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The Directed Trustee in the Post-*Dudenhoeffer* World

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The authors would like to thank Jo-el J. Meyer for her earlier contributions to this report.

Overview

Court cases challenging the actions of Employee Retirement Income Security Act fiduciaries have continued unabated since the scandal of Enron in 2002. Since then, a large number of cases are in the "stock drop" area, which encompasses cases relating to employer securities investments when the stock price drops severely. The litigation has focused on whether a presumption of prudence exists that protects fiduciaries holding employer securities investments on behalf of a retirement plan. In June 2014, the U.S. Supreme Court ruled in the case of *Fifth Third Bancorp v. Dudenhoeffer* that ERISA doesn't provide a presumption of prudence to protect fiduciaries of plans investing in employer securities.[1] Now that the *Dudenhoeffer* decision resolves the presumption issue, it is reasonable to expect that ERISA cases may return to focus on the fiduciary duties of a directed trustee.

ERISA provides that a directed trustee is intended to follow the direction of a plan's "named fiduciary." The directed trustee's exposure for ERISA fiduciary liability, it stood to reason, was therefore limited. Directed trustees may, however, have fiduciary exposure. When employees' retirement benefits have suffered significant losses, plaintiffs have looked to recover from all involved, including the directed trustee. Some questions that cases have raised are:

- Is a retirement plan's directed trustee liable when it follows the directions of a named fiduciary but the resulting investment performs poorly?
- What happens when the directions given by the named fiduciary conflict with the plan's purpose or with ERISA?
- May a directed trustee diverge from the named fiduciary's directions?
- If a directed trustee intervenes to take a position contrary to the named fiduciaries, is the directed trustee subject to more fiduciary liability than it would otherwise have under the plan?

In December 2004, the Department of Labor's Employee Benefits Security Administration released general guidance on the responsibilities of directed trustees with respect to directions involving publicly-traded employer securities.[2] Federal courts have relied on this guidance to find that directed trustees didn't breach their fiduciary duties by not acting on their own initiative, when faced with public information about a plan sponsor, to halt employee investment in the sponsor's stock.[3] While the focus had shifted away from directed trustees' responsibilities and toward the presumption of

[1] 573 U.S. __, 2014 BL 175777, 58 EBC 1405 (2014).

[2] Field Assistance Bulletin 2004-03.

[3] *In re WorldCom Inc. ERISA Litigation*, 354 F. Supp. 2d 423, 34 EBC 1545 (S.D.N.Y. 2005); *Summers v. UAL Corporation*, 453 F.3d 404, 38 EBC 1065 (7th Cir. 2006), *cert. denied*, 549 U.S. 1245 (2007).

prudence, since the Supreme Court has address the prudence issue in the *Dudenhoeffer* decision, expect litigation in the coming years to return to the area of directed trustee responsibilities.

The Assignment of Responsibility

ERISA Section 402(a)(1)[4] provides that a written plan document must include one or more "named fiduciaries" who control and manage the plan's operation and administration. ERISA Section 403(a)[5] states that plan assets generally are held in trust, managed by trustees either named in the trust instrument or appointed by the plan's named fiduciary. Trustees typically have authority to manage and control plan assets unless the plan expressly provides that the trustees are subject to the direction of the named fiduciary[6] or delegates such authority to an investment manager.[7]

ERISA defines fiduciary status in functional terms. ERISA Section 3(21)(a)[8] states that a person or entity is a fiduciary only "to the (1) extent he exercises any discretionary authority or discretionary control respecting the management of such plan or exercises any authority or control with the respect to the management or disposition of its assets." Fiduciary status, therefore, is defined under ERISA in functional terms of control and authority and is limited by the qualifying phrase "to the extent." At the same time, ERISA permits the allocation of authority and control of the plan assets over multiple fiduciaries.

The trustee must act in accordance with fiduciary rules under ERISA with respect to plan assets unless one of three exceptions is met:

- In the first exception, the plan may delegate authority to manage plan assets to one or more investment managers.[9]
- In the second exception, the plan may provide for individual participant accounts and give participants control over the investment selection for the assets in their accounts.[10]
- In the third and final exception, which is the focus of this report, the plan may provide that trustees are subject to the direction of a named fiduciary who isn't the trustee.[11]

Trustees who are subject to the direction of the named fiduciary are called "directed trustees." The practice of selecting directed trustees has often been used to allow plan assets to be under the custody of a qualified independent financial institution without subjecting the plan to expenses often incurred when a trustee or fiduciary is bound by ERISA's fiduciary standards.

Under ERISA Section 403(a)(1)[12], a directed trustee is to follow the named fiduciary's "proper directions" that are made "in accordance with the terms of the plan" and are "not contrary to ERISA." ERISA doesn't, however, define what it means for a direction to be "proper," nor does ERISA define the level of analysis that a directed trustee must undertake to determine whether the direction is consistent with the plan terms and ERISA.

Question for Directed Trustees: When should the trustee scrutinize the directions of the named fiduciary, and should the trustee ever disregard the directions of the named fiduciary when, in light of relevant financial information, it appears the named fiduciary's directions are contrary to the plan or ERISA?

Fiduciary Standards for Directed Trustees

There has been a split in opinion over the correct standard by which a directed trustee should operate. Some contend that the proper standard is for the trustee to follow the directions of a named fiduciary unless it is "clear on the face" of those directions that they violate the plan or trust document or ERISA. This "clear on the face" standard is drawn from ERISA's legislative history.[13]

The DOL's position, on the other hand, is that a directed trustee shouldn't follow the directions of a named fiduciary if it "knows or should know" that the directions violate the ERISA duty of prudence. The "knows or should know" standard is described in FAB 2004-03 as well as in case briefs.

In FAB 2004-03, the DOL made clear that a directed trustee is an ERISA fiduciary, even if it has significantly narrower duties than those generally ascribed to a named fiduciary. Citing to statutory language, the FAB states that a directed trustee is subject to the proper directions of a named fiduciary and a direction is only "proper" if it is: (1) made in accordance with the terms of the plan and (2) not contrary to ERISA.

According to the FAB, directed trustees have a duty to request and review all documents and instruments governing the plan and if the directed trustee either fails to request such documents or fails to review the documents and, as a result, follows a direction that is contrary to the terms of the plan, the directed trustee may be liable for following such direction. The FAB states that the direction is consistent with the terms of a plan if the documents pursuant to which the plan is established or operated don't prohibit the direction.

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[4] 29 U.S.C. § 1102(a)(1).
[5] 29 U.S.C. § 1103(a).
[6] 29 U.S.C. § 1103(a)(1), ERISA § 403(a)(1).
[7] 29 U.S.C. § 1103(a)(2), ERISA § 403(a)(2).
[8] 29 U.S.C. § 1002(21)(a).
[9] 29 U.S.C. § 1103(a)(2), ERISA § 403(a)(2).
[10] 29 U.S.C. § 1104(c), ERISA § 404(c).
[11] 29 U.S.C. § 1103(a)(1), ERISA § 403(a)(1).
[12] 29 U.S.C. § 1103(a)(1).
[13] H.R. Conf. Rep. No. 93-1280, 298 (1974), reprinted in 1974 U.S.C.C.A.N. 5038, 5079 (stating that a directed trustee is to follow the directions of the named fiduciary unless it is "clear on their face that those directions would be prohibited by fiduciary responsibility rules of the bill or would be contrary to the terms of the plan or trust").

Even if a direction is consistent with the terms of the plan, according to FAB 2004-03, the direction may nonetheless fail to be a proper direction if it is contrary to ERISA, and a directed trustee may not follow a direction that it knows is contrary to ERISA.

The guidance also provides that a named fiduciary has primary responsibility for determining the prudence of a particular transaction and thus a directed trustee doesn't, "in the view of the DOL," have an independent obligation to determine the prudence of, or "second guess," every transaction. A directed trustee with material nonpublic information regarding an employer's stock has a duty to inquire about the named fiduciary's knowledge and consideration of the information, according to the FAB. In addition, the FAB states that if the directed trustee performs an internal analysis in which it concludes that the employer's current financial statements are materially inaccurate, the directed trustee would have an obligation to disclose this analysis to the named fiduciary before making a determination whether to follow a direction to purchase the employer's stock.

Moreover, the FAB states that because stock prices fluctuate, even a steep drop in a stock's price wouldn't, in and of itself, indicate that a named fiduciary's direction to purchase or hold such stock is imprudent. The guidance further states that in "limited, extraordinary circumstances" where there are "clear and compelling" public indicators that call into question a company's viability as a going concern, the directed trustee may have a duty not to follow the named fiduciary's instruction without further inquiry. Such public indicators include an 8-K filing with the Securities Exchange Commission or a bankruptcy filing.

Finally, the FAB states that a directed trustee might still be liable as a co-fiduciary if it has knowledge of a fiduciary breach and fails to take reasonable steps to remedy the breach, such as reporting the breach to other fiduciaries of the plan or to the DOL.

The Case Law

Federal courts have typically held that a retirement plan's directed trustee can't be held liable if it followed the investment directions of the plan's named fiduciary. Below is a summary of cases dealing with directed trustee liability. While most of the cases didn't impose liability on a directed trustee, we note that none of the cases were decided after the *Dudenhoeffer* decision.

Cases Finding No Liability

In most of these cases, the courts found the directed trustee couldn't be held liable as a fiduciary when it followed the directives of the named fiduciary.

- *Donovan v. Cunningham*[14] (S.D. Texas 1982) - This early case briefly discussed the "limited role" of the directed trustee. The court noted that a directed trustee couldn't be liable for breach of fiduciary duty where its activities "at all times remained within the limited role of a directed trustee."

- *Ershick v. United Missouri Bank*[15] (10th Cir. 1991) - The Tenth Circuit ruled that a bank that acted as an ESOP's directed trustee didn't violate its fiduciary duty by following the direction of the plan administrator to purchase shares of employer stock, given that the trustee was subject to the direction of the plan administrator with respect to stock purchases that were consistent with the terms of the ESOP and ERISA. The fact that the stock declined sharply in value in a one-year period was insufficient to show imprudence by the trustee, according to the court. The court also found that the bank wasn't liable for plan losses because there was no evidence that it used its position to further its own interests at the expense of plan participants. In addition, the court found that the trustee, which was also a secured lender of the plan sponsor, didn't create a conflict of interest in this dual role.

- *Firstier Bank N.A. Omaha v. Zeller*[16] (8th Cir. 1994) - The Eighth Circuit ruled that a directed trustee didn't violate its fiduciary duties by making loans to plan participants pursuant to written directions from the plan administrator in accordance with the terms of the plan, where the participant loans ultimately were used to pay off a company loan from the trustee's commercial banking department. According to the court, the trustee did know of the use of the loans, but was unaware of the plan sponsor's financial situation. Although the court ultimately found that the trustee didn't violate its fiduciary duties, the court indicated that directed trustees aren't relieved of their fiduciary duties by virtue of ERISA Section 403.[17] In addition, the court rejected the notion that directed trustees have a broad duty of inquiry.

- *Maniace v. Commerce Bank of Kansas City*[18] (8th Cir. 1994) - Decided the same year as *Firstier*, the Eighth Circuit ruled that a bank serving as directed trustee of an ESOP didn't violate its fiduciary duties in allowing the plan to continue to hold large amounts of employer stock despite the stock's declining value. The court found that, as a directed trustee, the bank wasn't an ERISA fiduciary with respect to employer stock held by the ESOP because it lacked discretion over plan assets. According to the court, "the obligations of a directed trustee are something less than that owed by typical fiduciaries."

- *Herman v. Nationsbank Trust Co.*[19] (11th Cir. 1997) - The Eleventh Circuit found that ESOP trustees were ERISA fiduciaries subject to ERISA's prudence standard, and weren't merely directed trustees of plan participants as "named fiduciaries" with respect to the trustees' decision to tender unallocated ESOP shares in

[14] 541 F. Supp. 276, 3 EBC 1641 (S.D. Texas 1982), modified on other grounds by 716 F.3d 1455, 4 EBC 2329 (5th Cir. 1983).

[15] 948 F.2d 660, 14 EBC 1848 (10th Cir. 1991).

[16] 16 F.3d 907, 17 EBC 2313 (8th Cir. 1994).

[17] 29 U.S.C. § 1103.

[18] 40 F.3d 264, 18 EBC 2585 (8th Cir. 1994).

[19] 126 F.3d 1354, 21 EBC 2061 (11th Cir. 1997).

accordance with the plan's pass-through and mirror voting provisions in the midst of a corporate takeover contest. The court found, however, in remanding the case back to a lower federal court, that a question remained as to whether the ESOP trustees were subject to ERISA prudence standards with respect to their decision to tender allocated but non-voted ESOP shares in the midst of a corporate takeover, or whether the trustees were merely directed trustees subject to the direction of plan participants as named fiduciaries.

- *Grindstaff v. Green*[20] (6th Cir. 1998) - The Sixth Circuit ruled that a directed trustee isn't a fiduciary to the extent it doesn't control the management or disposition of plan assets. The court rejected ESOP participants' claim that the ESOP's directed trustee had a duty to investigate the merits of any directives given to it by the plan's named fiduciary. The court noted that the trustee had no discretion pertaining to voting the ESOP stock and could only act at the direction of the named fiduciary.

- *In re McKesson HBOC Inc. ERISA Litigation*[21] (N.D. Cal. 2002) - A California federal district court dismissed ESOP participants' claim that the plan's directed trustee breached its ERISA fiduciary duties by allowing plan fiduciaries to continue to invest in employer stock when it allegedly knew that such an investment was imprudent. The court found that as a directed trustee, the trustee was obligated to follow the investment instructions given by the named fiduciaries and thus couldn't be held liable for any losses that resulted from performance of its duty to follow those instructions. The court noted in a footnote, however, that if the participants could demonstrate that the trustee knew that the investment directives violated ERISA, then the trustee wouldn't be relieved of ERISA liability by following such imprudent directives.

- *Lalonde v. Textron Inc.*[22] (D. R.I. 2003) - In this case, the district court dismissed ESOP participants' claim that the plan's directed trustee breached its fiduciary duties by not rejecting the named fiduciary's directive to invest in the plan sponsor's stock. The court found that the directed trustee had no discretionary authority, and hence no fiduciary status. The First Circuit subsequently upheld the district court's decision after concluding that, even if it were to assume that the trustee wasn't a true directed trustee, there was nothing in the participants' complaint that would permit an inference that the trustee abused any discretion it might have had. The appeals court noted that the participants didn't allege that the trustee had any knowledge of the plan sponsor's malfeasance, but only allegedly learned, as events unfolded, that the sponsor's stock price and profits were declining and that the sponsor was undergoing a restructuring.[23]

- *Beauchem v. Rockford Products*[24] (N.D. Ill. 2003) - A federal court in Illinois dismissed claims against an ESOP's directed trustee. In so doing, the court rejected claims that the trustee breached its fiduciary duties by failing to obtain an independent fair market value appraisal of employer stock purchased by the ESOP, by failing to negotiate the terms of the ESOP stock purchase, and by failing to take action to recover losses incurred as a result of the ESOP stock purchase.

- *Wright v. Oregon Metallurgical Corp.*[25] (9th Cir. 2004) - The Ninth Circuit ruled that the directed trustee of a stock bonus plan didn't breach its duty when it allowed the plan's named fiduciaries to bar plan participants from selling off their employer stock. The court found that because the fiduciaries themselves didn't breach their duties by declining to allow the participants to sell their stock, "the directed trustee's compliance with that direction cannot serve as a basis for liability."

- *In re WorldCom Inc. ERISA Litigation*[26] (S.D.N.Y. 2005) - A New York federal trial court originally denied dismissal of claims that Merrill Lynch, as the directed trustee of WorldCom's 401(k) plan, breached its fiduciary duties by following the named fiduciaries' directions to invest 401(k) plan assets in WorldCom stock.[27] WorldCom 401(k) plan participants alleged that Merrill Lynch had sufficient information about WorldCom's financial condition that made it imprudent for the plan to invest in WorldCom stock. The court noted that Merrill Lynch "retained the discretion and even the obligation as a directed trustee to abide by the duties imposed by ERISA." In addition, the court noted that under ERISA Section 403,[28] Merrill Lynch could be liable to the extent that it allegedly followed instructions to invest in WorldCom stock when a prudent trustee would know that WorldCom's decision to continue to offer its own stock was imprudent, or otherwise in violation of ERISA. The district court subsequently found that the participants who sued Merrill Lynch failed to show that the company had nonpublic information about WorldCom that would have required Merrill Lynch to take the "extraordinary action" of stopping all investments in WorldCom stock. The court thus dismissed the participants' claims against Merrill Lynch. The district court was the first federal court to examine FAB 2004-03 and relied heavily on the FAB. Among other things, the court noted that directed trustee has a duty of inquiry under ERISA only when it "knows or should know" of reliable public information that calls into serious question a company's short-term viability as a going concern.

- *Summers v. UAL Corporation*[29] (7th Cir. 2006) - Affirming a district court decision, the Seventh Circuit

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[20] 133 F.3d 416, 21 EBC 2249 , (6th Cir. 1998).
[21] No. C00-20030 RMW, 2002 BL 2180, 29 EBC 1229 (N.D. Cal. September 30, 2002).
[22] 270 F. Supp. 2d 272, 30 EBC 2358 (D. R.I.2003).
[23] 369 F.3d 1, 32 EBC 2217 (1st Cir. 2004).
[24] No. 01 C 50134, 2003 BL 2120, 30 EBC 2342 (N.D. Ill.March 24, 2003).
[25] 360 F.3d 1090, 32 EBC 1417 (9th Cir. 2004).
[26] 354 F. Supp. 2d 423, 34 EBC 1545 (S.D.N.Y. 2005).
[27] 263 F. Supp.2d 745, 30 EBC 2035 (S.D.N.Y. 2003).
[28] 29 U.S.C. § 1103.
[29] 453 F.3d 404, 38 EBC 1065 (7th Cir. 2006), *cert. denied*, 549

held that the directed trustee of United Air Line's ESOP didn't breach its ERISA fiduciary duties by holding on to United's stock as the airline headed into bankruptcy. The court held that the directed trustee has a statutory duty of prudence, but that duty doesn't include a duty to diversify because an ESOP isn't subject to ERISA's diversification requirements, and ERISA forbids directed trustees from complying with the directions of the plan's named fiduciary if those directions aren't "proper." The court found that United's CEO's announcement that the company was "in a struggle just to survive" didn't trigger a duty to divest the plan of airline's stock, in that the stock market didn't react in any significant way to the announcement. The court added that it isn't imprudent for a trustee to assume that a major stock market provides the best estimate of value of stocks traded on it, and since, while an ESOP is a seemingly inefficient method of wealth accumulation for employees due to its under-diversification, plan participants didn't produce evidence of when it would have been feasible and prudent for the trustee to sell the airline's stock.

The court noted that FAB 2004-03 affirms both that the directed trustee has a duty of prudence and that he has no "direct obligation to determine the prudence of a transaction" entrusted by the plan to another fiduciary. "[D]irect" is the critical word," the court said, "inviting us to resolve the tension by ruling that the trustee can disobey the named fiduciary's directions when it is plain that they are imprudent." Concluding there was a failure of proof, the court stated that "determining the 'right' point, or even range of 'right' points, for an ESOP fiduciary to break the plan and start diversifying may be beyond the practical capacity of the courts to determine." The FAB's statement that a directed trustee may have a duty to sell "where there are clear and compelling public indicators, as evidenced by an 8-K filing with the Securities and Exchange Commission (SEC), a bankruptcy filing or similar public indicator, that call into serious question a company's viability as a going concern," according to the court, "is not an administrable standard; note the hedge in 'may' and the fact that selling when bankruptcy is declared will almost certainly be too late."

- *In re General Motors ERISA Litig.*[30] (E.D. Mich. 2006) - The scope of a directed trustee's authority with respect to disposition of fund assets was decided in favor of the directed trustee where the federal district court evaluated the trustee's fiduciary role under an investment management agreement (IMA) concerning General Motors Common Stock Funds held in GM plans. The plaintiffs argued that the directed trustee's status as "investment manager" pursuant to an IMA gave it the discretionary authority to divest the company stock in the Fund in lieu of cash or other investments. The court rejected that argument and dismissed the case against the directed trustee. The court noted that the trustee's discretionary authority under the IMA was limited by express language in the agreement, which provided that the trustee was to discharge its duties with respect to investments in the funds "in accordance with the documents and instruments governing the Programs." The court found that this included the SPDs that stated the Fund's investment strategy was to "invest solely in the shares of GM. . . except for a small portion ordinarily targeted at 1 percent, dedicated to short-term fixed income investments and money market instruments."

- *In re Delphi Corp. Securities, Derivative & "ERISA" Litigation*[31] (E.D. Mich. 2009) - A federal district court in Michigan found that a 401(k) plan's directed trustee didn't breach its fiduciary duties when it waited until just three days before the plan sponsor's bankruptcy to start unloading the plan's investments in the sponsor's stock. The court noted that a directed trustee is instructed under an investment manager agreement to act as directed by the plan's named fiduciary, and in this role the directed trustee couldn't have gone against the named fiduciary's directions unless extraordinary circumstances had called into question the sponsor's viability as a going concern, at which point the trustee would have had a possible duty to not follow the named fiduciary's instruction. The court found it wasn't until late September 2005 that reliable public information showed that the sponsor would be unable to reach a negotiated settlement that would stave off its bankruptcy, and thus it wasn't until then that the sponsor's viability was called into serious question, so it wasn't a fiduciary breach for the trustee to not take action to override the provisions of the plan documents and initiate a sale of the sponsor's stock before it did.

- *Renfro v. Unisys Corp.*[32] (3d Cir. 2011) - The Third Circuit ruled that a 401(k) plan's service provider wasn't an ERISA fiduciary with respect to selection and retention of investment options in the plan, and thus couldn't be held liable for alledgedly breaching its fiduciary duties by selecting plan investments that purportedly charged excessive fees. The court found that the directed trustee didn't have control over the mix and range of investment options, nor did it have authority to veto the plan sponsor's selection of investment options or to constrain the plan sponsor from including options in the plan that were administered by another company. The court also found that the directed trustee wasn't liable as a co-fiduciary for the plan sponsor's alleged fiduciary breach by selecting plan investments that purportedly charged excessive fees, since the directed trustee didn't have any actual knowledge of breach by the plan sponsor.

- *Tullis v. UMB Bank N.A.*[33] (6th Cir. 2011) The Sixth Circuit ruled in an unpublished opinion that UMB

U.S. 1245 (2007).

[30] No. 05-71085, 2006 BL 145635, 37 EBC 1951 (E.D. Mich. April 6, 2006).

[31] 453 F.3d 404, 2009 BL 56821, 46 EBC 1499 (E.D. Mich. 2009).

[32] 671 F.3d 314, 2011 BL 215021 51 EBC 1609 (3d Cir. 2011).

[33] No. 09-4370, 2011 BL 133241, 50 EBC 2778 (6th Cir. unpublished May 18, 2011), *cert. denied* 132 S.Ct. 1005, 51 EBC 2984 (2012).

Bank N.A. didn't breach its duties as the directed trustee of a Section 401(k) plan when it allegedly failed to tell two plan participants that their investment adviser had engaged in fraudulent activities.

Cases Finding Potential Directed Trustee Liability

Some courts have found a directed trustee liable even when it follows the directions of a named trustee.

- *Koch v. Dwyer*[34] (S.D.N.Y. 1999) - In denying a motion to dismiss, a New York federal district court ruled in this case that a directed trustee wouldn't be immune from liability if it was aware that the named fiduciary's investment directions were based on an inadequate investigation. The court rejected the trustee's contention that for a directed trustee to be held liable for an investment choice, it must be "clear on its face" that the instruction violated the plan or ERISA.

- *Srein v. Frankford Trust Co.*[35] (3d Cir. 2003) - Unlike many of the other directed trustee liability cases that have dealt primarily with investment in employer stock, this case dealt with a small employer's investment in viatical settlement agreements. The Third Circuit ruled that a bank that served as directed trustee of a retirement plan that invested primarily in viatical settlement agreements acted as an ERISA fiduciary and may have breached its duties when it failed to discover the double sale of a viatical settlement policy to two separate retirement plans. The court found that while the trustee had very limited discretion, it acted as more than a "plain vanilla" custodian of assets by performing more than merely administrative and ministerial duties, in that it took control of the viatical settlement policy proceeds and erroneously distributed the proceeds to the incorrect plan. However, on remand the Pennsylvania district court found that the bank didn't breach its fiduciary duties by not detecting the double sale of the viatical settlement policy.[36]

- *Kling v. Fidelity Management Trust Co.*[37] (D. Mass. 2003) - In denying a directed trustee's motion to dismiss, a Massachusetts court noted that there were allegations that the trustee knew that it was imprudent to invest in employer stock, yet continued to allow plan assets to be invested in such stock. According to the court, the trustee could be liable as a fiduciary if it followed the named fiduciaries' directions and those directions were contrary to the plan or ERISA. In addition, the court noted that the plaintiffs weren't required to prove that the violation of the plan or ERISA was "clear on its face" for the trustee to be held liable. In a subsequent decision, [38] the district court again said it would not dismiss the claims against the directed trustee. The court noted that, although the trustee may not have exercised discretion over plan assets sufficient to convey fiduciary status as to the investment of those assets, the trustee's duty to distinguish between proper and improper instructions from the plan's named fiduciary "was itself a fiduciary duty."

- *Tittle v. Enron*[39] (S.D. Texas 2003) - In a very extensive and thorough opinion, a federal district court in Texas denied a motion to dismiss filed by the directed trustee of Enron's retirement plan. In so ruling, the court rejected the trustee's argument—which was joined by the American Bankers Association—that under ERISA § 403[40], a directed trustee is protected from liability when it follows the directions it receives regarding the investment of plan assets so long as the directions are "clear on their face" that they are neither contrary to the terms of the plan nor contrary to ERISA. Instead, the court adopted a "knew or should have known" standard, as urged by the Department of Labor. Under this standard, a directed trustee could be liable if it knew or should have known that a plan's named fiduciary was breaching its duties by directing the investment of plan assets in employer stock. The court found that the Enron plan participants adequately alleged that a number of "significant waving red flags" put the trustee on notice that Enron was in financial danger. The court also noted that a directed trustee is an ERISA fiduciary and has a duty to "supervise" and "investigate" the directions it receives from a plan's named fiduciary when it has "some reason to know" that the directions may conflict with ERISA or the plan's terms.

- *Beam v. HSBC Bank USA*[41] (W.D.N.Y. 2003) - In denying a motion for summary judgment, a New York federal court in this case refused to dismiss ESOP participants' claim that the plan's directed trustee breached its ERISA fiduciary duties by allowing the plan to purchase $25 million in employer stock at inflated prices. The court found that genuine issues of material fact existed, requiring further discovery into whether the trustee was aware that it was imprudent to purchase the employer's stock and whether the stock purchase was contrary to ERISA.

Conclusion

While fewer courts have found fiduciary breaches by a directed trustee, courts are taking a closer look. Whether the standard is a "clear on its face" standard or a "knew or should have known" standard, it is clear that directed trustees can't simply bury their heads in the sand when it comes to overseeing the investment decisions made by named fiduciaries.

A directed trustee must, at minimum, make a cursory review of the direction it receives to ensure that it complies with the plan and ERISA. While the chance that the direction violates the plan or ERISA on its face is rare, the directed trustee may take other actions

[34] 1999 WL 528181 (S.D.N.Y. 1999).
[35] 323 F.3d 214, 30 EBC 1978 (3d Cir. 2003).
[36] No. 99-2652, 2004 BL 3716, 32 EBC 2252 (E.D. Pa., March 25, 2004).
[37] 270 F. Supp.2d 271, 30 EBC 2446 (D. Mass. 2003).
[38] 323 F. Supp.2d 132, 33 EBC 1035 (D. Mass. 2004)
[39] 284 F. Supp.2d 511, 30 EBC 2281 (S.D. Texas 2003).
[40] 29 U.S.C. § 1103.
[41] 31 EBC 1257 (W.D.N.Y. 2003).

short of disregarding the direction to affirm its duties. For example, it may:

- Ask the named fiduciary about the employer's financial problems.
- Ask what the employer has done to cure any financial problems and give deadlines for a response.
- If the named fiduciary and/or employer do not respond, the directed trustee could file a petition in federal court asking the court what to do or to appoint an independent fiduciary to decide what to do

All parties are best served if the participants are notified of the fiduciary roles each party is playing. Participants should be aware of the limitations of the fiduciary duties of the institution that holds the plan's assets.

A directed trustee may be in a worse position than a named fiduciary, who knows the scope of its duties under ERISA. While there is currently uncertainty as to the breadth of a directed trustee's responsibilities, a directed trustee must understand the position it is in based on existing law.