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The Law of Directed Trustees Under ERISA: A Proposed Blueprint for the Federal Courts

Colleen E. Medill

The dynamic asset growth necessary to meet its responsibilities has placed the private pension system in a position to influence the level of savings, the operation of our capital markets, and the relative financial security of millions of consumers, three of the fundamental elements of our national economic security.¹

Congress enacted the Employee Retirement Income Security Act ("ERISA"),² the federal law governing private employer-sponsored employee benefit plans,³ over twenty years ago. Since that time, private retirement plan funds have become an even more dominant element of United States savings and capital markets. In 1992, the most recent year for which data is available,

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1. Statement of the House of Representatives Committee on Education and Labor regarding the need for the Employee Retirement Income Security Act of 1974. H.R. REP. NO. 93-533 (1973), *reprinted in* 1974 U.S.C.C.A.N. 4639, 4640.

2. Employee Retirement Income Security Act of 1974, Pub. L. No. 93-406, 88 Stat. 829 (1974) (codified as amended at various sections of Titles 26 and 29 of the United States Code [hereinafter "ERISA"]). ERISA's original section numbers were changed when it was codified in Title 29 of the United States Code, which contains the federal labor provisions. Additionally, portions of ERISA were codified in the Internal Revenue Code, Title 26 of the United States Code. References to ERISA in this article will be to the 1994 edition of Title 29 and, where applicable, to the Internal Revenue Code of 1986, as amended.

3. Employee benefit plans subject to ERISA include both welfare benefit plans and pension benefit plans. *See* 29 U.S.C. § 1002(3) (1994). Welfare benefit plans provide medical, sickness, disability, death, unemployment, or vacation benefits, training programs, day care centers, scholarship funds, or prepaid legal expenses. *See* 29 U.S.C. § 1002(1) (1994). Some types of welfare benefit plans, most notably those providing medical benefits through a trust pursuant to section 501(c)(9) of the Internal Revenue Code, hold plan assets in a trust. Pension benefit plans provide retirement income to employees or result in a deferral of income by employees until the termination of employment or beyond. *See* 29 U.S.C. § 1002(2)(A) (1994). Types of pension benefit plans for for-profit private employers include defined benefit plans, profit sharing plans, cash or deferral arrangements (commonly known as "401(k)" plans), money purchase pension plans, employee stock ownership plans, and executive deferred compensation plans. ERISA requires that all pension benefit plans must hold plan assets in a trust. *See* 29 U.S.C. § 1103(a) (1994).

private retirement plan assets exceeded two trillion dollars, almost a ten-fold increase over 1975 asset levels.⁴

This enormous wealth of plan assets is generally required by ERISA to be held in trust by one or more trustees.⁵ Under ERISA there are two types of trustees. "Discretionary" trustees have exclusive discretionary authority to manage and control plan assets.⁶ "Directed" trustees manage and control plan assets subject to the directions of another fiduciary named in the document governing the plan.⁷ Such directed trustees typically are the employer sponsoring the plan or unrelated entities offering trustee services, such as banks, trust companies, or affiliates of mutual fund companies or stock brokerage companies.

One of the major issues Congress designed ERISA to address was fiduciary responsibility for plan assets, particularly "the course of conduct in fund transactions, the degree of responsibility required of the fiduciaries, the types of persons who should be deemed pension 'fiduciaries,' and the standards of accountability they shall be governed by in the management and disposition of pension funds."⁸ Unfortunately, achievement of these goals has been clouded by recent federal court decisions regarding directed trustees. By appearing to incorporate into ERISA principles developed under the common law of trusts, these decisions may have the unintended effect of undermining ERISA's carefully constructed statutory scheme of fiduciary responsibilities and its protections for plan participants.⁹

This article analyzes the law of directed trustees under ERISA, a subject that has received very little attention in scholarly literature.¹⁰ Part I of the

4. See PENSION AND WELFARE BENEFITS ADMINISTRATION, U.S. DEPT. OF LABOR, NO. 5 PRIVATE PENSION PLAN BULLETIN, ABSTRACT OF 1992 FORM 5500 ANNUAL REPORTS, Table E11 (Winter 1996). In 1975, total private pension plan assets were \$259,963,000,000. By 1992, total private pension plan assets were \$2,094,087,000,000. These figures do not include funds held by life insurance companies under insurance contracts for the payment of retirement benefits, which would add an additional ten to fifteen percent to the above figures. *See id.*

5. See 29 U.S.C. § 1103(a) (1994).

6. 29 U.S.C. § 1103(a) (1994).

7. See 29 U.S.C. § 1103(a)(1) (1994).

8. H. REP. NO. 93-533 (1973), reprinted in 1974 U.S.C.C.A.N. 4639, 4645.

9. See discussion *infra* Parts II.B and III.

10. The only comprehensive article to date on the law of directed trustees was published in 1977. See *Directed Trusts Under ERISA*, 12 REAL PROP. PROB. & TR. J. 535 (1977) [hereinafter *Directed Trusts*]. More recent articles have discussed the topic of directed trustees in the context of pass-through tender offers to plan participants, see Ronald S. Rizzo & James F. Carey, *Reich v. NationsBank of Georgia, N.A.*, 4 ERISA Lit. Rep. No. 4, 14-21 (1996); William P. Wade, *Employee Benefit Plans In Control Contests: An Analysis of Participant 'Pass Through' Arrangements*,

article is an introductory primer to the sections of ERISA which are most relevant to judicial decisions concerning directed trustees. Part II reviews the major federal court decisions addressing the duties of directed trustees under ERISA. This review of the case law indicates that early federal court decisions established fundamental principles concerning the fiduciary responsibilities of directed trustees that were consistent with the statutory language and the goals of ERISA. Two relatively recent judicial opinions, *FirsTier Bank v. Zeller*¹¹ and *Maniace v. Commerce Bank*,¹² are examined and criticized as contrary to ERISA's statutory scheme, legislative history and the purposes underlying the statute. Part III of the article analyzes and attempts to answer the key issues raised by *FirsTier Bank* and *Maniace* in two contexts: (1) when the person directing the trustee is a plan participant; and (2) when the person directing the trustee is a non-participant plan fiduciary. Part IV of the article proposes a general model of the fiduciary responsibilities of a directed trustee under ERISA when acting at the direction of a non-participant plan fiduciary. The model develops an internally consistent theory of the relationships between the multiple statutory sections of ERISA governing the conduct of directed trustees. The model is designed to assist the federal courts and practitioners in analyzing the fiduciary responsibilities of directed trustees under ERISA in a manner that is consistent with the statutory language of ERISA, its carefully crafted allocation of fiduciary responsibilities, and its purpose of protecting plan participants.

I. INTRODUCTORY PRIMER TO ERISA

Federal courts addressing the fiduciary responsibilities of directed trustees of employee benefit plans typically look to three sections of ERISA.¹³ These

17 Pen. & Ben. Rep. (BNA) 1290 (1990), and plans operating under ERISA § 404(c), see *Now That The 404(c) Regulations Are Final, Who Cares?*, 1 ERISA Lit. Rep. No. 11, 15 (1992).

11. 16 F.3d 907 (8th Cir. 1994).

12. 40 F.3d 264 (8th Cir. 1994).

13. With certain limited exceptions, ERISA preempts all state laws that "relate to" employee benefit plans covered by ERISA. See 29 U.S.C. § 1144(a) (1994). The scope of ERISA preemption in the past has been broadly construed by the Supreme Court. See *Shaw v. Delta Airlines*, 463 U.S. 85, 97 (1983) (A State law "relates to" an ERISA plan if it has a connection with or reference to such a plan.); *Ingersoll-Rand Co. v. McClendon*, 498 U.S. 133, 139 (1990) (A State law may "relate to" an ERISA plan, and thereby be preempted, even if the law is not specifically designed to affect such plans, or the effect is only indirect.). Recently, the Supreme Court has indicated a willingness to limit the scope of ERISA preemption and uphold state laws producing only an "indirect economic effect" on ERISA plans. See *New York State Conference of Blue Cross and Blue Shield Plans v. Travelers Ins. Co.*, 115 S. Ct. 1671, 1680,

sections are: (1) section 3(21)(A),¹⁴ the definition of a "fiduciary"; (2) section 403(a)(1),¹⁵ which describes the role of a directed trustee; and (3) section 404(a)(1),¹⁶ which defines general fiduciary duties under ERISA. Not usually discussed by the courts, but of equal importance, is section 405(a),¹⁷ which describes the liability of a fiduciary for a breach of duty by a co-fiduciary, and section 409(a),¹⁸ pursuant to which a fiduciary is personally liable for breaches of fiduciary duty. Finally, because ERISA's civil enforcement scheme is a critical component of the statute, section 502(a),¹⁹ which prescribes the types of civil actions available under ERISA, is briefly described.

A. Section 3(21)(A): Definition of a Fiduciary

The starting point for determining the duties of a directed trustee is the definition of a "fiduciary" contained in ERISA section 3(21)(A). Under this definition, a "person"²⁰ is a fiduciary with respect to an ERISA plan to the extent that person exercises any discretionary authority, discretionary control, or discretionary responsibility respecting the management or administration of the plan or exercises any authority or control respecting management or disposition of the plan's assets.²¹

1683 (1995). State laws that mandate certain benefit structures, affect plan administration, or provide alternate enforcement mechanisms would still be preempted under the new Supreme Court standard articulated in the *Travelers* decision. *See id.* at 1678, 1683. Thus, state law claims against directed trustees of ERISA plans for breach of duty would appear to continue to be preempted by ERISA. *See Pilot Life Ins. Co. v. Dedeaux*, 481 U.S. 41, 49 (1987) (State common law causes of action which "relate to" benefit plans are preempted); *Travelers Ins. Co.*, 115 S. Ct. at 1683 (prior rulings holding that ERISA preempts direct regulation of benefit plans are unaffected by *Travelers* holding, citing *Pilot Life v. Dedeaux*).

14. Codified at 29 U.S.C. § 1002(21)(A) (1994).

15. Codified as amended at 29 U.S.C. § 1103(a)(1) (1994).

16. Codified as amended at 29 U.S.C. § 1104(a) (1994).

17. Codified at 29 U.S.C. § 1105(a) (1994).

18. Codified at 29 U.S.C. § 1109(a) (1994).

19. Codified as amended at 29 U.S.C. § 1132(a) (1994).

20. ERISA defines a "person" as "an individual, partnership, joint venture, corporation, mutual company, joint-stock company, trust, estate, unincorporated organization, association, or employee organization." Codified at 29 U.S.C. § 1002(9) (1994). This definition of "person" will be used throughout the article.

21. The complete text of ERISA § 3(21)(A) reads:

[a] person is a fiduciary with respect to a plan to the extent (i) he exercises any discretionary authority or discretionary control respecting management of such plan or exercises any authority or control respecting management

The case law construing the definition of a fiduciary has focused primarily on the discretionary functions with respect to plan management and administration which qualify a person as an ERISA fiduciary.²² A person's fiduciary status under the discretionary conduct part of the definition is coterminous with the person's exercise of discretionary authority respecting the management or administration of the plan.²³ Thus, under the discretionary prong of the definition, a person can be a fiduciary when exercising the requisite discretionary authority, but may also be a non-fiduciary for other purposes.²⁴ In contrast, under the plain language of the definition, a person who exercises *any* authority or control (discretionary or not) with respect to the management or disposition of plan assets is a fiduciary.²⁵

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. . . .

Codified at 29 U.S.C. § 1002(21)(A) (1994). This article does not address the duties of fiduciary investment advisors referred to in 29 U.S.C. § 1002(21)(A)(ii) (1994).

22. See, e.g., *Donovan v. Mercer*, 747 F.2d 304, 308-09 (5th Cir. 1984) (exercise of discretionary authority respecting plan management and disposition of plan assets made party a fiduciary); *Brock v. Hendershott*, 840 F.2d 339, 342 (6th Cir. 1988) (holding union representative was a fiduciary because of exercise of discretionary authority in influencing local unions to choose certain dental association); *Pohl v. National Ben. Consultants*, 956 F.2d 126, 129 (7th Cir. 1992) ("ERISA makes the existence of discretion a sine qua non of fiduciary duty"); *O'Neil v. Davis*, 721 F. Supp. 1013, 1015 (N.D. Ill. 1989) (voting of shares held as plan assets is fiduciary act of plan management).

23. See, e.g., *Sommers Drug Stores Co. Employee Profit Sharing Trust v. Corrigan*, 793 F.2d 1456, 1459-60 (5th Cir. 1986) (person is a fiduciary only with respect to those aspects of the plan over which he exercises authority or control); *Leigh v. Engle*, 727 F.2d 113, 133-35 (7th Cir. 1984) (defendants were fiduciaries to the extent they performed fiduciary functions); *Martin v. Feilen*, 965 F.2d 660, 669 (8th Cir. 1992) (ERISA fiduciary is liable only to the extent he exercises discretionary control or has discretionary management authority).

24. See, e.g., *Corrigan*, 793 F.2d at 1459-60 (ERISA recognizes that a person may be a fiduciary for some purposes and not others); *Leigh*, 727 F.2d at 133 (same).

25. See *infra* discussion and notes 94-95.

B. Section 403(a)(1): Directed Trustees

ERISA section 403(a) requires that the assets of an employee benefit plan, with certain limited exceptions,²⁶ must be held in trust by one or more trustees. Each trustee must be named in the written documents governing the plan and trust or appointed by a person who is a "named fiduciary"²⁷ under the plan. Under ERISA section 403(a), a trustee has exclusive discretionary authority over the assets of the plan, unless the plan expressly provides that the trustee is subject to the direction of a named fiduciary (hereinafter referred to as a "directing fiduciary"). The plan participants themselves can be the named plan fiduciaries for purposes of directing the trustee.²⁸ Under ERISA section 403(a)(1), a directed trustee is required to follow the "proper"

26. ERISA § 403(b), codified as amended at 29 U.S.C. § 1103(b) (1994), excepts the following from the trust requirement: (1) plan assets which are insurance contracts or policies issued by an insurance company qualified to do business in a state; (2) plan assets held by an insurance company; (3) "Keogh" plans under Internal Revenue Code § 401(c), I.R.C. § 401(c) (1994), for self-employed individuals to the extent that the assets are held in a qualifying custodial account under Internal Revenue Code § 401(f), I.R.C. § 401(f) (1994); (4) individual retirement accounts under Internal Revenue Code § 408, I.R.C. § 408 (1994), to the extent that the assets are held in a qualifying custodial account under Internal Revenue Code § 408(h), I.R.C. § 408(h) (1994); and (5) assets of plans of tax-exempt employers under Internal Revenue Code § 403(b), I.R.C. § 403(b) (1994), to the extent such assets are held in a qualifying custodial account under Internal Revenue Code § 403(b)(7), I.R.C. § 403(b) (1994). Section 403(b)(4) also permits the Secretary of Labor to exempt from the trust requirement any plan which is not subject to ERISA's requirements for minimum participation, vesting, funding, or defined benefit plan insurance termination provisions. To date, no such exemptions have been issued, although the Department of Labor has extended indefinitely its "non-enforcement policy" with respect to the trust requirement for "cafeteria" plans under Internal Revenue Code § 125, I.R.C. § 125 (1994). *See* Pension And Welfare Benefits Administration Notice, Extension of Enforcement Policy With Respect to Welfare Plans With Participant Contributions, 58 Fed. Reg. 459 (1993) (proposed Aug. 27, 1993).

27. A "named fiduciary," defined in 29 U.S.C. § 1102(a)(2), is a fiduciary who is named in the plan instrument, or who, pursuant to a procedure specified in the plan, is identified as a fiduciary by an employer or employee organization with respect to a plan.

28. *See* Reich v. NationsBank of Georgia, N.A., Civ. A. 1:92-CV-1474-HTW, 1995 WL 316550, at *3 (N.D. Ga. March 29, 1995); DOL Info. Ltr., 22 Pen. & Ben. Rep. (BNA) 2249, 2250 (Sept. 28, 1995) [hereinafter AFL-CIO Letter]; DOL Info. Ltr., 1994 ERISA LEXIS 51 (Aug. 19, 1994) [hereinafter International Games Letter]; DOL Op. Ltr., 16 Pen. & Ben. Rep. (BNA) 390 (Feb. 23, 1989) [hereinafter Polaroid Letter].

directions of the directing fiduciary, so long as those directions are "made in accordance with the terms of the plan" and are "not contrary to" ERISA.²⁹

Much of the controversy surrounding the scope of fiduciary responsibility for a directed trustee centers around the disputed meaning of the language of section 403(a)(1).³⁰ The case law and Department of Labor interpretations of the meaning of section 403(a)(1) vary significantly.³¹ The root of the problem lies in the fact that there is no guidance in the statute as to what constitutes a "proper" direction. Furthermore, there is no guidance in the statute concerning to what lengths the directed trustee must go to ascertain whether the direction is in accordance with the terms of the plan and ERISA.

C. Section 404(a)(1): Fiduciary Duties

ERISA section 404(a)(1) establishes four fundamental duties governing the conduct of fiduciaries.³² The legislative history of ERISA section 404

29. The text of ERISA § 403(a) reads:

[A]ll assets of an employee benefit plan shall be held in trust by one or more trustees. Such trustee or trustees shall be either named in the trust instrument or in the plan instrument described in section 402(a) or appointed by a person who is a named fiduciary, and upon acceptance of being named or appointed, the 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], . . .

Codified as amended at 29 U.S.C. § 1103(a) (1994).

30. See discussion *infra* Part III.B.

31. See discussion *infra* Parts II.B and III.B.3.

32. The complete text of ERISA § 404(a)(1) reads:

Subject to sections 403(c) and (d), 4042, and 4044, a fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and—

(A) for the exclusive purpose of:

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

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

indicates that Congress intended section 404 to codify the principles of fiduciary conduct developed under the common law of trusts, but with modifications appropriate for employee benefit plans.³³ Under ERISA section 404(a)(1)(A), a fiduciary generally must discharge all of his duties with respect to a plan "solely in the interest" of the participants and beneficiaries and for the exclusive purpose of providing benefits to participants and their beneficiaries and defraying reasonable expenses of administering the plan. The courts have construed the phrase "solely in the interest" to mean that the fiduciary must discharge his duties "with an eye single to the interests of the participants and beneficiaries."³⁴ This duty is commonly referred to as the fiduciary's "duty of loyalty."³⁵ ERISA section 404(a)(1)(B) requires the fiduciary to discharge his duties with the "care, skill, prudence and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of like character and with like aims." This duty is commonly referred to as the ERISA "prudent man rule" or "duty of care."³⁶ ERISA section 404(a)(1)(C), commonly known as the "duty of diversification,"³⁷ requires the fiduciary to diversify the investments of the plan prudently under the circumstances so as to minimize the risk of large losses, unless under the circumstances it is clearly imprudent to do so. Finally, ERISA section 404(a)(1)(D) requires the fiduciary to discharge his duties in accordance with the documents governing the plan insofar as such documents

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

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

Codified as amended at 29 U.S.C. § 1104(a) (1994).

33. See H.R. REP. NO. 93-533 (1973), *reprinted in* 1974 U.S.C.C.A.N. at 4649-51; S. REP. NO. 93-127 (1973), *reprinted in* 1974 U.S.C.C.A.N. 4838, 4866; H.R. CONF. REP. NO. 93-1280 (1973), *reprinted in* 1974 U.S.C.C.A.N. 5038, 5076; *Varity Corp. v. Howe*, 116 S. Ct. 1065, 1070 (1996); *Donovan v. Cunningham*, 716 F.2d 1455, 1464 n.15 (5th Cir. 1983); *Leigh v. Engle*, 727 F.2d 113, 122-23 n.19 (7th Cir. 1984).

34. See *Donovan v. Bierwirth*, 680 F.2d 263, 271 (2d Cir. 1982).

35. See *id.* at 271; *Eaves v. Penn*, 587 F.2d 453, 457 (10th Cir. 1978).

36. See, e.g., *Donovan v. Mazzola*, 716 F.2d 1226, 1231 (9th Cir. 1983); *Donovan v. Cunningham*, 716 F.2d 1455, 1464 (5th Cir. 1983).

37. See, e.g., *Brock v. Citizens Bank of Clovis*, 841 F.2d 344, 346 (10th Cir. 1988), *cert. denied*, 488 U.S. 829 (1988); *Marshall v. Glass/Metal Ass'n & Glaziers & Glassworkers Pension Plan*, 507 F. Supp. 378, 383 (D. Haw. 1980).

are consistent with the provisions of ERISA. This duty requires a fiduciary to *not* follow any terms of the plan which are contrary to ERISA.³⁸

The statutory language does not address how the broad fiduciary duties prescribed in ERISA section 404(a)(1) are to be reconciled with the narrow duties of a directed trustee under ERISA section 403(a)(1). Judicial attempts to interpret and apply section 404(a)(1) to directed trustees have resulted in conflicting decisions concerning the fiduciary responsibilities of directed trustees.³⁹

D. Section 405(a): Co-Fiduciary Liability

ERISA section 405(a)⁴⁰ describes the circumstances under which a fiduciary will be liable for a breach of duty by a co-fiduciary. Under ERISA sections 405(a)(1) and (3), a fiduciary is liable if he has actual knowledge of the breach by the co-fiduciary and knowingly participates in or undertakes to conceal the breach, or fails to make reasonable efforts to remedy the breach. Absent actual knowledge of the co-fiduciary's breach of duty, the fiduciary will still be liable under ERISA section 405(a)(2) if he fails to comply with his duties under ERISA section 404(a)(1) and thereby enables the co-fiduciary to commit a breach of duty.

A directed trustee by definition under ERISA section 403(a)(1) always acts at the direction of another plan fiduciary.⁴¹ Consequently, section 405(a) would appear to be significant for purposes of determining the liability of a directed trustee.

38. See authorities cited *infra* note 168.

39. See discussion *infra* Parts II.B & III.B.

40. The text of ERISA § 405(a) reads:

(a) In addition to any liability which he may have under any other provisions of this part, 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;

(2) if, by his failure to comply with section 404(a)(1) 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.

Codified at 29 U.S.C. § 1105(a) (1994).

41. See 29 U.S.C. § 1103(a)(1) (1994).

E. Section 409(a): Fiduciary Liability

ERISA section 409(a) makes a fiduciary personally liable to restore to the plan: (1) any losses resulting from the fiduciary's breach of his duties under ERISA; or (2) any profits of the fiduciary made through the use of plan assets by the fiduciary.⁴² ERISA section 409(a) also authorizes any other equitable or remedial relief as the court deems appropriate, such as the removal of the fiduciary. ERISA section 409(a) does not authorize any sort of monetary relief to a party other than the plan, such as an individual damage award to a plan participant.⁴³

ERISA section 409(a) is significant in the directed trustee context for two reasons. First, this section establishes the *personal liability* of the directed trustee for a breach of fiduciary duty. Second, this section, along with ERISA section 502(a), reflects the practical significance of the status of a directed trustee as a fiduciary under ERISA. If a directed trustee is a fiduciary, the plan may recover against the directed trustee personally for losses incurred or profits obtained through a breach of fiduciary duty. Conversely, if a directed trustee is *not* a fiduciary, the plan may not recover against the directed trustee any losses incurred or profits obtained through the directed trustee's misconduct.

F. Section 502(a): Civil Enforcement Actions

ERISA section 502(a) authorizes specific types of civil causes of actions which may be brought under ERISA.⁴⁴ There are no "implied" civil causes

42. The text of ERISA § 409(a) reads in relevant part:

(a) Any person who is a fiduciary with respect to a plan who breaches any of the responsibilities, obligations, or duties imposed upon fiduciaries by this title shall be personally liable to make good to such plan any losses to the plan resulting from each such breach, and to restore to such plan any profits of such fiduciary which have been made through use of assets of the plan by the fiduciary, and shall be subject to such other equitable or remedial relief as the court may deem appropriate, including removal of such fiduciary.

Codified at 29 U.S.C. § 1109(a) (1994).

43. See *Massachusetts Mut. Life Ins. Co. v. Russell*, 473 U.S. 134, 139-42 (1985).

44. The text of ERISA § 502(a) reads in relevant part:

(a) A civil action may be brought—

(1) by a participant or beneficiary—

...

(2) by the Secretary, or by a participant, beneficiary or fiduciary for appropriate relief under section 409;

of actions outside of the statutory civil actions recognized under ERISA section 502(a).⁴⁵ Furthermore, ERISA preempts claims based on state laws or regulations.⁴⁶ Consequently, if a plan participant cannot fit his claim into one of ERISA's statutory causes of actions discussed in section 502(a), he will be left without a remedy under either federal or state law.⁴⁷

ERISA sections 502(a)(2) and (3) are the most relevant civil enforcement actions for purposes of directed trustees. Section 502(a)(2) authorizes a plan participant to bring a civil action against a fiduciary for appropriate plan-wide relief under ERISA section 409(a).⁴⁸ ERISA section 502(a)(3) is a "catch-all" provision⁴⁹ authorizing a plan participant to bring a civil action to enjoin any act or practice in violation of the term of the plan or ERISA, or to obtain other appropriate equitable relief.⁵⁰

Section 502(a) is significant in the directed trustee context principally because it represents the consequences of a determination that a directed trustee is a fiduciary under ERISA. A "fiduciary" directed trustee may be sued by a plan participant, either on behalf of the plan under ERISA section 502(a)(2)⁵¹ or, individually, under ERISA section 502(a)(3),⁵² for a breach of fiduciary duty. If, however, the court rules that the directed trustee is *not* a fiduciary, the plan participant is without a cause of action under ERISA and any state laws claims are preempted—in short, the plan participant has no recourse against the directed trustee. This significant consequence appears to have been overlooked in judicial decisions holding that a directed trustee is not a fiduciary.⁵³

(3) by a participant, beneficiary, or fiduciary (A) to enjoin any act or practice which violates any provision of this title or the terms of the plan, or (B) to obtain other appropriate equitable relief (i) to redress such violations or (ii) to enforce any provisions of this title or the terms of this plan.

Codified as amended at 29 U.S.C. § 1132 (1994).

45. See *Russell*, 473 U.S. at 146-48.

46. See authorities discussed *supra* note 13.

47. This result, known as "betrayal without a remedy," is a common phenomenon in ERISA litigation. See, e.g., *Betrayal Without Remedy—Part VII: The Recent Non-3rd Circuit Decisions*, 3 ERISA Lit. Rep. No. 3, 9-17 (1994) (seventh article in an ongoing series discussing "betrayal without a remedy" cases).

48. See 29 U.S.C. § 1132(a)(2) (1994).

49. See *Varity Corp. v. Howe*, 116 S. Ct. 1065, 1075 (1996).

50. See 29 U.S.C. § 1132(a)(3) (1994).

51. See *Massachusetts Mut. Life Ins. Co. v. Russell*, 473 U.S. 134, 146-48 (1985).

52. See *Varity Corp.*, 116 S. Ct. at 1075.

53. See *infra* note 84 and text accompanying notes 87-89.

II. REVIEW OF THE CASE LAW ON DIRECTED TRUSTEES

Cases addressing the duties of directed trustees under ERISA are sparse. Two major early cases in the directed trustee area are *Newton v. Van Otterloo*⁵⁴ and *Ershick v. United Missouri Bank*.⁵⁵ In both of these cases the courts assumed, without discussion of the issue, that the directed trustee was a "fiduciary" under ERISA. The court's analysis in each of these early decisions focused on the degree of deference the directed trustee must give to the direction provided to the directed trustee by another plan fiduciary who was not a plan participant. In each instance the court ruled that, absent actual knowledge on the part of the directed trustee that the direction was a breach of duty by the directing fiduciary, the directed trustee was entitled to rely upon the direction and was not liable for carrying out the instructions of the directing fiduciary.

Two recent Eighth Circuit decisions, *FirsTier Bank v. Zeller*⁵⁶ and *Maniace v. Commerce Bank*,⁵⁷ have created confusion concerning the principles established by the early cases. These Eighth Circuit decisions have reached opposite conclusions on two fundamental issues concerning directed trustees: (1) the status of a directed trustee as a fiduciary for purposes of ERISA; and (2) the degree of deference the directed trustee must give to the direction. The language used by the Eighth Circuit in these decisions illustrates the need for a thorough analysis and clarification of the law of directed trustees under ERISA which is grounded in ERISA's statutory language, legislative history, and the remedial purposes underlying the statute.

A. The Early Directed Trustee Cases

1. *Newton v. Van Otterloo*

*Newton v. Van Otterloo*⁵⁸ addressed the duty of a directed trustee with respect to voting directions for the election of corporate directors. The case has enormous practical significance because it represents a situation often encountered by directed trustees of employee stock ownership plans ("ESOPs") holding as the primary plan asset the stock of a non-publicly traded company.

In *Newton*, the ESOP held eighty-one percent of the company's outstanding stock. Under the terms of the ESOP the plan participants were permitted to vote directly the shares of stock allocated to their accounts for the

54. 756 F. Supp. 1121 (N.D. Ind. 1991).

55. 948 F.2d 660 (10th Cir. 1991).

56. 16 F.3d 907 (8th Cir. 1994), *cert. denied*, 115 S. Ct. 194 (1994).

57. 40 F.3d 264 (8th Cir. 1994), *cert. denied*, 115 S. Ct. 1964 (1995).

58. 756 F. Supp. 1121 (N.D. Ind. 1991).

election of corporate directors. The ESOP committee was the named fiduciary responsible for directing the trustee how to vote the remaining unallocated shares. The unallocated shares controlled by the ESOP committee represented nearly seventy percent of the outstanding stock of the company. The participants' allocated shares represented a little more than eleven percent of the outstanding stock. The company's president personally owned eighteen percent of the company's stock outside of the ESOP and the remaining one percent was held by 11 other individuals.

The ESOP committee consisted of five members. Two members were hourly union employees and three members were management employees, consisting of the chief financial officer, the personnel manager, and the personnel manager's secretary. The president of the company, whose management was being challenged by the union, recommended that the ESOP committee abstain from voting the unallocated ESOP shares and any allocated shares not voted by participants for the election of corporate directors. The ESOP committee followed this recommendation and ordered the ESOP directed trustee to abstain from voting the unallocated and allocated but not voted shares. The directed trustee followed the direction to abstain from voting the shares.⁵⁹ As a result, the incumbent management slate of directors, which included the president, was reelected on the strength of the president's personal share ownership of eighteen percent of the outstanding stock of the company.

Four ESOP participants sued the management members of the ESOP committee and the president, alleging that they manipulated the voting of the ESOP share to retain incumbent management. The participants claimed that the management members of the ESOP committee were interested in preserving their management jobs and thus had a conflict of interest that prevented them from fulfilling their fiduciary duties to the ESOP participants. The ESOP participants also sued the ESOP directed trustee, alleging that the directed trustee violated its fiduciary duties under ERISA section 404(a)(1) and was liable as a co-fiduciary under ERISA section 405(a) for participating in the committee's breach of fiduciary duty by following the direction to abstain from voting the shares.

The court did not question the premise underlying the participant's claims against the directed trustee under ERISA sections 404(a)(1) and 405(a)—that the directed trustee was a fiduciary. Instead, the court focused on the standards for a directed trustee under ERISA section 403(a)(1), namely that the directed 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."⁶⁰ The participants argued that the committee's direction to

59. *See id.* at 1132.

60. *Id.*

abstain from voting nearly seventy percent of the company's stock was so unusual that the directed trustee should not have followed the ESOP committee's direction.

The court rejected the participants' claim, relying on the narrow standard of ERISA section 403(a)(1). The court found that the terms of the plan gave the ESOP committee discretion to decide how to vote the unallocated shares, and that a decision to abstain was within this discretionary power. Therefore, the direction to the directed trustee to abstain on its face was in accordance with the terms of the plan. The more difficult question addressed by the court was whether, under these circumstances, the direction to abstain was contrary to ERISA due to the apparent conflict of interest on the part of the management members of the ESOP committee. Here the court relied on the earlier part of its opinion, which found that the management committee members with divided loyalties nevertheless could have directed the trustee to vote or abstain from voting the shares if, after an "independent and scrupulous investigation" of their options, the management members determined that the direction to abstain was in the best interests of the plan participants. The incumbent management members of the management members of the committee had not conducted such an investigation. The court found that this failure on the part of the management members of the committee was not fatal to the directed trustee. Rather, the court reasoned, had the ESOP committee conducted such an investigation, the direction to abstain would not have been contrary to ERISA. Significantly, the court did not impose upon the directed trustee a duty to ask the committee if the committee had, in fact, conducted such an investigation. Instead, the court ruled that because the directed trustee lacked actual knowledge that the ESOP committee did not conduct the proper investigation, the directed trustee was bound by the plan document and ERISA section 403(a)(1) to follow the committee's direction. Therefore, the court concluded, there was no basis upon which the directed trustee could be held liable for a violation of ERISA.⁶¹

2. *Ershick v. United Missouri Bank*

*Ershick v. United Missouri Bank*⁶² is significant because it involved a claim against a directed trustee for following a direction concerning the purchase and sale of plan assets. The directed trustee in *Ershick* again was the trustee of an ESOP established for the employees of a privately-held company. The plan documents stated that the ESOP was intended to be invested primarily in company stock and expressly permitted investment of up to 100%

61. *Id.* at 1132-33.

62. 948 F.2d 660 (10th Cir. 1991).

of the ESOP funds in company stock.⁶³ Under the terms of the plan document, the company served as the plan administrator with the express power to direct the trustee "with regard to purchases of Company stock and the fair market value thereof."⁶⁴ The plan document also stated that one of the duties of the directed trustee was to invest any or all of the ESOP funds in company stock, but that all purchases and sales of company stock must be made only at the direction of the plan administrator, who would be responsible for determining the terms for such purchases at prices that, in the best judgment of the administrator, did not exceed fair market value.⁶⁵

The company prospered until the death of its founder in 1981. Thereafter, the fortunes of the company declined precipitously under the direction of the new chief executive officer. While the company fortunes were declining, the bank serving as the ESOP's directed trustee and as a lender to the company, lowered the company's borrowing limit in response to the company's declining financial situation. At the direction of the company the ESOP directed trustee purchased 410 shares of company stock in 1983 at a price of \$300 per share and 899 shares in 1984 at a price of \$285 per share. These purchases made the ESOP the majority stockholder of the company, effectively consolidating control of the company in incumbent management. Before carrying out each of these purchase directives, the ESOP directed trustee first ascertained that the stock purchase price was supported by a current appraisal performed by an independent appraiser who was not affiliated with the company.

The plaintiffs in the case were former company employees who were fully vested ESOP participants. Upon learning that in 1986 that their ESOP account balances (consisting almost entirely of company stock) had declined to seventy-five percent of their former values, the former employees sued the ESOP directed trustee, claiming that it had violated the prudence requirement of ERISA section 404(a)(1)(B) by continuing to invest in company stock in 1983 and 1984 when the financial condition of the company was deteriorating. The plaintiffs also claimed that the directed trustee should have attempted to sell some or all of the company stock held by the ESOP once the bank's commercial lending department had learned of the declining financial position of the company and in response lowered the company's borrowing limit.

As in *Newton v. Van Otterloo*, the court accepted the underlying premise of the plaintiffs' claim that the directed trustee was a fiduciary and therefore was subject to the fiduciary duties described in ERISA section 404(a)(1). And

63. ERISA § 404(a)(2), codified at 29 U.S.C. § 1104(a)(2) (1994), expressly exempts employee stock ownership plans from the prudent diversification requirements of ERISA § 404(a)(1)(C), codified at 29 U.S.C. § 1104(a)(1)(C) (1994).

64. *Ershick*, 948 F.2d at 662-63.

65. *Id.* at 663.

again, just like the court in *Newton v. Van Otterloo*, the *Ershick* court relied on the more narrow duties of a directed trustee under ERISA section 403(a)(1). The *Ershick* court ruled that the purchase directions to the ESOP trustee were made in accordance with the terms of the plan and were not contrary to ERISA, and concluded that the directed trustee was not liable for following the directions to purchase company stock. A key factual finding relied upon by the *Ershick* court was a lack of evidence that the directed trustee had actual knowledge of the mismanagement of the company by the new chief executive officer at the time the purchase directions were given.⁶⁶ The court also relied on the lower court's factual finding that a "Chinese wall" between the bank's commercial lending and trust departments prevented the commercial loan department from communicating the company's poor loan performance to the trust department.⁶⁷ The court suggested that this Chinese wall prevented the directed trustee (in reality the trust department of the bank) from having access to company financial information that would have prompted the directed trustee to question the direction to purchase company stock. The court's opinion did not address what, if any, duty the directed trustee would have under ERISA had the trust department had actual knowledge of the company's declining financial situation.

3. Fundamental Principles Established By The Early Cases

Newton and *Ershick* recognized several fundamental principles governing directed trustees under ERISA. First, directed trustees were assumed to be fiduciaries under ERISA, and, therefore, were subject to fiduciary duties and liability under ERISA. Second, although the relationships among the relevant statutory sources of such fiduciary duties and liabilities, ERISA sections 403(a)(1), 404(a)(1), and 405(a), had not been clearly articulated, it appeared that, in the context where the direction was made by another plan fiduciary, the courts viewed the narrow duties of the directed trustee under ERISA section 403(a)(1) as controlling over the general fiduciary duties described in ERISA section 404(a)(1). As a result, if the direction given to the directed trustee by the named plan fiduciary *on its face* was in accordance with the terms of the plan and was not contrary to ERISA, the directed trustee *did not have a duty* to inquire beyond the facially valid direction and would not be held liable for following the direction. If, however, the directed trustee had *actual knowledge* that the direction was a breach of duty by the directing fiduciary, the directed trustee would be held liable for following the direction.

These fundamental principles, although not always favorable to the participants, had the virtue of providing relatively clear rules that could be

66. *Id.* at 667-68.

67. *Id.* at 665.

readily ascertained and applied by directed trustees. These "bright line" rules subsequently have been blurred by the apparently contradictory twin Eighth Circuit decisions of *FirsTier Bank v. Zeller* and *Maniace v. Commerce Bank*.

B. Recent Case Law Developments

1. *FirsTier Bank v. Zeller*

As in *Ershick*, the bank, acting as directed trustee in *FirsTier Bank v. Zeller*,⁶⁸ was both a lender to the company and the trustee of the company's profit sharing plan. The company, deeply in debt and in a precarious financial condition, lacked the cash to meet a \$600,000 loan repayment to the bank. After exhausting all possible sources of cash, the company still needed \$100,000 to repay the loan. Four days before the loan payment was due, the company's president had the board of directors remove the bank as trustee and substitute the president of the company as trustee of the profit sharing plan. Once installed as trustee, the company president intended to remove the cash held in the profit sharing plan participant accounts and substitute annuities. The bank trustee advised the president that the annuity substitution proposal was impermissible. The trustee also refused to accept its removal as trustee because the bank officer in charge knew of the company's heavy indebtedness and feared misuse of the profit sharing plan assets by the company president.⁶⁹

A few days later, the company's president met with the profit sharing plan participants and persuaded them that the company would fail unless the participants borrowed the cash from their individual plan accounts and reloaned the money to the company. The company president then wrote to the trustee and directed the trustee to make loans to each plan participant pursuant to the terms of the plan, which provided that the "Trustee may, and shall at the direction of the Company, make a loan or loans to a Participant." The trustee promptly prepared the plan loan documents, obtained the signatures of the individual plan participants on installment notes secured by their interests in the plan, and disbursed loan proceeds totaling \$93,950 to the individual plan participants.⁷⁰

The participants each transferred their loan proceeds to the president's personal account at another bank, receiving in return promissory notes from the company and the president. The president then wrote a \$240,000 check on his personal account to the company, which used the money to repay the loan to the bank trustee. Shortly thereafter, the company went into bankruptcy

68. 16 F.3d 907 (8th Cir. 1993).

69. *Id.* at 909.

70. *Id.* at 910.

and its assets were sold. Both the plan loans to the participants and the participant loans to the company president were never repaid.⁷¹

In a preemptive strike, the bank trustee filed a declaratory judgment action seeking a declaration of its status with respect to the plan. The plan participants counterclaimed against the bank trustee, alleging that the trustee violated ERISA by knowingly making or permitting improper plan loans. The district court found in favor of the bank trustee on the ERISA claims. One of the issues on appeal to the Eighth Circuit was whether the bank as a directed trustee had breached its fiduciary duties under ERISA by following the directions of the plan participants to make the loans.

The Eighth Circuit characterized the critical legal issue in the case as "the precise nature and extent of FirstTier's duty as trustee in lending Plan assets to the Participants."⁷² The directed trustee's first contention was that it had *no* fiduciary duty *at all* with respect to the participant loans because under the terms of the plan the loans were made at the direction of the company and therefore the trustee did not exercise fiduciary discretion in making the loans. The Eighth Circuit properly rejected this contention based on the definition of a fiduciary in ERISA section 3(21)(A)(i), stating:

Note that this section imposes fiduciary duties [not] only if one exercises *discretionary* authority or control over plan *management*, but imposes those duties *whenever* one deals with plan *assets*. This distinction is not accidental—it reflects the high standard of care trust law imposes upon those who handle money or other assets on behalf of another.⁷³

The Eighth Circuit next turned to the duties of the directed trustee; in particular, whether the directed trustee had a duty to inquire behind the direction to make the loans to the plan participants. For guidance, the court looked to a directed trustee's duty of inquiry developed under the common law of trusts. The court described a directed trustee's common law duty as follows:

Where 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 direction.⁷⁴

71. *Id.*

72. *Id.* at 910-11.

73. *Id.* at 911 (citing *John Hancock Mut. Life Ins. Co. v. Harris Trust & Sav. Bank*, 510 U.S. 86, 95 (1993)) (emphasis in original).

74. *Id.* at 911 (quoting 2 AUSTIN WAKEMAN SCOTT & WILLIAM F. FRATCHER, SCOTT ON TRUSTS § 185, at 574 (4th ed. 1987)).

The Eighth Circuit then drew the following conclusion:

We conclude from the limitation in [ERISA section 403(a)(1)] to directions "not contrary to this chapter" that Congress adopted *this standard* [the common law] in ERISA. Thus, 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, *see* [ERISA section 404(a)]; to attempt to remedy known breaches of duty by other fiduciaries, *see* [ERISA section 405(a)]; and to avoid prohibited transactions, *see* [ERISA section 406].⁷⁵

The common law "standard" referred to by the court in the above-quoted passage is the duty imposed on directed trustees under the common law of trusts to make reasonable inquiry and investigation to determine whether the directing fiduciary is violating his fiduciary duty in making the direction. With this statement the Eighth Circuit appears to have altered the duties of directed trustees under ERISA in a manner which, as discussed in great detail below, Congress never intended. Moreover, the court failed to address and reconcile the apparent conflict between a directed trustee's limited duties under ERISA section 403(a)(1) and the broad general fiduciary duties created under ERISA section 404(a).

Significantly, the Eighth Circuit never addressed the obvious issue of whether, applying its newly created standard of reasonable inquiry and investigation, the directed trustee's conduct in making the participant loans violated its duty of prudence under ERISA section 404(a)(1)(B). The participants contended that this duty of reasonable inquiry arose because the trustee had rejected an improper attempt to substitute the company president as trustee, and the trustee knew that the company was in financial difficulty and was deeply indebted. Had the trustee inquired, the participants argued, it would have learned that the loans to the participants were really indirect loans from the plan to the company in violation of ERISA. Perhaps realizing that it had painted itself into a corner by imposing a duty of reasonable inquiry upon the directed trustee, the court again looked to the common law of trusts for an exception to the duty it had just created. The Eighth Circuit found such an exception based on the fact that the directed trustee had made the loans not just at the direction of the company, but also at the request of the plan participants, the "beneficiaries" of the trust. Using this factual distinction, the court again relied on another rule under the common law of trusts, namely 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

75. *Id.* (emphasis added) (citations to ERISA statutory sections omitted).

direction that does not violate the terms of the trust."⁷⁶ The court then drew an analogy between participants in an ERISA plan and the beneficiaries of a common law trust. Based on this analogy, the court held that ERISA did not require the directed trustee to reasonably inquire of the plan participants the purposes for which they were borrowing the plan assets.

FirsTier Bank was correct in its ruling that despite a lack of discretionary authority, a directed trustee is still a fiduciary as defined by ERISA section 3(21)(A)(i). The other key ruling in the case, applying the principles developed under the common law of trusts to ERISA directed trustees, represents a fundamental change in the law of directed trustees under ERISA. As discussed below, this judicial incorporation of a directed trustee's duties under the common law into ERISA undermines ERISA's goals in certain instances by simultaneously overburdening the directed trustee while failing sufficiently to protect the plan participants.⁷⁷

2. *Maniace v. Commerce Bank*

In *Maniace v. Commerce Bank*,⁷⁸ the Eighth Circuit had an opportunity to revisit the issues addressed in *FirsTier Bank*. *Maniace* involved a privately-held company with an ESOP. Under the terms of the plan document, the trustee of the ESOP had general investment authority, but was a directed trustee subject to directions of the ESOP committee with respect to purchases or sales of company stock.

After establishing the ESOP the company went into a decade of decline, culminating in bankruptcy in 1989. The directed trustee essentially took a "hands-off" attitude toward company management until less than a year prior to the bankruptcy filing. The directed trustee then became concerned about the financial condition of the company and resigned as trustee.⁷⁹

After the company's collapse, the ESOP participants sued the directed trustee on two grounds. First, the participants argued that the directed trustee had failed to fulfill its fiduciary obligation to prudently manage and protect plan assets.⁸⁰ Second, the participants argued that the directed trustee breached its fiduciary duty when it knew of, but failed to remedy, alleged breaches of fiduciary duty by the ESOP committee. The court characterized

76. *FirsTier Bank*, 16 F.3d at 912 (citing 2 AUSTIN WAKEMAN SCOTT & WILLIAM F. FRATCHER, SCOTT ON TRUSTS § 185, at 575 (4th ed. 1987)).

77. See discussion *infra* Part III.B.

78. 40 F.3d 264 (8th Cir. 1994).

79. *Id.* at 265-66.

80. Although the opinion does not state under which section of ERISA the participants made this claim, presumably it was under ERISA § 404(a)(1)(B), codified at 29 U.S.C. § 1104 (a)(1)(B) (1994).

the participants' claims as primarily involving the directed trustee's retention of large amounts of company stock despite the stock's declining value, the directed trustee's overall lack of participation in company finances, and internal disputes concerning the management of the company.⁸¹

The Eighth Circuit began its analysis by finding that the ESOP trustee was a directed trustee under ERISA section 403(a)(1). The court then characterized the issue in the case as one of determining the duties of a directed trustee under ERISA. The participants urged that the fiduciary duty of prudence under ERISA section 404(a)(1)(B) should apply, and that the directed trustee violated this duty of prudence by retaining the company stock as a plan asset when the stock was declining in value and by choosing not to become involved in company financial matters. Rather than dismissing this argument as imposing an obligation beyond the scope of a directed trustee's duty under ERISA section 403(a)(1), the Eighth Circuit held that the trustee *was not a fiduciary at all* under the definition in ERISA section 3(21)(A)(i) because the directed trustee did not exercise discretion with respect to purchases and sales of company stock by the ESOP.⁸² In so doing, the court did not address the second part of ERISA section 3(21)(A)(i), correctly relied upon by the court in *FirsTier Bank*, stating that a directed trustee is a fiduciary to the extent he exercises *any* authority or control respecting management or disposition of plan assets.⁸³

Having concluded that the directed trustee was not a fiduciary, the Eighth Circuit returned to ERISA section 403(a)(1) to determine if the trustee followed its statutory mandate to act only upon directions from the ESOP committee which were made in accordance with the terms of the plan and which were not contrary to ERISA.⁸⁴ Here the Eighth Circuit again departed from its prior ruling in *FirsTier Bank*. The *Maniace* court stated:

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

82. *Id.* at 267; *contra* John Hancock Mut. Life Ins. Co. v. Harris Trust & Sav. Bank, 510 U.S. 86, 95-96 (1993) (emphasizing that under ERISA's definition of a fiduciary, *any* exercise of authority or control over plan assets gives rise to fiduciary status).

83. Prior to *Maniace*, there appears to have been only one reported decision in which a district court had ruled, without analysis, that a directed trustee was not a fiduciary under ERISA. *See* Jenkins v. Bradshaw, 5 E.B.C. 2754 (W.D. Wash. 1984) (directed trustee was custodian, not fiduciary).

84. The court appears to have overlooked the significance of its ruling that the directed trustee was not a fiduciary. Having so held, the participants' claims should have been dismissed because they had no cause of action under ERISA against a non-fiduciary and all state law claims would be preempted. Hence, the participants would have been left without any possible remedy.

The obligations of a directed trustee are something less than that owed by typical fiduciaries. [The directed trustee] was not required to weigh the merits of an investment in [company] stock against all other investment options every time it was directed to purchase said stock by the Committee. Section [403(a)(1)] establishes the standard to be followed by directed trustees, and under the present facts it cannot be said that the purchase of [company] stock violated the Plan or was contrary to ERISA.⁸⁵

The *Maniace* court's analysis implies a rejection of *FirsTier Bank's* incorporation of the directed trustee's common law duty of reasonable inquiry into ERISA. The *Maniace* court's analysis also represents a return to the fundamental principles of *Newton* and *Ershick*. The *Maniace* court acknowledged the conflict with its *FirsTier Bank* decision, but attempted to distinguish *FirsTier Bank* on the ground that the directed trustee of the profit sharing plan in *FirsTier Bank* had investment authority for all plan assets, whereas the *Maniace* directed trustee did not have investment authority with respect to the major asset of the ESOP, the company stock.⁸⁶ The *Maniace* court added to the confusion by stating that it was "reaffirming" its ruling in *FirsTier Bank* that ERISA section 403(a)(1) modified, but did not eliminate, the directed trustee's duty of prudence under ERISA section 404(a)(1)(B). The alternative, more probable reading of *FirsTier Bank* is that the court *rejected* ERISA section 403(a)(1) as a potential limitation upon the general fiduciary duties outlined in ERISA section 404(a)(1) when applied to a directed trustee.

3. *FirsTier Bank* And *Maniace*: Double Trouble For The Future

Both *FirsTier Bank* and *Maniace* appear to contain fundamental errors which, if not corrected by subsequent federal court decisions, will result in federal case law on the duties of directed trustees that is contrary to ERISA's carefully crafted statutory scheme, its legislative history, and the remedial purposes underlying the statute. These fundamental errors lie in two key areas: (1) the status of a directed trustee as an ERISA fiduciary; and (2) the nature of the duties of a directed trustee under ERISA and the degree of deference the directed trustee must afford the directions given to him.

If a directed trustee is not a fiduciary under ERISA section 3(21)(A), as found by the *Maniace* court, the ramifications of this determination run throughout the statute. A "nonfiduciary" directed trustee cannot be subject to the fiduciary standards of ERISA section 404(a)(1) because these duties only

85. *Maniace*, 40 F.3d at 268 (citing *Ershick v. United Missouri Bank*, 948 F.2d 660, 665 (10th Cir. 1991)).

86. *Id.*

apply to a *fiduciary*.⁸⁷ Moreover, if a directed trustee is not a fiduciary, then the directed trustee cannot be held personally liable under ERISA section 409(a) for his own breach of duty or vicariously liable for a breach of duty by the directing fiduciary under ERISA section 405 because, again, these sections only apply to a *fiduciary*.⁸⁸ Finally, if the directed trustee is not a fiduciary, then the plan participants who are injured by the directed trustee's conduct may be without a remedy under ERISA because ERISA section 502(a) does not permit a civil action against a *nonfiduciary*.⁸⁹

The consequences resulting from *FirsTier Bank's* incorporation into ERISA of principles developed under the common law of trusts are more subtle, but of equal significance. Imposing the common law duty of independent inquiry upon a directed trustee when the direction is given by another plan fiduciary undermines ERISA's carefully crafted statutory scheme allocating fiduciary responsibilities and liabilities.⁹⁰ In addition, the imposition of the common law duty of independent inquiry upon the directed trustee sets up an unnecessary dichotomy in the responsibilities of the directed trustee depending upon whether the direction is given by the named fiduciary or the named fiduciary's designated investment manager.⁹¹ These results are contrary to the legislative history of ERISA describing the role of a directed trustee vis-à-vis the other plan fiduciaries.⁹² *FirsTier Bank's* incorporation into ERISA of the common law rule that a directed trustee has no duty of independent inquiry when the direction is given by a trust beneficiary is equally unsatisfactory in the ERISA plan context. Such a rule provides no protection to the plan participants in situations where they are potentially vulnerable to coercion by their employer who sponsors the plan.⁹³ This danger is particularly acute when the plan holds as an asset shares of company stock.

The confusion evidenced by the Eighth Circuit's decisions in *FirsTier Bank* and *Maniace* appears to result from the lack of a cohesive theory of the role of a directed trustee within ERISA's statutory scheme. Part III of this article attempts to fill this intellectual void by analyzing the two key issues upon which *FirsTier Bank* and *Maniace* reached opposite conclusions.

87. See text of ERISA § 404(a)(1), quoted *supra* note 32.

88. See text of ERISA § 409(a), quoted *supra* note 42; text of ERISA § 405(a), quoted *supra* note 40.

89. See *infra* discussion and notes 102-08.

90. See *infra* discussion and notes 158, 162-65.

91. See discussion *infra* Part III.B.5.

92. See discussion *infra* Part III.B.2.

93. See discussion *infra* Part III.B.3.

III. RESOLVING THE KEY ISSUES RAISED BY *FIRSTTIER BANK AND MANIACE*

A. Fiduciary Status of a Directed Trustee Under ERISA

Contrary to the decision in *Maniace v. Commerce Bank*, a directed trustee is *always* a fiduciary under ERISA. This conclusion is supported by the plain language of ERISA section 3(21)(A), the legislative history, and by the purposes underlying the statute.

Under ERISA section 3(21)(A)(i), discretionary authority is clearly *not* required for fiduciary status. ERISA section 3(21)(A)(i) reads:

[a] person is a fiduciary with respect to a plan to the extent (i) he exercises any discretionary authority or discretionary control respecting management of such plan or *exercises any authority or control respecting management or disposition of its assets*, (ii) he renders investment advice for a fee or other compensation, direct or indirect, with respect to any 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. . . .⁹⁴

Although the first part of ERISA section 3(21)(A)(i) refers to discretionary authority or control, the second part of ERISA section 3(21)(A)(i) defines a person as a fiduciary if he "exercises *any* authority or control respecting management or disposition of [the plan's] assets." By virtue of the directed trustee's position as trustee of the trust holding the plan assets, the trustee possesses the prerequisite authority or control over the plan assets necessary to satisfy the definition.⁹⁵

The few references to directed trustees in the legislative history of ERISA are consistent with this interpretation that a directed trustee lacking discretionary authority is nevertheless a fiduciary for purposes of ERISA. The

94. Codified at 29 U.S.C. § 1002(21)(A) (1994) (emphasis added).

95. See *John Hancock Mut. Life Ins. Co. v. Harris Trust & Sav. Bank*, 510 U.S. 86, 95-96 (1993) (emphasizing that under ERISA's definition of a fiduciary, *any* exercise of authority or control gives rise to fiduciary status); 29 C.F.R. § 2509.75-8, D-3, Q&A (1995) (some offices or positions of an employee benefit plan by their very nature require persons who hold them to perform one or more of the functions described in Section 3(21)(A)); AFL-CIO Letter, *supra* note 28, at 2330 (emphasizing that in the context of a directed trustee of an ESOP, *any* exercise of authority or control respecting the management or disposition of ESOP assets was a fiduciary action under ERISA § 3(21)); AMERICAN BAR ASSOCIATION, *EMPLOYEE BENEFITS LAW*, 266-67 (1991) (position of trustee is necessarily a fiduciary one) [hereinafter *EMPLOYEE BENEFITS LAW*].

House Conference Report accompanying ERISA discusses the duties of directed trustees under the section entitled "Fiduciary Responsibility."⁹⁶ There is no indication that the conferees contemplated excluding directed trustees as fiduciaries.

The conclusion reached by the *Maniace* court—that a directed trustee is not a fiduciary—would leave the plan participants without a remedy against a wrong-doing trustee who misused plan assets.⁹⁷ Such a result would be absurd in light of the well-documented past abuses by plan trustees which prompted the passage of ERISA.⁹⁸ This result, which would be directly contrary to the remedial purpose of protecting plan participants underlying the statute,⁹⁹ is a product of ERISA's civil enforcement scheme under ERISA section 502(a). Under ERISA's civil enforcement scheme, any claim by the plan participants against the directed trustee must satisfy one of ERISA section 502(a)'s statutory causes of actions.¹⁰⁰ ERISA section 502(a) does not authorize a participant to bring a civil cause of action against a *non-fiduciary*.¹⁰¹ The civil actions listed in ERISA section 502(a) are the only possible avenues for relief for a participant under ERISA.¹⁰² Therefore, if a directed trustee is not a fiduciary, a participant cannot bring a claim against the directed trustee based on the directed trustee's personal liability for breach of fiduciary duty under ERISA, and any state law-based claims would be preempted.¹⁰³

Assuming still that a directed trustee is not a fiduciary, the other possible relief for injured participants would be to bring a claim against the directed trustee for aiding a breach of duty by the directing fiduciary. Prior to the

96. See H.R. CONF. REP. NO. 93-1280 (1973), reprinted in 1974 U.S.C.C.A.N. 5038, 5075, 5079, 5082-83.

97. See discussion *supra* text accompanying notes 87-89.

98. See H.R. REP. NO. 93-533 (1973), reprinted in 1974 U.S.C.C.A.N. at 4640-43; S. REP. NO. 93-127 (1973), reprinted in 1974 U.S.C.C.A.N. at 4839-44; see also EMPLOYEE BENEFITS LAW, *supra* note 95, at 609 (major weakness of prior pension plan legislation prior to ERISA was the absence of a private right of action for plan participants).

99. See 29 U.S.C. § 1001(b) (1994) (policy of ERISA is to protect the interests of plan participants and provide appropriate remedies, sanctions and ready access to federal courts).

100. See 29 U.S.C. § 1132(a) (1994).

101. See text of 29 U.S.C. § 1132(a), quoted *supra* note 44.

102. See *Massachusetts Mut. Life Ins. Co. v. Russell*, 473 U.S. 134, 146-48 (1985) (rejecting implied private right of action for extra contractual damages under ERISA and holding that the carefully integrated civil enforcement provisions found in ERISA § 502(a) are the only remedies available under ERISA).

103. See authorities cited *supra* note 13.

Supreme Court's decision in *Mertens v. Hewitt Associates*,¹⁰⁴ the circuit courts of appeals were divided over whether ERISA section 502(a)(3) permitted a cause of action against a non-fiduciary for aiding a breach of duty by a fiduciary.¹⁰⁵ Since the *Mertens* decision, however, every federal circuit court of appeals addressing the issue has held that ERISA section 502 does not authorize a private cause of action by a plan participant against a non-fiduciary.¹⁰⁶ Thus, an interpretation that a directed trustee is not a fiduciary would bar any monetary recovery by the plan or plan participants against the directed trustee for breach of his responsibilities under ERISA.¹⁰⁷ Such an outcome would be directly contrary to ERISA's stated goal of providing

104. 508 U.S. 248 (1993). In *Mertens*, the Supreme Court did not specifically address the issue of whether a cause of action existed under ERISA § 502(a)(3) against a non-fiduciary for aiding a breach of duty by a fiduciary. The question upon which certiorari was granted was whether legal damages were available as a remedy under ERISA § 502(a)(3). The Supreme Court assumed arguendo that a non-fiduciary could be sued for knowingly participating in a breach of duty by a fiduciary under ERISA § 502(a)(3), and held that any remedy available for such a claim must be limited to traditional equitable relief, not legal damages. Dicta in the *Mertens* opinion indicated that the Supreme Court did not believe that ERISA permitted any type of claim against a non-fiduciary. See *id.* at 253-54. The Supreme Court has subsequently cited *Mertens* in a non-ERISA case as rejecting non-fiduciary liability. See *Central Bank of Denver v. First Interstate Bank of Denver*, 114 S. Ct. 1439, 1447 (1994).

105. Prior to *Mertens* the Second, Fifth, Sixth, Seventh and District of Columbia Circuits appeared to recognize a private cause of action under ERISA § 502(a)(3) against a non-fiduciary for aiding a breach of duty by a fiduciary. See *Pappas v. Buck Consultants, Inc.*, 923 F.2d 531, 541-42 (7th Cir. 1991) (rejecting cause of action for failure to plead necessary elements); *Whitfield v. Lindemann*, 853 F.2d 1298, 1303 (5th Cir. 1988), *cert. denied*, *Klepak v. Dole*, 490 U.S. 1089 (1989); *Brock v. Hendershott*, 840 F.2d 339, 342 (6th Cir. 1988); *Lowen v. Tower Asset Management, Inc.*, 829 F.2d 1209, 1220 (2d Cir. 1987); *Fink v. National Sav. and Trust Co.*, 772 F.2d 951, 955, 958 (D.C. Cir. 1985). The Ninth and Eleventh Circuits had rejected a private cause of action under ERISA against a non-fiduciary. See *Nieto v. Ecker*, 845 F.2d 868, 871 (9th Cir. 1988); *Useden v. Acker*, 947 F.2d 1563, 1582 (11th Cir. 1991), *cert. denied*, 508 U.S. 959 (1993).

106. See *Reich v. Compton*, 57 F.3d 270, 284 (3d Cir. 1995); *Reich v. Rowe*, 20 F.3d 25, 29-35 (1st Cir. 1994); *Reich v. Continental Cas. Co.*, 33 F.3d 754, 757-58 (7th Cir. 1994), *cert. denied*, 115 S. Ct. 1104 (1995).

107. A participant still arguably could bring a suit to enjoin any "act or practice" by a non-fiduciary directed trustee which violated the terms of the plan or ERISA. See ERISA § 502(a)(3), codified as amended at 29 U.S.C. § 1132(a)(2) (1994); *Useden*, 947 F.2d at 1581. A nonfiduciary directed trustee would not be personally liable, however, for restoring any losses to the plan or ill-gotten profits resulting from a breach of duty. See ERISA § 409(a), quoted *supra* note 42; *Useden*, 947 F.2d at 1581-82 (liability under ERISA § 409(a) limited to fiduciaries).

appropriate remedies and access to the federal courts for injured plan participants.¹⁰⁸

B. The Directed Trustee's Duty of Independent Inquiry Under ERISA

ERISA was designed to incorporate the principles of fiduciary conduct developed under the common law of trusts, but with modifications appropriate for employee benefit plans.¹⁰⁹ The appropriate starting point for an analysis of the duties of a directed trustee is ERISA section 403(a)(1), which states:

[I]f the plan expressly provides that the trustee or trustees are subject to the direction of a named fiduciary who is not a trustee, . . . [then] 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.¹¹⁰

The above-quoted statutory language is capable of two competing interpretations regarding the scope of the directed trustee's duty to determine if the direction is in accordance with the terms of the plan and is not contrary to ERISA. One possible interpretation is that the direction is "proper" and thus the directed trustee must follow the direction if the direction *on its face* is in accordance with the terms of the plan and is not contrary to ERISA. Another possible interpretation is that in addition to determining that the direction on its face is consistent with the terms of the plan and is not contrary to ERISA, the directed trustee has a duty of reasonable care (hereinafter referred to as the trustee's "duty of independent inquiry") to independently inquire and determine that the direction is a "proper" one for the directing fiduciary to make pursuant to the directing fiduciary's duties under ERISA. Under this interpretation, the directed trustee would be liable for breach of fiduciary duty under ERISA for following a facially valid direction if he "should have known" that the directing fiduciary violated his duties as a fiduciary under ERISA in issuing the direction.

The significance of whether a directed trustee has a duty of independent inquiry with respect to a direction given by another plan fiduciary is highlighted by the following example. Assume ABC Company sponsors a pension plan for its employees (the "Plan"). The assets of the Plan are held in trust by Trust Company. Under the terms of the Plan, Trust Company is a directed trustee subject to the directions of the Plan's Administrative

108. See 29 U.S.C. § 1001(b) (1994).

109. See *supra* note 33.

110. Codified as amended at 29 U.S.C. § 1103(a)(1) (1994).

Committee. The Administrative Committee is the named fiduciary under the Plan and has investment authority with respect to the Plan's assets. The assets of the Plan have always been invested in Fortune 500 equity securities, which have averaged a fifteen percent annual rate of return over the years. Trust Company receives a direction from the Administrative Committee to sell twenty-five percent of the Plan's equity security holdings and invest the proceeds in stock of High-Tech, Inc., a start-up computer software company.

Trust Company determines that the direction on its face is in accordance with the terms of the Plan. Although Trust Company may disagree with the Administrative Committee's change in investment strategy, it nevertheless determines that the direction on its face is not contrary to the Administrative Committee's duties of prudence and prudent diversification under ERISA section 404(a)(1). If Trust Company does not have a duty of independent inquiry, it must follow the Administrative Committee's investment direction, and Trust Company will not be liable for any resulting investment losses to the Plan. If, however, Trust Company has a duty of independent inquiry, it must independently determine that the investment does not violate the Administrative Committee's duties of fiduciary loyalty, prudence and prudent diversification of plan assets under ERISA section 404(a)(1), and ERISA's other provisions, most notably the prohibited transaction rules,¹¹¹ before Trust Company can follow the direction. Furthermore, under ERISA section 409(a), Trust Company will be liable if its breach of this duty of independent inquiry results in a loss to the Plan caused by the purchase of the High-Tech, Inc. stock.

Under the common law of trusts, a directed trustee was *not* subject to a duty of independent inquiry if the direction was made by a trust beneficiary solely for his own account.¹¹² Therefore, the *FirsTier Bank* court reasoned by analogy that the directed trustee was relieved from his common law duty of independent inquiry when the direction was made by a plan participant. Again, an example highlights the significance of the role of the directed trustee's duty of independent inquiry when the direction is made by a plan participant instead of by another plan fiduciary.

Assume XYZ Company sponsors an ESOP for its employees (the "ESOP"), the assets of which consist entirely of XYZ Company stock. Under the terms of the ESOP, each participant is entitled to vote the shares of XYZ Company stock allocated to that participant's account for the election of XYZ Company directors. These allocated shares held by the ESOP represent the controlling votes in the election of directors. XYZ Company becomes the subject of a proxy battle between a slate of incumbent management directors

111. See 29 U.S.C. §§ 1106, 1107 (1994).

112. See discussion *supra* text accompanying note 76 and discussion *infra* Part III.B.1.

and a slate of outside directors. The fiduciary for the ESOP, the Administrative Committee (whose members are associated with the incumbent management slate of directors), provides the proxy materials prepared by the incumbent management slate of directors to the ESOP participants. Trust Company, the directed trustee of the ESOP, learns that, in the proxy materials prepared by the incumbent management slate, one of the reasons given for voting for the slate of incumbent management directors is that the business plan proposed by the outside directors calls for wide-spread layoffs. The outside directors protest that this proxy information provided to the ESOP participants is false and misleading.

Trust Company receives voting instructions from the ESOP participants which are unanimously in favor of the incumbent management slate of directors. If Trust Company does not have a duty of independent inquiry, it must follow the voting instructions of the ESOP participants in favor of the incumbent management slate of directors. If, however, Trust Company has a duty of independent inquiry, it must attempt to ascertain whether the proxy materials provided to the ESOP participants were false or misleading.

The above examples illustrate the significant increase in the level of responsibility of the directed trustee if ERISA imposes a duty of independent inquiry upon the directed trustee. Such a substantial increase in the directed trustee's duties under ERISA and the accompanying liability for breach of those duties should not be imposed without careful consideration of ERISA's statutory language, its legislative history, and its underlying purposes.

1. Origins Of The Directed Trustee's Duty Of Independent Inquiry Under The Common Law Of Trusts

Under the common law of trusts, where there were one or more co-trustees, each trustee had a duty to use reasonable care to prevent a co-trustee from committing a breach of duty.¹¹³ If a trustee had reason to suspect that a co-trustee was committing or attempting to commit a breach of duty, failure by the trustee to take reasonable steps to prevent the breach of duty by the co-trustee would render the trustee liable for the co-trustee's breach of duty.¹¹⁴

The directed trustee's duty of reasonable independent inquiry under the common law of trusts originates from this duty of reasonable care among co-

113. See RESTATEMENT (SECOND) OF TRUSTS § 184 (1959); 2A AUSTIN WAKEMAN SCOTT & WILLIAM F. FRATCHER, SCOTT ON TRUSTS § 184, at 561 (4th ed. 1987).

114. See RESTATEMENT (SECOND) OF TRUSTS § 224(2)(d) (1959); 3 SCOTT & FRATCHER, *supra* note 113, § 224.3 at 411.

trustees to prevent a co-trustee from committing a breach of trust.¹¹⁵ Where the person directing the trustee was a fiduciary, under the common law of trusts the directed trustee was not entitled to rely blindly on the direction. Rather, the directed trustee was liable for following the direction if he knew or *should have known* that the directing fiduciary was violating his duties in issuing the direction. Thus, under the common law of trusts, a directed trustee had a duty to reasonably inquire and independently investigate to determine whether the directing fiduciary was violating his duties to the trust beneficiaries in making the direction.¹¹⁶

The directed trustee was not subject to a duty of reasonable independent inquiry under the common law of trusts when the person giving the direction was a beneficiary of the trust acting only on his own behalf. In such a situation, the directed trustee's only duty was to ascertain whether the direction was in accordance with the terms of the trust and, if so, to follow the direction.¹¹⁷

2. Legislative History Regarding The Directed Trustee's Duty Of Independent Inquiry

Shortly after Congress enacted ERISA, trust law practitioners debated whether the directed trustee's duty of independent inquiry under the common law of trusts had been incorporated into ERISA.¹¹⁸ These discussions, which predated any judicial decisions on the issue, generally discounted relevant portions of ERISA's legislative history in arguing that the directed trustee's duty of independent inquiry under the common law of trusts survived under ERISA.¹¹⁹

The legislative history of ERISA describing the obligations of a directed trustee under ERISA section 403(a)(1) appears to reject the common law duty

115. See 2A SCOTT & FRATCHER, *supra* note 113, § 185 at 574 (directed trustee is under a duty similar to duty owed to co-trustees); RESTATEMENT (SECOND) OF TRUSTS § 184 (1959) (describing co-trustee duty of reasonable care) and § 185 cmt. e (directed trustee has duty similar to co-trustee's duty of reasonable care).

116. See *Directed Trusts*, *supra* note 10, at 537; *Responsibility of Trustee Where Investment Power Is Shared Or Exercised By Others*, 9 REAL PROP. PROB. & TR. J. 517, 521 (1974); 2A SCOTT & FRATCHER, *supra* note 113, § 185, at 574-75; RESTATEMENT (SECOND) OF TRUSTS § 185 cmts. d & e (1959).

117. See RESTATEMENT (SECOND) OF TRUSTS § 185 cmt. d (1959); 2A SCOTT & FRATCHER, *supra* note 113, § 185 at 574.

118. See *Directed Trusts*, *supra* note 10, at 546-550; Allen H. Merrill, *Liability for Breaches by Co-Fiduciaries*, 31 BUS. LAW. 115, 120 (1975).

119. See *Directed Trusts*, *supra* note 10, at 546-47; Merrill, *supra* note 118, at 119-20.

of independent inquiry when the direction to the trustee is given by another plan fiduciary. The Conference Report states:

If the plan provides that the trustees are subject to the direction of named fiduciaries, then the trustees are not to have 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 . . . 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.¹²⁰

The legislative history also appears to expressly absolve the directed trustee from liability for following a facially valid direction made by another plan fiduciary.¹²¹ The legislative history does not, however, address the duties of the directed trustee when the direction is made by a plan participant instead of by a non-participant plan fiduciary.

3. Agency Interpretation Of The Duty Of Independent Inquiry When Direction Is Made By A Plan Participant

The Pension and Welfare Benefits Administration ("PWBA"), the administrative division under the United States Department of Labor charged with enforcement of ERISA, has taken the position that under some circumstances a directed trustee has a limited duty of independent inquiry under ERISA section 403(a)(1) with respect to a direction made by a plan participant. The PWBA most recently reiterated this position in a published information letter dated September 28, 1995 ("AFL-CIO Letter").¹²² In the AFL-CIO Letter, the agency expressed its views on the meaning of a "proper" direction under ERISA section 403(a)(1) in the context of a directed trustee of an ESOP with participant-directed, pass-through voting for those shares

120. H.R. CONF. REP. NO. 93-1280 (1973), *reprinted in* 1974 U.S.C.C.A.N. 5038, 5079 (emphasis added).

121. *See* H.R. CONF. REP. NO. 93-1280 (1973), *reprinted in* 1974 U.S.C.C.A.N. 5038, 5082-83 ("[I]f 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.").

122. AFL-CIO Letter, *supra* note 28.

allocated to the accounts of the ESOP participants.¹²³ The AFL-CIO Letter stated that:

[I]t is the Department's position that a trustee can assure itself that the instructions it receives from the participants under such a pass-through voting provision with respect to allocated shares are proper and not contrary to ERISA if (1) it follows procedures to assure that the eligible individual account plan's provisions are fairly implemented, that the participants have not been subjected to coercion or undue pressure in making their decisions, that necessary information is provided to the participants, that clearly false information or misleading information is not distributed to the participants or that any false or misleading information that may have been distributed by other parties is corrected), and (2) it determines that following the participant instructions would not violate ERISA.¹²⁴

The AFL-CIO Letter indicates that the PWBA views a "proper" direction in the context of participant-directed voting of employer stock as creating a duty of independent inquiry for the directed trustee under ERISA section 403(a)(1). The requirements described by the PWBA clearly require the directed trustee to go beyond the face of the direction and independently investigate the voting procedures and the conduct of other plan fiduciaries, particularly those fiduciaries who are associated with the employer. It is noteworthy that the PWBA's interpretation of the duty of a directed trustee goes beyond the requirements for a directed trustee under the common law of trusts. Recall that under the common law of trusts, the directed trustee was not required to independently investigate a facially valid direction made by a trust beneficiary solely for his own behalf.¹²⁵ In the context of an ESOP with participant-directed voting, each participant directs the trustee solely with respect to the shares held in his own ESOP account, a situation similar to where a trust beneficiary directs the trustee solely for his own benefit. Therefore, under a strict application of the common law of trusts, the directed trustee of the ESOP would not be required to look behind the facially valid voting directions of the ESOP participants to determine the fairness of the voting procedures. The PWBA's position resurrects the common law duty of independent inquiry for directed trustees, but goes further than the common

123. Where the directions to the trustee are given by the plan participants, in order for ERISA § 403(a)(i) to apply the plan document must designate the plan participants as the named fiduciaries, *see* Reich v. NationsBank of Georgia, Civ.A. 1:92-CV-1474-HTW, 1995 WL 316550, at *3 (N.D. Ga. March 29, 1995); International Games Letter, *supra* note 28; Polaroid Letter, *supra* note 28.

124. AFL-CIO Letter, *supra* note 28, at 2250.

125. *See* discussion *supra* Part III.B.1.; 2A SCOTT & FRATCHER, *supra* note 113, § 185 at 574; RESTATEMENT (SECOND) OF TRUSTS § 185 cmt. d (1959).

law in its efforts to safeguard the plan participants from unfairness in the voting procedures, inadequate or inaccurate information, or the potentially coercive influence of the employer sponsoring the plan.¹²⁶

The position of the PWBA with respect to the directed trustee's duty of independent inquiry differs in the context of a participant-directed plan loan, which was the situation at issue in *FirsTier Bank*. Absent actual knowledge that the employer has somehow coerced the participant into borrowing from his account, if the participant's request for a loan complies on its face with the terms of the plan and is not contrary to the rules governing plan loans under ERISA, the directed trustee may rely on the participant's direction.¹²⁷

Another common situation where participant directions are made to the directed trustee involves retirement plans which permit the participants to direct the investment of the assets held in the participant's individual plan account pursuant to section 404(c) of ERISA¹²⁸ and its implementing regulations.¹²⁹ In the "404(c) plan" context, the PWBA's implementing regulations focus on whether the participant's exercise of "control" over the investment of his plan assets is truly "independent," *i.e.*, not subject to improper influence by a plan fiduciary.¹³⁰ The regulation itself does not, however, expressly place a burden of inquiry on the fiduciary to determine such independent control.¹³¹ For transactions involving employee securities, as an additional precaution, an independent fiduciary who is not affiliated with the employer sponsoring the plan must be appointed to act as plan fiduciary when there is a potential for undue employer influence in the direct or indirect

126. See DOL Letter re: Profit Sharing Plan for Employees of Carter Hawley Hale Stores, Inc., 11 Pen. & Ben. Rep. (BNA) 633 (April 30, 1984) [hereinafter "CHH Letter"]; Polaroid Letter, *supra* note 28; International Games Letter, *supra* note 28.

127. See 29 C.F.R. § 2550.408b-1(a)(4), Example (3) (1995).

128. ERISA § 404(c) (1994) provides:

In the case of a pension plan which provides for individual accounts and permits a participant or beneficiary to exercise control over the assets in his account, if a participant or beneficiary exercises control over the assets in his account (as determined under regulations of the Secretary)—

- (1) such participant or beneficiary shall not be deemed to be a fiduciary by reason of such exercise, and
- (2) no person who is otherwise a fiduciary shall be liable under this part for any loss, or by reason of any breach, which results from such participant's or beneficiary's exercise of control.

Codified at 29 U.S.C. § 1104(c) (1994).

129. 29 C.F.R. § 2550.404c-1(a)-(f) (1995).

130. See 29 C.F.R. § 2550.404c-1(c)(2)(i) (1995) (defining independent control); 29 C.F.R. § 2550.404c-1(d)(2)(E)(4) (defining special procedures for employer securities).

131. See 29 C.F.R. § 2550.404c-1(c)(2) (1995).

exercise of shareholder rights by plan participants.¹³² Thus, assuming the substantial requirements of the regulations are satisfied, the PWBA's position appears to be that the directed trustee is entitled to rely on the participant's investment direction and is not subject to a duty of independent inquiry.¹³³ An unresolved issue in the section 404(c) area is whether the directed trustee is subject to a duty of independent inquiry with respect to the participant's direction when some, but not all, of the requirements set forth in the regulations pursuant to ERISA section 404(c) have been satisfied.

4. ERISA Section 405(b) Rejects A Duty Of Independent Inquiry When The Direction Is Made By Another Plan Fiduciary

ERISA section 405(b), a section discussed in Part I of this article as directly relevant to directed trustee issues, nevertheless provides some indication that the directed trustee's common law duty of independent inquiry was not incorporated into ERISA when the direction to the trustee is made by another plan fiduciary. Section 405(b) provides that "if the assets of the plan are held by two or more trustees, each shall use reasonable care to prevent a co-trustee from committing a breach." This subsection appears to incorporate the duty of reasonable care for co-trustees developed under the common law of trusts.¹³⁴ ERISA section 405(b), however, clearly *excludes* directed trustees from this duty of reasonable care. First, the introductory language of ERISA section 405(b) indicates that this section is to apply "except as provided in Section 403(a)(1)," the section defining the duties of directed trustees. Second, ERISA section 405(b)(3)(B) reemphasizes that "[n]o trustee shall be liable under this subsection for following instructions referred to in Section 403(a)(1)." Finally, ERISA section 405(b)'s duty of reasonable care only applies if the directing fiduciary is a "trustee." By definition, however, under ERISA section 403(a)(1), the directing fiduciary *cannot* be a

132. See 29 C.F.R. § 2550.404c-1(d)2(ii)(E)(4)(ix) (1995).

133. *Accord*, Ronald S. Rizzo & James F. Carey, Reich v. NationsBank of Georgia, N.A., 4 ERISA Lit. Rep. No. 4, 14, 18 (1995).

134. See discussion *supra* Part III.B.1.

trustee.¹³⁵ Therefore, the duty of reasonable care under the common law of trusts incorporated into ERISA section 405(b) is, by definition under section 403(a)(1), inapplicable to a directed trustee.¹³⁶

The exclusion of directed trustees from liability under ERISA section 405(b) indicates that an ERISA directed trustee is not subject to a duty of independent inquiry when the direction is made by another plan fiduciary. Under the common law of trusts, the directed trustee's duty of independent inquiry with respect to a direction given by another fiduciary originated from and was based upon the duty of reasonable care of a co-trustee. The essence of the directed trustee's duty of independent inquiry under the common law of trusts was to verify that the directing fiduciary had acted consistently with his duties to the trust beneficiaries in issuing the direction. The exclusion of directed trustees from liability under ERISA section 405(b)'s duty of reasonable care indicates that the common law duty of independent inquiry for directed trustees should *not* be read into ERISA.

In drafting ERISA, Congress used as a foundation the common law of trusts, but made certain modifications.¹³⁷ The duty of independent inquiry for directed trustees, a derivation of the general duty of reasonable care among co-trustees, was well-established under the common law of trusts at the time ERISA was created.¹³⁸ Consequently, the exclusion of directed trustees from liability under ERISA section 405(b) is strong evidence that Congress did not intend to impose the common law of trusts duty of independent inquiry upon a directed trustee when the direction is made by another plan fiduciary.¹³⁹

135. ERISA § 403(a)(1) states that a trustee is "subject to the direction of a named fiduciary *who is not a trustee . . .*" (emphasis added) (codified as amended at 29 U.S.C. § 1103(a)(1) (1994)).

136. ERISA § 405(b)(2) makes clear that a directed trustee is still liable under ERISA § 405(a) if the directed trustee has actual knowledge that the direction is a breach of fiduciary duty by the directing fiduciary. *See* 29 U.S.C. § 1105(b)(1)(B) (1994).

137. *See supra* note 33.

138. *See* discussion and authorities cited *supra* Part III.B.1.

139. *Cf.* *Mertens v. Hewitt Associates*, 508 U.S. 248, 253-54 (ERISA section 502(a)'s limitation of civil actions to fiduciaries in light of well-established liability of nonfiduciary under common law of trusts is strong evidence that Congress did *not* intend to authorize remedy against nonfiduciary).

5. Imposing a Duty of Independent Inquiry Upon the Directed Trustee Creates an Unnecessary Distinction in the Duties of the Directed Trustee

Viewing ERISA section 405(b) as rejecting a duty of independent inquiry for directed trustees when the direction is made by a non-participant plan fiduciary is consistent with ERISA's allocation of fiduciary responsibilities and liabilities, particularly when the directed trustee is subject to the investment directions of a duly appointed "investment manager." Under ERISA section 402(c)(3),¹⁴⁰ the named fiduciary of the plan may appoint an investment manager to manage the assets of the plan. This allows the named fiduciary to delegate to the investment manager the named fiduciary's responsibility under ERISA section 402(a)(1)¹⁴¹ to manage the assets of the plan. If the named fiduciary appoints an investment manager, the liability of the directed trustee for following the investment directions of the investment manager is determined under ERISA section 405(d).¹⁴² ERISA section 405(d)(1) provides:

If an investment manager or managers have been appointed under section 402(c)(3), then, notwithstanding subsections (a) (2) and (3) and subsection (b), *no trustee 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.¹⁴³

Thus under ERISA section 405(d)(1) the trustee does not have a duty of independent inquiry with respect to the directions of the investment manager.

Reading ERISA section 405(b) as rejecting the common law duty of independent inquiry for the directed trustee places the directed trustee in a similar position regardless of whether the party providing the investment direction is the named fiduciary or the named fiduciary's duly appointed investment manager. A contrary interpretation creates an unnecessary distinction in the duties of the directed trustee, depending upon whether the party giving the direction is the named fiduciary or the named fiduciary's investment manager.¹⁴⁴

140. Codified at 29 U.S.C. § 1102(c)(3) (1994).

141. Codified at 29 U.S.C. § 1102(a)(1) (1994).

142. Codified at 29 U.S.C. § 1105(d) (1994).

143. Codified at 29 U.S.C. § 1105(d)(1) (1994) (emphasis added).

144. *Accord* Merrill, *supra* note 118, at 120.

This unnecessary distinction can be illustrated by example: Recall the earlier example of ABC Company, which sponsors a pension plan for its employees and has Trust Company as the directed trustee. In that example, Trust Company was subject to the investment directions of the named plan fiduciary, the Administrative Committee. Trust Company's dilemma in the example was that if Trust Company was subject to the common law duty of independent inquiry, it must independently determine that the direction to invest twenty-five percent of the Plan's assets in High-Tech, Inc. stock was not contrary to the Administrative Committee's fiduciary duties or ERISA's other requirements. If Trust Company failed to take reasonable measures to determine that the Administrative Committee's investment direction was not contrary to its fiduciary duties, Trust Company would be liable for following the facially valid investment direction if the Administrative Committee had committed a breach of duty in issuing the investment direction and a loss to the Plan resulted from the purchase of the High-Tech, Inc. stock.

Assume that instead of the Administrative Committee directing the Plan investments itself, the Administrative Committee appoints Securities Brokers, Inc. as an investment manager, pursuant to ERISA section 402(c)(3), to manage the investment of the Plan's assets. Securities Brokers, Inc. issues the exact same investment direction to Trust Company. What is the duty of Trust Company with respect to the direction? Under ERISA section 405(d)(1), Trust Company has *no* duty of independent inquiry with respect to the direction and is *not liable* if the purchase of the High-Tech, Inc. stock results in a loss to the Plan, irrespective of whether Securities Brokers, Inc. had acted contrary to ERISA in issuing the direction.

As the above example illustrates, if the reference to a "proper" direction in ERISA section 403(a)(1) is read as creating a duty of independent inquiry for the directed trustee when acting at the direction of a non-participant plan fiduciary, the directed trustee would act at his peril if he relied on a facially valid investment direction issued by the named plan fiduciary. If, however, the investment direction was made by an investment manager appointed to manage the plan's assets on behalf of the named plan fiduciary, under ERISA section 405(d)(1) the directed trustee would be absolved from liability if he followed the exact same facially valid investment direction made by an investment manager appointed by the named plan fiduciary.

The interpretation of ERISA section 403(a)(1) as not incorporating the common law duty of independent inquiry with respect to a direction made by a non-participant plan fiduciary avoids this unnecessary distinction in the duties of the directed trustee. A parallel liability structure for a directed trustee, regardless of whether the direction is from a named fiduciary or from the named fiduciary's appointed investment manager, is consistent with the report of the House and Senate Conference Committee ("Conference Report") comparing the liability of the directed trustee when acting at the direction of

the named plan fiduciary versus an investment manager. The Conference Report states:

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 . . . *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 . . . , 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.¹⁴⁵

A contrary argument may be made that the clear exculpatory language of ERISA section 405(d)(1) absolving the directed trustee from liability where the direction is from an investment manager is evidence that Congress knew how to protect a directed trustee from liability for following directions, but chose to limit this protection to the investment manager context.¹⁴⁶ Thus, section 405(d)(1) could be read as an indication that the directed trustee has a duty of independent inquiry under ERISA with respect to the directions of another plan fiduciary *except* in the investment manager context.

There are two countervailing reasons why ERISA section 405(d)(1) should not be read as evidence that the directed trustee is subject to a duty of independent inquiry except when the direction is made by an investment manager. First, as a practical matter such an analysis sets up the possibility that *two* fiduciaries—the directing fiduciary and the directed trustee—must approve the direction.¹⁴⁷ Such a result is inconsistent with ERISA's statutory scheme permitting the allocation of fiduciary responsibilities.¹⁴⁸ Such an interpretation also undermines the statute's careful balancing of

145. H.R. CONF. REP. NO. 93-1280 (1973), *reprinted in* 1974 U.S.C.C.A.N. 5038, 5079 (emphasis added).

146. *See* Rizzo & Carey, *supra* note 133, at 19.

147. *See* Rizzo & Carey, *supra* note 133, at 19.

148. *See* discussion and authorities cited *infra* notes 158, 162-65.

competing interests to avoid creating rules which are so costly to administer that employers are discouraged from offering benefit plans to their employees.¹⁴⁹ Quite simply, if directed trustees are required to assume the full range of fiduciary responsibility and liability associated with the duty of independent inquiry, they must increase the price of their services accordingly.

A second compelling reason for rejecting the common law duty of independent inquiry when the directed trustee acts at the direction of a non-participant plan fiduciary is the plain language of ERISA section 405(b). ERISA section 405(b) imposes the common law duty of independent inquiry upon co-trustees.¹⁵⁰ ERISA section 405(b)(3)(B), however, expressly states that "[n]o trustee shall be liable under this subsection for following instructions referred to in ERISA section 403(a)(1)."¹⁵¹ This exclusion of a directed trustee from liability under ERISA section 405(b) is meaningless if the directed trustee is nevertheless subject to a duty of independent inquiry under ERISA section 403(a)(1). A contrary interpretation would render the exculpatory language of ERISA section 405(b)(3)(B) superfluous.¹⁵²

6. Conclusion

Under the common law of trusts, a directed trustee had a duty of reasonable care to independently determine that the fiduciary directing the trustee had not violated his duties to the trust beneficiaries in issuing the direction. Although an argument could be made that the reference to a "proper" direction in ERISA section 403(a)(1) incorporates the common law duty of independent inquiry for directed trustees, the legislative history of ERISA indicates that when the person directing the trustee is a non-participant plan fiduciary, the directed trustee is entitled to rely on a facially valid direction. The rejection of a duty of independent inquiry for a direction made by a non-participant plan fiduciary is consistent with ERISA section 405(b), which excludes directed trustees from liability for breach of duty of reasonable care to prevent a breach of duty by a co-fiduciary. This express exclusion of a directed trustee from a co-trustee's duty of reasonable care is significant because the directed trustee's duty of independent inquiry under the common law was based upon the co-trustee's duty of reasonable care. The conclusion that ERISA section 403(a)(1) does not impose a duty of independent inquiry upon the directed trustee when the direction is made by a non-participant plan fiduciary also avoids creating an unnecessary distinction in the duties of the

149. See *Varity Corp. v. Howe*, 116 S. Ct. 1065, 1070 (1996).

150. See discussion *supra* Part III.B.4.

151. Codified at 29 U.S.C. § 1105(b)(3)(B) (1994).

152. See discussion and authorities cited *infra* note 160.

directed trustee depending upon whether the direction is made by the named plan fiduciary or his duly appointed investment manager.

The statutory analysis of the meaning of a "proper" direction under ERISA section 403(a)(1) becomes much less clear when the direction is made by a plan participant solely for his own account. Under the common law of trusts, if the person directing the trustee was a trust beneficiary acting solely on his own behalf and not in a fiduciary capacity, the directed trustee did not have a duty of independent inquiry and could rely on the direction if it was in accordance with the terms of the trust. ERISA's standards and procedural protections, however, are a reflection that the common law of trusts did not always offer sufficient protection to plan participants.¹⁵³ A strict application of this common law rule in all situations pursuant to the reasoning of the *FirsTier Bank* decision would leave plan participants vulnerable to unfair voting procedures and the exercise of undue influence by their employer, particularly in the context of participant directions involving employer stock.¹⁵⁴ In other situations, such as participant-directed plan loans¹⁵⁵ or participant-directed investments,¹⁵⁶ the elaborate procedures governing the participant's directions under ERISA arguably provide sufficient protection to the participants so that imposing a duty of independent inquiry upon the directed trustee is unnecessary. Such a determination necessarily will involve a case-by-case analysis balancing ERISA's competing interests between protecting plan participants and not creating a system that is so costly to administer that employers are discouraged from offering benefit plans to their employees.¹⁵⁷

In summary, situations where the direction to the trustee is made by a plan participant must be analyzed on a case-by-case basis, bearing in mind ERISA's underlying purposes and the safeguards created through the statute and its implementing regulations. The analytical approach adopted in the *FirsTier Bank* court decision, a literal incorporation of the common law of trusts rules into the context of ERISA, is inappropriate because in some situations *more* protection is needed for the plan participants than was afforded by the common law of trusts. When the direction to the trustee is made by a non-participant plan fiduciary, however, ERISA appears to reject the common law duty of independent inquiry for directed trustees.

153. See *Varity Corp. v. Howe*, 116 S. Ct. 1065, 1070 (1996).

154. See AFL-CIO Letter, *supra* note 28; CHH Letter, *supra* note 126; Polaroid Letter, *supra* note 28; International Games Letter, *supra* note 28.

155. See 29 C.F.R. § 2550.408b-1 (1995) (regulations governing plan loans to participants).

156. See 29 C.F.R. § 2550.404c-1 (1995) (regulations governing participant directed investment of plan assets held in their accounts).

157. See *Varity Corp. v. Howe*, 116 S. Ct. 1065, 1070 (1996).

IV. PROPOSED MODEL OF THE LAW OF DIRECTED TRUSTEES

A. The Need For A Model

The conclusion that ERISA rejects the common law duty of independent inquiry when the directed trustee acts at the direction of a non-participant plan fiduciary does not answer the fundamental questions of: (1) what *are* the fiduciary duties of a directed trustee under ERISA; and (2) how do the fiduciary duties of a directed trustee differ from the duties of the directing fiduciary? The model discussed below attempts to address these fundamental questions by setting forth a theory reconciling the three key statutory provisions under ERISA governing directed trustees and directing fiduciaries. These sections are ERISA sections 403(a)(1), 404(a)(1), and 405(a).

B. Overview Of The Model

There are two basic concepts underlying the model. The first concept is that ERISA's statutory scheme authorizes the allocation and delegation of responsibilities among fiduciaries.¹⁵⁸ The model is designed to be consistent with the statutory framework permitting the allocation and delegation of such fiduciary responsibilities. The second concept underlying the model is the well-established rule of statutory interpretation that specific statutory provisions control over more general ones.¹⁵⁹ The model balances this rule of statutory interpretation against other rules of statutory construction that an

158. See H.R. CONF. REP. NO. 93-1280 (1973), *reprinted in* 1974 U.S.C.C.A.N. 5038, 5080-83; 29 C.F.R. § 2509.75-8, FR-13-14.16 (1995). ERISA's rules governing the allocation of fiduciary responsibilities are scattered throughout the statute. See 29 U.S.C. § 1102(b)(2) (1994) (plan shall describe any procedures for the allocation of responsibilities for its operation and administration); 29 U.S.C. § 1102(c)(2)-(3) (1994) (named plan fiduciary may designate persons to render advice with respect to fiduciary's responsibilities or appoint investment manager to manage plan assets); 29 U.S.C. § 1105(b)(1)(B) (1994) (co-trustees may allocate specific duties by agreement authorized in trust instrument); 29 U.S.C. § 1105(c)(1) (1994) (plan instrument may provide for procedures allocating fiduciary responsibilities among named fiduciaries and permitting named fiduciaries to designate other persons to carry out non-trustee fiduciary duties under plan).

159. See *Varity Corp. v. Howe*, 116 S. Ct. 1065, 1077 (1996); *Morales v. Trans World Airlines*, 112 U.S. 2031, 2037 (1992) ("it is a commonplace of statutory construction that the specific governs the general"); *Busic v. United States*, 446 U.S. 398, 406 (1981); *Preiser v. Rodriguez*, 411 U.S. 475, 489-90 (1973); *Hearn v. Western Conference of Teamsters Pension Fund*, 68 F.3d 301, 304 (9th Cir. 1995) (construing ERISA); *United States v. LaPorta*, 46 F.3d 152, 156 (2d Cir. 1994); *Wetlands Water Dist. v. Natural Resources Defense Council*, 43 F.3d 457, 461 (9th Cir. 1994).

interpretation which gives effect to the entire statute and does not render part of the statutory language superfluous¹⁶⁰ or lead to a result contrary to the intent of the legislation is preferred.¹⁶¹

The model places primary responsibility for compliance with the fiduciary duties of ERISA section 404(a)(1) on the directing fiduciary, who must be the "named fiduciary" under the plan.¹⁶² Under ERISA's statutory scheme, every plan must have at least one named fiduciary.¹⁶³ In the hierarchy of fiduciary responsibilities established by ERISA, the named fiduciary occupies the position with the highest level of responsibility. The purpose of the named fiduciary requirement is to focus with a degree of certainty the overall responsibility for managing and operating the plan and the liability for its mismanagement.¹⁶⁴ The named fiduciary may delegate his responsibilities to another fiduciary, but only if such delegation of authority is authorized by the terms of the plan.¹⁶⁵

In contrast to the directing fiduciary, under the model a directed trustee's responsibilities are limited to the functions described by the specific language

160. See *Massachusetts Mut. Life Ins. Co. v. Russell*, 473 U.S. 134, 142 (1985) (construing ERISA); *United States Nat'l Bank v. Independent Ins. Agents of America, Inc.*, 113 S. Ct. 2173, 2182 (1993); *Freytag v. Commissioner*, 501 U.S. 868, 877 (1991); *Crandon v. United States*, 494 U.S. 152, 158 (1990); *Pennsylvania Dept. of Pub. Welfare v. Davenport*, 495 U.S. 552, 562 (1990); *Mountain States Tel. & Tel. Co. v. Pueblo of Santa Ana*, 472 U.S. 237, 249 (1985); *Hearn v. Western Conference of Teamsters Pension Trust Fund* 68 F.3d 301, 304 (9th Cir. 1995) (construing ERISA); *American Stores Co. v. American Stores Co. Retirement Plan*, 928 F.2d 986, 990 (10th Cir. 1991) (construing ERISA); *Board of Trustees v. Centra*, 983 F.2d 495, 504 (3rd Cir. 1992) (construing ERISA); *United States v. Bacon*, 21 F.3d 209, 212 (8th Cir. 1994).

161. See *Commissioner v. Engle*, 464 U.S. 206, 217 (1984); *Griffin v. Oceanic Contractors, Inc.*, 458 U.S. 564, 575 (1982); *American Tobacco Co. v. Patterson*, 456 U.S. 63, 71 (1982).

162. Codified as amended at 29 U.S.C. § 1103(a)(1) (1994).

163. 29 U.S.C. § 1102(a)(1) (1994) (written instrument establishing ERISA plan shall provide for one or more named fiduciaries).

164. See *Birmingham v. Sagen-Swiss Int'l Corp. Retirement Plan*, 718 F.2d 515, 522 (2d Cir. 1983); *Arakeleian v. National W. Life Ins. Co.*, 680 F. Supp. 400, 404 (D.D.C. 1987); H.R. CONF. REP. NO. 93-1280 (1973), reprinted in 1974 U.S.C.C.A.N. 5038, 5077-78, 5081 (purpose of requirement that plan must identify named fiduciary is so that plan participants will know who is responsible for managing and operating the plan).

165. See 29 U.S.C. § 1102(b)(2) (1994) (plan shall describe any procedure for the allocation of responsibilities for the operation and management of the plan); H.R. CONF. REP. NO. 93-1280 (1973), reprinted in 1974 U.S.C.C.A.N. 5038, 50781 (allocation or delegation of fiduciary responsibilities is allowed only if the plan provides for it).

of ERISA section 403(a)(1). The model takes the position that ERISA section 403(a)(1) establishes only two substantive criteria for directed trustees to use in evaluating whether to follow the instructions of the non-participant directing fiduciary. These two criteria require the directed trustee to determine if the direction *on its face* is, first, in accordance with the terms of the plan, and second, is not contrary to ERISA. If both of these substantive criteria are satisfied, the direction is "proper" and the directed trustee may rely on the direction. The directed trustee has no duty to independently inquire behind or investigate the propriety of the direction to verify that the direction does not violate the duties of the non-participant directing fiduciary under ERISA.

The model takes the position that the limited duties specifically pertaining to a directed trustee under ERISA section 403(a)(1) control over the more general fiduciary duties described in ERISA section 404(a)(1).¹⁶⁶ Consequently, ERISA section 403(a)(1) makes some of the duties described in section 404(a)(1) inapplicable to directed trustees, and restricts the application of other ERISA section 404(a)(1) duties, in particular the duty of prudence described in ERISA section 404(a)(1)(B), to the limited role of the directed trustee described in ERISA section 403(a)(1).

Under the model, the directed trustee is liable for a breach of duty by the directing fiduciary in making the direction if the directed trustee has actual knowledge that the direction is a breach of duty by the directing fiduciary. The directed trustee also is liable if he follows a direction which on its face fails to satisfy the two substantive criteria of ERISA section 403(a)(1). The directed trustee has no duty of independent inquiry, however, to detect and prevent a breach of duty by the directing fiduciary. Consequently, the directed trustee will not be liable for carrying out a facially valid direction which in fact is a breach of duty by the directing fiduciary, absent actual knowledge of such breach of duty.

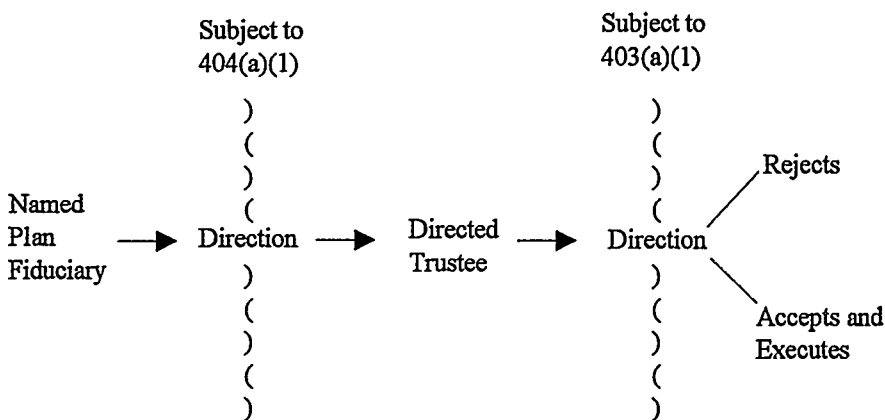
C. The Relationship Between ERISA Sections 403(a)(1) and 404(a) In The Directed Trustee Context

The model takes the position that the duties of a directed trustee are determined by the specific language of ERISA section 403(a)(1). The general fiduciary duties described in ERISA section 404(a) apply to a directed trustee only to the limited extent of carrying out the directions of the directing fiduciary. In contrast, the complete range of duties described in ERISA section 404(a) would apply to the directing fiduciary in making the direction.

166. See *Varity Corp. v. Howe*, 116 S. Ct. 1065, 1077 (1996) (rationale for the canon of statutory construction that "the specific governs the general" is a warning against applying a general provision when doing so would undermine the limitations created by a more specific provision).

Diagram 1 below illustrates the respective duties of the non-participant directing fiduciary and the directed trustee.

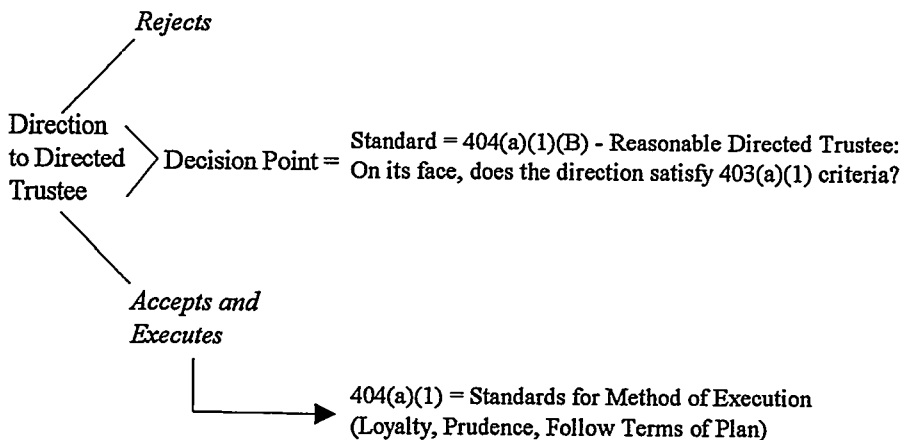
DIAGRAM 1



As a threshold matter, the model takes the position that ERISA section 404(a) applies, albeit in a limited fashion, to a directed trustee by virtue of the trustee's status as a fiduciary. This position is consistent with the introductory language of ERISA section 404(a)(1), which states: "Subject to *Sections 403(c) and (d)*, 4042, and 4044, a *fiduciary* shall discharge *his duties* with respect to a plan. . . ."¹⁶⁷ The introductory language to ERISA section 404(a)(1) excludes subsections (c) and (d) of ERISA section 403, but does not exclude subsection 403(a)(1), the directed trustee subsection, thereby indicating that ERISA section 404(a)(1) does apply to a directed trustee because of the trustee's status as a fiduciary. This introductory language limits the application of ERISA section 404(a), however, to the *specific duties* carried out by the fiduciary. For a directed trustee, these duties are limited by section 403(a)(1) to ascertaining whether the direction is in accordance with the terms of the plan and is not contrary to ERISA. Diagram 2, below, illustrates how the fiduciary responsibilities described in ERISA section 404(a) should apply in a limited fashion to directed trustees.

167. Codified at 29 U.S.C. § 1104(a)(1) (1994).

DIAGRAM 2



The directed trustee is subject to a limited duty of reasonable care under ERISA section 404(a)(1)(B) by virtue of the nature of his specific duties under ERISA section 403(a)(1). This limited duty of reasonable care requires the directed trustee to decide if the direction on its face satisfies the two criteria of ERISA section 403(a)(1) and, if so, to carry out the direction with the care of a *reasonable directed trustee* under the circumstances. The directed trustee is required to examine the direction on its face and determine, as a reasonable directed trustee would, if the direction is in accordance with the terms of the plan and is not contrary to the directing fiduciary's duties under ERISA section 404(a)(1) and the other provisions of ERISA. This inquiry pursuant to ERISA section 403(a)(1) incorporates the directed trustee's duty under ERISA section 404(a)(1)(D) to "override" a direction made in accordance with the terms of the plan if following the direction would be contrary to ERISA.¹⁶⁸ The directed trustee is *not* required (or even permitted) to substitute his judgment for the discretionary judgment of the directing fiduciary regarding the direction. In fact, under ERISA section 403(a)(1), the directed trustee is *required* to follow the direction pursuant to the procedures

168. See AFL-CIO Letter, *supra* note 28 (trustee may follow terms of plan only to the extent permitted by ERISA Section 404(a)(1)(D)); Polaroid Letter, *supra* note 28 (same); CHH Letter, *supra* note 126 (if plan prescribes a course of action that is inconsistent with ERISA, trustee cannot engage in that action).

under the plan if the directed trustee reasonably determines that the direction is in accordance with the terms of the plan and not contrary to ERISA.¹⁶⁹

Applying the objective standard of a reasonable directed trustee pursuant to ERISA section 404(a)(1)(B) provides a measure of protection to the plan participants against an erroneous decision by the directed trustee to follow a direction which a reasonable directed trustee would have determined did not meet the two criteria of ERISA section 403(a)(1). This construction is consistent with judicial rulings interpreting ERISA section 404(a)(1)(B) that a "pure heart and an empty head" are not enough to satisfy the fiduciary's duty of reasonable care.¹⁷⁰

The limited duties of the directed trustee under ERISA section 403(a)(1) render the remaining fiduciary duties under ERISA section 404(a)(1) only indirectly applicable to the directed trustee in evaluating the direction given by the directing fiduciary. These duties, specifically the duty to override the direction pursuant to section 404(a)(1)(D) if the direction is contrary to ERISA, apply to the directed trustee only to the extent that the directed trustee must determine whether, based on the face of the direction, the directing fiduciary has acted contrary to his ERISA section 404(a)(1) duties in issuing the direction. Thus, the directed trustee must determine, under an objective standard of a reasonable directed trustee, whether the direction on its face is not contrary to the directing fiduciary's duties of loyalty,¹⁷¹ prudence,¹⁷² and prudent diversification,¹⁷³ the prohibited transaction rules,¹⁷⁴ and any other applicable ERISA requirements.¹⁷⁵

The limited application of ERISA section 404(a)(1) in the directed trustee context can be illustrated by example: recall the prior example of ABC Company where the Administrative Committee directed Trust Company to purchase High-Tech, Inc. stock. Assume that Trust Company purchased the High-Tech, Inc. stock. The Administrative Committee now directs Trust Company to sell the Plan's holdings of High-Tech, Inc. stock, which have quadrupled in value. Trust Company must first decide whether the direction on its face is in accordance with the terms of the Plan and is not contrary to ERISA. Under the model, this determination is subject to the standard of a

169. See 29 U.S.C. § 1103(a)(1) (1994) (directed trustee *shall be* subject to proper directions of other fiduciary).

170. See *Donovan v. Cunningham*, 716 F.2d 1455, 1467 (5th Cir. 1983), *cert. denied*, 467 U.S. 1251 (1984); *Marshall v. Glass/Metal Ass'n & Glaziers & Glassworkers Pension Plan*, 507 F. Supp. 378, 384 (D. Haw. 1980).

171. 29 U.S.C. § 1104(a)(1)(A) (1994).

172. 29 U.S.C. § 1104(a)(1)(B) (1994).

173. 29 U.S.C. § 1104(a)(1)(C) (1994).

174. 29 U.S.C. §§ 1106-07 (1994).

175. 29 U.S.C. § 1104(a)(1)(D) (1994).

reasonable directed trustee based on ERISA section 404(a)(1)(B). Although Trust Company may believe that the stock should not be sold because the stock price potentially could increase even more, Trust Company reasonably determines that the direction on its face is not contrary to the Administrative Committee's duties of loyalty, prudence and prudent diversification. The direction on its face also is not contrary to ERISA's other provisions.

Having decided that the direction on its face satisfies the two criteria of ERISA section 403(a)(1), Trust Company negligently delays executing the direction to sell the High Tech, Inc. stock for a month, during which time the price of the stock declines. Trust Company's failure prudently to carry out the direction to sell the stock would be a violation of ERISA section 404(a)(1)(B), and Trust Company would be liable to the Plan under ERISA section 409(a) to restore the gains from the sale of the stock that were lost due to the delay in executing the direction to sell.

The two points at which the directed trustee is subject to a reasonable care standard under ERISA section 404(a)(1)(B), the review of the direction for facial validity under ERISA section 403(a)(1) and the execution of a facially valid direction, give a measure of protection to the plan participants. Their real protection, however, lies in the directing fiduciary's compliance with the full spectrum of duties described in ERISA section 404(a). It is the directing fiduciary's responsibility to issue directions which comply with his duties under section 404(a)(1) and which are not contrary to ERISA's other requirements. If the directing fiduciary fails, he is the liable fiduciary under ERISA's statutory scheme.

Such a result is consistent with ERISA's allocation of fiduciary responsibilities and liabilities.¹⁷⁶ The Conference Report implicitly sanctions this allocation of fiduciary liability.

[T]he 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 a breach of these rules*).¹⁷⁷

176. See discussion and authorities cited *supra* notes 158, 162-65.

177. H.R. CONF. REP. NO. 93-1280 (1973), *reprinted in* 1974 U.S.C.A.N. 5038, 5082-83.

D. Analysis Of The Standards Of Liability For A Discretionary Fiduciary And A Directed Trustee Under ERISA Section 405

The starting point for the model's analysis of the liability of the directed trustee for a breach of duty by the directing fiduciary is the language of ERISA section 405(a), which states:

(a) In addition to any liability which he may have under any other provision of this part, 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;

(2) if, by his failure to comply with section 404(a)(1) 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.¹⁷⁸

As a prerequisite to co-fiduciary liability, ERISA sections 405(a)(1) and (3) require the directed trustee to have *actual knowledge* of the directing fiduciary's breach of duty. This actual knowledge requirement is consistent with ERISA section 405(b)'s exclusion of directed trustees from liability for failure to reasonably prevent a co-fiduciary's breach of duty. ERISA section 405(b)(2), however, expressly states that nothing in section 405(b) limits any liability a fiduciary may have under section 405(a).¹⁷⁹ Under ERISA section 405(a)(1), if the directed trustee has actual knowledge that a facially valid direction is a breach of duty by the directing fiduciary, the directed trustee will also be liable if he carries out the direction, an act of active participation in the breach. For example, assume that Trust Company receives a facially valid investment direction from the Administrative Committee to use the proceeds from the sale of the High-Tech, Inc. stock to purchase 10,000 shares of Company X. The President of ABC Company, who is one of the two members of the Administrative Committee, tells Trust Company that he knows that the Company X stock is a poor investment for the Plan. However, he

178. Codified at 29 U.S.C. § 1105(a) (1994).

179. See 29 U.S.C. § 1105(b)(2) (1994).

personally has purchased 10,000 shares of Company X, and his personal share ownership, when combined with the shares to be purchased by the ABC Company Plan, will enable him to control fifty-one percent of Company X's outstanding stock. Under these circumstances Trust Company potentially will be liable under ERISA section 409(a) for any investment losses to the Plan if it carries out the direction because Trust Company has actual knowledge that at least one of the two members of the Administrative Committee has breached his duty of loyalty under ERISA section 404(a)(1) in issuing the direction for the Plan to purchase the Company X stock.

Under ERISA section 405(a)(3), even if the directed trustee does not actively participate in the directing fiduciary's breach of duty, once the directed trustee has actual knowledge of the directing fiduciary's breach of duty, the directed trustee has an affirmative obligation to make "reasonable efforts" under the circumstances to remedy the breach. Subsection (3) is most likely to come into play only in limited circumstances where the directed trustee somehow learns that the directing fiduciary is engaged in a breach of duty that does not involve a direction to the directed trustee. In such rare circumstances, the PWBA has indicated that mere resignation in protest of the directing fiduciary's conduct will not be sufficient to avoid co-fiduciary liability under ERISA section 405(a)(3). The directed trustee may be required to go so far as to seek an injunction against the directing fiduciary or notify the PWBA of the violation.¹⁸⁰

180. See 29 C.F.R. § 2509.75-5 FR-10 Q&A (1995). This regulation describes the steps that the minority group of trustees may be required to take in the event that the majority group of trustees engages in conduct constituting a breach of fiduciary duty:

FR-10 Q: An employee benefit plan is considering the construction of a building to house the administration of the plan. One trustee has proposed that the building be constructed on a cost plus basis by a particular contractor without competitive bidding. When the trustee was questioned by another trustee as to the basis of choice of the contractor, the impact of the building on the plan's administrative costs, whether a cost plus contract would yield a better price to the plan than a fixed price basis, and why a negotiated contract would be better than letting the contract for competitive bidding, no satisfactory answers were provided. Several of the trustees have argued that letting such a contract would be a violation of their general fiduciary responsibilities. Despite their arguments, a majority of trustees appear to be ready to vote to construct the building as proposed. What should the minority trustees do to protect themselves from liability under section 409(a) of the Act and section 405(b)(1) of the Act?

A: Here, where a majority of trustees appear ready to take action which would clearly be contrary to the prudence requirement of section 404(a)(1)(B) of the Act, *it is incumbent on the minority trustees to take all reasonable and legal steps to prevent the action. Such steps might include*

Once again, the status of the directed trustee as a fiduciary under ERISA is critical to the integrated operation of ERISA's statutory scheme. As a non-fiduciary, a directed trustee would lack standing to bring a private civil action under ERISA section 502 to enjoin the directing fiduciary's conduct. As a fiduciary, a directed trustee could bring a private civil action to enjoin the directing fiduciary's conduct, a course of conduct clearly contemplated as possibly required under ERISA by the PWBA.

Subsection (2) of ERISA section 405(a) is the most difficult conceptually to apply in the context of a directed trustee because it incorporates by reference the directed trustee's "specific responsibilities which give rise to his status as a fiduciary" under ERISA section 404(a).¹⁸¹ As discussed above, the "specific responsibilities" of a directed trustee under ERISA section 404(a)(1) are limited by ERISA section 403(a)(1). Therefore, the model takes the position that a directed trustee can only be liable under subsection (2) of section 405(a) if the directed trustee acted imprudently in failing to determine that the direction on its face did not satisfy the two criteria of ERISA section 403(a)(1) under the reasonable directed trustee standard of ERISA section 404(a)(1)(B). Such a failure would result in the directed trustee either following a direction that was contrary to the terms of the plan, or following a direction which, although in accordance with the terms of the plan, was

preparations to obtain an injunction from a Federal District court under section 502(a)(3) of the Act, to notify the Labor Department, or to publicize the vote if the decision is to proceed as proposed. If, having taken all reasonable and legal steps to prevent the imprudent action, the minority trustees have not succeeded, they will not incur liability for the action of the majority. Mere resignation, however, without taking steps to prevent the imprudent action, will not suffice to avoid liability for the minority trustees once they have knowledge that the imprudent action is under consideration.

More generally, trustees should take great care to document adequately all meetings where actions are taken with respect to management and control of plan assets. Written minutes of all actions taken should be kept describing the action taken, and stating how each trustee voted on each matter. If, as in the case above, trustees object to a proposed action on the grounds of possible violation of the fiduciary responsibility provisions of the Act, the trustees so objecting should insist that their objections and the responses to such objections be included in the record of the meeting. It should be noted that, where a trustee believes that a cotrustee has already committed a breach, resignation by the trustee as a protest against such breach will not generally be considered sufficient to discharge the trustee's positive duty under section 405(a)(3) to make reasonable efforts under the circumstances to remedy the breach.

(emphasis added).

181. Codified as amended at 29 U.S.C. § 1105(a)(2) (1994).

contrary to ERISA. In either situation, the directed trustees' conduct in following the direction would result in a breach of fiduciary duty under ERISA section 404(a)(1)(D).

V. CONCLUSION

Directed trustees play an important role in the management and administration of employee benefit plans under ERISA. A directed trustee's status as a fiduciary under ERISA ensures that the plan participants will be able to redress a breach of fiduciary duty by the directed trustee through the federal courts. The fiduciary duties of a directed trustee, however, are limited by ERISA section 403(a)(1). The directed trustee's limited fiduciary responsibility is consistent with ERISA's statutory scheme permitting the allocation of fiduciary responsibilities and liabilities.

Recent judicial decisions concerning directed trustees depart from the principle that a directed trustee is a fiduciary under ERISA, but with statutorily limited fiduciary duties. By incorporating the rules for directed trustees developed under the common law into ERISA, these decisions simultaneously overburden the directed trustee when acting at the direction of a non-participant plan fiduciary while failing to provide adequate protection to the plan participants when they are the ones providing directions to the trustee.

This article rejects a literal incorporation of the common law of trusts into ERISA in the context of directed trustees. The article proposes that where the directed trustee acts at the direction of the plan participants, the degree of deference that a directed trustee must afford the direction will vary depending upon the context and the particular safeguards built into ERISA and its implementing regulations for situations involving participant directions. When the directed trustee acts at the direction of a non-participant plan fiduciary, principles of general application governing the duties of the directed trustee can be derived from ERISA's statutory provisions in a manner that is consistent with the statute's legislative history and remedial purposes.

Part IV of this article proposes an analytical model of the duties under ERISA of a directed trustee who acts at the direction of a non-participant plan fiduciary. The model addresses a theoretical void in the law and the scholarly literature by reconciling the three key statutory sections of ERISA which govern the duties of directed trustees and directing fiduciaries. The design of the model is consistent with ERISA's statutory scheme allocating and delegating responsibilities among fiduciaries while harmonizing ERISA's various statutory provisions governing directed trustees.

Directed trustees of employee benefit plans subject to ERISA are responsible for the custody of plan assets worth billions of dollars. ERISA was enacted in part because the law developed under the common law of trusts was deemed inadequate in the areas of fiduciary responsibility for

employee benefit plan assets and remedies for injured plan participants. ERISA's statutory scheme reflects a careful balancing of fiduciary responsibilities and protections for plan participants designed for the unique context of employee benefit plans. Recent federal court decisions have undermined this statutory scheme by incorporating into ERISA principles developed under the common law of trusts in order to determine the fiduciary status and duties of directed trustees. Federal courts faced with directed trustee issues in the future should reconsider the reasoning of the *FirstTier Bank* and *Maniace* decisions in light of ERISA's statutory language and remedial purposes. This article provides a blueprint for such reconsideration.