a duty of inquiry in the presence of facts triggering cause for concern.

Relying on that premise, there must be some duty of inquiry to carry out section 403(a)(1)'s commands.[595] The only open question is how thorough the inquiry must be. Generally, it is the fiduciary's investigation, not

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[opportunities] associated with [the trust's] investments." RESTATEMENT (THIRD) OF TRUSTS § 227 cmt. d (1992) (quoting Sommer et al., *Corporate Social Responsibility Panel: The Role of the SEC*, 28 BUS. LAW. 215, 219 (Mar. 1973)). This would include the ability to vote proxies for shares of stock the trust owns. *See* RESTATEMENT (SECOND) OF TRUSTS § 193 (1959). The trustee in many circumstances also has a duty to seek out expert advice as to particular courses of action. *E.g.*, RESTATEMENT (THIRD) OF TRUSTS § 227 cmt. d & illus. 10 (1992).

589. *See, e.g.*, Guild v. First Nat'l Bank, 553 P.2d 955, 958 (Nev. 1976); Davis v. Pennsylvania Co. For Ins. on Lives & Granting Annuities, 12 A.2d 66, 69 (Pa. 1940); UNIFORM FIDUCIARIES ACT, §§ 1, 2, 5, 7, 9, 7A U.L.A. 395 (1985) (adopted in 25 states and the District of Columbia).

590. Hosselton v. K's Merchandise Mart, Inc., 617 N.E.2d 797, 799 (Ill. App. Ct. 1993); Johnson v. Citizens Nat'l Bank, 334 N.E.2d 295, 300 (Ill. App. Ct. 1975); Zelikofsky v. Prewett, 507 N.Y.S.2d 518, 519 (N.Y. App. Div. 1986).

591. *See* cases cited *supra* note 590.

592. *See supra* part VIII.A.

593. As the legislative history pointed out, "[fiduciary-commercial] relationships tend to subordinate the strict professionalism . . . to business pressures." S. REP. NO. 127, 93d Cong., 1st Sess. 32 (1973), *reprinted in* I LEGIS. HIST., *supra* note 20, at 618. There is evidence that sponsors change trustees when thwarted by refusals to comply with directions. *See, e.g.*, Sandoval v. Simmons, 622 F. Supp. 1174, 1204 (C.D. Ill. 1985) (sponsor fired directed trustee after the latter raised ERISA concerns about a direction).

594. *See, e.g.*, Wilmington Trust Co. v. Coulter, 200 A.2d 441, 451 (Del. 1964).

595. *See* ERISA § 403(a)(1), 29 U.S.C. § 1103(a)(1) (1994).

the merits of the investment, that will be evaluted in a prudence case.[596] The same standard should be applied to directed trustees.[597]

Like most questions involving fiduciary standards, this one must necessarily be answered case by case.[598] In particular, a directed trustee that is subject to a conflict of interest—for example, an officer or a subsidiary of the plan sponsor[599]—should be held to a heightened standard of when it has "reason to suspect" or "know" of a breach by the named fiduciary.

1. "Bright-Line" Rules

As described earlier,[600] the legislative history of section 403(a)(1) is less than illuminating on the question of duty of inquiry.[601] The Conference Report suggested that a directed trustee could follow the named fiduciary's "directions unless it is clear on their face" that the directions would violate the plan or ERISA.[602] This suggestion has prompted one commentator to argue that the legislative history cannot "be reconciled with a general duty [on the directed trustee's part] to investigate," at least in the case of "facially valid directives."[603] However, the language of section 403(a)(1), requiring "proper" directions consistent with ERISA and the plan,[604] belies the more lenient-sounding legislative history.[605]

The "clear on its face" language suggests that the Conference Committee reasonably viewed some fiduciary duties as more black-and-white than others. The directed trustee should have the duty to investigate each direction to ascertain compliance with certain "bright-line" rules. Because these rules, by definition, can usually be applied mechanically, this duty is not overly burdensome to the trustee. As a result, the trustee should be held liable for following any direction that, with this kind of minimal investigation, would have revealed the violation of a "bright-line" rule.

596. *E.g.*, Lanka v. O'Higgins, 810 F. Supp. 379, 387 (N.D.N.Y. 1992); Fisher v. MacKenzie, No. C-84-868-JLQ, slip op. (E.D. Wash. Oct. 8, 1985) (LEXIS, Genfed library, Dist file).

597. *Fisher*, No. C-84-868-JLQ, slip op., applied the same standard to a directed trustee without discussion.

598. Knickerbocker, *supra* note 99, at 658-59 (quoting Liebig, *The Deprivation of Employee Benefit and Labor Law*, 49 LAW & CONTEMP. PROBS. 183, 189 (1986)).

599. *E.g.*, *Fisher*, No. C-84-868-JLQ, slip op. (officer); *Bradshaw*, 5 Employee Benefits Cas. (BNA) 2754 (subsidiary).

600. *See supra* part IV.B.4.

601. *Id.*

602. H.R. CONF. REP. NO. 1280, 93d Cong., 2d Sess. 298 (1974).

603. *404(c) Regulations*, *supra* note 121, at 18-19.

604. ERISA § 403(a)(1), 29 U.S.C. § 1103(a)(1) (1994).

605. Rizzo & Carey, *supra* note 123, at 18; COMM. ON FIDUCIARY RESPONSIBILITY, *supra* note 15, at 546; *Special Problems of Banks*, *supra* note 15, at 250.

Compliance with plan terms. For example, the fiduciary duty to ensure that the direction not be followed unless it conforms to the plan terms[606] can normally be satisfied by an inquiry circumscribed by the four corners of the plan and trust documents. The duty to comply with plan terms was imposed on the directed trustee under the common law even if the person with the power of direction was not a fiduciary.[607] Thus, the court's exoneration of the *Omni Funding*[608] directed trustee, which approved loans exceeding express numerical limits or lacking specified forms of security, failed even this most elementary principle.

Prohibited transactions. In addition, many of the prohibited transaction rules are "bright-line" tests.[609] Under section 406, the plan may not sell, buy, lend, lease, or transfer property to or from a "party in interest."[610] "Parties in interest" are specifically defined individuals with an important relationship to the plan or the sponsoring employer, such as the plan administrator, the employer's officers and directors, and the employer's major stockholders.[611] While applying this definition may present interpretive difficulties at the margin,[612] compiling and periodically updating a list of most of the defined "parties in interest" should not be unduly onerous, especially since the task is aided by reference to the plan's required annual report.[613] The parties to the proposed transaction can then be compared to the list.[614]

A fiduciary is liable if he "knows or should know" that the transaction violates section 406.[615] Congress interpreted "should know" in this context to require prudence, and tied the required thoroughness of the fiduciary's investigation to the size and importance of the proposed transaction:

> [A] fiduciary will be liable for losses to a plan from a prohibited transaction in which he engaged if he would have known the transaction involving the particular party-in-interest was prohibited if he had acted as a prudent man. The type of investigation that will be needed to satisfy the

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606. ERISA §§ 403(a)(1), 404(a)(1)(D), 29 U.S.C. §§ 1103(a)(1), 1104(a)(1)(D) (1994).

607. *See supra* note 249 and accompanying text.

608. *See* discussion *supra* notes 304-18 and accompanying text.

609. ERISA § 406(a), 29 U.S.C. § 1106(a) (1994).

610. ERISA § 406(a)(1), 29 U.S.C. § 1106(a)(1) (1994).

611. ERISA § 3(14), 29 U.S.C. § 1002(14) (1994).

612. *See* Knickerbocker, *supra* note 99, at 650 ("The class of persons designated as parties in interest with respect to any plan is so vast as to make their identification, and the avoidance of dealings with them, a formidable task.").

613. *See* ERISA § 103(a), 29 U.S.C. § 1023(a) (1994).

614. A. Richard Susko, *Investment Checklist Under ERISA, reprinted in* PIANKO & SUSKO, *supra* note 50, at 29-36 (identifying five steps fiduciary should follow in ascertaining that a proposed investment does not violate the prohibited transaction rules).

615. ERISA § 406, 29 U.S.C. § 1106 (1994).

> test of prudence will depend upon the particular facts and circumstances of the case. In the case of a significant transaction, generally for a fiduciary to be prudent he must make a thorough investigation of the other party's relationship to the plan to determine if he is a party-in-interest. In the case of a normal and insubstantial day-to-day transaction, it may be sufficient to check the identity of the other party against a roster of parties-in-interest that is periodically updated.[616]

Even the latter illustration envisions some duty of inquiry rather than blind obedience to a direction. Recently, the DOL has indicated a willingness to enforce this view by bringing suit against Bank of America for following a direction that it should have known was prohibited.[617]

Diversification. While not crisply defined, the diversification rule[618] should trigger a directed trustee investigation at some clear point; for instance when a proposed investment that would constitute 10% of trust assets.[619] One commentator, who reads the legislative history to excuse directed trustees from any duty of inquiry in the case of "facially valid directives," gives a hypothetical example of a facially invalid direction: "Suppose a plan required all assets to be invested in the stock of an unrelated company. This investment may be consistent with the terms of the plan, but it obviously violates ERISA's diversification rules. Therefore, the trustee must disregard the investment instruction."[620]

This hypothetical fails to provide guidance for more common situations and could prevent a profitable investment that a court might uphold.[621] This approach flatly concludes that at some level, the instruction to make a highly-concentrated investment should not be followed. The better approach to a diversification issue—where the standards are loosely defined, rather than carved in stone—would require investment directions of a certain

616. H.R. CONF. REP. NO. 1280, 93d Cong., 2d Sess. 307 (1974); *see also* Kroll & Tauber, *supra* note 24, at 671.

617. *See supra* notes 432-35 and accompanying text.

618. ERISA § 404(a)(1)(C), 29 U.S.C. § 1104(a)(1)(C) (1994).

619. Neither the DOL nor courts have set a percentage of plan value that will violate the diversification rule if invested in one asset. Lanka v. O'Higgins, 810 F. Supp. 379, 386 (N.D.N.Y. 1992). *See* H.R. CONF. REP. NO. 1280, 93d Cong., 2d Sess. 304-06 (1974); Materials Explaining H.R. 12906 Together With Supplemental Views (To Accompany H.R. 2), *reprinted in* II LEGIS. HIST. *supra* note 7, at 1310 ("To apply these principles in a particular case is ultimately a judicial function.").

620. *404(c) Regulations, supra* note 121, at 19.

621. For example, in Etter v. J. Pease Constr. Co., 963 F.2d 1005, 1010-11 (7th Cir. 1992), the court upheld, against a lack-of-diversification challenge, trustees' investment of $112,000 of $128,000 in total plan assets in a profitable real estate venture partly owned by the company president and another plan trustee, on the grounds that many plans under $200,000 were not diversified and that the trustees had carefully researched the venture. *See also Lanka*, 810 F. Supp. at 390 (holding that an investment of plan assets in three stocks is not a breach of duty to diversify).

magnitude to trigger a duty of further investigation, which may still result in a conclusion that the investments should proceed.[622]

Other "bright-line" rules. Section 407 imposes a 10% limitation on plan investment in the employer's stock (excepting ESOPs and similar plans) and employer-owned real estate.[623] Whenever the named fiduciary directs a plan investment in employer stock or real estate, the trustee should, at minimum, ascertain that the investment would not violate section 407.

Further, the trust must maintain the indicia of ownership of plan assets in the United States.[624] The plan trustee is responsible for complying with this requirement, and as one commentator has stated, "even a directed trustee should not permit plan assets to be held in violation of the regulations."[625]

2. Investigating a Plan's Investment in Employer Stock

The duty of investigation also may vary with the plan type and the investments the plan contemplates. Where the plan is an ESOP or similar plan, the primary investment will be the sponsoring employer's stock.[626] There are two principal investment directions the directed trustee of such a plan can receive: first, a direction to purchase (or a lack of direction to sell) employer stock, and second, directions on voting the proxies.

Given the likelihood that such directions will be received, an ESOP directed trustee should remain conversant enough with the employer's financial condition to be able to make an informed judgment about whether the stock is and remains a good investment.[627] Certainly, annual review of the company's financial statements does not seem particularly onerous.[628] However, the courts have

622. Moreover, the plaintiff bears the initial burden of demonstrating a failure to diversify. The burden then shifts to the defendant "to demonstrate that [the] failure to diversify was prudent." *Lanka*, 810 F. Supp. at 386; H.R. REP. NO.1280, 93d Cong., 2d Sess. 304 (1974).

623. ERISA § 407(a), 29 U.S.C. § 1107(a) (1994).

624. ERISA § 404(b), 29 U.S.C. § 1104(b) (1994); 29 C.F.R. § 2550.404b-1 (1995).

625. John W. Valentine, *Foreign Assets As Viewed By An ERISA Fiduciary, reprinted in* PENSION PLAN INVESTMENTS 325, 334 (P.L.I. 1995), *available in* Westlaw, 366 PLI/Tax 325.

626. ERISA § 407(d)(6)(A), 29 U.S.C. § 1107(d)(6)(A) (1994).

627. While fiduciaries making such investments are relieved from the prohibited transaction and diversification rules, they are still subject to the prudence (except to the extent prudence requires diversification) and exclusive benefit rules. ERISA § 404(a)(2), 29 U.S.C. § 1104(a)(2) (1994). For example, the DOL filed a complaint against a directed trustee bank "that followed investment committee directions to invest in company stock when the bank knew of the company's financial difficulties." BARBARA J. COLEMAN, PRIMER ON ERISA 92 (4th ed. 1993) (citing Donovan v. Ashplant, No. 83 Civ. 1455 (S.D.N.Y. July 30, 1984)).

628. *See* Moench v. Robertson, 62 F.3d 553, 556 (3d Cir. 1995), *cert. denied*, 116 S. Ct. 917 (1996) (holding that "in limited circumstances, ESOP fiduciaries can be liable under ERISA for continuing to invest in employer stock according to the plan's direction"). In *Moench*, the Third Circuit vacated the district court's grant of summary judgment to the

been inexplicably uneasy imposing such a duty on ESOP directed trustees, even trustees with a conflict of interest.[629]

Thus, the directed trustee in *Ershick v. United Missouri Bank*[630] should have known enough to inquire further into the wisdom of purchasing more company stock for the ESOP.[631] Through its knowledge of the company's financial commitments, its review of the company's financial statements, and its own reduction of the company's credit limit, the directed trustee should have known the company was in financial straits.[632] Moreover, it knew the ESOP was the majority shareholder,[633] and it should have known that voting the shares was a fiduciary act. Yet without any inquiry at all into the quality of current management or indeed into whether an alternate management slate was presented, it gave the ESOP's proxies to the named fiduciary, who was the current president.[634]

One of the ironies of the ESOP concept is that while theoretically installed to grant more employee control of the company, ESOPs have in fact been used more as a tool of corporate finance,[635] and in particular, corporate takeover warfare. The employees' investment in an ESOP remains passive—they have little control in fact[636]—while the employer receives significant tax advantages. To afford these employees the protection Congress intended, courts should examine the actions of ESOP directed trustees, particularly if they have a conflict of interest,[637] more carefully.

ESOP Committee, composed of company officers, which had continued to invest "the ESOP fund in [company] common stock, despite the continual and precipitous drop in its price and despite the Committee's knowledge of Statewide's precarious condition by virtue of the members' status as [company] directors." *Id.* at 558. The opinion is unclear, but it appears that the Committee may have directed a trustee that the plaintiff chose not to sue. *Id.* at 559. The trustee apparently decided unilaterally at some point to "cease investing in [company] stock and to place all of the ESOP assets in money market accounts." *Id.*

629. For example, the *Bradshaw* directed trustee, which was also the plan sponsor, should have known that its own management policies were tending to inflate the price of the stock the plan purchased. *Bradshaw*, 5 Employee Benefits Cas. (BNA) at 2757. Yet the complaint against the directed trustee was dismissed with little discussion. *See* discussion *supra* notes 279-92 and accompanying text.

630. *Ershick*, 12 Employee Benefits Cas. (BNA) 2323.

631. *See* discussion *supra* notes 421-26 and accompanying text.

632. *Ershick*, 12 Employee Benefits Cas. (BNA) at 2325.

633. *Id.* at 2324.

634. *Id.* at 2326.

635. Fischel & Langbein, *supra* note 66, at 1155-57.

636. Gregory S. Alexander, *Pensions and Passivity*, 56 LAW & CONTEMP. PROBS. 111, 128-29 (1993).

637. When a fiduciary has a conflict of interest, as ESOP fiduciaries who are officers of the company nearly always do, the ESOP fiduciary must "make a careful and impartial investigation of all investment decisions." *Moench*, 62 F.3d at 572 (citations omitted).

3. Duties of Exclusive Benefit and Prudence

What about the more general fiduciary duties of prudence and exclusive benefit, where no bright-line rules are triggered? In such a case, the directed trustee should not be required to further investigate a direction absent apparently suspicious circumstances.

Queen's Harbour[638] illustrates a situation where the directed trustee, Northern, knew enough disturbing facts to trigger a duty of further inquiry.[639] At the time of the named fiduciary's direction to wire $44 million of trust assets for a planned land purchase, Northern knew the sponsor's president was facing imminent incarceration for securities fraud.[640] It knew the sponsor's management was losing a corporate control battle in the Delaware courts.[641] It knew the "named fiduciary" was new and was tied to management.[642] It knew that a $44 million investment by a pension plan in raw land in the early 1990s was highly unusual.[643] It knew the directed investment represented a significant percentage (6%) of total trust assets.[644] What it did not know was any of the details of the proposed transaction, including the relationship between the putative sellers and the company (which might constitute a prohibited transaction).[645]

Thus, in the one case where the directed trustee was actually aware of enough problems to investigate and then refused to follow the direction, the trustee was rewarded for its efforts by a court upholding the putative seller's suit against the trustee for tortious interference.[646] If even these facts were not enough to spur a court to recognize a directed trustee's duty of inquiry, then the trust requirement provides no protection to participants and beneficiaries.

C. Protection for the Directed Trustee

Despite the directed trustee's fiduciary status, there are several protections available to counterbalance the directed trustee's obligations.

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638. No. 92-254-CIV-J-10, slip op.

639. *See* discussion *supra* notes 526-33 and accompanying text.

640. *See Bilzerian*, 926 F.2d at 1289, 1302.

641. *See Bicoastal*, 600 A.2d at 347-48.

642. *Queen's Harbour*, No. 92-254-CIV-J-10, slip op. at 3.

643. *See* Defendant's Memorandum, *supra* note 526, at 2.

644. The trust's total assets were worth about $720 million, *In re* Bicoastal Corp., 149 B.R. at 217, while the directed purchase was for approximately $44 million.

645. Defendant's Memorandum, *supra* note 526, at 1.

646. *Queen's Harbour*, No. 92-254-CIV-J-10, slip op. at 7 (denying defendant's motion for summary judgment).

Fees. The directed trustee is not, in the memorable words of Judge Easterbrook in a different context, an "eleemosynary institution."[647] If the directed trustee is an institution independent of the sponsor, it will negotiate a fee for its services that is calculated to compensate it for the time expended and the risk involved.[648] (Of course, the time to negotiate a higher fee is not after a questionable direction has been received.) The trust agreement should expressly authorize the reimbursement of any additional expenses the trustee may incur (such as appraisals or opinions of counsel) if further investigation of a direction is warranted.[649]

Indemnity and insurance. Plans may purchase liability insurance for directed trustees, which the trustees may require in their trust agreements.[650] A trust agreement may provide for indemnity of the directed trustee by the employer,[651] which will likely be upheld in the absence of willful misconduct, bad faith, or negligence.[652]

Standard of review. A full examination of the proper standard of review for alleged breaches of fiduciary duty under ERISA is beyond the scope of this article.[653] However, many cases have applied a highly deferential "arbitrary and capricious" or "abuse of discretion" standard.[654] Although

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647. Kham & Nate's Shoes No. 2, Inc. v. First Bank, 908 F.2d 1351, 1358 (7th Cir. 1990). Used here, eleemosynary means "[r]elating or devoted to charity; given in charity; having the nature of alms." BLACK'S LAW DICTIONARY 520 (6th ed. 1990).

648. Even with the fee of the directed trustee, one company saved $350,000 when it changed from an investment manager to in-house direction by a named fiduciary of a directed trustee. *Sandoval*, 622 F. Supp. at 1187.

649. *E.g.*, CANAN, *supra* note 46, at 1323 ("All other administrative expenses incurred by the Trustee in the performance of its duties, including such compensation to the Trustee as may be agreed upon from time to time between the Employer and the Trustee . . . and all proper charges and disbursements of the Trustee . . . shall be paid by the Employer, but until paid shall constitute a charge upon the Trust Fund.").

650. ERISA § 410(b), 29 U.S.C. § 1110(b) (1994). However, the policy must permit recourse against the trustee by the carrier. *Id.*; H. Aleta M. Spence, *Insulating a Plan Fiduciary From Liability For Breaches of Fiduciary Duty*, *reprinted in* PENSION PLAN INVESTMENTS 1993: CONFRONTING TODAY'S LEGAL ISSUES 95, 114 (P.L.I. 1993).

651. 29 C.F.R. § 2509.75-4 (1995).

652. *Wells Fargo*, 860 F. Supp. at 714 (enforcing indemnity agreement under federal common law of ERISA); *see* Martin v. NationsBank, 16 Employee Benefits Cas. (BNA) 2138, 2140-41 (N.D. Ga. Apr. 6, 1993); Kroll & Tauber, *supra* note 24, at 667. For an example of a provision indemnifying a trustee for acts of an investment manager, see Heald & Mulhern, *supra* note 106, at 637 n.81.

653. *See generally* LANGBEIN & WOLK, *supra* note 69, at 786-88 (discussing standard of judicial review for benefit denials); Bradley R. Duncan, Note, *Judicial Review of Fiduciary Claim Denials Under ERISA: An Alternative to the Arbitrary and Capricious Test*, 71 CORNELL L. REV. 986 (1986) (addressing "the regulation of fiduciary behavior"); John A. McCreary, Jr., Comment, *The Arbitrary and Capricious Standard Under ERISA: Its Origins and Application*, 23 DUQ. L. REV. 1033 (1985).

654. *E.g.*, *Moench*, 62 F.3d at 571; *Ershick*, 948 F.2d at 666; Fentron Indus. v.

controversial, there is at least a colorable argument that this deferential standard should be applied to an ERISA directed trustee's decision to follow the named fiduciary's direction. The directed trustee exercises discretion in making this decision.[655] Thus, the trustee's actions may be judged under the "deferential standard" normally applicable "when a trustee exercises discretionary powers."[656] Instead, a more exacting standard of review should be applied when the trustee is subject to a conflict of interest.[657]

IX. CONCLUSION

Most institutional trustees already hold themselves to the standards advocated in this article.[658] The price of this compliance must not be too high, because directed trusts are common. When courts water down ERISA's standards (or fail to apply them at all) they provide a potential windfall to careless trustees (and those who improperly deal with them).

Upholding these standards will not wreak havoc on most trustees, but will serve ERISA's purpose of protecting trust assets for participants and beneficiaries. Only by making sure that a trustee really acts like one will the courts fulfill Congress' intent to safeguard "other people's" employee benefit funds.

National Shopmen Pension Fund, 674 F.2d 1300, 1307 (9th Cir. 1982); Kuper v. Quantum Chem. Corp., 852 F. Supp. 1389, 1397 (S.D. Ohio 1994), *aff'd sub nom.* Kuper v. Iovenko, 66 F.3d 1447 (6th Cir. 1995); *Bradshaw*, 5 Employee Benefits Cas. (BNA) at 2761. *But see* Davidson v. Cook, 567 F. Supp. 225, 239 (E.D. Va. 1983) (holding "arbitrary and capricious" standard only applies to benefits determinations), *aff'd*, 734 F.2d 10 (4th Cir.), *cert. denied sub nom.* Zahn v. Davidson, 469 U.S. 899 (1984).

655. *See* discussion *supra* notes 269-72 and accompanying text.

656. Firestone Tire & Rubber Co. v. Bruch, 489 U.S. 101, 111, 115 (1989); *see* Varity Corp. v. Howe, 116 S. Ct. 1065, 1079 (1996) ("[C]haracterizing a denial of benefits as a breach of fiduciary duty does not necessarily change the [deferential] standard a court would apply when reviewing the administrator's decision to deny benefits."); RESTATEMENT (SECOND) OF TRUSTS § 187 (1959) ("Where discretion is conferred upon the trustee with respect to the exercise of a power, its exercise is not subject to control by the court, except to prevent an abuse by the trustee of his discretion."); Langbein, *supra* note 270, at 219.

657. *See, e.g.*, *Firestone*, 489 U.S. at 115; Van Boxel v. Journal Co. Employees' Pension Trust, 836 F.2d 1048, 1052-53 (7th Cir. 1987); LANGBEIN & WOLK, *supra* note 69, at 799-803.

658. *E.g.*, *Moench*, 62 F.3d at 559 (apparent directed trustee finally refused to invest further ESOP funds in employer stock); Pension Benefit Guar. Corp. v. Ross, 733 F. Supp. 1005, 1006 (M.D.N.C. 1990) (directed trustee discovered plan assets were diverted for prohibited transactions and notified parties, which stopped further, similar transactions); *Sandoval*, 622 F. Supp. at 1194, 1203 (directed trustee warned that investment committee's decision not to tender pension plan's stock to interested tender offeror might violate ERISA; then subsequently informed DOL); *Queen's Harbour*, No. 92-254-CIV-J-10, slip op. at 4 (directed trustee refused to fund named fiduciary's proposed $40 million investment in undeveloped land).