LEGAL UPDATE

The Duty to Monitor

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An Employee Retirement Income Security Act (ERISA) fiduciary's duty is derived from the common law of trusts, and the Third Restatement of Trusts provides that an appointing fiduciary has a "duty to act with prudence in supervising or monitoring the agent's performance and compliance with the terms of the delegation." Similarly, the Supreme Court in *Tibble* concluded that there is a continuing duty to monitor investments. However, what is far less clear, both with respect to the monitoring of service providers and the monitoring of investments, is the contours of that duty. With respect to the monitoring of service providers, it is clear that the duty to monitor applies only to a person who has the power to appoint and remove the service provider. There is also consensus with respect to the rationale for the duty. As the Court of Appeals for the Seventh Circuit stated in *Howell v. Motorola, Inc.*, "The duty exists so that a plan administrator or sponsor cannot escape liability by passing the buck to a third person and then turning a blind eye." Also, in a litigation context, almost all courts are in agreement that a claim for a breach of the fiduciary duty to monitor is a derivative claim, which means that the claim can only be sustained if the fiduciary whose conduct is being monitored has breached its fiduciary duty. That is, a claimant would need to establish: (i) that the service provider acted imprudently; (ii) that the appointing fiduciary knew or should have known of this activity; and (iii) the appointing fiduciary failed to take steps to protect the plan from the service provider's imprudence. *Thus, the essence of a duty to monitor claim is a failure to respond to the wrongdoing of others.*

When it comes to specifics there is limited guidance. The DOL regulations state that the appointing fiduciary must monitor at reasonable intervals to ensure that "performance has been in compliance with the terms of the plan and statutory standards, and satisfies the needs of the plan." "Reasonable intervals" is likely dependent upon the size of the plan and the nature of the services being provided. The follow-up question is what does monitoring entail. For example, suppose that a plan for purposes of a particular transaction needed to appoint an independent fiduciary. In such circumstances, the monitoring fiduciary must balance its need to observe the independent fiduciary with the need to preserve the independent fiduciary's independence by not meddling with the independent fiduciary's performance of its duties. If a plan provision requires a committee to annually report to the Board, it is questionable whether that provision in and of itself would suffice, even assuming such reports were filed with the Board. In some instances, a plan document will attempt to specify the scope of the duty. In *Ramirez v. J C Penney Corp.*, the plan document limited the plan's duty to monitor the service provider to "qualifications, capacity and personnel to discharge its obligations under the plan." It is unclear if a plan sponsor can limit the scope of its duty to monitor by defining its scope under the terms of the plan, and the court did not decide that issue. As a practical matter, the duty to monitor must fall short of an obligation to, in effect, redo the services of the service provider, because that would effectively eliminate delegation of duties as an option.

Perhaps the most significant open issue with respect to the duty to monitor is whether it includes a duty to inform, that is, a duty to provide the monitored fiduciary with complete and accurate information, or whether that may be a separate independent duty. *Woods v. Southern Co.*, 396 E Supp. 2d 1351 (N.D. Ga. 2005) noted that "duty to inform claims have gained reasonably wide acceptance, and even those courts that have seemed less inclined to unequivocally endorse the duty to inform have found it inappropriate to dismiss such claims on a 12(6)(6) motion." Other courts, consistent with the view that duty to monitor claims are derivative, have concluded that duty to inform claims are not viable absent a primary breach by the monitored fiduciaries. In a decision from the Southern District of New York in the Lehman Brothers Securities and ERISA Litigation, Judge Kaplan concluded that ERISA does not impose a duty on appointing fiduciaries to keep their appointees apprised of nonpublic information. In his view, nothing in ERISA or traditional principles of trust law creates such a duty.

With respect to the monitoring of investments, an open question is how frequently this must occur. This may also be a fact-specific determination, depending in part upon the size of the plan and the nature of the investments. Quarterly adjustments may generally suffice, although the District Court in *Tibble,* noting that share classes could be changed in a day, held that the change in share classes to an identical less expensive fund should occur immediately.

However, while the outer boundaries of the duty to monitor will be fleshed out by the courts in forthcoming decisions, appointing fiduciaries must be aware of the duty and take reasonable steps towards satisfying it.

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