Nexus Requirement for Fiduciary Breach

Marcia S. Wagner, Esq.

Although there is no disagreement, the term fiduciary under ERISA is to be broadly defined, both the statutory language of ERISA and the gloss that courts have put upon it may make it difficult in litigation to establish that a party is a fiduciary or has breached his or her fiduciary duty, particularly with respect to allegations of excessive fees. Some of these limitations are well-known. One way that a party not specifically named as a fiduciary to a plan owes a fiduciary duty is "to the extent" that the parry exercises any discretionary authority or control respecting management of a plan or exercises any authority or control respecting management or disposition of its assets. Courts have held that dis, cretionary authority and discretionary control refer to actual decisionmaking power, not any influence that a party may have over the decision. It is for this reason contracts with service providers will frequently provide that a proposed action will not take place without providing a notice of such changes, frequently 60 days, to a client. So that it is the client, rather than the service provider, who has the final say on whether the change is implemented, even if the client's only recourse, if it disagrees with the proposed change, is to terminate the contract. Of at least of equal importance to the definition of fiduciary is the timing of when a parry becomes a fiduciary. A service provider cannot be a fiduciary with respect to a plan to which it has no contractual relationship. Until the contract is signed, a plan sponsor is free to reject the terms of the contract and seek to contract with an alternative service provider who may offer more attractive pricing or superior investment products. Because a party does not owe a fiduciary duty to plan participants while negotiating the terms of a contract, it cannot breach any duty to plan participants simply by charging the fees in the contract. Several courts have held that a service provider's adherence to the terms of its agreement with a plan sponsor/plan administrator does not implicate any fiduciary duty where the parties negotiated and agreed to the terms of the agreement in an arm's length bargaining process. Therefore, *even* if the fees in the agreement are not market, the service provider can continue to receive them.

What is less well-known is that some Circuits, specifically the Third and the Eighth Circuits, have an additional nexus requirement for determining if there has been a breach of fiduciary duty. This test, derived from language by the Supreme Court in Pegram v. Herdrich, is that in assessing claims under ERISA, a court must ask "whether the person was acting as a fiduciary ... when taking the action subject to a complaint." The Third Circuit and the Eighth Circuit understand this to mean that there must be a nexus between the alleged basis for fiduciary responsibility and the wrongdoing alleged in the complaint.

In *McCaffiee Financial Corp v. Principal Life Insurance*, the Court of Appeals for the Eighth Circuit explained the meaning of this test in practice. In that case, under the terms of a contract that *McCaffree* had agreed to, Principal had the right to limit the number of separate account contracts offered to plan participants. Under the terms of the contract, in consideration for Principal offering these separate accounts to plan participants, Principal would charge them a management fee and an operating fee. The complaint alleged that Principal violated its fiduciary duty to plan participants by charging excessive fees, but the courts concluded that not only was Principal not a fiduciary at the time the parties agreed to the allegedly excessive fees but also any subsequent fiduciary duty that Principal owed lacked a sufficient nexus with the alleged excessive fees. For example, the plaintiffs alleged that Principal acted as a fiduciary when it selected from the 63 accounts included in the contract the 29 that it ultimately made available to plan participants. Plaintiff's contention was that this winnowing process, which occurred after the parties had entered into the contract, gave rise to a fiduciary duty on behalf of Principal to ensure that the *fees* were reasonable. The Eighth Circuit, however, concluded that plaintiff had not established any connection between the act of winnowing down the available accounts. Plaintiff did not assert that only some of the 63 accounts in the contract had excessive fees, or that Principal used its post-contractual account selection authority to ensure that participants had access only to the higher fee accounts. Rather, plaintiff's complaint challenged the management fees and operating expenses associated with all of the separate accounts, claiming the Principal lacked a legitimate basis for charging these amounts to any separate account. The Court therefore concluded that because Principal's alleged selection of the 29 accounts was not the action subject to the complaint, plaintiff could not base its excessive fee claims on any fiduciary duty that Principal may have owed to plan participants while choosing those accounts. It is unclear whether other Circuits will also apply the nexus requirement in analyzing ERISA fiduciary breach claims and, if so, whether it will be applied in the same manner. In an October 2017 decision, the Court of Appeals for the Second Circuit indicated it was not bound by these decisions, but did not need to decide the issue, because plaintiff's complaint was otherwise dismissed.

Marcia S. Wagner *is the Managing Director of The Wagner Law Group. She can be reached at 617-357-5200 or* Marcia@WagnerLawGroup.com.