

## LEGAL UPDATE

### Duty of Loyalty

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**A**lthough ERISA Section 404(a) lists four distinct duties that are imposed upon fiduciaries—the duty of prudence, the duty of loyalty, the duty to administer a plan in accordance with its terms, and the duty to diversify plan assets—the first two are frequently cited as the most important of the duties of an ERISA fiduciary. In fact, the duty of loyalty, *i.e.*, the duty to act solely in the interest of plan participants and beneficiaries and for the exclusive purpose of providing benefits to participants and beneficiaries and defraying reasonable expenses of administering a plan, has been cited as the highest known to law. Further, the Supreme Court in *Pegram v. Herdrich* stated that the duty of loyalty requires fiduciaries to make decisions with a single eye toward participants and beneficiaries.

In the litigation context, the duties of prudence and loyalty are frequently associated, and the same facts that support a breach of the fiduciary duty of prudence may support a breach of the duty of loyalty. Courts frequently comment that breach of loyalty claims piggyback on breach of prudence claims, with the consequence that if the prudence claims are dismissed, the derivative breach of duty of loyalty claims will also be dismissed. Although analysis of the duty of loyalty may inform the duty of prudence and vice-versa, the two remain conceptually distinct from one another, however. This is apparent from the codification by Congress of these two duties as separate subsections of ERISA. As a result, although it is often not difficult to convert a breach of duty of prudence claim into a claim for breach of duty of loyalty, a breach of the duty of prudence will not necessarily constitute a breach of the duty of loyalty, because the elements of the claims differ in a significant respect. As the DOL indicated in the preamble to the now departed Best Interest Contract Exemption, the prudence standard is an objective standard of care that requires investment advice fiduciaries to investigate and evaluate investments, make recommendations, and exercise sound judgment in the same way that knowledgeable and impartial professionals would do so. In the words of the frequently cited *Donovan v. Cunningham* case, “this

is not a search for subjective good faith – a pure heart and an empty head are not enough.” The question presented to a court is whether the action challenged as a breach of fiduciary duty of prudence is an action that a hypothetical fiduciary would have taken under the same circumstances.

The law with respect to the duty of loyalty is less clear. While there is consensus that the duty of loyalty is derived from the common law of trusts, and the restatement of trusts states that the duty of loyalty is an objective standard, case law has generally taken a different approach based upon the language of ERISA Section 404(a)(1) (which is framed in terms of acting for an exclusive purpose). [Note, however, there was a recent difference of opinion on this issue between District Courts. *See In Re Wells Fargo ERISA Litigation (subjective)* and *In Re Target Corp. Securities Litigation (objective)*]. If the standard is acting for the exclusive purpose, then the question presented is not whether a hypothetical fiduciary would have taken the same action, but what was the purpose of a defendant’s actions. Subjective purpose can be derived from objective facts, but it can be difficult to establish. For example, in an issue that has arisen in several recent litigations, even if a particular fee or recordkeeping arrangement may have been imprudent and greatly benefited a third party, it does not follow from that fact that the goal of the fiduciary was impermissibly to benefit the third person. Further, the mere fact that a fiduciary had an adverse interest does not by itself state a claim for relief, or ERISA would not have permitted corporate officers to be fiduciaries. In other words, the potential for a conflict of interest, without more, is not synonymous with a plausible claim for a breach of the fiduciary duty of loyalty. The issue is rather why did the fiduciary take the action that it did?

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