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Guilt by Association: The ERISA Fiduciary Status of Principals, Agents, Officers, Directors, and Other Affiliates

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Cases involving serious breaches of ERISA fiduciary duties typically raise the question whether parties who have some legal relationship to plan fiduciaries, as well as parties who work for plan fiduciaries, are themselves fiduciaries who may be sued under ERISA. The Labor Department's definition of "fiduciary" that was issued in 1975 introduced the idea of a "fiduciary by affiliation," but to date the courts largely have ignored the regulation in their analyses of the law. This article discusses the Labor Department's Regulation, its history and legal antecedents, and concludes that the Labor Department's rule should be revisited in view of recent Supreme Court cases.

As the old adage goes, you can tell a lot about a person by the company he keeps. A person's associates certainly can expose one to liability for a fiduciary breach under ERISA. Dominating the first 25 years of ERISA fiduciary law have been the intertwined issues of (1) who is a fiduciary and when are they acting as such and (2)

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what is the exposure of non-fiduciaries who participate in a breach of an ERISA duty. Obviously, to the extent that ERISA provides an adequate remedy against non-fiduciary malefeasors, there is less likelihood the courts will be inclined to find marginal actors to be fiduciaries. Stating the proposition in reverse, to the extent that the remedy against a non-fiduciary is imperfect, a court is more likely to find a particular person to be a fiduciary.

The recent Supreme Court decision in *Great-West Life and Annuity Insurance Company v. Knudson*, 534 U.S. 204 (2002), reinforces the importance of the fiduciary definition and its scope. While the Supreme Court concluded in the *Harris Trust*, 508 U.S. 248 (1993), that a non-fiduciary can be sued under ERISA for participating in an ERISA fiduciary breach, the more recent decision in *Knudson* points out that the ERISA remedy available against a non-fiduciary who engages in an ERISA fiduciary breach is quite limited, due to a very narrow interpretation of the notion of "restitution." To ensure full legal remedies, a plaintiff would prefer to sue a party in their capacity as a fiduciary or co-fiduciary, rather than as a conspiring non-fiduciary.

Doubtless, who qualifies as a "fiduciary" will be an important part of any lawsuits stemming from the Enron and Global Crossing situations. Questions likely will be raised concerning the fiduciary status of directors, officers, and other key employees who may, or may not, have been formally denominated plan fiduciaries. Similarly, there may also be questions whether business entities related to ERISA fiduciaries also qualify as fiduciaries. The ERISA status of outside entities and individuals who provided services in connection with these company's 401(k) plans also will come into question.

While it is often said that the ERISA "fiduciary" definition propounds a "functional" test and that a person does not become an ERISA fiduciary merely by reason of their status, this may overstate the law. There is support for the idea that fiduciary status may be attributed from one person to another based solely on their legal relationship. This article will analyze the extent to which ERISA fiduciary status may be attributed up and down a corporate chain of command. The issues include (1) whether status is attributed between corporations and a director or officer, (2) whether fiduciary status is attributed to and from corporations to key shareholders, (3) whether fiduciary status is attributed from one controlled entity to another, and (4) whether fiduciary status is attributed from a corporation to an employee of the corporation. As with many parts of ERISA, the authorities do not stack up neatly and the legal analysis in many cases has been incomplete.

DOL AUTHORITIES AND THE ELEMENT OF CONTROL

The definition of "fiduciary" is found in Section 3(21) of ERISA. The definition generally requires that a person exercise some kind of discretionary authority over plan administration or plan assets, and the courts generally admonish that the definition of "fiduciary" should be construed broadly.[1] The definition has three basic subparts, but to date the Labor Department has published regulations dealing with the subpart dealing with the provision of investment advice. This regulation is one of the earliest regulations issued by the Labor Department after the passage of ERISA, and it embodies an astonishingly broad interpretation of the term "fiduciary." For reasons unknown, however, the regulation has sparked little discussion in ERISA commentary and it virtually has been ignored in the developing case law.

The "investment advice" regulation provides that an investment advisor is a "fiduciary" if the person renders advice as to the value of investment and "directly or indirectly" has discretionary authority or control with respect to the purchasing or selling of investments.[2] The interesting part of the regulation is the "direct or indirect" reference. The regulation parenthetically explains that "indirect" discretionary authority is found if an "affiliate" of the investment advisor has discretionary authority over the ERISA plan or its assets. The term "affiliate" includes three categories: (1) any person directly or indirectly, through one or more intermediaries controlling, controlled by or under common control with the investment advisor; (2) any officer, director, partner, employee, or relative of the investment advisor; or (3) any corporation or partnership of which the investment advisor is an officer or director. For purposes of determining who falls into the first category, the regulation provides that "control" means "the power to exercise a controlling influence over the management or policies of a person other than an individual."[3] Presumably, the reference to an "individual" is intended to refer to a "natural person."

The "investment advice" regulation is noteworthy for its attribution of discretionary power—which is the essence of fiduciary status—from one "affiliate" to another. Likewise, the regulation stands out for the broad proposition that someone "controls" someone else if they have the power to exercise a controlling influence over the other party. With one important exception that applies to individuals, the "investment advice" regulation attributes "discretionary" power up and down a corporate chain of command. If an individual has discretionary authority with respect to a plan and that individual is an

employee, officer, or director of a corporation, the regulation attributes the discretionary authority of the individual to the employing corporation. If an individual shareholder has a controlling influence over a corporation, any discretionary authority of the shareholder is attributed to the corporation. Attribution of discretionary power also applies to tiers of corporations. A parent and subsidiary corporation are each attributed the discretion of the other if the parent corporation has a "controlling influence" over the subsidiary. Presumably, the same would be true for "brother-sister" corporations if common shareholders have a "controlling influence" over both entities.

The "affiliation" rule has an important limitation when it comes to individuals. Since the "control" definition does not apply to a "controlling influence" over an individual person, it appears that the discretionary authority of an employing corporation is not attributed down the chain of command to an officer or other employee. This exception to the "control" principle dovetails with the position taken in other Labor Department guidance concerning the ERISA status of officers and employees. Interpretive Bulletin 75-8 stated that officers or employees of the plan sponsor are not per se ERISA fiduciaries by virtue of their position or employment.[4] Importantly, the exception for individuals only applies to prevent "controlled" individuals from "affiliate" status; it does not state that an individual cannot be a "controlling" person and thereby attributed discretionary authority of the person they "control." For example, it appears that if a corporate plan sponsor is found to be an ERISA "fiduciary," the discretionary authority of the plan sponsors can be attributed to a board of directors if, as should always be the case, the board has the power to exert a controlling influence over the plan sponsor/fiduciary.

This conclusion, however, does not square with other Labor Department guidance dealing with the fiduciary status of a board of directors. In Interpretative Bulletin 75-8, the Labor Department stated that the members of the Board of Directors of a plan sponsor are not automatically plan fiduciaries, and that they qualify as "fiduciaries" only to the extent they have explicit responsibility for fiduciary functions.[5]

The "affiliation" provisions in the "investment advice" regulation leaves a number of important questions unaddressed. First, the rule does not express any particular stock or ownership percentage that constitutes per se "control." Second, it is also unclear whether the mere "power to exert a controlling influence" is all that is needed to attribute discretionary power, or whether controlling influence must be wielded in fact. The Labor Department's broad notion of "affiliation" and "control" are not just a function of the "investment advice"

regulation; the same "controlling influence" definition has appeared in a number of the Labor Department's prohibited transaction class exemption cases.[6]

The Labor Department's "investment advice" regulation has been cited in a wide variety of cases, although only three cases have cited the regulation for its application to affiliated entities. In *Lowen v. Tower Asset Management, Inc.*, 653 F. Supp. 1542 (S.D.N.Y. 1987), the court cited the broad definition of "control"—the "power to exercise a controlling influence if over the management or policies of a person"—to find that a parent corporation, an investment manager subsidiary, and an associated corporate broker dealer were fiduciaries in connection with a co-investment scheme. The *Lowen* court also found three individuals—who were officers and the sole shareholders of the corporate defendants—were also fiduciaries. Curiously, the court did discuss the "affiliate" definition in the investment advice regulation to reach this conclusion; rather, it found the shareholders were fiduciaries by piercing the corporate veil.

The second decision that cites the "control" definition in the investment advice definition dealt with an HMO and its corporate parent. In *Drolet v. Healthsource*, 969 F. Supp. 757 (D.N.H. 1997), the court also cited the "controlling influence" language in the investment advice regulation and held that the parent corporation of an HMO—where the HMO clearly qualified as a "fiduciary"—was also a fiduciary because the parent corporation controlled the policies and practices of the HMO. The *Drolet* case is noteworthy because it attributes fiduciary status from a subsidiary corporation to a parent corporation in the context of a plan administrator-type fiduciary, and not in the case of an investment advisory-type fiduciary.

The third case that cites the "affiliation" aspect of the regulation is *Daniels v. National Employee Benefit Services, Inc.*, 858 F. Supp. 684 (N.D. Ohio 1994). The case dealt with was the sole shareholder and sole officer of one entity and who was president and 100-percent shareholder (including his spouse's 50-percent interest) in another entity. The court cited the Labor Department's investment advice regulation and noted that an investment advisor need not have discretionary authority over the plan and that, "if, for example, [the defendant] acts through an affiliate, he has satisfied the definition."

INVESTMENT COMPANY ACT "AFFILIATION" AND "CONTROL"

While the legal authorities citing and applying the broad "affiliate" rule in the Labor Department's investment advice regulation are

few, there are analogous legal authorities that help give some shape to the rule. The definitions of "affiliate" and "control" in the Labor Department regulation quite clearly were borrowed from the definitions of "affiliated person" and "control" in Sections 2(a)(3) and 2(a)(9) of the Investment Company Act of 1940.[7] Under the Investment Company Act definition of "affiliate," corporations with overlapping boards of directors, as well as companies with substantially the same officers and directors, were found by the Securities Exchange Commission to be "affiliates" in *In Re Matter of Equity Fund Incorporated et al*, 15 S.E.C. 288, '41-'44 Celt Dec ¶75,424 (1944). Also, a corporation owning as little as 15.5 percent interest in another corporation was held to be an affiliate in *Hallmark Lithographers, Inc.*, '74-'75 CCH Dec. ¶79,913 (SEC 1974). The authorities under the Investment Company Act of 1940 also deal with the question of "control" and the requisite proof required to find "control." One court has held that proof of control demands a presentation of evidence establishing actual domination and operation and that mere influence falls short of this proof.[8] The SEC, in contrast, has noted that "control" includes situations where less than absolute and complete domination of a company is present. According to the SEC, "controlling influence" includes not only the active exercise of power but also the latent existence of power to exert a controlling influence.[9]

While the Labor Department clearly appropriated elements of the Investment Company Act in fashioning the "affiliate" and "control" provisions in the "fiduciary" definition, there are significant differences between the "affiliate" and "control" definitions in the Investment Company Act and the Labor Department's version of these "control" principles. The 1940 Act includes a number of important statutory presumptions, which are not reflected under the ERISA rule. First, the 1940 Act includes a presumption that a 25-percent stock ownership is a "control"; no such presumption appears in the ERISA regulation. Second, the 1940 Act also includes a presumption—but not an outright exception—when it comes to "control" over natural persons. The 1940 Act presumes that a natural person is not a "controlled person," while the Labor Department's regulation states as a hard-and-fast rule that an individual does not become an "affiliate" by reason of being a "controlled person." The 1940 Act also includes an important exception that does not appear in the Labor Department's rule. The 1940 Act provides that "control" does not include the power to exercise a controlling influence over the management or policies of a company if that power is solely the result of an

official position with the company. The Labor Department regulation does not include this exception.

OFFICERS AND DIRECTORS OF FIDUCIARIES

Although the Labor Department's "affiliation" rule in the fiduciary regulation is extremely broad, it does leave some gaps. For example, since the "controlling influence" rule does not apply to individuals, the rule does not deal with persons who are employees or officers of a fiduciary. Two questions are raised. First, are these individuals working for a fiduciary "per se" fiduciaries because of their working arrangements and, second, if officers and directors are not per se fiduciaries, may they nonetheless separately qualify as fiduciaries by reason of the particular authority over ERISA plan matters. Not surprisingly, the courts have addressed these issues, although not always with consistent results.

As noted, the Labor Department's Interpretative Bulletin 75-8 took the position that officers and directors are not plan fiduciaries solely by reason of their status with respect to a plan sponsor, but that they may become fiduciaries based on the activities they undertake with respect to an ERISA plan.[10] The Labor Department has filed a number of briefs supporting the notion that employees and directors of fiduciaries may be separate ERISA fiduciaries, and the Labor Department's position has been upheld by a variety of courts.[11] Officers and directors have been held to be ERISA fiduciaries even when they did not have formal authority with respect to a plan, but exerted de facto control over the plan.[12]

There is at least one major case that deviates from the bulk of the authorities dealing with corporate officers. In *Confer v. Custom Engineering*, 952 F.2d 34 (3d Cir. 1991), the Third Circuit held that when an ERISA plan names a corporation as a fiduciary, the officers who exercise discretion on behalf of that corporation are not fiduciaries under ERISA unless it can be shown that these officers have individual discretionary roles as to plan administration. According to the Third Circuit, "when a corporation is the 'person' who performs the fiduciary functions . . . the officer who controls the corporate action is not also the person who performs the fiduciary functions."

COMPARISON OF CASE LAW

As we have already noted, the Labor Department's concepts of "affiliation" and "controlling influence" in the investment advice regulation has been cited in just three cases that we are aware of. There have been

scores of cases raising the question of affiliation and whether certain relationships with plan fiduciaries also make someone a fiduciary. The courts have struggled with these decisions and have resorted to a variety of rationales in deciding the question. The legal theories developed by the courts have included the following:

1. *Respondent superior.* These cases deal with the case where an employee of a corporation exercises discretion with respect to a plan, and the fiduciary status of the employee is attributed to the employing corporation. Perhaps the most prominent of these cases is *Stanton v. Shearson/American Express*, 631 F. Supp. 100 (N.D. GA 1986). The court found that a corporation employing a broker who qualified as an ERISA fiduciary was itself a fiduciary. The court held that the employing corporation was a fiduciary under a respondent superior theory, or alternatively, because of the corporation's exercise of control over the broker. Other courts also have applied "respondent superior" theories to find an employing corporation liable for the fiduciary breaches of an employee, although they do not specifically find that the employer is a fiduciary by reason of the employment relationship.[13]
2. *Alter Ego and Other Theories.* The courts have advanced a number of different theories to find a person or entity an ERISA fiduciary because of their relationship to an ERISA fiduciary. There are a number of cases that find controlling shareholders or parent corporations are fiduciaries because one entity is the "alter ego" of another entity.[14] Similarly, courts have held that various corporate entities should be viewed as one acting entity under a piercing of the corporate veil theory.[15] Other courts have focused on "day to day" working control that one entity or shareholder has over another.[16]

CONCLUSION

The courts have used a variety of legal theories to ensnare individuals and corporations within the definition of ERISA largely because of their affiliation or association with a plan fiduciary. The Labor Department's "investment advice" regulation casts a very broad net and attributes the ERISA discretion of certain parties to an affiliated party. Of course, the mere attribution of discretionary power from one person to another does not make both parties liable

for a fiduciary breach under ERISA. To breach a particular ERISA duty, a party with fiduciary-making discretion (or attributed discretion) must perform, or fail to perform, some "act" involving the plan or plan participants. To date, the courts have dealt with a variety of cases that seem to be within the scope of the Labor Department's "affiliation" rule, but only a handful courts have relied upon the Labor Department's regulation in reaching a result. It is not clear why the courts have ignored the Labor Department regulation to the extent they have.

The Labor Department's broad fiduciary "affiliation" rules are not supported by the statute. The "party in interest" definition includes broad statutory "affiliation" rules, but these rules do not appear in the "fiduciary" definition. The "affiliation" rules in the "investment advice" regulation clearly were borrowed from the 1940 Investment Company Act and appear to be an early attempt by the Labor Department to sweep as many actors as possible into the definition of ERISA "fiduciaries." Now that the *Harris Trust* clarifies that a non-ERISA fiduciary can be sued under ERISA for participating in an ERISA fiduciary breach—even if the available remedy is imperfect under the *Knudson* case—the argument for an incredibly broad, mechanical rule of fiduciary attribution makes less sense and the need for such a rule should be revisited.

NOTES

1. *Blatt v. Marshall and Lassman,* 812 F.2d 810 (2d Cir. 1987).

2. 29 C.F.R. §2510.3-21(e)(1).

3. 29 C.F.R. §2510.3-21(e)(2).

4. 629 C.F.R. §2509.75-8 (D-5).

5. 29 C.F.R. §2509.75-8 (D-4).

6. PTE 81-8, Class Exceptions Covering Certain Short-Term Investments.

7. (3) "Affiliated person" of another person means (A) any person directly or indirectly owning, controlling, or holding with power to vote, 5 per centum or more of the outstanding voting securities of such other person; (B) any person 5 per centum or more of whose outstanding voting securities are directly or indirectly owned, controlled, or held with power to vote, by such other person; (C) any person directly or indirectly controlling, controlled by, or under common control with such other person; (D) any officer, director, partner, co-partner, or employee of such other person; (E) if such other person is an investment company, any investment adviser thereof or any member of an advisory board thereof; and (F) if such other person is an unincorporated investment company not having a board of directors, the depositor thereof.

(9) "Control" means the power to exercise a controlling influence over the management or policies of a company, unless such power is solely the result of an official

position with such company. Any person who owns beneficially, either directly or through one or more controlled companies, more than 25 per centum of the voting securities of a company shall be presumed to control such company. Any person who does not so own more than 25 per centum of the voting securities of any company shall be presumed not to control such company. A natural person shall be presumed not to be a controlled person within meaning of this title.

8. *Acampora v. Birkland,* 220 F. Supp. 527 (D.C. Cal. 1963).

9. *First Australia Fund, Inc.*, '87-88 CCH Dec. ¶78,551 (SEC 1987).

10. 29 C.F.R §2509.75-8 (D-5).

11. The Labor Department filed briefs in *Kayes v. Pacific Lumber,* 51 F.3d 1449 (9th Cir. 1995), and in *LoPresti v. Terwilliger,* 126 F.3d 34 (2d Cir. 1997). See also *Yeseta v. Baima,* 837 F.2d 380, 384-5 (9th Cir. 1988) (corporate officer of plan sponsor which also administered the plan held to be a fiduciary based on his discretionary authority and responsibility in plan administration); *Blatt v. Marshall and Lassman,* 812 F.2d 812 (2d Cir. 1987) (principals of accounting firm held to be fiduciaries based on actual control over the disposition of plan assets); *Freund v. Marshall & Ilsley Bank,* 485 F. Supp. 629, 641 (W.D. Wis. 1979).

12. *Anderson v. Ciba-Geigy Corp.*, 759 F.2d 1518, 1522 (11th Cir. 1985) (corporate officer with no formal plan responsibility held to be a fiduciary based on conduct); *Professional Helicopter Pilots Ass'n v. Denison,* 804 F. Supp. 1447 (M.D. Ala. 1992); *Newton v. Van Otterloo,* 756 F. Supp. 1121 (N.D. Ind. 1991) (president and chief executive officer of corporate plan sponsor held to be a fiduciary based on authority over plan assets although he did not serve on the plan committee); *Eaton v. D'Amato,* 581 F. Supp. 743, 845-47 (D. DC. 1980) (officers and directors of corporation which provides services to plan held to be fiduciaries).

13. See *National Football Scouting, Inc. v. Continental Assurance Col.,* 931 F.2d 646 (10th Cir. 1991); *American Fed'n of Unions v. Equitable Life Assurance Soc'y,* 841 F.2d 658, 665 (5th Cir. 1988); *Stuart Park Assoc. Ltd. Partnership v. Ameritech Pension Trust,* 846 F. Supp. 701, 708 (N.D. Ill. 1994).

14. *Daniels v. National Employee Benefit Servs., Inc.*, 858 F. Supp. 684 (N.D. Ohio 1994).

15. *Reich v. Lancaster,* 843 F. Supp. 194, 1993 U.S. Dist. LEXIS 14891, 17 EBC 1629 (N.D. TX 1993).

16. *Hazel v. Curtis- Wright Corp.*, 12 EBC 1809 (S.D. Ind. 1990); *Fulk v. Smith W. Bagley,* 88 F.R.D. 153 (M.D.N.C. 1980) (individuals would be fiduciaries by reason of control over the plan by reason of being corporate officers, directors, and shareholders).

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