

The ERISA Litigation Newsletter

October 2013

Editor's Overview

This month we return to the age-old question - "*What makes someone a fiduciary?*" As Nicole Eichberger explains, the Seventh Circuit reminded us that the meaning of a "functional fiduciary" depends on exercise/conduct in relation to the claims at issue. Thus, close examination of fiduciary breach allegations at each stage of a dispute can become a key defensive tool in dismissing or limiting the claims alleged and the discovery related thereto.

As always, be sure to review the Rulings, Filings, and Settlement of Interest where we discuss the DOL's "Place of Celebration" rule, proposed legislation on executive compensation, bankruptcy discharge of ERISA withdrawal liability, and a common law slayer rule.

Leimkuehler v. Am. United Life Ins. Co.:* Revisiting Functional Fiduciary Status

Contributed by Nicole Eichberger

Unless an individual or entity is a named fiduciary under ERISA, a plaintiff must show that the defendant is a "functional fiduciary" under ERISA § 3(21)(A), 29 U.S.C. § 1002(21)(A) in order to sustain a fiduciary claim. In *Pegram v. Herdrich*, 530 U.S. 211 (2000), the Supreme Court stated that fiduciary status is dependent upon the answer to the question: "whether [the] person was acting as a fiduciary (that is, was performing a fiduciary function) when taking the action subject to the complaint." The analysis of, and answer to, this question have become key issues with respect to current fee and ESOP litigations. Recently, the Seventh Circuit revisited this threshold question in *Leimkuehler v. Am. United Life Ins. Co.*, 713 F.3d 905 (2013), and, following the *Pegram* Court, held that functional fiduciary status relies on the defendant's conduct in relation to the claims at issue in the complaint.

ERISA Fiduciary Status

Under ERISA, an individual or entity may be an ERISA fiduciary in one of two circumstances. First, fiduciary status may be conferred by being named in the plan instruments. ERISA § 405(c)(1)(B), 29 U.S.C. § 1105(c)(1)(B). Alternatively, if fiduciary status is not conferred in name, an individual or entity may be a "functional fiduciary" under ERISA § 3(21)(A) 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 ..., (iii) he has any discretionary authority or discretionary responsibility in the administration of such plan." The Seventh Circuit recently addressed when, and to what extent, an individual is an ERISA functional fiduciary in *Leimkuehler*.

***Leimkuehler*: Factual & Procedural Background**

The trustee of the Leimkuehler, Inc. Profit Sharing Plan (the "Plan") filed a breach of fiduciary duty class action suit against American United Life Insurance Company ("AUL"), which provided various services to the Plan, but was not a named fiduciary under the plan documents. AUL's services included the provision and use of a group variable annuity contract, enabling participants to invest in mutual funds. The structure of the contract was such that the participants did not directly invest in the mutual funds; rather, the contributions were deposited in a separate account that AUL subsequently used to invest as selected by the participants. AUL would then credit the proceeds back to the participants. The costs associated with this provision of services were borne through the practice of "revenue sharing," whereby the mutual fund companies paid a portion of the fees charged to investors to AUL as compensation for AUL's provision of these services. The fees charged to investors by the mutual funds, i.e. expense ratios, were disclosed to participants; however, the amount of revenue sharing between the funds and AUL was not required to be disclosed at the time of the lawsuit. What AUL did not receive from the "revenue sharing" arrangement from the mutual funds, it billed to the plan sponsor and participants.

The Plan trustee alleged AUL and its revenue sharing practices breached AUL's ERISA fiduciary duty. AUL filed summary judgment, arguing the case should be dismissed because it was not a "functional fiduciary" under ERISA § 3(21)(A). The district court granted AUL's summary judgment, holding that AUL was not an ERISA fiduciary under Section 3(21)(A) with respect to its revenue sharing practices. The Plan trustee appealed.

***Leimkuehler*: The Seventh Circuit's Ruling**

On appeal, the Plan's trustee argued that AUL was a fiduciary because (1) it exercised authority or control over the management or disposition of the Plan's assets by selecting which mutual fund share classes to include on its investment menu; and (2) it exercised authority or control through various activities associated with maintaining the separate account. In an *amicus* brief, the DOL urged a third theory: AUL's contractual reservation of the right to substitute or delete funds made available to plan participants was itself an exercise of authority or control over the Plan's assets even if AUL never affirmatively exercised this contractual right.

The Seventh Circuit labeled the Plan trustee's first argument the "product design" theory. The court determined that this theory could not be sustained in light of the court's prior decision in *Hecker v. Deere & Co.*, 556 F.3d 575 (2009). In *Hecker*, the court ruled that the mere act of selecting which funds to include in a defined contribution investment product without any other action does not rise to fiduciary responsibility under ERISA § 3(21)(A). The *Leimkuehler* court saw no basis to distinguish the facts presented here from those in *Hecker*, and reaffirmed that "standing alone, the act of selecting both funds and their share classes for inclusion on a menu of investment options offered to 401(k) plan customers does not transform" the provider into an ERISA fiduciary.

The Seventh Circuit also rejected the Plan trustee's second argument. Relying on the Supreme Court's decision in *Pegram*, it held that whether AUL was actually a fiduciary with respect to the maintenance of the separate account was irrelevant to whether AUL was a fiduciary with respect to the issue raised in the complaint: mutual fund selection and the corresponding revenue sharing practice.

The court then turned to the DOL's proffered theory contained in its *amicus* brief: that AUL "exercised" authority by reserving its right to delete or substitute funds that the Plan trustee selected for the Plan. The Seventh Circuit labeled this argument a "non-exercise" theory and swiftly rejected it on the grounds that it was "unworkable," and would expand improperly ERISA's fiduciary definition under Section 3(21)(A) by including conduct that conflicted with the actual exercise of authority. In short the Seventh Circuit held that AUL's decision *not* to exercise its contractual rights did not make it a functional fiduciary under ERISA.

Proskauer's Perspective: Functional Fiduciary Status & Defense Strategy

The Seventh Circuit's revisiting of "functional fiduciary" status under ERISA reminds us that fiduciary status is at the core of fiduciary litigation. The court's analysis reinforces what the Supreme Court held in *Pegram*: functional fiduciary status depends on exercise/conduct in relation to the claims at issue. Accordingly, close examination of fiduciary breach allegations at each stage of a dispute can become a key defensive tool in dismissing or limiting the claims alleged and the discovery related thereto.

Rulings, Filings and Settlements of Interest

U.S. Department of Labor Announces a "Place of Celebration" Rule in Implementing the U.S. Supreme Court's DOMA Decision With Regard to Employee Benefit Plans

By Roberta Chevlowe

- A few weeks after the Internal Revenue Service (IRS) stated that it will apply a "place of celebration" rule in recognizing same-sex spouses for purposes of the Internal Revenue Code (including with respect to employee benefit plans), the U.S. Department of Labor (DOL) announced today that it too will interpret the term "spouse" as including a same-sex spouse legally married in any state or foreign jurisdiction that recognizes the marriage, even if the couple resides in a state that does not permit or recognize same-sex marriage, for purposes of ERISA, the Internal Revenue Code and governing DOL regulations. (DOL Technical Release No. 2013-04.) Like the IRS, the DOL confirmed that this interpretation does not include individuals (of the same or opposite sex) in a domestic partnership or civil union, even if the partners have the same rights as married couples under the applicable state law.

Although the Release does not provide detailed guidance for employee benefit plans (e.g., with regard to COBRA or HIPAA), the DOL notes that it intends to issue further guidance addressing specific provisions of ERISA and its regulations. In addition, the Secretary of Labor stated in the related press release that he has "directed the department's agency heads to ensure that they are implementing the decision in a way that provides maximum protection for workers and their families."

The rule announced in the Technical Release is welcome news for employers and other benefit plan sponsors, as it "provides a uniform rule of recognition that can be applied with certainty by stakeholders, including employers, plan administrators, participants, and beneficiaries." As the DOL acknowledges, if employee benefit plans were required to follow a rule based on the state of the employee's residence,

there would be significant challenges and burdens in employee benefit plan administration, particularly for employers operating in more than one state. The same would be true for multiemployer plans covering participants across the country.

Proposed Legislation Threatens Executive Compensation Tax Deductions

By Justin Alex and Joshua Miller

- In early August, U.S. Senators Jack Reed and Richard Blumenthal introduced the "Stop Subsidizing Multimillion Dollar Corporate Bonuses Act" (S. 1476) in the U.S. Senate. The proposed bill would significantly expand the scope of Section 162(m) of the Internal Revenue Code. Section 162(m) currently limits the deductibility of compensation paid in excess of \$1 million to a publicly traded company's currently employed chief executive officer and its three other highest compensated officers (other than its chief financial officer). Section 162(m) includes exceptions from the limits for certain commissions and qualified performance-based compensation.

Specifically, the bill proposes:

1. To eliminate the existing Section 162(m) exceptions for commission payments and qualified performance-based compensation;
2. To include all current *and former* employees (whether or not they are or were ever executive officers) within the scope of Section 162(m); and
3. To impose the limitations of Section 162(m) to public companies subject to periodic reporting under Section 15(d) of the Exchange Act (not just public corporations with securities registered under Section 12 of the Exchange Act, as is currently the case).

If this bill were ever to become law, it would essentially eliminate all tax deductions for compensation in excess of \$1 million paid by publicly held companies to all of their current and former employees. It could also have unintended consequences, however, by discouraging public companies from continuing certain performance-based compensation programs and by taking away certain incentives a public company otherwise would have in designing equity and cash bonus plans. For example, in order to qualify for the performance-based compensation exception to Section 162(m), affected companies have to seek shareholder approval of their annual cash bonus plans, including the applicable performance goals and maximum annual payments. If the Section 162(m) exception does not apply and this compensation is no longer deductible, companies may not have the tax incentive to seek shareholder approval. Further, in order to qualify for the performance-based exception to Section 162(m), compensation committees must set objective performance goals and are prohibited from exercising discretion to increase compensation during or after the applicable performance period; this bill could potentially encourage the greater use of subjective performance metrics and the greater exercise of discretion as compared to current practices.

Although it may be unlikely that the bill will become law, it is another example of the political/legislative scrutiny of executive compensation and calls for reform and regulation, and undoubtedly not the last one.

Ninth Circuit Allows Bankruptcy Discharge of ERISA Withdrawal Liability

By Aaron Feuer

- The Ninth Circuit recently held that an employer who failed to pay \$170,045 in withdrawal liability could discharge the liability in bankruptcy. *Carpenters Pension Trust Fund v. Moxley*, No. 11-16133 (9th Cir. August 20, 2013). In so ruling, the Court rejected the Fund's argument that unpaid withdrawal liability constituted a plan asset. The Court distinguished claims for unpaid withdrawal liability, which arise by operation of law when the CBA no longer applies to the withdrawn employer, from claims for unpaid contributions, which arise under the terms of a collective bargaining agreement and could be plan assets where the CBA's language so provides.

Life Insurance Beneficiary Who Murdered Policyholder Is Not Entitled To Benefits

By Joseph Clark

- Applying the common law "slayer rule," a federal district court in New York held that a beneficiary of an ERISA-governed life insurance plan forfeit his claim to insurance proceeds after he pled guilty to murdering the policyholder. *Metropolitan Life Ins. Co. v. Little*, E.D.N.Y., No. 13-cv-1059-BMC, Aug. 17, 2013. The policy holder, Rosemary Little, named her son as a 60% beneficiary, and her grandson a 40% beneficiary. Rosemary's grandson pled guilty to murdering her

After paying Rosemary's son 60% of the benefit, MetLife initiated an interpleader action seeking a direction from the court as to how to distribute the remaining 40% of the benefits. The son filed a counterclaim and motion for summary judgment seeking the remaining 40% of the benefit. The Court held that the grandson forfeited any claim to the remaining benefits because the slayer rule, a common law principle dating to the late nineteenth century, precludes an individual who causes the death of an insured from recovering under the insured's policy. The court thus ordered that the remaining proceeds be paid to the son, the only other named beneficiary under the policy.

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