Legal *Update*

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Are Trustees' Employees Fiduciaries Under ERISA?

ESOPs have been a "national project" of Department of Labor (DOL) enforcement since the 1980s. But unlike other regulatory agencies, the DOL has put off issuing clear guidance—other than a proposed regulation that has never been finalized—regarding how fiduciaries should meet the standards articulated in ERISA.

Instead, the DOL has effectively engaged in "regulation by litigation," and devoted substantial resources to challenging transactions in which ESOPs have purchased or sold company stock.

As a result, DOL-initiated litigation regarding ESOP transaction valuations has become fairly commonplace. The targets of that litigation traditionally have been trustees (both "inside" and institutional), and in many cases the sellers or buyers of company stock.

But in a recently filed complaint, the DOL expanded its target list to include an employee of an institutional trustee who was appointed to oversee an ESOPs acquisition of company stock. *Perez v. Vinoskey, et al.*, Case No. 6:16-cv-00062-NKM (W.D. Va).

It is too soon to tell whether the DOL's approach in *Vinoskey* is a harbinger of more aggressive DOL litigation strategy in the future, or an aberration confined to the particular facts of the case and the regional office from which the investigation arose. The complaint in *Vinoskey* tells us almost nothing about why, exactly, the DOL chose to pursue not only an institutional trustee but one of its employees as well.

In any case, institutional trustees of any plan or trust (and their key employees) should be aware of the claims that the DOL is making in *Vinoskey,* as well as the current law in this area.

The Background

Vinoskey arose out of a second-stage ESOP transaction involving the stock of Sentry Equipment Erectors, Inc. (Sentry). According to the complaint filed on October 14, 2016—which, so far, is the only document filed in the case—the Sentry ESOP owned 48 percent of the company's outstanding stock, as of 2010. (The ESOP acquired the initial 48 percent of the company's shares in a 2004 transaction.)

The company's founder, Adam Vinoskey, and the Adam Vinoskey Trust, owned the remaining 52 percent of the company's shares of stock. From 2007-2011, as participants retired, their shares were valued in a range between $241 to $285 per share. The value was arrived at through appraisal analyses prepared by a professional valuation firm.

The ESOP acquired the balance of Vinoskey's shares in December 2010. Evolve Bank & Trust (Evolve) was hired as an independent trustee on behalf of the ESOP in connection with the transaction.

The ESOP paid $406 per share for Vinoskey's majority interest in Sentry. The price was arrived at through a valuation performed by the same firm that had previously appraised the stock for purposes of determining amounts the ESOP would pay to repurchase participant shares upon retirement.

The DOL alleged that the $406 price was inflated. In its complaint, the DOL alleged two specific criticisms of the valuation that the ESOP fiduciaries relied upon to reach the $406 price.

First, the Department claimed that in projecting future income, the valuation should have taken into account not only the 2007-2009 period immediately preceding the transaction, but also the 2004-2006 period. According to the DOL, the company had been much less profitable in those earlier years. (The complaint does not mention whether or how the company's profitability was impacted in those earlier years by the 2004 ESOP transaction.)

Second, the complaint alleged that the discount rate used in its capitalization of earnings valuation methodology was too low when compared to discount rates used to value company shares in 2009 and earlier in 2010. (The lower discount rate resulted in a higher per-share value.)

Thus, the DOL claimed that because the per-share price used for the 2010 transaction was too high, the fiduciaries breached their duties of loyalty and prudence to the ESOP, and engaged in a transaction prohibited by ERISA §406(a)(1)(A) and (a)(1)(D). (Those sections prohibit fiduciaries from causing a plan to engage in a transaction if they know or should know that the transaction constitutes a direct or indirect sale or exchange of property between the plan and a party in interest, and a transfer to or use by the benefit of a party in interest.)

In those respects, the DOL's complaint is not particularly remarkable. (Although it remains to be seen whether its criticisms of the valuation are valid.) What is striking about the complaint is *who* the DOL elected to name as defendants. In addition to naming as defendants Sentry, Vinoskey, and Evolve, the complaint named Michael New, who it described as "a lawyer employed by [Evolve]" who "performed the duties of the independent transaction trustee and as such was a fiduciary with respect to the plan pursuant to ERISA Section 3(21)(A)."

In most cases, the DOL has refrained from naming individuals as defendants when they are merely "employed by" institutional trustees. So this new case represents something of a departure from the DOL's established practice. What's more, the complaint in *Vinoskey* gives virtually no inkling of why the DOL chose to veer from that approach in this case.

Calendar of Deadlines and Important Dates

Jan. 1	Dues Increase Takes Effect
Jan. 1	New Code of Responsibility Takes Effect
Feb. 3	Deadline for Applying to the Board of Governors
Feb. 3	Deadline for Entering Annual Award for Communications Excellence Competition
Feb. 3	Deadline for Entering Employee Ownership Month Poster Competition
March 2-3	Professional ESOP Forum

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Looking Ahead

It remains to be seen whether the DOL's claims against Mr. New will hold up.

ERISA defines "fiduciary" in functional terms. While some persons and entities—such as trustees—are fiduciaries by virtue of their titles and the roles they take on, ERISA generally looks to the functions that persons perform to determine whether they are fiduciaries.

The *Vinoskey* complaint does not allege what *specific* functions Mr. New performed relative to the 2010 Sentry ESOP transaction, other than to say that he "performed the duties of the independent transaction trustee."

Consequently, *Vinoskey* raises the question whether, when an entity is named as a fiduciary, individuals employed by that entity also may be fiduciaries when they carry out the entity's fiduciary functions.

The Federal Courts of Appeal are split on this issue.

The Third Circuit Court of Appeals focuses on whether individual employees of an entity named as a fiduciary have some individual discretion separate and apart from the entity by whom they are employed. In the case of *Confer v. Custom Eng'g Co.*, 952 F.2d 34, 37 (3rd Cir. 1991), the court ruled that "when an ERISA plan names a corporation as a fiduciary, the officers who exercise discretion on behalf of that corporation are not fiduciaries within the meaning of section 3(21)(A)(iii), unless it can be shown that these officers have individual discretionary roles as to plan administration."

The Ninth Circuit has rejected the Third Circuit's reasoning at least twice.

In *Kayes v. Pac. Lumber Co.*, 51 F.3d 1449, 1460 (9th Cir. 1995), the Ninth Circuit, referring to the text of ERISA itself, stated "there is no indication that an officer of a named fiduciary cannot be a fiduciary and the personal liability provision [i.e., ERISA §409(a)] asserts that all fiduciaries will be held personally liable, without mention of named fiduciaries."

And in *Stewart v. Thorpe Holding Co. Profit Sharing Plan,* 207 F.3d 1143 (9th Cir. 2000), the court extended the holding in *Kayes* to impose personal liability upon individual members of a committee that was the named plan administrator.

The Fifth Circuit Court of Appeals agrees with the Ninth in the ruling on *Musmeci v. Schwegmann Giant Super Markets, Inc.,* 332 F.3d 339, 350-351 (5th Cir. 2003).

The Sixth Circuit Court of Appeals has recognized the differences among the Ninth, Fifth, and Third Circuits. But the court essentially concluded that, in the circumstances of the case in which its decision arose—*Briscoe v. Fine,* 444 F.3d 478, 487-488 (6th Cir. 2006)—there was no evidence that the individual directors claimed to be fiduciaries in that case "made any decisions with respect to plan management or the collection or distribution of plan assets." As a result, the court found, those directors were not fiduciaries under either the Ninth Circuit test or the Third Circuit approach.

The *Vinoskey* case is pending in the Western District of Virginia, within the Fourth Circuit. The Fourth Circuit has not yet weighed in on the issue.

Vinoskey may, therefore, have a significant impact on the scope of liability of individual employees of ESOP trustees generally, and employees of institutional trustees in particular.